Section 1: 10-Q (10-Q)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2019

OR

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

For the transition period from <> to <>

Commission file number: 0-20167

MACKINAC FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

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

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

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐	Accelerated Filer ☒
Non-accelerated Filer ☐	Smaller reporting company ☒
	Emerging growth company ☐

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

Yes ☐ No ☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.☐

Title of each class:	Trading Symbol	Name of each exchange on which registered:
Commmon Stock, No par value	MFNC	The NASDAQ Stock Market, LLC

As of May 9, 2019, there were outstanding 10,740,712 shares of the registrant’s common stock, no par value.

MACKINAC FINANCIAL CORPORATION

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

	March 31, 2019 (Unaudited)	December 31, 2018
ASSETS		
Cash and due from banks	**$ 55,923**	$ 64,151
Federal funds sold	**1,040**	6
Cash and cash equivalents	**56,963**	64,157
Interest-bearing deposits in other financial institutions	**12,712**	13,452
Securities available for sale	**113,460**	116,748
Federal Home Loan Bank stock	**4,924**	4,924
Loans:		
Commercial	**732,678**	717,032
Mortgage	**293,126**	301,461
Consumer	**19,624**	20,371
Total Loans	**1,045,428**	1,038,864
Allowance for loan losses	**(5,154)**	(5,183)
Net loans	**1,040,274**	1,033,681
Premises and equipment	**23,479**	22,783
Other real estate held for sale	**1,961**	3,119
Deferred tax asset	**6,906**	5,763
Deposit based intangibles	**5,549**	5,720
Goodwill	**19,224**	22,024
Other assets	**31,544**	25,669
TOTAL ASSETS	**$ 1,316,996**	$1,318,040
LIABILITIES AND SHAREHOLDERS’ EQUITY		
LIABILITIES:		
Deposits:		
Noninterest bearing deposits	**$ 245,201**	$ 241,556
NOW, money market, interest checking	**363,753**	368,890
Savings	**110,978**	111,358
CDs<$250,000	**245,427**	225,236
CDs>$250,000	**12,706**	13,737
Brokered	**119,183**	136,760
Total deposits	**1,097,248**	1,097,537
Federal funds purchased	**6,780**	2,905
Borrowings	**46,878**	57,536
Other liabilities	**11,344**	7,993
Total liabilities	**1,162,250**	1,165,971
SHAREHOLDERS’ EQUITY:		
Common stock and additional paid in capital - No par value Authorized - 18,000,000 shares Issued and outstanding - 10,740,712 and 10,712,745 respectively	**129,204**	129,066
Retained earnings	**25,347**	23,466
Accumulated other comprehensive income (loss)		
Unrealized gains (losses) on available for sale securities	**413**	(245)
Minimum pension liability	**(218)**	(218)
Total shareholders’ equity	**154,746**	152,069
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	**$ 1,316,996**	$1,318,040

MACKINAC FINANCIAL CORPORATION

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

	Three Months Ended March 31,	
	2019	**2018**
	(Unaudited)	
INTEREST INCOME:		
Interest and fees on loans:		
Taxable	**$14,595**	$10,390
Tax-exempt	**47**	25
Interest on securities:		
Taxable	**703**	372
Tax-exempt	**98**	69
Other interest income	**385**	199
Total interest income	**15,828**	11,055
INTEREST EXPENSE:		
Deposits	**2,354**	1,236
Borrowings	**238**	510
Total interest expense	**2,592**	1,746
Net interest income	**13,236**	9,309
Provision for loan losses	**100**	50
Net interest income after provision for loan losses	**13,136**	9,259
OTHER INCOME:		
Deposit service fees	**406**	269
Income from mortgage loans sold on the secondary market	**312**	177
SBA/USDA loan sale gains	**125**	51
Net mortgage servicing fees (amortization)	**(8)**	(8)
Other	**282**	125
Total other income	**1,117**	614
OTHER EXPENSE:		
Salaries and employee benefits	**5,435**	4,154
Occupancy	**1,081**	811
Furniture and equipment	**718**	531
Data processing	**709**	504
Advertising	**309**	195
Professional service fees	**434**	304
Loan origination expenses and deposit and card related fees	**179**	126
Writedowns and losses on other real estate held for sale	**28**	26
FDIC insurance assessment	**134**	156
Communications	**228**	155
Transaction related expenses	**—**	189
Other	**989**	777
Total other expenses	**10,244**	7,928
Income before provision for income taxes	**4,009**	1,945
Provision for income taxes	**842**	408
NET INCOME	**$ 3,167**	$ 1,537
INCOME PER COMMON SHARE:		
Basic	**$ 0.30**	$ 0.24
Diluted	**$ 0.30**	$ 0.24

MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME
(Dollars in Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2019	**2018**
Net income	**$ 3,167**	$ 1,537
Other comprehensive income		
Change in securities available for sale:		
Unrealized gains (losses) arising during the period	**973**	(537)
Tax effect	**(315)**	113
Net change in unrealized gains (losses) on available for sale securities	**658**	(424)
Total comprehensive income	**$ 3,825**	$ 1,113

MACKINAC FINANCIAL CORPORATION

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

	Three Months Ended March 31, 2019				
	Shares of Common Stock	**Common Stock and Additional Paid in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (loss)**	**Total**
Balance, beginning of period	**10,712,745**	**$ 129,066**	**$23,466**	**$ (463)**	**$152,069**
Net income for period	—	—	**3,167**	—	**3,167**
Other comprehensive income					
Net unrealized gain on securities available for sale	—	—	—	**658**	**658**
Total comprehensive income	—	—	**3,167**	**658**	**3,825**
Stock compensation	—	**138**	—	—	**138**
Issuance of common stock:					
Restricted stock award vesting	**27,967**	—	—	—	—
Dividend on common stock	—	—	**(1,286)**	—	**(1,286)**
Balance, end of period	**10,740,712**	**$ 129,204**	**$25,347**	**$ 195**	**$154,746**

	Three Months Ended March 31, 2018				
	Shares of Common Stock	**Common Stock and Additional Paid in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Total**
Balance, beginning of period	6,294,930	$ 61,981	$ 19,711	$ (292)	$81,400
Net income for period	—	—	1,537	—	1,537
Other comprehensive income					
Net unrealized gain on securities available for sale	—	—	—	(424)	(424)
Total comprehensive income	—	—	1,537	(424)	1,113
Stock compensation	—	99	—	—	99
Issuance of common stock:					
Restricted stock award vesting	37,630	—	—	—	—
Dividend on common stock	—	—	(755)	—	(755)
Balance, end of period	6,332,560	$ 62,080	$ 20,493	$ (716)	$81,857

MACKINAC FINANCIAL CORPORATION

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

	Three Months Ended March 31,	
	2019	**2018**
Cash Flows from Operating Activities:		
Net income	**$ 3,167**	$ 1,537
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**618**	631
Provision for loan losses	**100**	50
Deferred tax expense, net	**324**	408
Gain on sale of loans sold in the secondary market	**(258)**	(139)
Origination of loans held for sale in the secondary market	**(13,604)**	(8,201)
Proceeds from sale of loans in the secondary market	**13,862**	8,340
Loss on sale of other real estate held for sale	**28**	26
Stock compensation	**138**	99
Change in other assets	**(2,386)**	513
Change in other liabilities	**3,351**	(1,144)
Net cash provided by operating activities	**5,340**	2,120
Cash Flows from Investing Activities:		
Net decrease (increase) in loans	**(9,291)**	(1,454)
Net decrease in interest bearing deposits in other financial institutions	**740**	1,983
Proceeds from maturities, sales, calls or paydowns of securities available for sale	**4,306**	1,336
Capital expenditures	**(346)**	(548)
Proceeds from sale of other real estate, premises and fixed assets	**415**	1,070
Net cash (used in) provided by investing activities	**(4,176)**	2,387
Cash Flows from Financing Activities:		
Net (decrease) increase in deposits	**(289)**	(11,201)
Net activity on line of credit	**—**	1,000
Increase in fed funds purchased	**3,875**	10,000
Principal payments on borrowings	**(10,658)**	(550)
Dividend on common stock	**(1,286)**	(755)
Net cash used in financing activities	**(8,358)**	(1,506)
Net increase in cash and cash equivalents	**(7,194)**	3,001
Cash and cash equivalents at beginning of period	**64,157**	37,426
Cash and cash equivalents at end of period	**$ 56,963**	$ 40,427
Supplemental Cash Flow Information:		
Cash paid during the year for:		
Interest	**$ 2,523**	$ 1,746
Income taxes	**—**	40
Noncash Investing and Financing Activities:		
Transfers of Foreclosures from Loans to Other Real Estate Held for Sale	**298**	64

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements of Mackinac Financial Corporation (the "Corporation") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2018.

In order to properly reflect some categories of other income and other expenses, reclassifications of expense and income items have been made to prior period numbers. The "net" other income and other expenses were unchanged by these reclassifications.

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

Acquired Loans

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

In recording the fair values of acquired impaired loans at acquisition date, management calculates a non-accretable difference (the credit component of the purchased loans) and an accretable difference (the yield component of the purchased loans).

Over the life of the acquired loans, management continues to estimate cash flows expected to be collected. We evaluate at each balance sheet date whether it is probable that we will be unable to collect all cash flows expected at acquisition and if so, recognize a provision for loan loss in our consolidated statement of operations. 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 Financial Accounting Standards Board ("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.

Allowance for Loan Losses

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

The Corporation also has an unallocated 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.

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 awards ("RSAs"), stock grants, or stock appreciation rights. The aggregate number of shares of the Corporation's common stock issuable under the plan is 575,000. At March 31, 2019 there were 216,310 shares available for issuance under this plan. Awards are made to certain other senior officers at the discretion of the Corporation's management. Compensation cost equal to the fair value of the award is recognized over the vesting period.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, Leases, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize an asset with the right of use and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance was adopted January 1, 2019, and accordingly an asset and liability of $4.838 million were recognized. The asset is included in other assets and the liability is included within other liabilities.

In September 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income.

ASU 2016-13 requires an entity to measure expected credit losses for financial assets over the estimated lifetime of expected credit loss and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The standard includes the following core concepts in determining the expected credit loss. The estimate must: (a) be based on an asset's amortized cost (including premiums or discounts, net deferred fees and costs, foreign exchange and fair value hedge accounting adjustments), (b) reflect losses expected over the remaining contractual life of an asset (considering the effect of voluntary prepayments), (c) consider available relevant information about the estimated collectability of cash flows (including information about past events, current conditions, and reasonable and supportable forecasts), and (d) reflect the risk of loss, even when that risk is remote.

ASU 2016-13 also amends the recording of purchased credit-deteriorated assets. Under the new guidance, an allowance will be recognized at acquisition through a gross-up approach whereby an entity will record as the initial amortized cost

the sum of (a) the purchase price and (b) an estimate of credit losses as of the date of acquisition. In addition, the guidance also requires immediate recognition in earnings of any subsequent changes, both favorable and unfavorable, in expected cash flows by adjusting this allowance.

ASU 2016-13 also amends the impairment model for available-for-sale debt securities and requires entities to determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. Management may not use the length of time a security has been in an unrealized loss position as a factor in concluding whether a credit loss exists, as is currently permitted. In addition, an entity will recognize an allowance for credit losses on available-for-sale debt securities as a contra-account to the amortized cost basis rather than as a direct reduction of the amortized cost basis of the investment, as is currently required. As a result, entities will recognize improvements to credit losses on available-for-sale debt securities immediately in earnings rather than as interest income over time under current practice.

New disclosures required by ASU 2016-13 include: (a) for financial assets measured at amortized cost, an entity will be required to disclose information about how it developed its allowance, including changes in the factors that influenced management's estimate of expected credit losses and the reasons for those changes, (b) for financial receivables and net investments in leases measured at amortized cost, an entity will be required to further disaggregate the information it currently discloses about the credit quality of these assets by year or the asset's origination or vintage for as many as five annual periods, and (c) for available-for-sale debt securities, an entity will be required to provide a roll-forward of the allowance for credit losses and an aging analysis for securities that are past due.

Upon adoption of ASU 2016-13, a cumulative-effect adjustment to retained earnings will be recorded as of the beginning of the first reporting period in which the guidance is effective. ASU 2016-13 is effective for SEC registrants for interim and annual periods beginning after December 15, 2019, with early adoption permitted for annual periods beginning after December 15, 2018. The Corporation is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Corporation's consolidated financial condition and results of operations. The Corporation has formed a cross-functional implementation team consisting of individuals from finance, credit and information systems. A project plan and timeline has been developed and the implementation team meets regularly to assess the project status to ensure adherence to the timeline. The implementation team has also been working with a software vendor to assist in implementing required changes to credit loss estimation models and proceses, an is finalizing the historical data collected to be utilized in the credit loss models. The Corporation expects to recognize a cumulative effect adjustment to the opening balance of retained earnings as of the beginning of the first reporting period in which ASU 2016-13 is effective. The Corporation has not yet determined the magnitude of any such one-time adjustment or ther potential impact of ASU 2016-13 on its condensed consolidated financial statements.

3. EARNINGS PER SHARE

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

The following shows the computation of basic and diluted earnings per share for the three months ended March 31, 2019 and 2018 (dollars in thousands, except per share data):

	Three Months Ended March 31,	
	2019	**2018**
(Numerator):		
Net income	**$ 3,167**	$ 1,537
(Denominator):		
Weighted average shares outstanding	**10,720,127**	6,304,203
Effect of restricted stock awards	**3,794**	26,007
Diluted weighted average shares outstanding	**10,723,921**	6,330,210
Income per common share:		
Basic	**$ 0.30**	$ 0.24
Diluted	**$ 0.30**	$ 0.24

4. INVESTMENT SECURITIES

At March 31, 2019 the Corporation has an investment security portfolio totaling $113.460 million, a decrease of $3.288 million from December 31, 2018 balance of $116.748 million. The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2019 and December 31, 2018 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2019				
Corporate	**$ 20,172**	**$ 30**	**$ (44)**	**$ 20,158**
US Agencies	**15,952**	**13**	**(118)**	**15,847**
US Agencies - MBS	**31,158**	**345**	**(126)**	**31,377**
Obligations of states and political subdivisions	**45,654**	**587**	**(163)**	**46,078**
Total securities available for sale	**$ 112,936**	**$ 975**	**$ (451)**	**$ 113,460**
December 31, 2018				
Corporate	$ 20,198	$ 24	$ (158)	$ 20,064
US Agencies	16,198	5	(233)	15,970
US Agencies - MBS	32,974	124	(258)	32,840
Obligations of states and political subdivisions	47,828	341	(295)	47,874
Total securities available for sale	$ 117,198	$ 494	$ (944)	$ 116,748

	March 31, 2019		December 31, 2018	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available -for-sale securities				
Under 1 year	**$ 18,890**	**$ 18,846**	$ 13,683	$ 13,665
After 1 year through five years	**78,722**	**79,156**	83,928	83,486
After 5 years through 10 years	**12,455**	**12,589**	16,712	16,739
After 10 years	**2,869**	**2,869**	2,875	2,858
Total available -for-sale securities	**$ 112,936**	**$ 113,460**	$ 117,198	$ 116,748

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

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were $26.330 million and $26.583 million, respectively, at March 31, 2019.

5. LOANS

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

	March 31, 2019	December 31, 2018
Commercial real estate	**$ 498,471**	$ 496,207
Commercial, financial, and agricultural	**201,089**	191,060
Commercial construction	**33,118**	29,765
One to four family residential real estate	**281,104**	286,908
Consumer	**19,624**	20,371
Consumer construction	**12,022**	14,553
Total loans	**$1,045,428**	$1,038,864

The Corporation completed the acquisition of Peninsula Financial Corporation ("PFC") on December 5, 2014, The First National Bank of Eagle River ("Eagle River") on April 29, 2016, Niagara Bancorporation ("Niagara") on August 31, 2016, First Federal of Northern Michigan Bancorp ("FFNM") on May 18, 2018 and Lincoln Community Bank ("Lincoln") on October 1, 2018. The PFC acquired impaired loans totaled $13.290 million, the Eagle River acquired impaired loans totaled $3.401 million, the Niagara acquired impaired loans totaled $2.105 million, the FFNM acquired impaired loans totaled $5.440 million, and the Lincoln impaired loans totaled $1.901 million.
The table below details the outstanding balances of the PFC acquired portfolio and the fair value adjustments at acquisition date (dollars in thousands):

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

The table below details the outstanding balances of the Eagle River acquired portfolio and the fair value adjustments at acquisition date (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 3,401	$ 80,737	$ 84,138
Nonaccretable difference	(1,172)	—	(1,172)
Expected cash flows	2,229	80,737	82,966
Accretable yield	(391)	(1,700)	(2,091)
Carrying balance at acquisition date	$ 1,838	$ 79,037	$ 80,875

The table below details the outstanding balances of the Niagara acquired portfolio and the fair value adjustments at acquisition date (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 2,105	$ 30,555	$ 32,660
Nonaccretable difference	(265)	—	(265)
Expected cash flows	1,840	30,555	32,395
Accretable yield	(88)	(600)	(688)
Carrying balance at acquisition date	$ 1,752	$ 29,955	$ 31,707

The table below details the outstanding balances of the FFNM acquired portfolio and the fair value adjustments at acquisition date (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 5,440	$187,302	$192,742
Nonaccretable difference	(2,100)	—	(2,100)
Expected cash flows	3,340	187,302	190,642
Accretable yield	(700)	(4,498)	(5,198)
Carrying balance at acquisition date	$ 2,640	$182,804	$185,444

The table below details the outstanding balances of the Lincoln acquired portfolio and the fair value adjustments at acquisition date (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 1,901	$ 37,700	$ 39,601
Nonaccretable difference	(546)	—	(546)
Expected cash flows	1,355	37,700	39,055
Accretable yield	(561)	(493)	(1,054)
Carrying balance at acquisition date	$ 794	$ 37,207	$ 38,001

The table below presents a rollforward of the accretable yield on acquired loans for the three months ended March 31, 2019 (dollars in thousands):

	PFC			Eagle River		
	Acquired Impaired	Acquired Non-impaired	Acquired Total	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2018	$ 128	$ —	$ 128	$ 213	$ 16	$ 229
Accretion	—	—	—	—	(16)	(16)
Reclassification from nonaccretable difference	—	—	—	—	—	—
Balance, March 31, 2019	$ 128	$ —	$ 128	$ 213	$ —	$ 213

	Niagara			First Federal Northern Michigan		
	Acquired Impaired	Acquired Non-impaired	Acquired Total	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2018	$ 26	$ 69	$ 95	$ 571	$ 3,446	$4,017
Accretion	—	(51)	(51)	—	(410)	(410)
Reclassification from nonaccretable difference	—	—	—	—	—	—
Balance, March 31, 2019	$ 26	$ 18	$ 44	$ 571	$ 3,036	$3,607

	Lincoln Community Bank			Total		
	Acquired Impaired	Acquired Non-impaired	Acquired Total	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2018	$ 140	$ 442	$ 582	$ 1,078	$ 3,973	$5,051
Accretion	(15)	(49)	(64)	(15)	(526)	(541)
Reclassification from nonaccretable difference	12	—	12	12	—	12
Balance, March 31, 2019	$ 137	$ 393	$ 530	$ 1,075	$ 3,447	$4,522

The table below presents a rollforward of the accretable yield on acquired loans for the three months ended March 31, 2018 (dollars in thousands):

	PFC			Eagle River			Niagara		
	Acquired Impaired	Acquired Non-impaired	Acquired Total	Acquired Impaired	Acquired Non-impaired	Acquired Total	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2017	$ 149	$ —	$ 149	$ 218	$ 603	$ 821	$ 38	$ 281	$ 319
Accretion	(30)	—	(30)	—	(150)	(150)	—	(54)	(54)
Reclassification from nonaccretable difference	23	—	23	—	—	—	—	—	—
Balance, March 31, 2018	$ 142	$ —	$ 142	$ 218	$ 453	$ 671	$ 38	$ 227	$ 265

Allowance for Loan Losses

An analysis of the allowance for loan losses for the three months ended March 31, 2019 and March 31, 2018 is as follows (dollars in thousands):

	March 31, 2019	March 31, 2018
Balance, January 1	**$ 5,183**	$ 5,079
Recoveries on loans previously charged off	**32**	25
Loans charged off	**(161)**	(53)
Provision	**100**	50
Balance at end of period	**$ 5,154**	$ 5,101

In the first three months of 2019, net charge-offs were $129,000, compared to net charge-offs of $28,000 in the same period in 2018. In the first three months of 2019, the Corporation recorded a provision for loan loss of $100,000 compared to a $50,000 provision for loan losses in the first three months of 2018. The Corporation's allowance for loan loss reserve policy calls for a measurement of the adequacy of the reserve at each quarter end. This process includes an analysis of the loan portfolio to take into account increases in loans outstanding and portfolio composition, historical loss rates, and specific reserve requirements of nonperforming loans.
A breakdown of the allowance for loan losses and recorded balances in loans at March 31, 2019 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	$ 1,682	$ 648	$ 101	$ 199	$ 6	$ 8	$ 2,539	$ 5,183
Charge-offs	(20)	(19)	—	(63)	—	(59)	—	(161)
Recoveries	12	4	—	5	—	11	—	32
Provision	(109)	372	(1)	60	—	49	(271)	100
Ending balance ALLR	$ 1,565	$ 1,005	$ 100	$ 201	$ 6	$ 9	$ 2,268	$ 5,154
Loans:								
Ending balance	$ 498,471	$ 201,089	$ 33,118	$ 281,104	$ 12,022	$19,624	$ —	$1,045,428
Ending balance ALLR	(1,565)	(1,005)	(100)	(201)	(6)	(9)	(2,268)	(5,154)
Net loans	$ 496,906	$ 200,084	$ 33,018	$ 280,903	$ 12,016	$19,615	$ (2,268)	$1,040,274
Ending balance ALLR:								
Individually evaluated	$ 467	$ 648	$ —	$ —	$ —	$ —	$ —	$ 1,115
Collectively evaluated	1,098	357	100	201	6	9	2,268	4,039
Total	$ 1,565	$ 1,005	$ 100	$ 201	$ 6	$ 9	$ 2,268	$ 5,154
Ending balance Loans:								
Individually evaluated	$ 2,138	$ 1,245	$ —	$ —	$ —	$ —	$ —	$ 3,383
Collectively evaluated	493,570	198,425	32,753	279,943	11,809	19,585	—	1,036,085
Acquired with deteriorated credit quality	2,763	1,419	365	1,161	213	39	—	5,960
Total	$ 498,471	$ 201,089	$ 33,118	$ 281,104	$ 12,022	$19,624	$ —	$1,045,428

Impaired loans, by definition, are individually evaluated.

A breakdown of the allowance for loan losses and recorded balances in loans at March 31, 2018 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	$ 1,650	$ 576	$ 54	$ 160	$ 6	$ 10	$ 2,623	$ 5,079
Charge-offs	—	—	—	(47)	—	(6)	—	(53)
Recoveries	7	3	1	2	—	12	—	25
Provision	676	965	371	58	—	(7)	(2,013)	50
Ending balance ALLR	$ 2,333	$ 1,544	$ 426	$ 173	$ 6	$ 9	$ 610	$ 5,101
Loans:								
Ending balance	$ 411,526	$ 160,188	$ 8,004	$ 204,542	$ 11,262	$ 16,919	$ —	$812,441
Ending balance ALLR	(2,333)	(1,544)	(426)	(173)	(6)	(9)	(610)	(5,101)
Net loans	$ 409,193	$ 158,644	$ 7,578	$ 204,369	$ 11,256	$ 16,910	$ (610)	$807,340
Ending balance ALLR:								
Individually evaluated	$ 362	$ 310	$ —	$ —	$ —	$ —	$ —	$ 672
Collectively evaluated	1,971	1,234	426	173	6	9	610	4,429
Total	$ 2,333	$ 1,544	$ 426	$ 173	$ 6	$ 9	$ 610	$ 5,101
Ending balance Loans:								
Individually evaluated	$ 1,568	$ 1,307	$ 372	$ —	$ —	$ —	$ —	$ 3,247
Collectively evaluated	408,273	158,881	7,632	203,032	11,215	16,919	—	805,952
Acquired with deteriorated credit quality	1,685	—	—	1,510	47	—	—	3,242
Total	$ 411,526	$ 160,188	$ 8,004	$ 204,542	$ 11,262	$ 16,919	$ —	$812,441

As part of the management of the loan portfolio, risk ratings are assigned to all commercial loans. Through the loan review process, ratings are modified as believed to be appropriate to reflect changes in the credit. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans.

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

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

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, and other relevant characteristics.

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, and other relevant characteristics.

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.

Acceptable Watch (44)

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. Acceptable Watch assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Examples of this type of credit include a start-up company fully based on projections, a documentation issue that needs to be corrected or a general market condition that the borrower is working through to get corrected.

Substandard (6)

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

Doubtful (7)

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

Charge-off/Loss (8)

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

General Reserves:

For loans with a credit risk rating of 44 or better and any loans with a risk rating of 6 or 7 not considered impaired, 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. 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 is in excess of the computed allowance, the allocation is increased for the higher anticipated loss. These computations provide the basis for the allowance for loan losses as recorded by the Corporation.

Below is a breakdown of loans by risk category as of March 31, 2019 (dollars in thousands):

	(1) Strong	(2) Good	(3) Average	(4) Acceptable	(44) Acceptable Watch	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	**$10,557**	**$21,313**	**$189,296**	**$262,811**	**$ 3,596**	**$ 10,898**	**$ —**	**$ —**	**$ 498,471**
Commercial, financial and agricultural	**8,882**	**11,408**	**66,533**	**109,164**	**2,313**	**2,789**	**—**	**—**	**201,089**
Commercial construction	**919**	**515**	**8,120**	**13,481**	**820**	**836**	**—**	**8,427**	**33,118**
One-to-four family residential real estate	**70**	**2,898**	**6,988**	**15,186**	**2,122**	**5,040**	**—**	**248,800**	**281,104**
Consumer construction	**—**	**—**	**—**	**153**	**90**	**9**	**—**	**11,770**	**12,022**
Consumer	**17**	**206**	**446**	**978**	**—**	**61**	**—**	**17,916**	**19,624**
Total loans	**$20,445**	**$36,340**	**$271,383**	**$401,773**	**$ 8,941**	**$ 19,633**	**$ —**	**$286,913**	**$1,045,428**

Below is a breakdown of loans by risk category as of December 31, 2018 (dollars in thousands):

	(1) Strong	(2) Good	(3) Average	(4) Acceptable	(44) Acceptable Watch	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	$ 9,564	$22,265	$189,898	$257,627	$ 5,993	$ 10,860	$ —	$ —	$ 496,207
Commercial, financial and agricultural	8,077	8,678	72,466	97,441	2,269	2,129	—	—	191,060
Commercial construction	734	706	6,844	12,244	829	823	—	7,585	29,765
One-to-four family residential real estate	70	2,873	6,941	15,711	2,095	4,757	—	254,461	286,908
Consumer construction	—	—	—	200	50	11	—	14,292	14,553
Consumer	19	236	625	1,156	42	77	—	18,216	20,371
Total loans	$18,464	$34,758	$276,774	$384,379	$ 11,278	$ 18,657	$ —	$294,554	$1,038,864

Impaired Loans

Impaired 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.

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 loan 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.

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

	Impaired Loans with No Related Allowance	Impaired Loans with Related Allowance	Total Impaired Loans	Unpaid Principal Balance	Related Allowance for Loan Losses
March 31, 2019					
Commercial real estate	**$ 2,763**	**$ 2,138**	**$ 4,901**	**$ 10,635**	**$ 467**
Commercial, financial and agricultural	**1,419**	**1,245**	**2,664**	**2,211**	**648**
Commercial construction	**365**	**—**	**365**	**1,092**	**—**
One to four family residential real estate	**1,161**	**—**	**1,161**	**3,843**	**—**
Consumer construction	**213**	**—**	**213**	**—**	**—**
Consumer	**39**	**—**	**39**	**52**	**—**
Total	**$ 5,960**	**$ 3,383**	**$ 9,343**	**$ 17,833**	**$ 1,115**
December 31, 2018					
Commercial real estate	$ 2,777	$ 2,148	$ 4,925	$ 10,740	$ 486
Commercial, financial and agricultural	1,460	577	2,037	2,249	340
Commercial construction	366	—	366	1,132	—
One to four family residential real estate	1,231	—	1,231	4,136	—
Consumer construction	217	—	217	—	—
Consumer	42	—	42	55	—
Total	$ 6,093	$ 2,725	$ 8,818	$ 18,312	$ 826

	Individually Evaluated Impaired Loans			
	March 31, 2019		December 31, 2018	
	Average Balance for the Period	**Interest Income Recognized for the Period**	Average Balance for the Period	Interest Income Recognized for the Period
Commercial real estate	**$ 7,968**	$ **76**	$ 5,024	$ 410
Commercial, financial and agricultural	**563**	**2**	374	26
Commercial construction	**746**	**2**	383	13
One to four family residential real estate	**3,990**	**45**	2,879	203
Consumer construction	**—**	**—**	9	—
Consumer	**54**	**1**	38	4
Total	**$ 13,321**	$ **126**	$ 8,707	$ 656

A summary of past due loans at March 31, 2019 and December 31, 2018 is as follows (dollars in thousands):

	March 31, 2019				December 31, 2018			
	30-89 days Past Due (accruing)	**90+ days Past Due (accruing)**	**Nonaccrual**	**Total**	30-89 days Past Due (accruing)	90+ days Past Due (accruing)	Nonaccrual	Total
Commercial real estate	**$ 138**	**$ —**	**$ 1,396**	**$ 1,534**	$ 298	$ —	$ 1,700	$ 1,998
Commercial, financial and agricultural	**274**	**—**	**737**	**1,011**	398	—	320	718
Commercial construction	**52**	**—**	**282**	**334**	112	—	266	378
One to four family residential real estate	**4,315**	**—**	**3,145**	**7,460**	5,456	18	2,725	8,199
Consumer construction	**—**	**—**	**—**	**—**	—	—	—	—
Consumer	**71**	**—**	**28**	**99**	108	5	43	156
Total past due loans	**$ 4,850**	**$ —**	**$ 5,588**	**$10,438**	$ 6,372	$ 23	$ 5,054	$11,449

Troubled Debt Restructuring

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

The Corporation has, in accordance with generally accepted accounting principles and applicable 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.

There were 3 troubled debt restructuring that occurred during the three months ended March 31, 2019 and no troubled debt restructurings during the three months ended March 31, 2018. The three restructured loans included only modifications to the repayment schedules. The balance of these restructured loans remained at $.450 million.

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):

	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Loans outstanding, January 1	**$ 9,817**	$ 10,037
New loans	**1,872**	—
Net activity on revolving lines of credit	**358**	—
Repayment	**(96)**	(123)
Loans outstanding at end of period	**$ 11,951**	$ 9,914

There were no loans to related parties classified substandard as of March 31, 2019 or March 31, 2018. In addition to the outstanding balances above, there were unfunded commitments of $.486 million to related parties at March 31, 2019.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

The Corporation through the acquisition of Peninsula in 2014, Eagle River and Niagara in 2016, and FFNM and Lincoln in 2018, has recorded goodwill and core deposit intangibles as presented below (dollars in thousands):

	Goodwill Balance	Deposit Based Intangible Initital Balance
Peninsula	**$ 3,805**	**$ 1,206**
Eagle River	**1,839**	**993**
Niagara	**50**	**300**
FFNM	**12,278**	**2,894**
Lincoln	**1,252**	**1,353**
Total	**$ 19,224**	**$ 6,746**

	Deposit Based Intangible March 31, 2019 Balance	March 31, 2019 Amortization Expense	Future Annual Amortization Expense
Peninsula	**$ 684**	**$ 30**	**$ 121**
Eagle River	**703**	**25**	**99**
Niagara	**223**	**7**	**30**
FFNM	**2,653**	**82**	**290**
Lincoln	**1,286**	**27**	**135**
Total	**$ 5,549**	**$ 171**	**$ 675**

	Deposit Based Intangible December 31, 2018 Balance	2018 Amortization Expense
Peninsula	$ 714	$ 121
Eagle River	728	99
Niagara	230	30
FFNM	2,735	159
Lincoln	1,313	41
Total	$ 5,720	$ 450

The deposit based intangible asset is reported net of accumulated amortization at $5.549 million at March 31, 2019. Amortization expense in the first three months of 2019 is $.171 million. Amortization expense for the next five years is expected to be at $.675 million per year.

7. SERVICING RIGHTS

Mortgage Loans

Mortgage servicing rights ("MSRs") are recorded when loans are sold in the secondary market with servicing retained. As of March 31, 2019, the Corporation had obligations to service approximately $288.687 million of residential first mortgage loans. The valuation of MSRs 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 which management estimates at $2.898 million. On a quarterly basis, management evaluates the MSRs for impairment. The key economic assumptions used in determining the fair value of the MSRs include an annual constant prepayment speed of 10.57% and a discount rate of 10.17% as of March 31, 2019.

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

	March 31, 2019	March 31, 2018
Balance at beginning of period	**$ 1,144**	$ 1,033
Additions from loans sold with servicing retained	**500**	—
Amortization	**(60)**	(108)
Balance at end of period	**$ 1,584**	$ 925
Balance of loan servicing portfolio	**$ 288,687**	$ 195,235
Mortgage servicing rights as % of portfolio	**.55%**	.47%
Fair value of servicing rights	**2,898**	1,737

Commercial Loans

The Corporation periodically retains the servicing on certain commercial loans that have been sold. These loans were originated and underwritten under the SBA and USDA government guarantee programs, in which the guaranteed portion of the loan was sold to a third party with servicing retained. The balance of these sold loans with servicing retained at March 31, 2019 was approximately $41 million. The Corporation valued these servicing rights at $80,000 as of March 31, 2019 and at $80,000 as of December 31, 2018. This valuation was established in consideration of the discounted cash flow of net expected servicing income over the life of the loans.

8. BORROWINGS

Borrowings consist of the following at March 31, 2019 and December 31, 2018 (dollars in thousands):

	March 31, 2019	December 31, 2018
Federal Home Loan Bank fixed rate advances	**$ 46,398**	$ 57,060
USDA Rural Development note	**480**	476
	$ 46,878	$ 57,536

The Federal Home Loan Bank borrowings bear a weighted average rate of 1.72% and mature at various dates through 2026. They are collateralized at March 31, 2019 by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately $60.579 million; mortgage related and municipal securities with an amortized cost and estimated fair value of $30.586 million and $30.806 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling $4.924 million. Prepayment of the advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of March 31, 2019.

The Corporation currently has one correspondent banking borrowing relationship. The relationship currently consists of a $15.0 million revolving line of credit, which had a zero balance at March 31, 2019. The line of credit bears an interest rate of LIBOR plus 2.00%, with a floor rate of 3.00% and a ceiling of 22%. The line of credit expires on April 30, 2020. LIBOR at March 31, 2019 was 2.60%. The Corporation previously had a term note as part of this relationship that was paid in full during the second quarter of 2018. This relationship is secured by all of the outstanding mBank stock.

The USDA Rural Development borrowing bears an interest rate of 1.00% and matures in August, 2024. It is collateralized by an assignment of a demand deposit account held by the Corporation's wholly owned subsidiary, First Rural Relending, in the amount of $.427 million, and guaranteed by the Corporation.

9. DEFINED BENEFIT PENSION PLAN

The Corporation acquired the Peninsula Financial Corporation noncontributory defined benefit pension plan in 2014. 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 2019 are $22,000.

The anticipated distributions over the next five years and through December 31, 2028 are detailed in the table below (dollars in thousands):

2019	$ 136
2020	132
2021	131
2022	137
2023	143
2024-2028	823
Total	$ 1,502

The Corporation receives a valuation of the Plan annually. As such, at December 31, 2018, the plan's assets had a fair value of $1.987 million and the Corporation had a net unfunded liability of $1.004 million. The accumulated benefit obligation at December 31, 2018 was $2.991 million. The accumulated benefit obligation at March 31, 2018 was $3.331 million.

Assumptions in the actuarial valuation are:

	2019	2018
Weighted average discount rate	4.02%	3.33%
Rate of increase in future compensation levels	N/A	N/A
Expected long-term rate of return on plan assets	8.00%	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; which was in place at both March 31, 2019 and December 31, 2018.

	Target Allocation	Actual Allocation
Equity securities	50% to 70%	59%
Fixed income securities	30% to 50%	41%

10. STOCK COMPENSATION PLANS

Restricted Stock Awards

The Corporation's restricted stock awards are service-based and awarded based on performance. Each award has 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 has historically granted RSAs to members of the Board of Directors and management. Awards granted are set to vest equally over their award terms and are issued at no cost to the recipient. The table below summarizes each of the grant awards:

Date of Award	Units Granted	Market Value at grant date	Vesting Term
May, 2015	3,000	10.77	Immediate
February, 2016	35,733	9.91	4 years
February, 2017	28,427	13.39	4 years
February, 2018	18,643	16.30	4 years
April, 2018	8,000	16.00	Immediate
February, 2019	27,790	15.70	4 years

In the first quarter of 2019, the Corporation issued 27,967 shares of its common stock for vested RSAs. In the first quarter of 2018, the Corporation issued 37,630 shares of its common stock for vested RSAs.

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

	Number Outstanding	Weighted Average Grant Date Fair Value
Nonvested balance at January 1, 2019	69,322	$ 12.79
Granted during the period	27,790	15.70
Vested during the period	(27,967)	12.09
Nonvested balance at March 31, 2019	69,145	$ 13.28

11. INCOME TAXES

The Corporation has reported deferred tax assets of $6.906 million at March 31, 2019.

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The Corporation, as of March 31, 2019 had a net operating loss and tax credit carryforwards for tax purposes of approximately $12.5 million, and $1.7 million, respectively. As a result of the repeal of the corporate alternative minimum tax in the Tax Cuts and Jobs Act, any outstanding alternative minimum tax credits are believed to be utilized or refundable as of December 31, 2018. Therefore, the $1.6 million of alternative minimum tax credits, was reclassified to a current tax receivable included in other assets during 2018. The Corporation evaluated the future benefits from these carryforwards as of March 31, 2019 and determined that is was "more likely than not" that they would be utilized prior to expiration. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is $2.0 million for the NOL and the equivalent value of tax credits, which is approximately $.420 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004. 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.

The Corporation recognized a federal income tax expense of approximately $.842 million for the three months ended March 31, 2019 and $.408 million for the three months ended March 31, 2018.

12. FAIR VALUE MEASUREMENTS

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

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

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

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

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

The methodology in determining fair value of nonaccrual loans is to average them into the blended interest rate at 0% interest. This has the effect of decreasing the carrying amount below the risk-free rate amount and, therefore, discounts the estimated fair value.

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

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

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

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

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

The following table presents information for financial instruments at March 31, 2019 and December 31, 2018 (dollars in thousands):

	Level in Fair Value Hierarchy	March 31, 2019 Carrying Amount	March 31, 2019 Estimated Fair Value	December 31, 2018 Carrying Amount	December 31, 2018 Estimated Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	**$ 56,963**	**$ 56,963**	$ 64,157	$ 64,157
Interest-bearing deposits	Level 2	**12,712**	**12,712**	13,452	13,452
Securities available for sale	Level 2	**111,972**	**111,972**	115,260	115,260
Securities available for sale	Level 3	**1,488**	**1,488**	1,488	1,488
Federal Home Loan Bank stock	Level 2	**4,924**	**4,924**	4,924	4,924
Net loans	Level 3	**1,040,274**	**1,020,821**	1,033,681	1,013,214
Accrued interest receivable	Level 3	**3,846**	**3,846**	3,005	3,005
Total financial assets		**$1,232,179**	**$1,212,726**	$1,235,967	$1,215,500
Financial liabilities:					
Deposits	Level 2	**$1,097,248**	**$1,053,029**	$1,097,537	$1,047,709
Borrowings	Level 2	**46,878**	**46,301**	57,536	56,771
Accrued interest payable	Level 3	**519**	**519**	391	391
Total financial liabilities		**$1,144,645**	**$1,099,849**	$1,155,464	$1,104,871

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 March 31, 2019, and the valuation techniques used by the Corporation to determine those fair values.

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

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

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

The fair value of all investment securities at March 31, 2019 and December 31, 2018 were based on level 2 and level 3 inputs. There are no other assets or liabilities measured on a recurring basis at fair value. For additional information regarding investment securities, please refer to "Note 4 - Investment Securities."

The table below shows investment securities measured at fair value on a recurring basis (dollars in thousands):

(dollars in thousands)	Balance at March 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Gains) Losses for Three Months Ended March 31, 2019
Assets					
Corporate	$ 20,158	$ —	$ 19,658	$ 500	$ —
US Agencies	15,847	—	15,847	—	—
US Agencies - MBS	31,377	—	31,377	—	—
Obligations of state and political subdivisions	46,078	—	45,090	988	—
	$113,460				$ —

(dollars in thousands)	Balance at December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Gains) Losses for Twelve months ended December 31, 2018
Assets					
Corporate	$ 20,064	$ —	$ 19,564	$ 500	$ —
US Agencies	15,970	—	15,970	—	—
US Agencies - MBS	32,840	—	32,840	—	—
Obligations of state and political subdivisions	47,874	—	46,886	988	—
	$ 116,748				$ —

The Corporation had no Level 3 assets or liabilities measured at fair value on a recurring basis as of March 31, 2019, or December 31, 2018 other than as described above.

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 certain impaired loans and other real estate owned. The Corporation has estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets Measured at Fair Value on a Nonrecurring Basis at March 31, 2019

(dollars in thousands)	Balance at March 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Gains) Losses for Three Months Ended March 31, 2019
Assets					
Impaired loans	$ 9,343	$ —	$ —	$ 9,343	$ 219
Other real estate owned	1,961	—	—	1,961	28
					$ 247

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2018

(dollars in thousands)	Balance at December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Twelve months ended December 31, 2018
Assets					
Impaired loans	$ 8,818	$ —	$ —	$ 8,818	$ 198
Other real estate held for sale	3,119	—	—	3,119	182
					$ 380

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).

13. SHAREHOLDERS' EQUITY

The Corporation currently has a share repurchase program. The program is conducted under authorizations by the Board of Directors. The Corporation repurchased 14,000 shares in 2016, 102,455 shares in 2015, 13,700 shares in 2014 and 55,594 shares in 2013. The share repurchases were conducted under Board authorizations made and publically announced of $.600 million on February 27, 2013, $.600 million on December 17, 2013 and an additional $.750 million on April 28, 2015. None of these authorizations has an expiration date. As of March 31, 2019, approximately $25,000 of the total authorization was available for future purchases.

14. COMMITMENTS, CONTINGENCIES AND CREDIT RISK

Financial Instruments With Off-Balance-Sheet Risk

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

The Corporation's exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. These commitments are as follows (dollars in thousands):

	March 31, 2019	December 31, 2018
Commitments to extend credit:		
Variable rate	**$ 96,811**	$ 88,862
Fixed rate	**53,811**	54,434
Standby letters of credit - Variable rate	**7,060**	7,208
Credit card commitments - Fixed rate	**5,269**	5,107
	$162,951	$ 155,611

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

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

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

Legal Proceedings and Contingencies

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

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan and Northeastern Wisconsin. The Bank's most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at March 31, 2019 represents $147.752 million, or 20.17%, compared to $150.251 million, or 20.95%, of the commercial loan portfolio on December 31, 2018. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gas stations and convenience stores, 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.

15. BUSINESS COMBINATIONS

First Federal of Northern Michigan Bancorp, Inc.

The Corporation completed its acquisition of First Federal of Northern Michigan Bancorp, Inc. in May 2018. FFNM had seven branch offices, one of which was consolidated into an existing mBank branch shortly after consummation of the transaction. Total assets of FFNM as of May 18, 2018 were $318 million, including total loans of $192 million. Deposits garnered in the acquisition, the majority of which were core deposits, totaled $254 million. The results of operations due to the merger have been included in the Corporation's results since the acquisition date. As consideration in the acquisition, the Corporation issued 2,146,378 new shares, approximating $34.101 million. The Corporation recorded deposit based intangibles of $2.894 million and goodwill of $12.278 million. In the first quarter of 2019, the Corporation concluded the business combination and purchase accounting based on the final tax returns and deferred tax calculations of FFNM. As a result, the purchase price allocation has been updated to reflect changes with an increase in the deferred tax asset of $2.637 million and a decrease in goodwill of $2.637 million.

The table below highlights the allocation of purchase price for the FFNM acquisition (dollars in thousands, except per share data):

Purchase Price:

FFNM shares outstanding	3,726,925	
Price per share	$ 9.15	
Total purchase price		$ 34,101
Net assets acquired:		
Cash and cash equivalents	$ 13,267	
Securities available for sale	96,297	
FHLB Stock	1,748	
Total loans	185,444	
Premises and equipment	5,134	
Other real estate owned	194	
Deposit based intangible	2,894	
Mortgage servicing rights	386	
Deferred tax assets	5,481	
Bank owned life insurance	5,170	
Other assets	1,775	
Total assets	317,790	
Non-interest bearing deposits	60,616	
Interest bearing deposits	193,099	
Total deposits	253,715	
FHLB borrowings	40,722	
Deferred tax liability	133	
Other liabilities	1,397	
Total liabilities	295,967	
Net assets acquired		21,823
Goodwill		$ 12,278

Lincoln Community Bank

On June 7, 2018 the Corporation announced the execution of a definitive agreement to acquire Lincoln Community Bank ("Lincoln") located in Merrill, WI, for $8.50 million in cash, to further expand the Corporation's market. Lincoln operated two (2) banking centers, one in each of Merrill and Gleason, WI. As of September 30, 2018, Lincoln had total assets in excess of $59 million, loans of approximately $39 million and deposits of $53 million. The acquisition and subsequent merger of Lincoln into mBank occurred on October 1, 2018. As part of the transaction, the Gleason location was closed at the end of 2018. In the first quarter of 2019, the Corporation made adjustments to the business comniation and purchase accounting based on additional tax provision information. As a result, the purchase price allocation has been updated to reflect changes with a decrease in the deferred tax liability of $.163 million and a decrease in goodwill of $.163 million. The Corporation believes the majority of the business combination and purchase accounting activity is complete, however, there may be further minor adjustments in the normal course within the allotted GAAP adjustment period.

Purchase Price:

Cash consideration	$ 8,500	
Net assets acquired:		
Cash and cash equivalents	$ 10,971	
Securities available for sale	6,947	
Total loans	38,001	
Premises and equipment	1,249	
Other real estate owned	69	
Deposit based intangible	1,353	
Bank owned life insurance	1,653	
Other assets	339	
Total assets	60,582	
Non-interest bearing deposits	15,559	
Interest bearing deposits	37,654	
Total deposits	53,213	
Deferred tax liability	68	
Other liabilities	53	
Total liabilities	53,334	
Net assets acquired		7,248
Goodwill		$ 1,252

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

Forward Looking Statements/Risk Factors

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 the Corporation 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 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 or prevent a material adverse effect on our business, profitability or financial condition.

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

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

Risks Related to Our Operations

- *We are subject to interest rate risk.*

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

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

- *We may not realize the expected benefits of our recent acquisitions of First Federal of Northern Michigan or Lincoln Community Bank.*

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

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

  In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carry back and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g. cumulative losses, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At March 31, 2019, net deferred tax assets were approximately $6.906 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 or 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.*

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 or 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.

The following discussion covers results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements, the related notes, and other supplemental information presented elsewhere in this report. It should be noted that there may be non-GAAP disclosures presented within this discussion to further assist readers in their analysis of the financial condition of the Corporation. This discussion should also be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2018. Throughout this discussion and elsewhere in this report, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

The Corporation recorded first quarter 2019 net income of $3.167 million, or $.30 per share, compared to net income of $1.537 million, or $.24 per share for the first quarter of 2018. The 2018 results were impacted by expenses related to the FFNM acquisition. Exclusion of these one-time costs resulted in adjusted net income for the first quarter of 2018 of $1.737 million, or $.28 per share.

Weighted average shares outstanding for the three month period in 2019 totaled 10,720,127, compared to 6,304,203 shares in the same period of 2018.

The net interest income and net interest margin for the first quarter of 2019 was $13.236 million, or 4.55%, respectively, compared to $9.309 million, or 4.19%, respectively, for the first quarter of 2018.

Total assets of the Corporation at March 31, 2019 were $1.317 billion, down by $1.044 million, or 0.08%, from the $1.318 billion in total assets reported at year-end 2018.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents decreased $7.194 million during the first three months of 2019, compared to 2018 year end. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale decreased $3.288 million from December 31, 2018 to March 31, 2019, with the balance on March 31, 2019 totaling $113.460 million. Investment securities are increased or decreased as appropriate as a result of managing interest rate risk and liquidity. As of March 31, 2019, investment securities with an estimated fair value of $26.583 million were pledged against borrowings at the FHLB and certain customer relationships.

Loans

Through the first three months of 2019, loan balances increased by $6.564 million from December 31, 2018 balances of $1.039 billion. This increase was partially offset by payoffs in the legacy portfolio. During the first three months of 2019, the Bank had total loan production of $81.368 million, which included $13.604 million of secondary market loan production. The increase in loan production, however, was partially offset by loan amortization and payoffs. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with a diligent loan approval process and exception reporting, management can effectively manage the

risk in the loan portfolio. Management intends to continue to pursue 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, while maintaining strong underwriting requirements.

Following is a summary of the loan portfolio at March 31, 2019 and December 31, 2018 (dollars in thousands):

	March 31, 2019	Percent of Total	December 31, 2018	Percent of Total
Commercial real estate	**$ 498,471**	**47.67%**	$ 496,207	47.76%
Commercial, financial, and agricultural	**201,089**	**19.24**	191,060	18.39
One to four family residential real estate	**281,104**	**26.89**	286,908	27.62
Consumer construction	**12,022**	**1.15**	14,553	1.40
Commercial construction	**33,118**	**3.17**	29,765	2.87
Consumer	**19,624**	**1.88**	20,371	1.96
Total loans	**$1,045,428**	**100.00%**	$ 1,038,864	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of March 31, 2019 and December 31, 2018 (dollars in thousands).

	March 31, 2019			December 31, 2018		
	Outstanding Balance	Percent of Loans	Percent of Capital	Outstanding Balance	Percent of Loans	Percent of Capital
Real estate - operators of nonresidential buildings	**147,752**	**20.17%**	**95.48%**	150,251	20.95%	98.80%
Hospitality and tourism	**85,604**	**11.68**	**55.32**	77,598	10.82	51.03
Lessors of residential buildings	**46,702**	**6.37**	**30.18**	50,204	7.00	33.01
Gasoline stations and convenience stores	**24,663**	**3.37**	**15.94**	24,189	3.37	15.91
Logging	**21,073**	**2.88**	**13.62**	20,860	2.91	13.72
Commercial construction	**33,118**	**4.52**	**21.40**	29,765	4.15	8.39
Other	**373,766**	**51.01**	**241.54**	364,165	50.80	250.66
Total Commercial Loans	**$ 732,678**	**100.00%**		$ 717,032	100.00%	

Management recognizes that additional risks presented by concentration in certain segments of the portfolio. Management does not believe that its current portfolio composition has increased such risk related to any specific industry concentration as of March 31, 2019. The current concentration of commercial real estate-related loans represents a broad customer base composed of a high percentage of owner-occupied developments. The company will, and has, slowed growth and origination of certain industry concentrations where internal limits have been reached.

Our residential real estate portfolio predominantly includes one to four family adjustable rate mortgages that have repricing terms generally from one to three years, construction loans to individuals and bridge financing loans for qualifying customers. As of March 31, 2019, our residential loan portfolio totaled $293.126 million, or 28.04%, of our total outstanding loans.

Due to the seasonal nature of many of the Corporation's commercial loan customers, our loan payment terms provide flexibility by structuring payments to coincide with our customers' business cycles. The lending staff evaluates the collectability of 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.

Credit Quality

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

	March 31, 2019	December 31, 2018
Nonperforming Assets:		
Nonaccrual loans	**$ 5,588**	$ 5,054
Loans past due 90 days or more	**—**	23
Restructured loans on nonaccrual	**—**	—
Total nonperforming loans	**5,588**	5,077
Other real estate owned	**1,961**	3,119
Total nonperforming assets	**$ 7,549**	$ 8,196
Nonperforming loans as a % of loans	**0.53%**	0.49%
Nonperforming assets as a % of assets	**0.57%**	0.62%
Reserve for Loan Losses:		
At period end	**$ 5,154**	$ 5,183
As a % of outstanding loans	**.49%**	.50%
As a % of nonperforming loans	**92.23%**	102.09%
As a % of nonaccrual loans	**92.23%**	102.55%
Texas Ratio	**5.59%**	6.33%

The following ratio provide additional information relative to the Corporation's credit quality (dollars in thousands):

	At Period End	
	March 31, 2019	December 31, 2018
Total loans, at period end	**$ 1,045,428**	1,038,864
Average loans for the period	**$ 1,046,740**	$ 941,221

	For the Period Ended	
	Year Ended March 31, 2019	Twelve Months Ended December 31, 2018
Net charge-offs during the period	**$ 129**	396
Net charge-offs to average loans, annualized	**.05%**	.04%

Management seeks to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and bank regulatory examinations, management reviews the Corporation's loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes an outside loan consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the 2018 independent review provided findings similar to management with respect to credit quality. In 2019, the Corporation will once again utilized a consultant for loan review.

As of March 31, 2019, the allowance for loan losses represented .49% of total loans. At March 31, 2019, the allowance included specific reserves in the amount of $1.115 million, as compared to specific reserves of $.826 million at December 31, 2018. 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. Purchased impaired credits do not have an effect on the allowance for loan losses, in accordance with ASC 310-30.

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

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

	Three Months Ended March 31, 2019	Year Ended December 31, 2018
Balance at beginning of period	**$ 3,119**	$ 3,558
Other real estate transferred from loans due to foreclosure	**298**	1,878
Other real estate acquired in business combinations	**—**	263
Proceeds from sale of other real estate	**(415)**	(2,398)
Transfer to premise and equipment	**(1,013)**	—
Writedowns on other real estate held for sale	**—**	(125)
Loss on other real estate held for sale	**(28)**	(57)
Balance at end of period	**$ 1,961**	$ 3,119

During the first three months of 2019, the Corporation received real estate in lieu of loan payments of $.298 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 balances and records any additional reductions in the fair value as a write-down of other real estate held for sale.

Deposits

The Corporation had a decrease in deposits in the first three months of 2019. Total deposits decreased by $.289 million, or .03%, in the first three months of 2019. The decrease in deposits for the first three months of 2019 is composed of a increase in core deposits of $18.319 million and a decrease in noncore deposits of $18.608 million. Management utilizes brokered deposits as a funding source, which provides flexibility in managing interest rate risk for fixed rate longer term loan fundings.

Management continues to monitor existing deposit products in order to stay competitive, both as to terms and pricing, which will remain important as we move through the current rate cycle to protect our margin. This focus on deposits has become especially important with changing client banking habits and demographics, as well as customer desire for more electronic and mobile based banking products and services. It is the intent of management to focus on growing core deposit levels, as the comparatively inexpensive deposits, in relation to wholesale deposit sources, will continue to prove valuable as rates continue to increase.

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

	March 31, 2019	% of Total	December 31, 2018	% of Total
Noninterest bearing	**$ 245,201**	**22.35%**	$ 241,556	22.01%
NOW, money market, checking	**363,753**	**33.15**	368,890	33.61%
Savings	**110,978**	**10.11**	111,358	10.15%
Certificates of Deposit <$250,000	**245,427**	**22.37**	225,236	20.52%
Total core deposits	**965,359**	**87.98**	947,040	86.29%
Certificates of Deposit >$250,000	**12,706**	**1.16**	13,737	1.25%
Brokered CDs	**119,183**	**10.86**	136,760	12.46%
Total non-core deposits	**131,889**	**12.02**	150,497	13.71%
Total deposits	**$1,097,248**	**100.00%**	$1,097,537	100.00%

Borrowings

The Corporation also utilizes FHLB borrowings as a source of funding. At March 31, 2019, this source of funding totaled $46 million and the Corporation secured this funding by pledging loans and investments. The $46 million of FHLB borrowings have a weighted average maturity of 2.97 years and a weighted average interest rate of 1.72% at March 31, 2019. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending, that has an outstanding balance of $.480 million, with a fixed interest rate of 1% that matures in August 2024.

The Corporation currently has one correspondent banking borrowing relationship. The relationship consists of a $15.0 million revolving line of credit, which had no outstanding balance at March 31, 2019. The line of credit bears an interest rate of 90-day LIBOR plus 2.00%, with a floor rate of 2.00% and a ceiling of 22%. The line of credit expires on April 30, 2020. LIBOR at March 31, 2019 was 2.60%. The Corporation previously had a term note as part of this relationship that was paid in full during the second quarter of 2018. This relationship is secured by all of the outstanding mBank stock.

Shareholders' Equity

Total shareholders' equity increased $2.677 million from December 31, 2018 to March 31, 2019. Contributing to the increase in shareholders' equity was net income of $3.167 million, offset by a reduction for cash dividends on common stock of $1.286 million, an increase due to stock compensation of $.138 million, and an increase in the market value of securities of $.658 million.

RESULTS OF OPERATIONS

Summary

The Corporation recorded first quarter 2019 net income of $3.167 million, or $.30 per share, compared to net income of $1.537 million, or $.24 per share for the first quarter of 2018. The 2018 results were impacted by expenses related to the FFNM acquisition. Exclusion of these costs resulted in adjusted net income for the first quarter of 2018 of $1.737 million, or $.28 per share.

Net Interest Income

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

Net interest income and net interest margin on a fully taxable equivalent basis amounted to $13.304 million, 4.57% of average earning assets, respectively in the first three months of 2019, compared to $9.352 million, 4.21% of average earning assets, respectively in the first three months of 2018.

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

	Three Months Ended										
								2019-2018			
	Average Balances			Average Rates		Interest		Income/			Rate/
	March 31,		Increase/	March 31,		March 31,		Expense	Volume	Rate	Volume
(dollars in thousands)	2019	2018	(Decrease)	2019	2018	2019	2018	Variance	Variance	Variance	Variance
Loans (1,2,3)	$ 1,046,740	$ 810,688	$ 236,052	5.69%	5.22%	$ 14,684	$ 10,426	$ 4,258	$ 3,036	$ 947	$ 275
Taxable securities	97,973	61,212	36,761	2.91	2.46	703	372	331	223	67	41
Nontaxable securities (2)	17,023	13,781	3,242	2.95	2.97	124	101	23	24	(1)	—
Federal funds sold	1,110	12	1,098	2.54	.57	7	—	7	—	—	7
Other interest-earning assets	18,143	15,766	2,377	8.46	5.12	378	199	179	30	130	19
Total earning assets	1,180,989	901,459	279,530	5.46	4.99	15,896	11,098	4,798	3,313	1,143	342
Reserve for loan losses	(5,180)	(5,072)	(108)								
Cash and due from banks	59,738	37,244	22,494								
Fixed Assets	22,679	16,274	6,405								
Other Real Estate	2,803	3,130	(327)								
Other assets	59,051	29,644	29,407								
Total assets	$ 1,320,080	$ 982,679	$ 337,401								
NOW and money market deposits	$ 263,185	$ 204,493	$ 58,692	.57	.40	$ 370	$ 201	$ 169	$ 58	$ 86	$ 25
Interest checking	113,664	67,569	46,095	.20	.15	56	25	31	17	8	6
Savings deposits	109,910	61,646	48,264	.26	.07	71	10	61	8	30	23
Certificates of deposit	250,527	149,849	100,678	1.76	1.11	1,087	410	677	275	240	162
Brokered deposits	128,111	178,840	(50,729)	2.44	1.34	770	590	180	(167)	484	(137)
Borrowings	53,224	90,178	(36,954)	1.81	2.29	238	510	(272)	(209)	(107)	44
Total interest-bearing liabilities	918,621	752,575	166,046	1.14	.94	2,592	1,746	846	(18)	741	123
Demand deposits	235,247	142,695	92,552								
Other liabilities	12,523	5,515	7,008								
Shareholders' equity	153,689	81,894	71,795								
Total liabilities and shareholders' equity	$ 1,320,080	$ 982,679	$ 337,401								
Rate spread				4.31%	4.05%						
Net interest margin/revenue				4.57%	4.21%	$ 13,304	$ 9,352	$ 3,952	$ 3,331	$ 402	$ 219

(1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
(2) The amount of interest income on loans and nontaxable securities has been adjusted to a tax equivalent basis, using a 21% tax rate.
(3) Interest income on loans includes fees.

The Corporation continues to reprice a significant portion of its loan portfolio. Management has been diligent when repricing maturing or new loans in establishing interest rate floors in order to maintain our interest rate spread. The Corporation is anticipating some margin pressure in future periods as we continue to see extremely competitive pricing on new and renewable loans.

Provision for Loan Losses

The Corporation records a provision for loan losses when it believes it is necessary to adjust the allowance for loan losses to maintain an adequate level after considering factors such as loan charge-offs and recoveries, changes in identified levels of risk in the loan portfolio, changes in the mix of loans in the portfolio, loan growth, and other economic factors. During the first three months of 2019, the Corporation recorded a loan loss provision of $100,000, compared to $50,000 in the first three months of 2018. There were net charge-offs of $129,000 in the first three months of 2019, compared to net charge-offs of $28,000 for the same period in 2018. There was no provision for loan losses for acquired loans as a result of acquisition fair value adjustments.

Other Income

Other income was $1.117 million in the first three months of 2019, compared to $.614 million in the same period in 2018. The increase year over year was largely a result of increased income from deposit service fees, including the impact of the FFNM and LCB acquisitions.Management continues to evaluate deposit products and services for ways to better serve its customer base and also enhance service fee income through a broad array of products that price services based on income contribution and cost attributes.

The following table details other income for the three months ended March 31, 2019 and 2018 (dollars in thousands):

	Three Months Ended March 31,			
			Increase/ (Decrease)	
	2019	2018	Dollars	Percent
Deposit service fees	**$ 406**	$269	$ 137	50.93%
Income from loans sold in the secondary market	**312**	177	135	76.27
SBA/USDA loan sale gains	**125**	51	74	145.10
Net mortgage servicing (amortization) income	**(8)**	(8)	—	-
Other noninterest income	**282**	125	157	125.60
Total other income	**$1,117**	$614	$ 503	81.92%

Other Expense

For the first three months of 2019, the Corporation recorded other expenses of $10.244 million, compared to $7.928 million in 2018, an increase of $2.316 million. The increase in salaries and benefits and other customary operating expenses were related to our efforts to ensure our platform infrastructure keeps pace with our growing asset base and the associated regulatory and risk management needs.

The following table details other expense for the three months ended March 31, 2019 and 2018 (dollars in thousands):

	Three Months Ended March 31,			
			Increase/(Decrease)	
	2019	2018	Dollars	Percentage
Salaries and employee benefits	**$ 5,435**	$4,154	$1,281	30.84%
Occupancy	**1,081**	811	270	33.29
Furniture and equipment	**718**	531	187	35.22
Data processing	**709**	504	205	40.67
Advertising	**309**	195	114	58.46
Professional service fees	**434**	304	130	42.76
Loan origination expenses and deposit and card related fees	**179**	126	53	42.06
Writedowns and losses on other real estate held for sale	**28**	26	2	7.69
FDIC insurance assessment	**134**	156	(22)	(14.10)
Communications	**228**	155	73	47.10
Transaction related expenses	**—**	189	(189)	(100.00)
Other	**989**	777	212	27.28
Total other expense	**$10,244**	$7,928	$2,316	29.21%

Federal Income Taxes

The Corporation recognized a federal income tax expense for the three months ended March 31, 2019 of $.842 million, compared to $.408 million a year earlier.

The Corporation has reported deferred tax assets of $6.906 million at March 31, 2019. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The Corporation, as of March 31, 2019 had a net operating loss and tax credit carryforwards for tax purposes of approximately $12.5 million, and $1.7 million, respectively. As a result of the repeal of the corporate alternative minimum tax in the Tax Cuts and Jobs Act, any outstanding alternative minimum tax credits are believed to be utilized or refundable as of December 31, 2018. Therefore, the $1.6 million of alternative minimum tax credits, was reclassified to a current tax receivable included in other assets during 2018. The Corporation evaluated the future benefits from these carryforwards as of December 31, 2018 and determined that is was "more likely than not" that they would be utilized prior to expiration. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is $2.0 million for the NOL and the equivalent value of tax credits, which is approximately $.420 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004. 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.

LIQUIDITY

We define liquidity 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 making payments on any 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, FHLB borrowings and brokered deposits. As a final source of liquidity, the Bank can exercise existing credit arrangements.

Current balance sheet liquidity consists of $56.963 million in cash and cash equivalents and $82.654 million of unpledged investment securities. Although current liquidity is deemed adequate, management has the ability to increase on hand liquidity by acquiring brokered CDs in order to fund any anticipated loan growth.

During the first three months of 2019, the Corporation decreased cash and cash equivalents by $7.194 million. The management of bank liquidity for funding of loans and deposit maturities and withdrawals includes monitoring projected loan fundings and scheduled prepayments and deposit maturities within a 30 day period, a 30- to 90- day period and from 90 days until the end of the year. This funding forecast model is completed weekly.

The Corporation's primary source of liquidity on a stand-alone basis is dividends from the Bank. During the first three months of 2019, the Bank paid no dividends to the Corporation. Bank capital after remains strong and above the "well capitalized" level for regulatory purposes as of March 31, 2019. The Corporation also has a line of credit with a correspondent bank that had borrowing availability at March 31, 2019 of $15 million. The Corporation's current plan for dividends from the Bank are dependent upon the profitability of the Bank, growth of assets at the Bank and the level of capital needed to stay "adequately capitalized." The Corporation will continue to explore 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 regularly to discuss asset and liability management in order to address liquidity and funding needs to provide a process to seek the best alternatives for investments of assets, funding costs, and risk management. The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank's liquidity is best illustrated by the mix in the Bank's core and noncore funding dependence ratio, which explains the degree of reliance on noncore liabilities to fund long-term assets.

Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under $250,000. Noncore funding consists of certificates of deposit greater than $250,000, brokered deposits, and FHLB, Farmers' Home Administration and other borrowings. At March 31, 2019, the Bank's core deposits in relation to total funding were 83.88% compared to 81.78% at December 31, 2018. These ratios indicate that at March 31, 2019, that the Bank had decreased its reliance on noncore deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. This was in large part due to the core deposits garnered in the FFNM transaction. The Bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has

correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of March 31, 2019, the Bank had $64 million of unsecured lines available and additional funding sources available if secured. The Bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank's liquidity.

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

REGULATORY CAPITAL

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, Tier 1 capital and Common Equity Tier 1 Capital to risk-weighted assets and of Tier 1 capital to average assets. Management has determined that, as of March 31, 2019, the Corporation is well capitalized.

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

The Corporation's and the Bank's actual capital and ratios compared to generally applicable regulatory requirements as of March 31, 2019 are as follows (dollars in thousands):

	Actual		Adequacy Purposes		Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets:						
Consolidated	**$128,026**	**12.7%**	**≥ $80,596**	**≥ 8.0%**	**≥ $ N/A**	**≥ N/A**
mBank	**$126,738**	**12.6%**	**≥ $80,581**	**≥ 8.0%**	**≥ $100,727**	**≥ 10.0%**
Tier 1 capital to risk weighted assets:						
Consolidated	**$122,872**	**12.2%**	**≥ $60,447**	**≥ 6.0%**	**≥ $ N/A**	**≥ N/A**
mBank	**$121,625**	**12.1%**	**≥ $60,436**	**≥ 6.0%**	**≥ $ 80,581**	**≥ 8.0%**
Common equity Tier 1 capital to risk weighted assets						
Consolidated	**$122,872**	**12.2%**	**≥ $45,335**	**≥ 4.5%**	**≥ $ N/A**	**≥ N/A**
mBank	**$121,625**	**12.1%**	**≥ $45,327**	**≥ 4.5%**	**≥ $ 65,472**	**≥ 6.5%**
Tier 1 capital to average assets:						
Consolidated	**$122,872**	**9.5%**	**≥ $51,544**	**≥ 4.0%**	**≥ $ N/A**	**≥ N/A**
mBank	**$121,625**	**9.4%**	**≥ $51,548**	**≥ 4.0%**	**≥ $ 64,435**	**≥ 5.0%**

Regulatory capital is not the same as shareholders' equity reported in the accompanying condensed consolidated financial statements. Certain assets cannot be considered assets for regulatory purposes, such as acquisition intangibles and noncurrent deferred tax benefits.

MACKINAC FINANCIAL CORPORATION
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

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

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

Loans are the Corporation's most significant earning asset. Management offers commercial and real estate loans priced at interest rates which fluctuate with various indices such as the prime rate or rates paid on various government issued securities. In addition, the Corporation prices the majority of its fixed rate loans so it has an opportunity to reprice the loan within 12 to 60 months.

As of March 31, 2019, the Corporation had established interest rate floors on approximately $138 million of its variable rate commercial loans. Historically these interest rate floors would result in a "lag" on the repricing of these variable rate loans when and if interest rates increased in future periods. However, the majority of these loans have surpassed their floors and will now reprice with each interest rate move.

The Corporation also has $113.460 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal as of March 31, 2019. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation 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.

Management can mitigate interest rate risk by managing the maturity periods of securities purchased, selling securities available for sale, and borrowing funds with targeted maturity periods, among other strategies. Also, the rate of interest rate changes can impact the actions taken since the rate environment affects borrowers and depositors differently.

Exposure to interest rate risk is reviewed on a regular basis. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect of interest rate changes on net interest income and to structure the composition of the balance sheet to minimize interest rate risk and at the same time maximize income.

Management realizes certain interest rate risks are inherent in the business of banking 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 regular asset/liability meetings with an outside consultant to review its current position and strategize about future opportunities on risks relative to pricing and positioning of assets and liabilities.

The difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of repricable assets over liabilities is referred to as a positive gap. An excess of repricable liabilities over assets is referred to as a negative gap. The cumulative gap is the summation of the gap for all periods to the end of the period for which the cumulative gap is being measured.

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

The following is the Corporation's repricing opportunities at March 31, 2019 (dollars in thousands):

	1-90 Days	91-365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	**$ 281,629**	**329,853**	**407,022**	**26,924**	**$1,045,428**
Securities	**13,597**	**13,671**	**65,452**	**20,740**	**113,460**
Other (1)	**5,416**	**4,137**	**7,836**	**247**	**17,636**
Total interest-earning assets	**300,642**	**347,661**	**480,310**	**47,911**	**1,176,524**
Interest-bearing obligations:					
NOW, money market, savings and interest checking	**474,731**	**—**	**—**	**—**	**474,731**
Time deposits	**32,703**	**97,228**	**127,652**	**550**	**258,133**
Brokered CDs	**41,223**	**77,960**	**—**	**—**	**119,183**
Borrowings	**—**	**16,048**	**27,830**	**3,000**	**46,878**
Total interest-bearing obligations	**548,657**	**191,236**	**155,482**	**3,550**	**898,925**
Gap	**$ (248,015)**	**$ 156,425**	**$ 324,828**	**$ 44,361**	**$ 277,599**
Cumulative gap	**$ (248,015)**	**$ (91,590)**	**$ 233,238**	**$ 277,599**	

(1) Includes Federal Home Loan Bank Stock.

The above analysis indicates that at March 31, 2019, the Corporation had a cumulative liability sensitivity gap position of $91.590 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates were to increase in the next twelve months, the Corporation has the potential to earn less net interest income. This is because more liabilities would reprice at higher rates than assets. Conversely, if market interest rates decrease in the next twelve months, the above gap position suggests the Corporation's net interest income would increase. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity.

At December 31, 2018, the Corporation had a cumulative liability sensitivity gap position of $119.352 million within the one-year time frame.

The borrowings in the gap analysis include $46 million of FHLB advances that have a weighted average maturity of 2.97 years and a weighted average rate of 1.72%.

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.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation has decided to curtail its foreign exchange services for customers, and accordingly, management believes the exposure to short-term foreign exchange risk is minimal.

OFF-BALANCE-SHEET RISK

Derivative financial instruments include futures, forwards, interest rate swaps, option contracts and other financial instruments with similar characteristics. The Corporation currently does not enter into futures, forwards, swaps, or options. However, the Corporation is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the condensed consolidated balance sheets. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower if deemed necessary by the Corporation. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party up to a stipulated amount and with specified terms and conditions.

Commitments to extend credit and standby letters of credit are not recorded as an asset or liability by the Corporation until the instrument is exercised.

IMPACT OF INFLATION AND CHANGING PRICES

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and results of operations in historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Corporation’s operations. Nearly all the assets and liabilities of the Corporation are financial, unlike industrial or commercial companies. As a result, the Corporation’s performance is directly impacted by changes in interest rates, which are indirectly influenced by inflationary expectations. The Corporation’s ability to match the interest sensitivity of its financial assets to the interest sensitivity of its financial liabilities tends to minimize the effect of changes in interest rates on the Corporation’s performance. Changes in interest rates do not necessarily move to the same extent as changes in the price of goods and services.

MACKINAC FINANCIAL CORPORATION
ITEM 4 CONTROLS AND PROCEDURES

As of March 31, 2019, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Our management, which includes our principal executive officer and our principal financial officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints; additionally, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate due to changes in conditions; also the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Our principal executive officer and principal accounting officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures, as defined under Rule 13a-15 of the Securities Exchange Act of 1934, are effective as of March 31, 2019.

Changes in Internal Control Over Financial Reporting

There were no changes in the Corporation's internal control over financial reporting that occurred during the quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation and its subsidiaries are subject to routine litigation incidental to the business of banking. Although the results of litigation and claims cannot be predicted, management believes there are no legal proceedings, the outcome of which, if determined adversely to the Corporation, would individually or in the aggregate be reasonably expected to have a material adverse effect on the Corporation's result of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Corporation currently has a share repurchase program. The program is conducted under authorizations from time to time by the Board of Directors. The share repurchases previously disclosed in prior periods are covered by Board authorizations made and publically announced for $600,000 on February 27, 2013, an additional $600,000 on December 17, 2013 and an additional $750,000 on April 28, 2015. None of these authorizations has an expiration date. As of March 31, 2019 there remains $25,335 to be utilized under the current authorizations. There were no purchases during the first three months of 2019.

Item 6. Exhibits

(a) Exhibits:

Exhibit 31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
Exhibit 31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
Exhibit 32.1	Section 1350 Certification of Chief Executive Officer.
Exhibit 32.2	Section 1350 Certification of Chief Financial Officer.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MACKINAC FINANCIAL CORPORATION
(Registrant)

Date: May 10, 2019

By: /s/ Paul D. Tobias
PAUL D. TOBIAS,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
(principal executive officer)

By: /s/ Jesse A. Deering
JESSE A. DEERING
EVP/CHIEF FINANCIAL OFFICER
(principal financial and accounting officer)

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATION

I, Paul D. Tobias, Chairman and Chief Executive Officer of Mackinac Financial Corporation certify that:

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report fairly present, in all material respects, the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal

control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ Paul D. Tobias
Paul D. Tobias
Chairman and Chief Executive Officer
(principal executive officer)

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATION

I, Jesse A. Deering, Executive Vice President/Chief Financial Officer of Mackinac Financial Corporation, certify that:

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ Jesse A. Deering
Jesse A. Deering
Executive Vice President/Chief Financial Officer
(principal financial officer)

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Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

CERTIFICATION PERSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C § 1350, and accompanies the quarterly report on Form 10-Q for the quarter ended March 31, 2019, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Paul D. Tobias, Chairman and Chief Executive Officer of the Issuer, certify that:

(1) The Form 10-Q fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
(2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operation of the Issuer.

/s/ Paul D. Tobias
Paul D. Tobias
Chairman and Chief Executive Officer
(chief executive officer)

Date: May 10, 2019

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Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

CERTIFICATION PERSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C § 1350, and accompanies the quarterly report on Form 10-Q for the quarter ended March 31, 2019, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Jesse A. Deering, Executive Vice President of the Issuer, certify that:

(1) The Form 10-Q fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
(2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operation of the Issuer.

/s/ Jesse A. Deering
Executive Vice President and Chief Financial Officer
(principal financial officer)

Date: May 10, 2019

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