ANNUAL REPORT

Mackinac Financial

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BUSINESS OF THE CORPORATION

Mackinac Financial Corporation is a registered bank holding company formed under the Bank Holding Company Act of 1956 with assets in excess of $740 million and whose common stock is traded on the NASDAQ stock market as "MFNC." The principal subsidiary of the Corporation is mBank. Headquartered in Manistique, Michigan, mBank has 17 branch locations; thirteen in the Upper Peninsula, three in the Northern Lower Peninsula and one in Oakland County, Michigan. The Company's banking services include commercial lending and treasury management products and services geared toward small to mid-sized businesses, as well as a full array of personal and business deposit products and consumer loans.

FORM 10-K

A copy of the Annual Report to the Securities and Exchange Commission on Form 10-K is available without charge by writing the Shareholders' Relations Department, Mackinac Financial Corporation, 130 South Cedar Street, Manistique, Michigan, 49854.

MARKET SUMMARY

The Corporation's common stock is traded on the Nasdaq Capital Market under the symbol MFNC. The Corporation had approximately 1,600 shareholders of record as of March 30, 2015.

March 30, 2015

TO OUR SHAREHOLDERS:

It was an eventful and productive year on numerous fronts for your company. We successfully completed the corporation's first acquisition (Peninsula Financial Corporation) since the 2004 recapitalization. We are very pleased with the transaction and believe our patience has been rewarded (we will comment more about this later in the letter). We also maintained focus on core operations without materially increasing the overall risk profile of the company. Total assets surpassed $740 million in part to the acquisition as well as the $50 million of organic balance sheet loan growth at the bank. Your company earned $1.7 million or $.30 per share despite onetime deal related expenses having a negative $1.810 million impact on earnings. Excluding these expenses your company earned about $3.5 million or $.62 per share, this would be an improvement over 2013 earnings of $.61 per share when excluding onetime gains.

Even with the aforementioned acquisition activity, the per share book price increased from $11.77 at year end 2013 to $11.81 at year end 2014. By increasing the book price in the same year as executing an acquisition, we believe we have created intrinsic shareholder value and strengthened future earnings capability of the corporation through increased scale. We believe this will bode well for long-term value creation.

2014 OVERVIEW

We are pleased with the progress in 2014 in what continues to be a very challenging economic, regulatory and overall community banking environment. The following are some specific highlights from the year:

- In a compressed and stagnant interest rate environment our Net Interest Margin increased from 4.17% in 2013 to 4.19% in 2014. We attribute the ability to maintain spread to continued discipline of loan and deposit pricing at the bank level. As we move closer to a potential raising rate environment, we believe we are well positioned in terms of our loan and funding mix to mitigate interest rate risk. Increased interest rates will likely benefit your company and should increase overall profitability.

- Total loan production at the bank remained fairly consistent and did not suffer greatly as a result of loan pricing parameters and the significant industry-wide slowdown in mortgage lending. 2014 saw sustained loan growth and production totaling approximately $183 million with net organic balance sheet growth of about $50 million. All three regions within Michigan contributed to loan origination success. Total assets of the corporation grew 29.85% to $743.785 as of December 31, 2014 due to both organic growth and the acquisition.

- Credit quality remains an important focus for the company as we believe the loan book is truly the cornerstone of risk management within any community bank. Nonperforming assets equated to $6.949 million or .93% of total assets at the end of the period. All of our asset quality metrics compare very favorably to our peers even as we continue to navigate the highly competitive lending environment within our various regions. We continue to be true to our underwriting and credit culture, which has proven to be effective over time.

- As the company increases in size, we maintain a close eye on financial efficiency i.e. how efficient operations are in creating profits. We pay particular attention to Non-interest Expense as a percentage of Average Assets as an indicator of success and the company continues to compare favorably to peers in this metric. This is another area where scale is beneficial given increased overall cyber security, regulatory and compliance oversight has contributed to generally higher operating expenses across the industry. Increased size allows us to spread these costs over more earning assets and create more efficient earnings.

- Capital levels for both the Bank and Corporation remain above regulatory guidelines following the acquisition. Strong capital levels as well as earnings allowed for an annualized dividend payment increase from $.20 per common share in 2013 to $.30 per common share in 2014.

- We also experienced growth in our deposits at the bank, primarily through the acquisition. As we grow our asset base, we prefer to fund our loans by using core deposits that are generally less expensive than alternative funding sources. The increased core deposit portfolio should support future loan origination in the markets we entered through the acquisition.

- Due to competition and difficult market conditions (a shortage of work out loans from other banks), our asset based lending subsidiary, Mackinac Commercial Credit, LLC (MCC) took longer to reach profitability than anticipated. However, the company was on-track to reach sustained profitability beginning in January 2015. We still believe the addition of MCC provides another diversified line of business and revenue stream to augment overall company earnings in the future.

PENINSULA BANK ACQUISITION

As we have communicated in the past, our posture on M&A activity is to be opportunistic but also mindful of strategic and financial benefits of any transaction. In early December 2014 we successfully completed the acquisition of Peninsula Financial Corporation the holding company for Peninsula Bank (Pen), a company that met both requirements. Pen was a 127-year old state chartered bank located in Ishpeming, Michigan. Ishpeming is located in western Marquette County in the Upper Peninsula. The bank was deeply rooted in the communities it served and shared similar customer centric cultures with your company.

The $125 million asset size and $100 million in core deposits were a good fit and the price allowed for immediate earnings accretion and an acceptable tangible book value earn back period. Given mBank's presence in the city of Marquette in the eastern part of the county, the acquisition added complimentary markets to the current footings with low execution risk in the largest economic center in the Upper Peninsula. It is believed that there continues to be growth opportunities through the new branch network which all remained open and staffed by many of the same employees who worked for Pen.

We believe the employee and cultural transition and data system conversion processes have gone well with much of the credit going to the employees and management who have worked tirelessly on the project. The goal is to continue to serve our new clients and communities and offer best in class banking products and services to meet their needs.

GENERAL COMMENTARY

All of the aforementioned strategic initiatives and the operating metrics that they will most directly impact are focused on creating increased long-term value for our stakeholders. We believe your company continues to be well positioned to achieve continued success in the ever changing banking landscape and will provide good operating results through a stable low risk operating platform, a well embedded company culture, and a highly experienced management team and Board of Directors.

EARNINGS RECAP

To add further detail to earnings commentary and the impact of "one-time" items, 2014 income of the company was $1.700 million, or $.30 per share, compared to net income available to common shareholders of $5.629 million, or $1.01, per share for 2013. In 2013, a deferred tax benefit of $2.250 million was recorded which equated to $.40 per share. In connection with this acquisition and other strategic initiatives, the Corporation had nonrecurring transaction related expenses totaling $2.475 million. These "one-time" costs reduced the reported net income in 2014 by $1.810 million, or $.32 per share, on an after tax basis. The adjusted net income for 2014 (not inclusive of the nonrecurring transaction related expenses) would equate to $3.510 million, or $.62 per share, compared to adjusted net income of $3.379 million in 2013 (not including the deferred tax benefit), or $.61 per share. Weighted average shares for 2014 totaled 5,592,738 compared to 5,558,383 shares in 2013.

To Our Shareholders

The Bank recorded net income of $4.070 million for 2014 compared to $4.939 million in 2013, as adjusted for the $2.250 million deferred tax benefit. In 2014, the Bank recorded $.786 million, after tax, of nonrecurring transaction related expenses. The adjusted income for 2014 would have been $4.856 million, compared to the adjusted income of $4.939 million in 2013. The slight reduction in core income for the bank was largely attributable to large reductions year to year in secondary market mortgage lending activities seen throughout the industry and some smaller reductions in our SBA originations for sale. While our performance in these lines of business remains solid, external economic factors will effect, to a certain extent, the volume of these products both on a macro (industry) and micro (bank) scale. These reductions were offset by strong gains in net interest income of approximately $1.1 million through continued strong balance sheet growth and sustained margin. Total assets of the Corporation at December 31, 2014 were $743.785 million, up 29.85% from the $572.800 million reported at December 31, 2013.

LOAN GENERATION / CREDIT QUALITY

Total loans at December 31, 2014 were $600.935 million compared to $483.832 million at 2013 year end. Loans acquired from Peninsula Bank were $67 million, and the Corporation had organic growth in 2014 of $50 million. In addition to the aforementioned balance sheet totals, the company services $224 million of sold mortgage loans and $46 million of sold SBA and USDA loans. Total loans under management total $871 million as of year end.

New loan production totaled $183 million with the Upper Peninsula contributing $105 million, the Northern Lower Peninsula $40 million and Southeast Michigan $38 million. Commercial loan production accounted for $110 million of the 2014 total, with consumer loans, primarily 1-4 family mortgages, of $73 million.

Nonperforming loans totaled $3.939 million, .66% of total loans at December 31, 2014 compared to $2.024 million, or .42% of total loans at December 31, 2013. Nonperforming assets were $6.949 million, .93% of total assets compared to $3.908 million, .68% of assets at 2013 year end with the increase primarily a result of the Pen acquisition.

DEPOSITS

Total deposits of $606.973 million at 2014 year end included $101 million deposits acquired with the Pen acquisition. The organic growth of deposits was approximately $40 million from 2013 year-end and was comprised primarily of wholesale deposit funding.

THE FOLLOWING TABLES AND COMMENTARY FURTHER ILLUSTRATE OUR ON-GOING PERFORMANCE IN DEVELOPING OUR LOAN PRODUCTION, CORE LINES OF BUSINESS'S AND OTHER KEY DRIVERS TO INCREASE SHAREHOLDER VALUE.

Loan Growth/Production

Three year loan production for our geographical regions is shown below: The Corporation has seen strong sustained loan production continue over the three year period even with the recent increasingly competitive landscape.

(dollars in thousands)	For the Year Ending December 31,		
	2014	2013	2012
REGION			
Upper Peninsula	**$ 104,601**	$ 124,836	$ 134,257
Northern Lower Peninsula	**40,133**	48,004	37,856
Southeast Michigan	**38,669**	18,078	41,989
TOTAL	**$ 183,403**	$ 190,918	$ 214,102

Government Guaranteed Lending Programs

Our total production of sold loans for the last three years was $27 million, with $2.837 million in fees. The Corporation does not sell all the loan guarantees from every credit, only those where acceptable market rates are paid above par that generates an acceptable internal rate of return. Continued demand from buyers has kept pricing strong and we believe there is opportunity in this line of business for further growth.

SBA/USDA Loans Originated
For the Year Ended December 31,

	2014			2013			2012		
	# Loans	SBA Amount	Premium	# Loans	SBA Amount	Premium	# Loans	SBA Amount	Premium
UP	**8**	**$ 4,123**	**$ 424**	11	$ 7,285	$ 819	13	$ 8,993	$ 881
NLP	**1**	**149**	**8**	2	750	89	2	354	14
SEM	**4**	**2,803**	**278**	1	359	43	2	2,615	281
Total	**13**	**$ 7,075**	**$ 710**	14	$ 8,394	$ 951	17	$ 11,962	$ 1,176

Key Performance Metrics

The following table illustrates stable operating metrics in several key performance areas. The Efficiency Ratio for year end is slightly skewed given the period-end fell in the middle of the operations integration of Pen and the slightly longer than expected period for Mackinac Commercial Credit to reach profitability. We expect that number to normalize over the first half of 2015.

	2014	2013	2012
Net Interest Margin	**4.19%**	**4.17%**	4.17%
Efficiency Ratio	**74.43%**	**67.46%**	67.95%
Credit Quality (Texas Ratio)	**9.37%**	**5.59%**	10.25%
Noninterest Expense to Average Assets	**3.28%**	**3.22%**	3.09%

Capital

The Corporation and Bank's capital levels are strong and exceed regulatory "well-capitalized" levels as shown in the table below. The holding company remains a solid source of strength to support both bank and non-bank subsidiaries as needed and, perhaps most importantly, we maintain strong capital position post transaction.

	Tier 1 Capital to Average Assets	Tier 1 Capital to Risk Weighted Assets	Total Capital to Risk Weighed Assets
Bank	9.11%	10.98%	11.82%
Consolidated	8.57%	10.23%	11.07%

LOOKING FORWARD:

As we look forward to 2015, we are keeping a close watch on industry trends that may potentially affect the company. Interest rate pressure and the potential for rates to begin to increase in 2015 will necessitate continued focus on Net Interest Margin, funding and loan portfolio pricing especially the ratio of fixed to floating rate loans. It will be important to maintain consistent underwriting and credit culture as competitive and interest rate pressure continues across the industry. Increased use of technology and banking solutions including mobile & online banking will require attention to customer demand for new products and services. IT infrastructure and capabilities must keep pace with demand as security will remain a high priority with the increased use of technology as a banking platform and given the continued increase in attempted cybercrimes across all industries.

Your management team continues to look for ways to enhance shareholder value through exploration of expansion opportunities within our current markets by way of bank or branch acquisition and potentially additional complimentary lines of business. We have a stable management team and experienced personnel with capacity to support future growth.

To Our Shareholders

We will continue to cultivate strong company culture which remains dedicated to serving the communities in which we live and work. Finally, as we have committed to in the past, we will be patient in evaluating and executing any external growth strategy while continuing with the daily execution of organic franchise development with increased operational efficiencies.

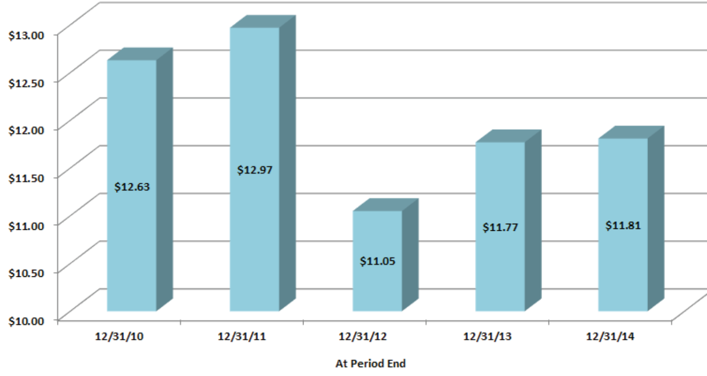
In closing, on behalf of the mBank Board of Directors, Management and employees, we would like to both thank our long time shareholders and welcome new owners to the company for their both their support and patronage as clients of the bank. We are fortunate to work for Mackinac Financial Corporation with a talented and hardworking team, we are all looking forward to success in 2015 and beyond.

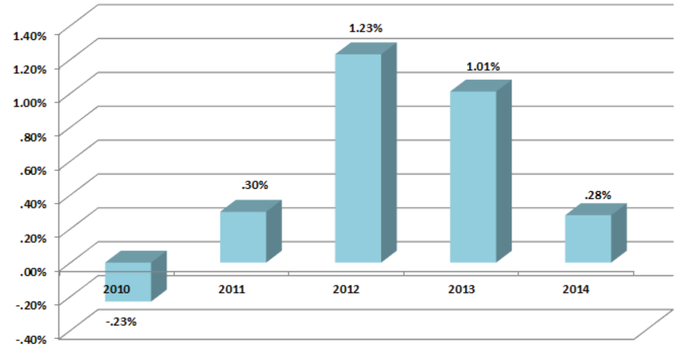
Sincerely,

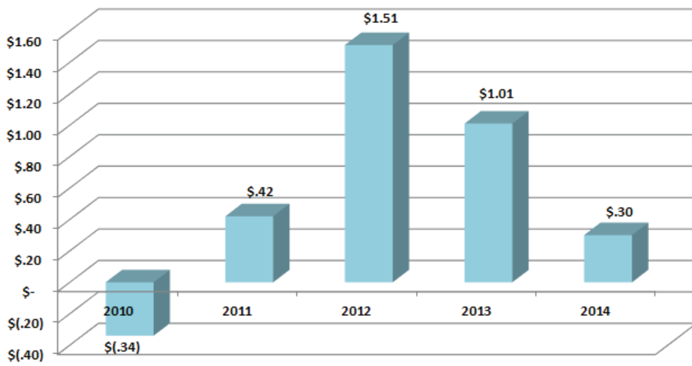
Paul D. Tobias
Chairman and CEO
Mackinac Financial Corporation

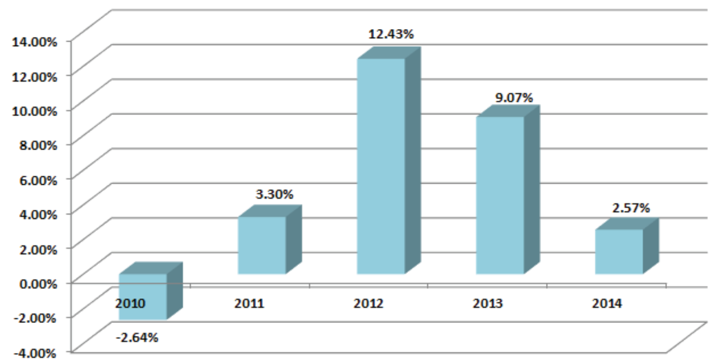
Kelly W. George
President and CEO
mBank

Five Year Overview

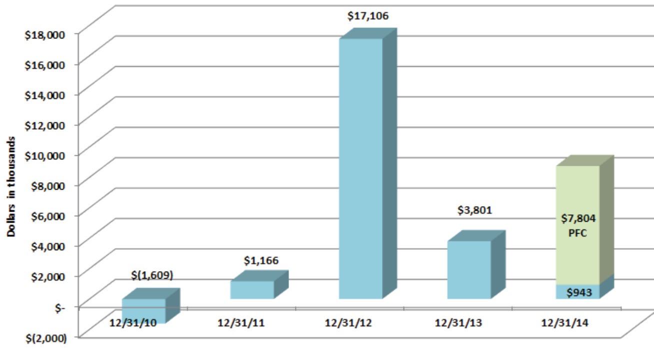


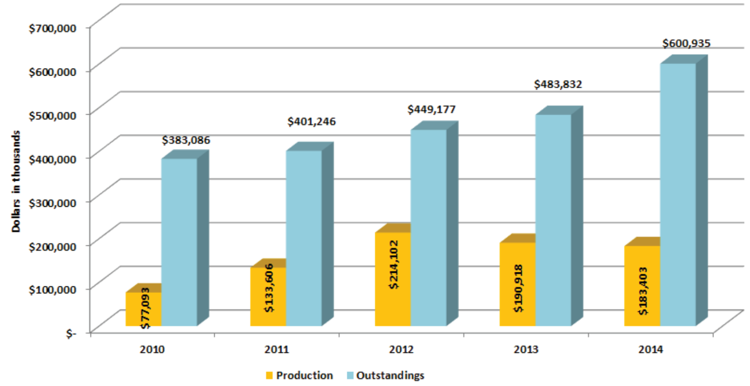




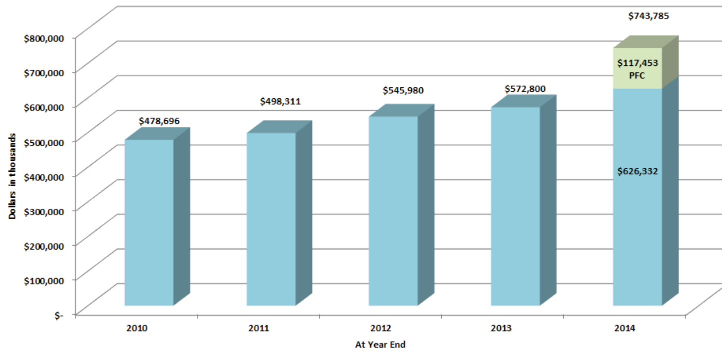


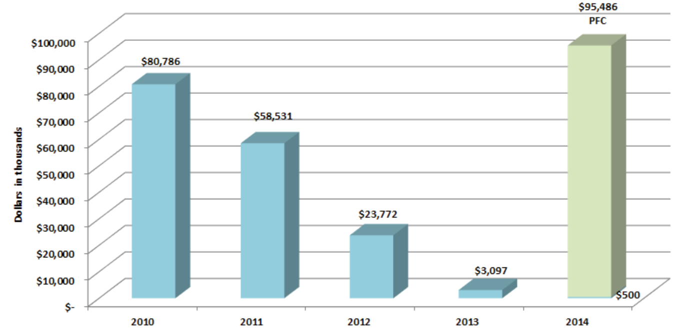
Five Year Overview





Loans outstanding at 2014 year end include $64.123 million of PFC loans outstanding.





(1) *Mackinac Financial Corporation acquired Peninsula Financial Corporation ("PFC") on December 5, 2014. The data above reflects the impact of the acquisition.*

BRANCH LOCATIONS

ESCANABA
2224 N. Lincoln Road
Escanaba, MI 49829
(906) 233-9443
Manager: April J. Stropich

ISHPEMING – DOWNTOWN
100 S. Main Street
Ishpeming, MI 49849
(906) 485-6333
Manager: Anita G. Sandberg

ISHPEMING – JUBILEE
Located in Jubilee Foods
Ishpeming, MI 49849
(906) 486-9595
Manager: Jill C. Dompierre

ISHPEMING – WEST
US 41 West & 170 N. Daisy Street
Ishpeming, MI 49849
(906) 485-5717
Manager: Jill C. Dompierre

MANISTIQUE
130 South Cedar Street
Manistique, MI 49854
(906) 341-8401
Manager: Kendra L. Lander

MANISTIQUE – LAKESHORE
Located in Jack's Supervalu
Manistique, MI 49854
(906) 341-7190
Manager: Kendra L. Lander

MARQUETTE
857 W. Washington Street
Marquette, MI 49855
(906) 226-5000
Manager: Teresa M. Same

MARQUETTE – MCCLELLAN
175 S. McClellan Avenue
Marquette, MI 49855
(906) 228-3933
Manager: Tia M. Rodda

MARQUETTE – MEDICAL CENTER
1414 W. Fair Avenue, Suite 140
Marquette, MI 49855
(906) 226-0581
Manager: Tia M. Rodda

NEGAUNEE
Located in Super One Foods
Negaunee, MI 49866
(906) 475-0120
Manager: Jill C. Dompierre

NEWBERRY
414 Newberry Avenue
Newberry, MI 49868
(906) 293-5165
Manager: Angela E. Buckingham

SAULT STE. MARIE
138 Ridge Street
Sault Ste. Marie, MI 49783
(906) 635-3992
Manager: Lori A. McKerchie

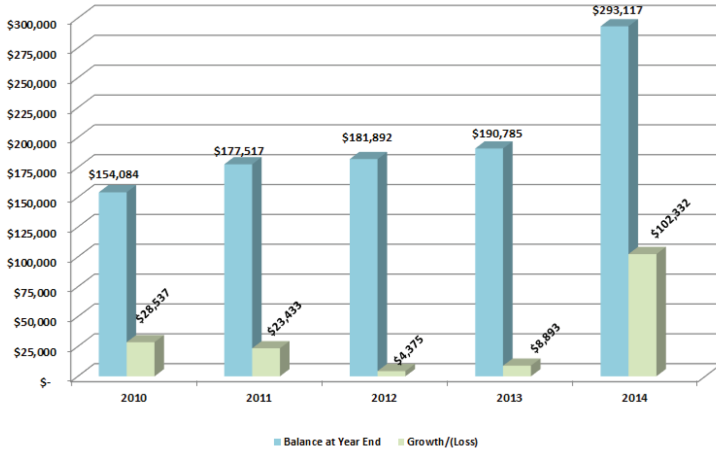
STEPHENSON
S216 Menominee Street
Stephenson, MI 49887
(906) 753-2225
Manager: Barbara A. Parrett

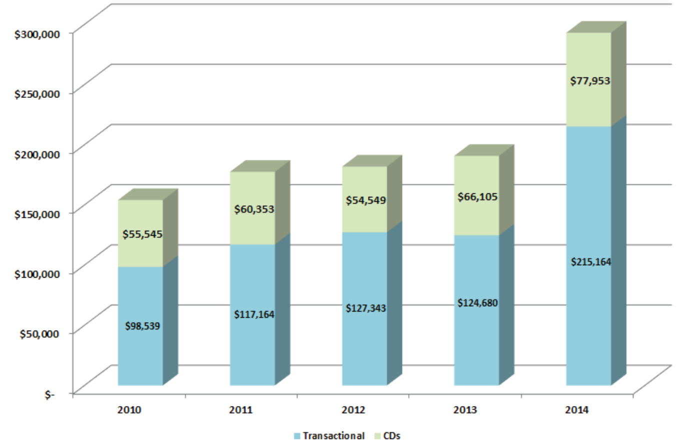
BALANCE SHEET HIGHLIGHTS

(dollars in thousands)	At December 31, 2014 Loans	At December 31, 2014 Core Deposits	2014 Loan Production*
Escanaba	$ 21,934	$ 17,221	$ 17,772
Ishpeming	41,466	73,267	-
Manistique	93,315	42,919	27,195
Marquette	140,080	64,063	45,599
Negaunee	1,166	2,490	-
Newberry	16,505	34,945	4,338
Sault Ste. Marie	44,303	22,344	8,604
Stephenson	9,168	35,868	1,093
TOTAL UPPER PENINSULA	$ 367,937	$ 293,117	$ 104,601

**** Includes production of mortgage loans sold on the secondary market.***

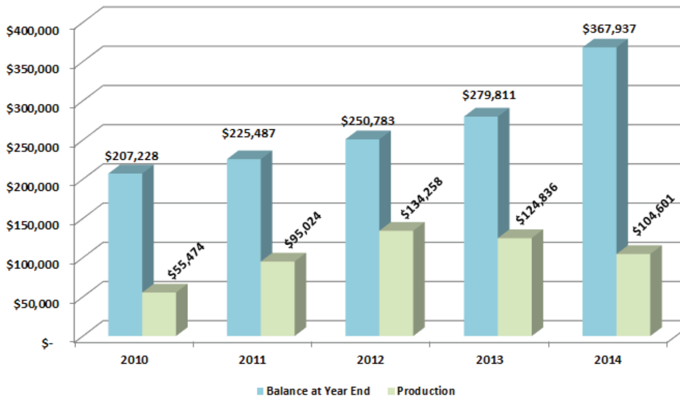
Regional Review – Upper Peninsula

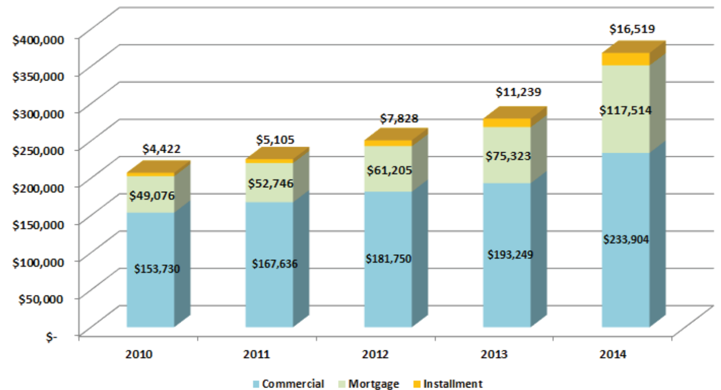




Core deposit increases were primarily a result of the acquisition of PFC on December 5, 2014.

Core deposits are defined as demand deposits, interest bearing checking accounts, money markets, savings and CDs less than $100,000.





Total loan production over the five year period amounted to $514.2 million.

Nonperforming assets in the Upper Peninsula totaled $6.705 million at the end of 2014, which included $3.010 million of OREO and $3.695 million of nonperforming loans. Nonperforming loans as a percent of total loans was 1.32%.

Regional Review – Northern Lower Peninsula

BRANCH LOCATIONS

GAYLORD
1955 South Otsego Avenue
Gaylord, MI 49735
(989) 732-3750
Manager: Jessica M. Beals

TRAVERSE CITY
3530 North Country Drive
Traverse City, MI 49684
(231) 929-5600
Manager: Daniel P. Galbraith

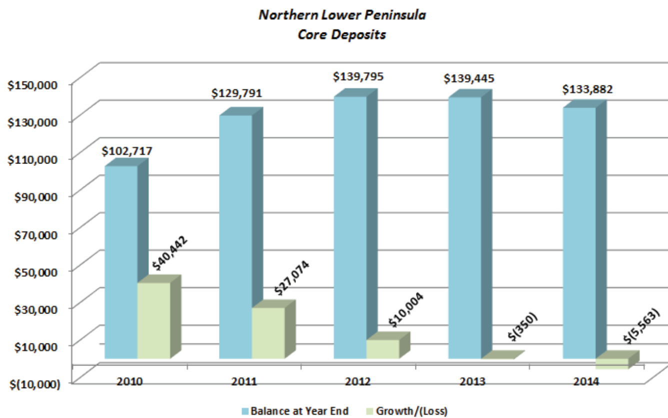
KALEVA
14429 Wuoksi Avenue
Kaleva, MI
(231) 362-3223
Manager: Barb J. Miller

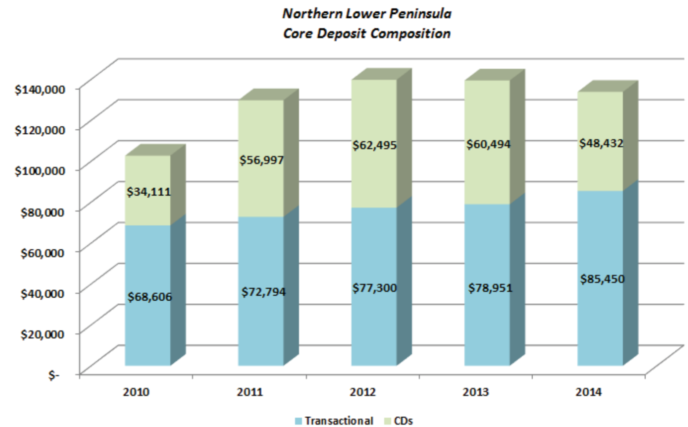
BALANCE SHEET HIGHLIGHTS

(dollars in thousands)	At December 31, 2014		2014
	Loans	Core Deposits	Loan Production*
Gaylord	$ 35,044	$ 59,727	$ 9,015
Kaleva	412	16,717	79
Traverse City	63,022	57,438	31,039
TOTAL NORTHERN LOWER PENINSULA	$ 98,478	$ 133,882	$ 40,133

**** Includes production of mortgage loans sold on the secondary market.***

Regional Review – Northern Lower Peninsula





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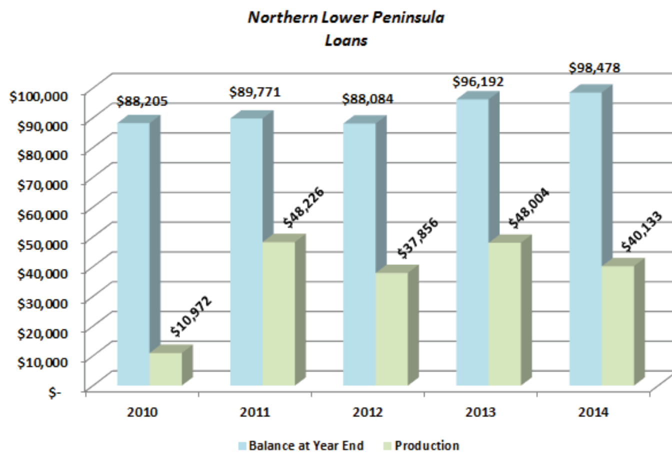
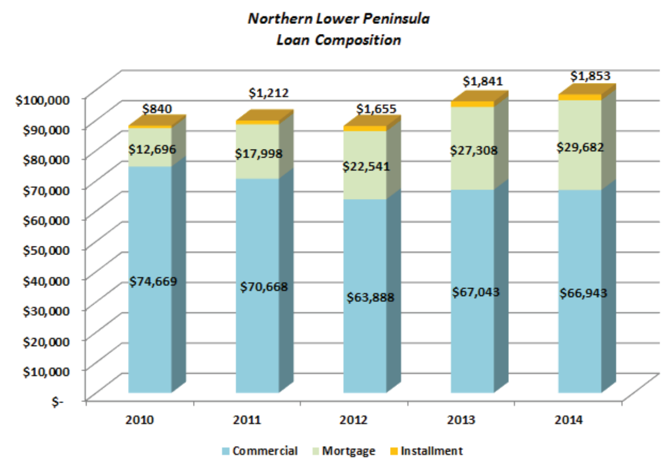




Total loan production over the five year period amounted to $185.2 million.

Nonperforming assets in the Northern Lower Peninsula totaled $.244 million at the end of 2014, all nonperforming loans. Nonperforming loans as a percent of total loans was .25%.

Regional Review – Southeast Michigan

BRANCH LOCATION

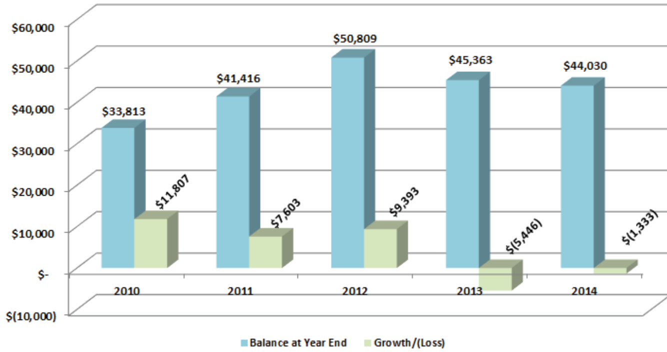
BIRMINGHAM
260 East Brown Street, Suite 300
Birmingham, MI 48009
(248) 290-5900
Manager: Mary B. Schroeder

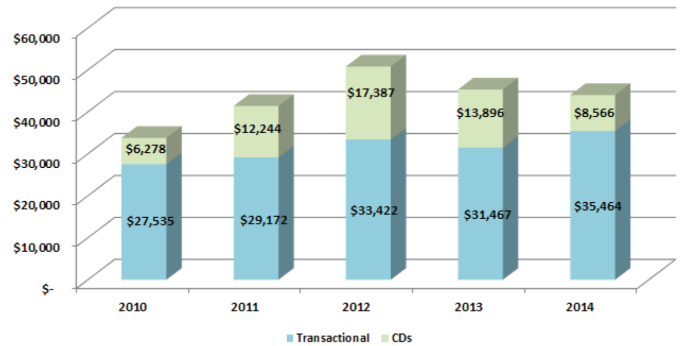
BALANCE SHEET HIGHLIGHTS

(dollars in thousands)	At December 31, 2014		2014
	Loans	**Core Deposits**	**Loan Production**
Birmingham	$ 125,816	$ 44,030	$ 38,669

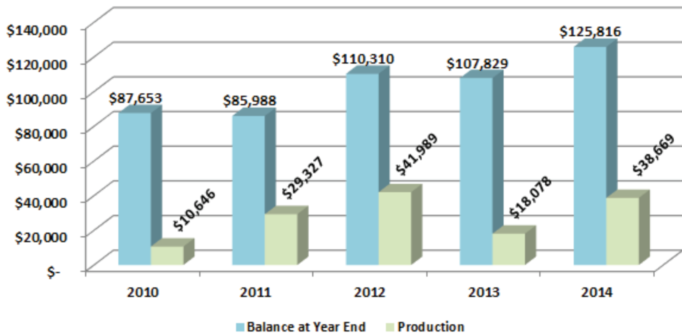
The Corporation's asset based lending subsidiary, Mackinac Commercial Credit ("MCC"), is also based in Southeast Michigan. The subsidiary began operations late in 2013, with 2014 year end loan balances of $8.704 million. The subsidiary reached sustained profitability in early 2015.

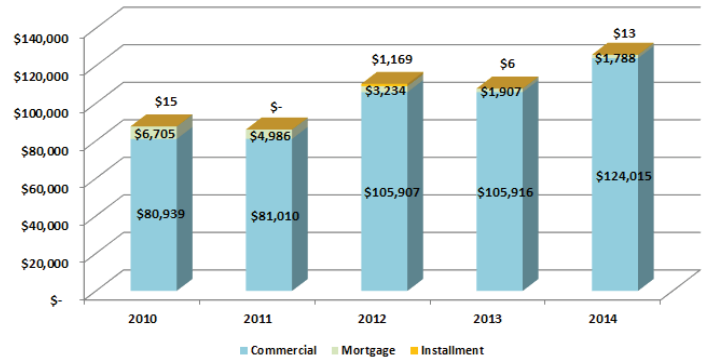
Regional Review – Southeast Michigan





Core deposits are defined as demand deposits, interest bearing checking accounts, money markets, savings and CDs less than $100,000.





Total loan production over the five year period amounted to $138.7 million.

There were no nonperforming assets in Southeast Michigan at 2014 year end.

Selected Financial Highlights

(Dollars in Thousands, Except Per Share Data)

(Dollars in thousands, except per share data)	**December 31, 2014**		December 31, 2013	
	(Unaudited)			
Selected Financial Condition Data ***(at end of period)*** **:**				
Assets	**$ 743,785**		$ 572,800	
Loans	**600,935**		483,832	
Investment securities	**65,832**		44,388	
Deposits	**606,973**		466,299	
Borrowings	**49,846**		37,852	
Common Shareholders' Equity	**73,996**		65,249	
Shareholders' equity	**73,996**		65,249	
Selected Statements of Income Data:				
Net interest income	**$ 23,527**		$ 21,399	
Income before taxes and preferred dividend	**2,829**		5,534	
Net income	**1,700**		5,629	
Income per common share - Basic	**.30**		1.01	
Income per common share - Diluted	**.30**		1.00	
Dividends paid per share	**$ .225**		$ .170	
Weighted average shares outstanding	**5,592,738**		5,558,313	
Weighted average shares outstanding- Diluted	**5,653,811**		5,650,058	
Selected Financial Ratios and Other Data:				
Performance Ratios:				
Net interest margin	**4.19**	**%**	4.17	%
Efficiency ratio	**74.43**		67.46	
Return on average assets	**.28**		1.01	
Return on average common equity	**2.57**		9.07	
Return on average equity	**2.57**		8.26	
Average total assets	**$ 605,612**		$ 555,152	
Average common shareholders' equity	**66,249**		62,082	
Average total shareholders' equity	**66,249**		68,172	
Average loans to average deposits ratio	**103.98**	%	103.46	%
Common Share Data at end of period:				
Market price per common share	**$ 11.85**		$ 9.90	
Book value per common share	**$ 11.81**		$ 11.77	
Tangible book value per share	**$ 11.01**		$ 11.77	
Common shares outstanding	**6,266,756**		5,541,390	
Other Data at end of period:				
Allowance for loan losses	**$ 5,140**		$ 4,661	
Non-performing assets	**$ 4,668**		$ 3,908	
Allowance for loan losses to total loans	**.86**	%	.96	%
Non-performing assets to total assets	**.63**	%	.68	%
Texas ratio	**9.37**	%	5.59	%
Number of:				
Branch locations	**17**		11	
FTE Employees	**160**		133	

The above summary should be read in connection with the related consolidated financial statements and notes included elsewhere in this report.

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Report of Independent Registered Public Accounting Firm

Board of Directors
Mackinac Financial Corporation, Inc.

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.

Plante & Moran, PLLC

March 30, 2015
Auburn Hills, Michigan

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.

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.

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.

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.

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.

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.

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.

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.

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

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.

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.

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)	(1,575)	(3,809)
Expected cash flows	11,056	52,274	63,330
Accretable yield	(744)	(525)	(1,269)
Carrying balance at acquisition date	$ 10,312	$ 51,749	$ 62,061

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.

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):

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
Allowance for loan loss reserve:								
Beginning balance ALLR	$ 3,267	$ 692	$ 125	$ 980	$ -	$ -	$ 154	$ 5,218
Charge-offs	(1,539)	(632)	-	(141)	-	(120)	-	(2,432)
Recoveries	92	56	2	26	2	22	-	200
Provision	29	1,262	(47)	(349)	23	246	511	1,675
Ending balance ALLR	$ 1,849	$ 1,378	$ 80	$ 516	$ 25	$ 148	$ 665	$ 4,661
Loans:								
Ending balance	$ 268,809	$ 79,655	$ 10,904	$ 103,768	$ 6,895	$ 13,801	$ -	$ 483,832
Ending balance ALLR	(1,849)	(1,378)	(80)	(516)	(25)	(148)	(665)	(4,661)
Net loans	$ 266,960	$ 78,277	$ 10,824	$ 103,252	$ 6,870	$ 13,653	$ (665)	$ 479,171
Ending balance ALLR:								
Individually evaluated	$ 99	$ 891	$ -	$ 103	$ -	$ 18	$ -	$ 1,111
Collectively evaluated	1,750	487	80	413	25	130	665	3,550
Total	$ 1,849	$ 1,378	$ 80	$ 516	$ 25	$ 148	$ 665	$ 4,661
Ending balance Loans:								
Individually evaluated	$ 649	$ 1,830	$ -	$ 385	$ -	$ 42	$ -	$ 2,906
Collectively evaluated	268,160	77,825	10,904	103,383	6,895	13,759	-	480,926
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.

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.

NOTE 4 – LOANS (CONTINUED)

General Reserves:

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

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

	(1) Strong	(2) Good	(3) Average	(4) 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

NOTE 4 – LOANS (CONTINUED)

payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In determining the estimated fair value of purchased loans, management considers a number of factors including the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, net present value of cash flows expected to be received, among others. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will 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

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
One to four family residential real estate	361	-	625	-	-	16
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

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

NOTE 4 – LOANS (CONTINUED)

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

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.

NOTE 4 – LOANS (CONTINUED)

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

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

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.

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

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.

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.

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)

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.

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.

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.

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.

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%**

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		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%

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

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	Number 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.

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.

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.

NOTE 20 - FAIR VALUE (CONTINUED)

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

	Level in Fair Value Hierarchy	December 31, 2014 Carrying Amount	December 31, 2014 Estimated Fair Value	December 31, 2013 Carrying Amount	December 31, 2013 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.

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
Other real estate held for sale	1,884	-	-	1,884	265
					$ 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.

NOTE 21 – BUSINESS COMBINATIONS (CONTINUED)

The table below highlights the allocation of the purchase price:

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

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.

NOTE 22 - PARENT COMPANY ONLY FINANCIAL STATEMENTS

BALANCE SHEETS
December 31, 2014 and 2013
(Dollars in Thousands)

ASSETS	**2014**	2013
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

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

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

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

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

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

SUMMARY QUARTERLY FINANCIAL INFORMATION

(Unaudited)

(Dollars in Thousands, Except per Share Data)

	FOR THE QUARTER ENDED 2014				FOR THE QUARTER ENDED 2013			
	12/31	9/30	6/30	3/31	12/31	9/30	6/30	3/31
BALANCE SHEET								
Total loans	$ 600,935	$ 518,373	$ 502,940	$ 485,862	$ 483,832	$ 472,495	$ 455,555	$ 454,051
Allowance for loan losses	(5,140)	(5,279)	(5,097)	(4,883)	(4,661)	(4,959)	(5,177)	(5,037)
Total loans, net	595,795	513,094	497,843	480,979	479,171	467,536	450,378	449,014
Total assets	743,785	613,943	595,869	583,592	572,800	567,917	553,501	541,896
Core deposits	471,029	403,950	380,772	384,846	375,593	375,166	357,935	362,911
Noncore deposits [1]	135,944	87,256	103,244	90,864	90,706	86,522	89,972	62,325
Total deposits	606,973	491,206	484,016	475,710	466,299	461,688	447,907	425,236
Total borrowings	49,846	52,409	42,087	38,852	37,852	35,852	35,925	40,925
Common shareholder' equity	73,996	67,132	66,477	65,730	65,249	63,045	62,520	62,039
Total shareholders' equity	73,996	67,132	66,477	65,730	65,249	67,045	66,520	73,039
Total tangible equity	68,995	67,132	66,477	65,730	65,249	67,045	66,520	73,039
Total shares outstanding	6,266,756	5,564,815	5,527,690	5,527,690	5,541,390	5,581,339	5,554,459	5,557,859
Weighted average shares outstanding	5,770,104	5,540,200	5,527,690	5,530,908	5,555,952	5,562,835	5,556,133	5,559,859
AVERAGE BALANCE SHEET								
Total loans	$ 549,411	$ 509,618	$ 492,923	$ 486,354	$ 479,321	$ 464,324	$ 456,937	$ 449,065
Allowance for loan losses	(5,674)	(5,084)	(4,858)	(4,776)	(4,872)	(5,094)	(5,180)	(5,127)
Total loans, net	543,737	504,534	488,065	481,578	474,449	459,230	451,757	443,938
Total assets	651,935	607,840	581,150	580,717	569,443	560,089	548,455	541,279
Core deposits	414,459	400,202	374,935	384,951	375,455	372,375	361,721	366,838
Noncore deposits [1]	107,696	95,512	96,010	90,762	86,175	83,816	78,059	62,336
Total deposits	522,155	495,714	470,945	475,713	461,630	456,191	439,780	429,174
Total borrowings	55,487	35,685	37,901	35,000	37,573	36,449	40,656	36,681
Total shareholders' equity	67,397	66,558	66,553	65,462	66,906	66,134	67,483	72,238
ASSET QUALITY RATIOS								
Nonperforming loans/total loans	.66	.52	.53	.31 %	.42 %	.91 %	.87 %	.84 %
Nonperforming assets/total assets	.93	0.74	0.77	0.63	.68	1.21	1.17	1.41
Allowance for loan losses/total loans	.86	1.02	1.01	1.01	.96	1.09	1.14	1.11
Allowance for loan losses/nonperforming loans	130.49	195.88	192.19	327.50	230.29	114.98	129.98	131.41
Net charge-offs/average loans	.57	N/M	N/M	N/M	.93	.50	(.04)	.50
Texas Ratio [2]	9.37	6.27	6.43	5.18	5.59	9.56	9.02	9.81
CAPITAL ADEQUACY RATIOS								
Tier 1 leverage ratio	8.57	10.23	10.50	10.25 %	10.31 %	10.90 %	11.01 %	12.23 %
Tier 1 capital to risk weighted assets	10.23	11.68	11.86	11.79	11.83	12.45	12.74	13.98
Total capital to risk weighted assets	11.07	12.68	12.87	12.79	12.79	13.47	13.85	15.06
Average equity/average assets	10.34	10.95	11.28	11.27	11.75	11.81	12.30	13.35
Tangible equity/tangible assets	9.25	10.93	11.16	11.26	11.75	11.81	12.30	13.35

[1] *Noncore deposits include brokered deposits and CDs greater than $100,000*

[2] *Texas Ratio: Nonperforming Assets Divided by Total Tangible Equity plus Allowance for Loan Losses*

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

SUMMARY QUARTERLY FINANCIAL INFORMATION

(Unaudited)
(Dollars in Thousands, Except per Share Data)

	FOR THE QUARTER ENDED 2014				FOR THE QUARTER ENDED 2013			
	12/31	9/30	6/30	3/31	12/31	9/30	6/30	3/31
INCOME STATEMENT								
Net interest income	$ 6,389	$ 5,886	$ 5,659	$ 5,593	$ 5,626	$ 5,348	$ 5,269	$ 5,156
Provision for loan losses	639	187	191	183	825	375	100	375
Net interest income after provision	5,750	5,699	5,468	5,410	4,801	4,973	5,169	4,781
Total noninterest income	1,003	768	650	691	1,191	738	1,251	758
Total noninterest expense	7,479	5,126	4,898	5,107	4,935	4,359	4,523	4,311
Income before taxes	(726)	1,341	1,220	994	1,057	1,352	1,897	1,228
Provision for income taxes	(74)	455	414	334	(1,911)	456	637	415
Net income	(652)	886	806	660	2,968	896	1,260	813
Preferred dividend and accretion of discount	-	-	-	-	58	50	63	137
Net income available to common shareholders	$ (652)	$ 886	$ 806	$ 660	$ 2,910	$ 846	$ 1,197	$ 676
PER SHARE DATA								
Earnings (loss) - basic*	$ (.13)	$ .16	$ .15	$ .12	$ .52	$ .15	$ .22	$ .12
Earnings (loss) - diluted*	(.13)	.16	.15	.12	.51	.15	.22	.12
Book value	11.81	12.06	12.03	11.89	11.77	11.30	11.26	11.16
Market value	11.85	11.30	12.90	12.54	9.90	9.10	8.88	9.21
PROFITABILITY RATIOS								
Return on average assets	(.40) %	.58 %	.56 %	.46 %	2.03 %	.60 %	.88 %	.51 %
Return on average common equity	(3.84)	5.28	4.94	4.09	18.34	5.40	7.69	4.47
Return on average total equity	(3.84)	5.28	4.93	4.09	17.26	5.08	7.12	3.79
Net interest margin	4.19	4.20	4.18	4.25	4.24	4.12	4.16	4.18
Efficiency ratio	70.27	73.83	77.55	80.57	66.94	70.64	68.02	72.65
Average loans/average deposits	105.22	103.03	104.94	102.62	103.83	101.78	103.90	104.63

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			
2014	**March 31**	**June 30**	**September 30**	**December 31**
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 delcared 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.

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.

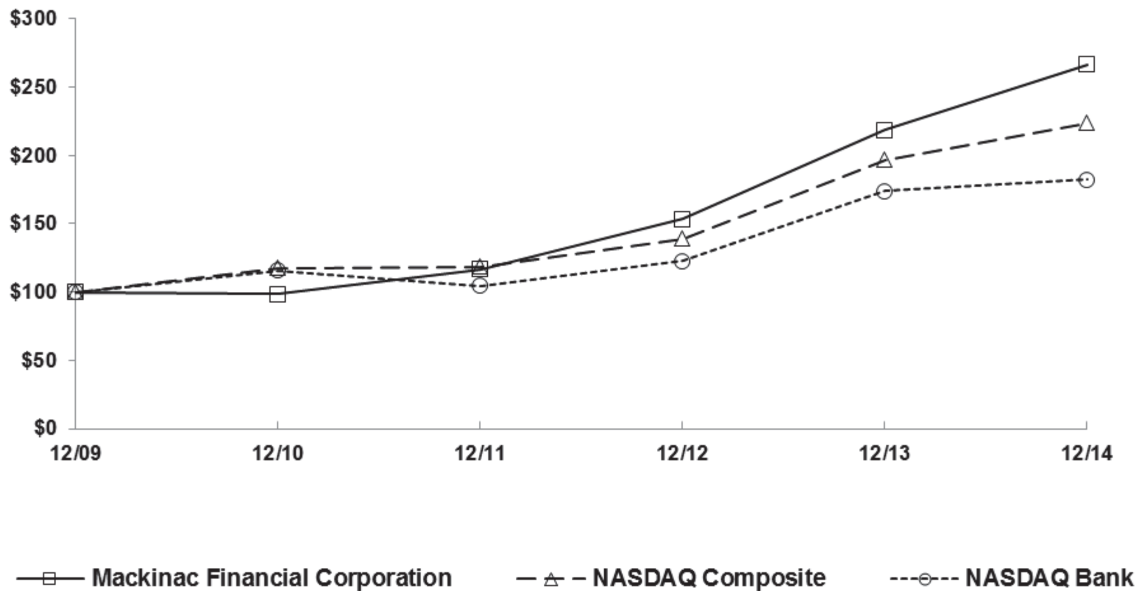
The Bank paid a $3.0 million dividend in 2013 and 2014. The Corporation declared a $.075 dividend per share on its common stock in the fourth quarter of 2014. There were no sales of unregistered securities in 2014. In 2013, the Corporation approved a stock buyback program. In 2014, the Corporation repurchased 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.

Shareholder Return Performance Graph

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

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.



*$100 invested on 12/31/09 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

Forward Looking Statements/Risk Factors

FORWARD LOOKING STATEMENTS

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

RISK FACTORS

Risks Related to our Lending and Credit Activities

- *Our business may be adversely affected by conditions in the financial markets and economic conditions generally, as our borrowers' ability to repay loans and the value of the collateral securing our loans decline.*
- *Weakness in the markets for residential or commercial real estate, including the secondary residential mortgage loan markets, could reduce our net income and profitability.*
- *As a community banking organization, the Corporation's success depends upon local and regional economic conditions and has different lending risks than larger banks.*
  We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimated based on experience, judgment and expectations regarding borrowers and economic conditions, as well as regulator judgments. We can make no assurance that our loan loss reserves will be sufficient to absorb future loan losses of prevent a material adverse effect on its business, profitability or financial condition.
- *Our allowance for loan losses may be insufficient.*
  Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside of our control, may require an increase in our allowance for loan losses.

Risks Related to Our Operations

- *We are subject to interest rate risk.*
  Our earnings and cash flows are largely dependent upon our net interest income, which is the difference between interest income on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. There are many factors which influence interest rates that are beyond our control, including but not limited to general economic conditions and governmental policy, in particular, the policies of the FRB.
- *Changes in our accounting policies or in accounting standards could materially affect how we report our financial results and condition.*
- *Our controls and procedures may fail or be circumvented.*
- *Impairment of deferred income tax assets could require charges to earnings, which could result in an adverse impact on our results of operations.*
  In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carry back and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g. cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At December 31, 2014, net deferred tax assets are approximately $11.498 million. If

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

- *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.

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, 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.

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.

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.

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.

(dollars in thousands)	Years ended December 31, 2014 Average Balance	2014 Interest	2014 Average Rate	2013 Average Balance	2013 Interest	2013 Average Rate	2012 Average Balance	2012 Interest	2012 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.

	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):

	2014	2013	2012	% Increase (Decrease) 2014-2013	% Increase (Decrease) 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) %

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	% Increase (Decrease) 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.

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 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.

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.

FINANCIAL POSITION

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

(dollars in thousands)	December 31, 2014 Balance	2014 Mix	2013 Balance	2013 Mix	2012 Balance	2012 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 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. These acquired loans did not results 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 %
Commercial, financial, and agricultural	**101,895**	79,655	80,646	**27.92**	(1.23)
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):

	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	27.92 %	153.77
Hospitality and tourism	**46,211**	**10.66**	**62.45**	45,360	12.62	69.52
Lessors of residential buildings	**19,776**	**4.56**	**26.73**	14,191	3.95	21.75
Commercial construction	**16,284**	**3.76**	**22.01**	10,904	3.03	16.71
Gasoline stations and convenience stores	**13,841**	**3.19**	**18.71**	11,534	3.21	17.68
Real estate agents and managers	**9,454**	**2.18**	**12.78**	10,922	3.04	16.74
Other	**221,356**	**51.05**	**299.15**	166,124	46.23	254.60
Total commercial loans	**$ 433,566**	**100.00 %**		$ 359,368	100.00 %	

Management recognizes the additional risk presented by the concentration in certain segments of the portfolio. On a historical basis, the Corporation's highest concentration of credit risk was the hospitality and tourism industry. Management does not consider the current loan concentrations in hospitality and tourism to be problematic, and has no intention of further reducing loans to this industry segment. Management does not believe that its current portfolio composition has increased exposure related to any specific industry concentration as of 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.

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	**.66 %**	.42 %	1.04
Nonperforming assets as a % of assets	**.93 %**	.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.

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 110.11% 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 310.00% at December 31, 2014, compared to 230.29% at 2013 year end.

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 %

The increase in deposits, as illustrated above, is composed of an increase in noncore deposits of $45.238 million, while core deposits increased by $95.436 million. Through the acquisition of Peninsula, the Corporation has enhanced its core deposit portfolio with additional stable deposit relationships from Peninsula's long term customer base.

Management has increased its efforts to grow core deposits in recent years by introducing several new deposit products and implementing a bank-wide deposit incentive program. As shown in the table above, core deposits now represent approximately 78% of total deposits. The Corporation will continue to emphasize core deposit growth in its funding sources, but will also supplement this funding with strategic utilization of wholesale brokered deposits to help manage interest rate risk.

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

Borrowings

The Corporation also utilizes FHLB borrowings as a source of funding. At 2014 year end, this source of funding totaled $35.000 million and the Corporation secured this funding by pledging loans and investments. The $35.000 million of

FHLB borrowings had a weighted average maturity of 2.6 years, with a weighted average rate of 1.68% at December 31, 2014.

Shareholders' Equity

Changes in shareholders' equity are discussed in detail in the "Capital and Regulatory" section of this report.

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):

	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.

	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.

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 and 2014, 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.

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.

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%**

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.

Corporate Information

DIRECTORS

Mackinac Financial Corporation and mBank

Walter J. Aspatore - Lead Director
Chairman
Methode Electronics Corp
Director Since: 2004

Dennis B. Bittner
Owner and President
Bittner Engineering, Inc.
Director Since: 2001

Joseph D. Garea
Managing Director
Hancock Securities and related entities
Director Since: 2007

Kelly W. George
President, Mackinac Financial Corporation
President and CEO, mBank
Director Since: 2006

Robert E. Mahaney
President and Owner
Veridea Group, LLC
Director Since: 2008

Robert H. Orley
Founding Partner
O2 Investment Partners, LLC
Director Since: 2004

L. Brooks Patterson
County Executive
Oakland County
Director Since: 2006

Randolph C. Paschke
Director of Community Relations & External Engagement
Wayne State University, School of Business Administration
Director Since: 2004

David R. Steinhardt
Founder and President
KCPS & Company Ltd.
Director Since: 2012

Paul D. Tobias
Chairman and CEO, Mackinac Financial Corporation
Chairman, mBank
Director Since: 2004

OFFICERS

Mackinac Financial Corporation

Paul D. Tobias
Chairman and Chief Executive Officer
Birmingham, MI

Kelly W. George
President
Manistique, MI

Ernie R. Krueger
Executive Vice President/Chief Financial Officer
Manistique, MI

Mackinac Commercial Credit, LLC

Officers

Paul D. Tobias
Chairman and Manager

Paul A. Barr
Credit Manager

Edward P. Lewan
EVP/Chief Lending Officer

Michael J. Gallagher
Regional Vice President

Darlene Goy
Controller

Board of Managers

Paul D. Tobias
Chairman and CEO
Mackinac Financial Corporation

Don Barr, Jr.
President
Baywood Holdings, LLC

Kelly W. George
President and CEO
mBank

Ernie R. Krueger
EVP - Chief Financial Officer
mBank

Tamara R. McDowell
EVP - Managing Director
Credit Administration/Operations

Walter J. Aspatore
Chairman
Methode Electronics Corp

Robert H. Orley
Founding Partner
O2 Investment Partners, LLC

Frank N. Sheckell
Managing Director
Oakland Capital Partners, LLC

mBank Officers

Bernadette C. Beaudre
Assistant Vice President
Deposit Compliance/BSA Officer
Manistique

Linda K. Bolda
Senior Vice President
Human Resources Director
Manistique

Catherine M. Bolm
Vice President
Mortgage Loan Officer
Marquette

Julie L. Bosanic
Assistant Vice President
Underwriting Supervisor
Manistique

Angela E. Buckingham
Assistant Vice President
District Branch Supervisor
Newberry

Michael A. Caruso
Vice President
Senior Commercial Banking Officer
Traverse City

Jesse A. Deering
Senior Vice President
Managing Director of Retail Branch Banking/Marketing
Birmingham

Richard B. Demers
Vice President
Commercial Banking Officer
Manistique

Trisha L. DeMars
Assistant Vice President
Senior Deposit Operations Specialist
Manistique

George J. Demou
Vice President
Senior Commercial Banking Officer
Birmingham

Elena C. Dritsas
Assistant Vice President
Branch Administrator
Birmingham

Jeremy W. Flodin
Vice President
Senior Credit Administrator/ Credit Risk Analyst
Manistique

Daniel P. Galbraith
Assistant Vice President
District Branch Supervisor
Traverse City

Terry L. Garceau
Senior Vice President
Ishpeming/Negaunee Market Executive
Ishpeming

Laura L. Garvin
Vice President
Commercial Portfolio Manager
Birmingham

Kelly W. George
President and Chief Executive Officer
Manistique, Marquette

Clarice A. Ghiardi
Vice President
Mortgage Loan Officer
Marquette

Joseph T. Havican
Vice President
Commercial Banking Officer
Marquette

Michael J. Hoar
Senior Vice President
Information Technology/ Communications Manager
Manistique

Ernie R. Krueger
Executive Vice President
Chief Financial Officer
Manistique

David W. Leslie
Senior Vice President
Southeast Michigan/Gaylord
Commercial Lending Manager
Birmingham

Magan L. MacArthur
Assistant Vice President
Mortgage Loan Officer
Manistique

Boris Martysz
Senior Vice President
Marquette Regional Executive
Marquette

Tamara R. McDowell
Executive Vice President
Managing Director, Credit Administration/ Operations/Information Technology
Manistique, Marquette

Jacquelyn R. Menhennick
Senior Vice President
Mortgage and Consumer Lending Manager
Marquette

Barbara A. Parrett
Assistant Vice President
District Branch Supervisor
Stephenson

Clay V. Peterson
Senior Vice President
Delta County Regional Executive
Escanaba

Debra L. Peterson
Vice President
Mortgage Loan Officer
Escanaba

Joan M. Pitera-Powell
Vice President
Commercial Banking Officer
Birmingham

Scott A. Ravet
Vice President
Commercial Banking Officer
Escanaba

Jason J. Rolling
Vice President
Premier Client Services
Marquette

Andrew P. Sabatine
Regional President
Northern Lower Peninsula
Traverse City

Teresa M. Same
Assistant Vice President
District Branch Supervisor
Marquette

Gregory D. Schuetter
Senior Vice President
Upper Peninsula
Commercial Lending Manager
Manistique, Marquette

Joanna B. Slaght
Senior Vice President
Compliance/Risk Manager
Manistique

Michael A. Slaght
Vice President
Commercial Banking Officer
Newberry

Jennifer A. Stempki
Vice President
Controller
Manistique

Daniel L. Stoudt
Assistant Vice President
Mortgage Loan Officer
Traverse City

David R. Thomas
Vice President
Commercial Banking Officer
Sault Ste. Marie

Paul D. Tobias
Chairman
Birmingham

Nicole A. Tryan
Assistant Vice President
Senior Loan Operations Officer
Manistique

Janet M. Willbee
Vice President
Mortgage Loan Officer
Gaylord

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Corporate Information

CORPORATE HEADQUARTERS
Mackinac Financial Corporation
130 South Cedar Street
Manistique, Michigan 49854
(888) 343-8147

TRANSFER AGENT
Computershare
480 Washington Blvd., 29th Floor
Jersey City, NJ 07310
(800) 368-5948

INVESTOR RELATIONS
Ernie R. Krueger
EVP/CFO
(906) 341-7158
ekrueger@bankmbank.com

WEBSITE
www.bankmbank.com

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
Plante Moran, PLLC
Auburn Hills, Michigan

STOCK LISTING AND SYMBOL
NASDAQ Capital Market
Symbol: MFNC

SHAREHOLDER INFORMATION
Copies of the Corporation's 10-K and 10-Q reports as filed with the Securities and Exchange Commission are available upon request from the Corporation.

ANNUAL SHAREHOLDERS' MEETING
The 2015 Annual Meeting of the Shareholders of Mackinac Financial Corporation will be held on May 27, 2015.

Visit our website, www.bankmbank.com, for updated news releases, financial reports, SEC filings, corporate governance and other investor information.

260 East Brown St., Suite 300, Birmingham

3530 North Country Dr., Traverse City

S216 Menominee St., Stephenson

138 Ridge St., Sault Ste. Marie

414 Newberry Ave., Newberry

440 US 41 East, Negaunee

1414 W. Fair Ave., Ste. #140, Marquette

175 S. McClellan Ave., Marquette

857 W. Washington Street, Marquette

735 E. Lake Shore Dr., Manistique

130 S. Cedar St., P.O. Box 369, Manistique

14429 Wuoksi Ave., Kaleva

US 41 West & 170 N. Daisy St., Ishpeming

900 US 41 West, Ishpeming

100 S. Main St., Ishpeming

1955 S. Otsego Ave, P.O. Box 3010, Gaylord

2224 N. Lincoln Rd., P.O. Box 458, Escanaba

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