

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 June 30, 2008

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
(State or other jurisdiction of
incorporation or organization)

38-2062816
(I.R.S. Employer Identification No.)

130 SOUTH CEDAR STREET, MANISTIQUE, MI
(Address of principal executive offices)

49854
(Zip Code)

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

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller reporting company

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

Yes No

As of July 31, 2008, there were outstanding 3,419,736 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)

| | June 30, 2008 <u>(unaudited)</u> | December 31, 2007 | June 30, 2007 <u>(unaudited)</u> |
|--|--|--------------------------|--|
| ASSETS | | | |
| Cash and due from banks | \$ 7,115 | \$ 6,196 | \$ 7,518 |
| Federal funds sold | 19,274 | 166 | 3,489 |
| Cash and cash equivalents | <u>26,389</u> | 6,362 | 11,007 |
| Interest-bearing deposits in other financial institutions | 387 | 1,810 | 3,687 |
| Securities available for sale | 23,230 | 21,597 | 24,086 |
| Federal Home Loan Bank stock | 3,794 | 3,794 | 3,794 |
| Loans: | | | |
| Commercial | 292,645 | 288,839 | 274,783 |
| Mortgage | 65,869 | 62,703 | 60,575 |
| Installment | 3,608 | 3,537 | 3,538 |
| Total Loans | <u>362,122</u> | 355,079 | 338,896 |
| Allowance for loan losses | <u>(3,585)</u> | <u>(4,146)</u> | <u>(4,920)</u> |
| Net loans | <u>358,537</u> | 350,933 | 333,976 |
| Premises and equipment | 11,377 | 11,609 | 12,471 |
| Other real estate held for sale | 3,395 | 1,226 | 77 |
| Other assets | <u>10,218</u> | 11,549 | 4,221 |
| TOTAL ASSETS | <u>\$ 437,327</u> | 408,880 | <u>\$ 393,319</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Liabilities: | | | |
| Non-interest-bearing deposits | \$ 27,741 | \$ 25,557 | \$ 28,811 |
| Interest-bearing deposits: | | | |
| NOW, money market, checking | 78,703 | 81,160 | 73,994 |
| Savings | 15,171 | 12,485 | 12,422 |
| CDs<\$100,000 | 78,678 | 80,607 | 96,546 |
| CDs>\$100,000 | 28,252 | 22,355 | 24,879 |
| Brokered | <u>128,431</u> | <u>98,663</u> | <u>84,594</u> |
| Total deposits | <u>356,976</u> | 320,827 | 321,246 |
| Borrowings | | | |
| Federal funds purchased | - | 7,710 | - |
| Short-term | - | 1,959 | - |
| Long-term | <u>36,280</u> | <u>36,280</u> | <u>38,307</u> |
| Total borrowings | <u>36,280</u> | 45,949 | 38,307 |
| Other liabilities | <u>3,096</u> | 2,783 | 3,281 |
| Total liabilities | <u>396,352</u> | 369,559 | 362,834 |
| Shareholders' equity: | | | |
| Preferred stock - No par value: | | | |
| Authorized 500,000 shares, no shares outstanding | | | |
| Common stock and additional paid in capital - No par value | | | |
| Authorized - 18,000,000 shares | | | |
| Issued and outstanding - 3,419,736; 3,428,695; and | | | |
| and 3,428,695 shares, respectively | | | |
| | 42,773 | 42,843 | 42,780 |
| Accumulated deficit | (1,672) | (3,582) | (12,162) |
| Accumulated other comprehensive income (loss) | <u>(126)</u> | 60 | <u>(133)</u> |
| Total shareholders' equity | <u>40,975</u> | 39,321 | 30,485 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | <u>\$ 437,327</u> | <u>\$ 408,880</u> | <u>\$ 393,319</u> |

See accompanying notes to condensed consolidated financial statements.

MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except per Share Data)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|-----------------|
| | June 30, | | June 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| INTEREST INCOME: | | | | |
| Interest and fees on loans: | | | | |
| Taxable | \$ 5,604 | \$ 6,448 | \$ 11,704 | \$ 12,681 |
| Tax-exempt | 102 | 143 | 210 | 314 |
| Interest on securities: | | | | |
| Taxable | 271 | 293 | 537 | 594 |
| Tax-exempt | 2 | - | 3 | - |
| Other interest | 81 | 166 | 170 | 366 |
| Total interest income | <u>6,060</u> | <u>7,050</u> | <u>12,624</u> | <u>13,955</u> |
| INTEREST EXPENSE: | | | | |
| Deposits | 2,551 | 3,267 | 5,616 | 6,489 |
| Borrowings | 391 | 514 | 845 | 1,019 |
| Total interest expense | <u>2,942</u> | <u>3,781</u> | <u>6,461</u> | <u>7,508</u> |
| Net interest income | 3,118 | 3,269 | 6,163 | 6,447 |
| Provision for loan losses | 750 | - | 750 | - |
| Net interest income after provision for loan losses | <u>2,368</u> | <u>3,269</u> | <u>5,413</u> | <u>6,447</u> |
| OTHER INCOME: | | | | |
| Service fees | 194 | 185 | 368 | 346 |
| Net security gains | - | - | 65 | - |
| Net gains on sale of secondary market loans | 49 | 91 | 97 | 199 |
| Proceeds from lawsuit settlements | 3,475 | - | 3,475 | 470 |
| Other | 29 | 66 | 52 | 240 |
| Total other income | <u>3,747</u> | <u>342</u> | <u>4,057</u> | <u>1,255</u> |
| OTHER EXPENSE: | | | | |
| Salaries and employee benefits | 2,075 | 1,672 | 3,882 | 3,410 |
| Occupancy | 348 | 327 | 703 | 661 |
| Furniture and equipment | 190 | 166 | 368 | 323 |
| Data processing | 216 | 210 | 437 | 381 |
| Professional service fees | 79 | 174 | 232 | 325 |
| Loan and deposit | 144 | 79 | 254 | 151 |
| Telephone | 39 | 59 | 84 | 117 |
| Advertising | 60 | 91 | 120 | 183 |
| Other | 320 | 287 | 582 | 570 |
| Total other expense | <u>3,471</u> | <u>3,065</u> | <u>6,662</u> | <u>6,121</u> |
| Income before income taxes | 2,644 | 546 | 2,808 | 1,581 |
| Provision for (benefit of) income taxes | 875 | - | 900 | - |
| NET INCOME | <u>\$ 1,769</u> | <u>\$ 546</u> | <u>\$ 1,908</u> | <u>\$ 1,581</u> |
| INCOME PER COMMON SHARE: | | | | |
| Basic | <u>\$.52</u> | <u>\$.16</u> | <u>\$.56</u> | <u>\$.46</u> |
| Diluted | <u>\$.52</u> | <u>\$.16</u> | <u>\$.56</u> | <u>\$.46</u> |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, | | June 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Balance, beginning of period | \$ 39,633 | \$ 29,932 | \$ 39,321 | \$ 28,790 |
| Net income for period | 1,769 | 546 | 1,908 | 1,581 |
| Stock option compensation | 21 | 30 | 42 | 60 |
| Net unrealized gain (loss) on securities available for sale | (338) | (23) | (186) | 54 |
| Total comprehensive income | 1,452 | 553 | 1,764 | 1,695 |
| Repurchase of common stock - oddlot shares | (110) | - | (110) | - |
| Balance, end of period | <u>\$ 40,975</u> | <u>\$ 30,485</u> | <u>\$ 40,975</u> | <u>\$ 30,485</u> |

See accompanying notes to condensed consolidated financial statements.

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

| | Six Months Ended June 30, | |
|--|------------------------------|------------------|
| | 2008 | 2007 |
| <u>Cash Flows from Operating Activities:</u> | | |
| Net income | \$ 1,908 | \$ 1,581 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 607 | 344 |
| Provision for (benefit of) deferred taxes | 900 | - |
| Provision for loan losses | 750 | - |
| (Gain) on sales/calls of securities available for sale | (65) | - |
| (Gain) on sale of premises, equipment and other real estate | (5) | (13) |
| Writedown of other real estate | 201 | - |
| Stock option compensation | 42 | 60 |
| Change in other assets | 283 | 348 |
| Change in other liabilities | 313 | 8 |
| Net cash (used in) provided by operating activities | <u>4,934</u> | <u>2,328</u> |
| <u>Cash Flows from Investing Activities:</u> | | |
| Net (increase) decrease in loans | (10,792) | (16,470) |
| Net (increase) decrease in interest-bearing deposits in other financial institutions | 1,423 | (2,831) |
| Purchase of securities available for sale | (24,481) | (13,564) |
| Proceeds from sales, maturities or calls of securities available for sale | 22,766 | 22,440 |
| Capital expenditures | (266) | (744) |
| Proceeds from sale of premises, equipment, and other real estate | 73 | 317 |
| Net cash (used in) provided by investing activities | <u>(11,277)</u> | <u>(10,852)</u> |
| <u>Cash Flows from Financing Activities:</u> | | |
| Net increase in deposits | 36,149 | 8,825 |
| Net increase (decrease) in federal funds purchased | (7,710) | - |
| Net increase (decrease) in line of credit | (1,959) | - |
| Net (decrease) repurchase of common stock - oddlot shares | (110) | - |
| Net cash (used in) provided by financing activities | <u>26,370</u> | <u>8,825</u> |
| Net increase in cash and cash equivalents | 20,027 | 301 |
| Cash and cash equivalents at beginning of period | <u>6,362</u> | <u>10,706</u> |
| Cash and cash equivalents at end of period | <u>\$ 26,389</u> | <u>\$ 11,007</u> |
| <u>Supplemental Cash Flow Information:</u> | | |
| Cash paid during the year for: | | |
| Interest | \$ 5,086 | \$ 5,771 |
| Income taxes | - | - |
| <u>Noncash Investing and Financing Activities:</u> | | |
| Transfers of foreclosures from loans to other real estate held for sale (net of adjustments made through the allowance for loan losses) | \$ 2,237 | \$ 69 |

See accompanying notes to condensed consolidated financial statements.

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 six month period ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. 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, 2007.

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

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

Allowance for Loan Losses

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

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

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 Option Plans

The Corporation sponsors three stock option plans. One plan was approved in 2000 and applies to officers, employees, and nonemployee directors. This plan was amended as a part of the December 2004 stock offering and recapitalization. The amendment, approved by shareholders, increased the shares available under this plan by 428,587 shares from the original 25,000 (adjusted for the 1:20 reverse stock split), to a total authorized share balance of 453,587. The other two plans, one for officers and employees and the other for nonemployee

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

directors, were approved in 1997. A total of 30,000 shares (adjusted for the 1:20 reverse stock split), were made available for grant under these plans. Options under all of the plans are granted at the discretion of a committee of the Corporation's Board of Directors. Options to purchase shares of the Corporation's stock are granted at a price equal to the market price of the stock at the date of grant. The committee determines the vesting of the options when they are granted as established under the plan.

The Corporation adopted SFAS No. 123 (Revised) "Share Based Payments" in the first quarter of 2006. This statement supersedes APB Opinion No. 25 "Accounting for Stock Issued to Employees" and its related implementation guidance. Under Opinion No. 25, issuing stock options to employees generally resulted in recognition of no compensation cost. This adoption resulted in the recognition of after tax compensation expense in the amount of \$42,000 for the six months ended June 30, 2008, and \$60,000 for the same period in 2007. The expense recorded recognizes the current period vesting of options outstanding. The per share impact of this accounting change was \$.01 and \$.02 in the first half of 2008 and 2007, respectively.

2. RECENT ACCOUNTING PRONOUNCEMENTS

FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued this interpretation to clarify the accounting for uncertainty in tax positions. FIN 48 requires, among other matters, that the Corporation recognize in its financial statements the impact of a tax position, if that position is more likely than not of being sustained on an audit, based on the technical merits of the position. The provisions of FIN 48 were effective as of the beginning of the Corporation's 2007 fiscal year and required any cumulative effect of the change in accounting principle to be recorded as an adjustment to opening retained earnings. The Corporation did not record an adjustment to retained earnings upon adoption of FIN 48. In future periods, The Corporation will, in accordance with FIN 48, evaluate its tax positions to determine whether or not an adjustment to deferred tax balances and related valuation accounts is warranted.

SFAS No. 157, Fair Value Measurements

SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is to be applied in concert with other accounting pronouncements which require or allow fair value measurements. This statement does not require any new fair value adjustments.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159)

SFAS No. 159 permits an entity to measure certain financial assets and financial liabilities at fair value. The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis, with a few exceptions, as long as it is applied to the instrument in its entirety. The fair value option election is irrevocable, unless a new election date occurs. The new Statement establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet.

SFAS No. 157 and No. 159 were effective January 1, 2008. The adoption of SFAS No. 157 and No. 159 by the Corporation did not have any material impact on the consolidated financial statements.

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

2. RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

The Corporation has reviewed other recent accounting pronouncements by the Financial Accounting Standards Board (FASB), in addition to those noted above and determined that there is no current impact of these accounting pronouncements in the consolidated financial statements of the Corporation.

3. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding.

Additional shares issued as a result of option exercises would not be dilutive in either period.

The following shows the computation of basic and diluted earnings per share for the three and six months ended June 30, 2008 and 2007 (dollars in thousands, except per share data):

| Three Months Ended June 30, | Net Income | Weighted Average Number of Shares | Income Per Share |
|---|-------------------|--|-----------------------------|
| <u>2008</u> | | | |
| Income per share - Basic and diluted | \$ 1,769 | 3,419,933 | \$.52 |
| <u>2007</u> | | | |
| Income per share - Basic and diluted | \$ 546 | 3,428,695 | \$.16 |
| <u>Six Months Ended June 30,</u> | | | |
| <u>2008</u> | | | |
| Income per share - Basic and diluted | \$ 1,908 | 3,424,314 | \$.56 |
| <u>2007</u> | | | |
| Income per share - Basic and diluted | \$ 1,581 | 3,428,695 | \$.46 |

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of June 30, 2008, December 31, 2007 and June 30, 2007 are as follows (dollars in thousands):

| | June 30, 2008 | | December 31, 2007 | | June 30, 2007 | |
|--|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| US Agencies - MBS | \$ 22,696 | \$ 22,623 | \$ - | \$ - | \$ - | \$ - |
| US Agencies | - | - | 20,982 | 20,969 | 23,708 | 23,517 |
| Obligations of states and political subdivisions | 550 | 607 | 556 | 628 | 511 | 569 |
| Total securities available for sale | \$ 23,246 | \$ 23,230 | \$ 21,538 | \$ 21,597 | \$ 24,219 | \$ 24,086 |

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were \$21.321 million and \$21.260 million, respectively, at June 30, 2008.

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

5. LOANS

The composition of loans at June 30, 2008, December 31, 2007 and June 30, 2007 is as follows (dollars in thousands):

| | June 30, 2008 | December 31, 2007 | June 30, 2007 |
|--|--------------------------|--------------------------|--------------------------|
| Commercial real estate | \$ 186,108 | \$ 171,695 | \$ 161,823 |
| Commercial, financial, and agricultural | 77,473 | 78,192 | 76,390 |
| One to four family residential real estate | 60,882 | 57,613 | 55,090 |
| Construction: | | | |
| Commercial | 29,064 | 38,952 | 36,570 |
| Consumer | 4,987 | 5,090 | 5,485 |
| Consumer | 3,608 | 3,537 | 3,538 |
| Total loans | <u>\$ 362,122</u> | <u>\$ 355,079</u> | <u>\$ 338,896</u> |

LOANS – Allowance for loan losses

An analysis of the allowance for loan losses for the six months ended June 30, 2008, the year ended December 31, 2007, and the six months ended June 30, 2007 is as follows: (dollars in thousands):

| | June 30, 2008 | December 31, 2007 | June 30, 2007 |
|--------------------------------|--------------------------|------------------------|------------------------|
| Balance at beginning of period | \$ 4,146 | \$ 5,006 | \$ 5,006 |
| Recoveries on loans | 9 | 50 | 25 |
| Loans charged off | (1,320) | (1,310) | (111) |
| Provision for loan losses | 750 | 400 | - |
| Balance at end of period | <u>\$ 3,585</u> | <u>\$ 4,146</u> | <u>\$ 4,920</u> |

In the first half of 2008, net charge off activity was \$1.311 million, or .36% of average loans outstanding compared to net charge-offs of \$86,000, or .03% of average loans, in the first half of 2007. In the first half of 2008, the Corporation recorded a provision for loan loss in the amount of \$750,000, which is discussed in more detail under “Management’s Discussion and Analysis.”

LOANS – Impaired loans

Nonperforming loans are those which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, or loans, the terms of which have been renegotiated to provide a reduction or deferral on interest or principal. The interest income recorded and that which would have been recorded had nonaccrual and renegotiated loans been current or not troubled was not material to the consolidated financial statements for the six months ended June 30, 2008 and 2007.

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

5. LOANS (Continued)

Information regarding impaired loans as of June 30, 2008, December 31, 2007 and June 30, 2007 is as follows (dollars in thousands):

| | <u>June 30,</u> <u>2008</u> | December 31, 2007 | June 30, 2007 | Valuation Reserve | | |
|---|--------------------------------|----------------------|------------------|--------------------------------|----------------------|------------------|
| | | | | <u>June 30,</u> <u>2008</u> | December 31, 2007 | June 30, 2007 |
| Balances, at period end | | | | | | |
| Impaired loans with specific valuation reserve | \$ 4,052 | \$ 3,639 | \$ 3,559 | \$ 946 | \$ 1,320 | \$ 968 |
| Impaired loans with no specific valuation reserve | <u>561</u> | <u>369</u> | <u>1,490</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Total impaired loans | <u>\$ 4,613</u> | <u>\$ 4,008</u> | <u>\$ 5,049</u> | <u>\$ 946</u> | <u>\$ 1,320</u> | <u>\$ 968</u> |
| Impaired loans on nonaccrual basis | \$ 4,613 | \$ 3,298 | \$ 4,758 | \$ 946 | \$ 1,219 | \$ 968 |
| Impaired loans on accrual basis | <u>-</u> | <u>710</u> | <u>291</u> | <u>-</u> | <u>101</u> | <u>-</u> |
| Total impaired loans | <u>\$ 4,613</u> | <u>\$ 4,008</u> | <u>\$ 5,049</u> | <u>\$ 946</u> | <u>\$ 1,320</u> | <u>\$ 968</u> |
| Average investment in impaired loans | \$ 4,779 | \$ 4,135 | \$ 4,113 | | | |
| Interest income recognized during impairment | 46 | 129 | 15 | | | |
| Interest income that would have been recognized on an accrual basis | 225 | 391 | 198 | | | |
| Cash-basis interest income recognized | 46 | 84 | 10 | | | |

The average investment in impaired loans was approximately \$4.779 million for the six-months ended June 30, 2008, \$4.135 million for the year ended December 31, 2007, and \$4.113 million for the six months ended June 30, 2007, respectively. Nonperforming assets are discussed in more detail under “Management’s Discussion and Analysis.”

LOANS – Related parties

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):

| | <u>June 30,</u> <u>2008</u> | December 31, 2007 | June 30, 2007 |
|---|--------------------------------|----------------------|------------------|
| Loans outstanding beginning of period | \$ 1,720 | \$ 1,621 | \$ 1,621 |
| New loans | - | - | - |
| Net activity on revolving lines of credit | 479 | 556 | - |
| Repayment | (41) | (457) | (16) |
| Change in related party interest | <u>2,733</u> | <u>-</u> | <u>-</u> |
| Loans outstanding end of period | <u>\$ 4,891</u> | <u>\$ 1,720</u> | <u>\$ 1,605</u> |

There were no loans to related-parties classified substandard at June 30, 2008, December 31, 2007 or June 30, 2007, respectively.

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

6. SHORT-TERM BORROWINGS

Short-term borrowings consist of the following at June 30, 2008, December 31, 2007, and June 30, 2007 (dollars in thousands):

| | <u>June 30, 2008</u> | <u>December 31, 2007</u> | <u>June 30, 2007</u> |
|--|--------------------------|------------------------------|--------------------------|
| Fed funds purchased | \$ - | \$ 7,710 | \$ - |
| Advance outstanding on line of credit with a correspondent bank, interest payable at the prime rate, 5.00% as of June 30, 2008, maturing November 30, 2008 | <u>-</u> | <u>1,959</u> | <u>1,959</u> |
| | <u>\$ -</u> | <u>\$ 9,669</u> | <u>\$ 1,959</u> |

7. LONG-TERM BORROWINGS

Long-term borrowings consist of the following at June 30, 2008, December 31, 2007 and June 30, 2007 (dollars in thousands):

| | <u>June 30, 2008</u> | <u>December 31, 2007</u> | <u>June 30, 2007</u> |
|---|--------------------------|------------------------------|--------------------------|
| Federal Home Loan Bank fixed rate advances at rates ranging from 4.98% to 5.16% maturing in 2010 | \$ 15,000 | \$ 15,000 | \$ 15,000 |
| Federal Home Loan Bank variable rate advances at rates ranging from 2.73% to 2.80% maturing in 2011 | 20,000 | 20,000 | 20,000 |
| Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024 interest payable at 1% | <u>1,280</u> | <u>1,280</u> | <u>1,348</u> |
| | <u>\$ 36,280</u> | <u>\$ 36,280</u> | <u>\$ 36,348</u> |

The Federal Home Loan Bank borrowings are collateralized at June 30, 2008, by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$22.862 million; mortgage related and municipal securities with an amortized cost and estimated fair value of \$20.071 million and \$20.010 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$3.794 million. Prepayment of the remaining advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of June 30, 2008.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling \$367,000 originated and held by the Corporation's wholly owned subsidiary, First Rural Relending, and an assignment of a demand deposit account in the amount of \$1.031 million, and guaranteed by the Corporation.

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

8. STOCK OPTION PLANS

A summary of stock option transactions for the six months ended June 30, 2008 and 2007, and the year ended December 31, 2007, is as follows:

| | <u>June 30, 2008</u> | December 31, 2007 | June 30, 2007 |
|--|--------------------------|----------------------|------------------|
| Outstanding shares at beginning of year | 446,417 | 446,417 | 446,417 |
| Granted during the period | - | - | - |
| Expired during the period | <u>180</u> | - | - |
| Outstanding shares at end of period | <u>446,237</u> | <u>446,417</u> | <u>446,417</u> |
| Weighted average exercise price per share at end of period | <u>\$ 12.14</u> | <u>\$ 12.29</u> | <u>\$ 12.29</u> |
| Shares available for grant at end of period | <u>18,488</u> | <u>18,488</u> | <u>18,488</u> |

There were no options granted in the first six months of 2008 and 2007.

Following is a summary of the options outstanding and exercisable at June 30, 2008:

| Exercise Price Range | Number | | Remaining Contractual Life-Years | Weighted Average Exercise Price |
|-------------------------|----------------|----------------|-------------------------------------|------------------------------------|
| | Outstanding | Exercisable | | |
| \$9.16 | 12,500 | 5,000 | 7.5 | \$ 9.16 |
| \$9.75 | 257,152 | 120,861 | 6.5 | 9.75 |
| \$10.65 | 72,500 | 14,500 | 8.5 | 10.65 |
| \$11.50 | 40,000 | 8,000 | 7.3 | 11.50 |
| \$12.00 | 60,000 | 12,000 | 7.0 | 12.00 |
| \$156.00 - \$240.00 | 3,545 | 3,545 | 2.7 | 186.75 |
| \$300.00 - \$406.60 | 540 | 540 | 1.6 | 333.33 |
| | <u>446,237</u> | <u>164,446</u> | <u>6.9</u> | <u>\$ 12.14</u> |

9. INCOME TAXES

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. At June 30, 2008, the Corporation evaluated the valuation allowance against the net deferred tax asset which would require future taxable income in order to be utilized. The Corporation, as of June 30, 2008 had a net operating loss and tax credit carryforwards for tax purposes of approximately \$34.2 million, and \$2.1 million, respectively.

The Corporation utilized NOL carryforwards to offset taxable income for the first nine months of 2007. In the third quarter of 2007, the Corporation reversed a portion of the valuation allowance, \$7.500 million that pertained to the deferred tax benefit of NOL and tax credit carryforwards. This valuation adjustment was recorded as a current period income tax benefit. In 2006, the Corporation recorded a \$500,000 tax benefit and utilized additional NOL carryforwards to offset current taxable income. The recognition of the deferred tax benefit in 2007 and 2006 was in accordance with generally accepted accounting principles, and considered among other things, the probability of utilizing the NOL and credit carryforwards.

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

9. INCOME TAXES (Continued)

The Corporation recorded the future benefits from these carryforwards at such time as it became “more likely than not” that they would be utilized prior to expiration. Please refer to further discussion on income taxes contained in “Management’s Discussion and Analysis.” The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL, approximately \$22 million, and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is \$1.4 million for the NOL and the equivalent value of tax credits, which is approximately \$.477 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December, 2004.

10. FAS 157 – FAIR VALUE MEASUREMENTS

The following tables present information about the Corporation’s assets and liabilities measured at fair value on a recurring basis at June 30, 2008, 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.

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.

Disclosures concerning assets and liabilities measured at fair value are as follows (dollars in thousands):

Assets and Liabilities Measured at Fair Value on a Recurring Basis at June 30, 2008

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at June 30, 2008 |
|--|--|---|---|-----------------------------|
| Assets | | | | |
| Investment securities - available for sale | \$ 23,162 | \$ 68 | \$ - | \$ 23,230 |
| Liabilities | | | | |
| None | | | | |

The Corporation had no Level 3 assets or liabilities on a recurring basis as of December 31, 2007 or June 30, 2008.

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

10. FAS 157 – FAIR VALUE MEASUREMENTS (Continued)

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

| Assets Measured at Fair Value on a Nonrecurring Basis | | | | | | |
|---|-----------------------------|---|--|--|-------------------------------------|-----------------------------------|
| (dollars in thousands) | Balance at June 30, 2008 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Losses for | |
| Assets | | | | | Three Months Ended June 30, 2008 | Six Months Ended June 30, 2008 |
| Impaired loans accounted for under FAS 114 | \$ - | \$ - | \$ - | \$ 1,161 | \$ 862 | \$ 862 |
| | | | | | <u>\$ 862</u> | <u>\$ 862</u> |

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

Impaired loans accounted for under FAS 114 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).

Other assets, including bank owned life insurance, goodwill, intangible assets and other assets acquired in business combinations, are also subject to periodic impairment assessments under other accounting principles generally accepted in the United States of America. These assets are not considered financial instruments. Effective February 12, 2008, the FASB issued a staff position, FSP FAS 157-2, which delayed the applicability of FAS 157 to nonfinancial instruments. Accordingly, these assets have been omitted from the above disclosures.

11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK

Financial Instruments With Off-Balance-Sheet Risk

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

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

11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

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

| | June 30, 2008 | December 31, 2007 | June 30, 2007 |
|---|--------------------------|----------------------|------------------|
| Commitments to extend credit: | | | |
| Variable rate | \$ 40,215 | \$ 43,903 | \$ 51,214 |
| Fixed rate | 8,601 | 8,055 | 8,881 |
| Standby letters of credit - Variable rate | 6,693 | 5,930 | 5,914 |
| Credit card commitments - Fixed rate | 2,521 | 2,414 | 2,432 |
| | \$ 58,030 | \$ 60,302 | \$ 68,441 |

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.

Contingencies

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

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank's most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at June 30, 2008 represents \$41.8 million, or 15.9%, compared to \$41.7 million, or 17.5%, of the commercial loan portfolio on June 30, 2007. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank's locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

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

FORWARD LOOKING STATEMENTS

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

- The highly regulated environment in which the Corporation operates could adversely affect its ability to carry out its strategic plan due to restrictions on new products, funding opportunities or new market entrances;
- General economic conditions, either nationally or in the state(s) in which the Corporation does business;
- Legislation or regulatory changes which affect the business in which the Corporation is engaged;
- Changes in the interest rate environment which increase or decrease interest rate margins;
- Changes in securities markets with respect to the market value of financial assets and the level of volatility in certain markets such as foreign exchange;
- Significant increases in competition in the banking and financial services industry resulting from industry consolidation, regulatory changes and other factors, as well as action taken by particular competitors;
- The ability of borrowers to repay loans;
- The effects on liquidity of unusual decreases in deposits;
- Changes in consumer spending, borrowing, and saving habits;
- Technological changes;
- Acquisitions and unanticipated occurrences which delay or reduce the expected benefits of acquisitions;
- Difficulties in hiring and retaining qualified management and banking personnel;
- The Corporation’s ability to increase market share and control expenses;
- The effect of compliance with legislation or regulatory changes;
- The effect of changes in accounting policies and practices;
- The costs and effects of existing and future litigation and of adverse outcomes in such litigation.

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.

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

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements and related notes and other supplemental information presented elsewhere in this report. This discussion should be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2007. Throughout this discussion, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

Year-to-date consolidated net income was \$1.908 million through June 30, 2008, compared to a net income of \$1.581 million for the same period in 2007. Basic income per share was \$.56 for the six months ended June 30, 2008, compared to an income per share of \$.46 for the same period in 2007. The income for the three months ended June 30, 2008 amounted to \$1.769 million, or \$.52 per share, compared to an income of \$.546 million, or \$.16 per share for the same period in 2007. The results of operations for the first six months of 2008 include \$3.475 million of proceeds from the settlement of a shareholder lawsuit, the negative effects of a severance agreement expense of \$.425 million, and a \$.750 million provision for loan loss. During the comparable six month period in 2007, the Corporation recorded income from proceeds of the settlement of a lawsuit against the Corporation's former accountants in the amount of \$470,000.

Total assets increased \$28.447 million from December 31, 2007 to June 30, 2008. The loan portfolio increased \$7.043 million in the first six months of 2008, from December 31, 2007 balances of \$355.079 million. Deposits totaled \$356.976 million at June 30, 2008, an increase of \$36.149 million from the \$320.827 million at December 31, 2007.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased \$20.027 million in 2008. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Available-for-sale securities increased \$1.633 million, or 7.56%, from December 31, 2007 to June 30, 2008, with the balance on June 30, 2008, totaling \$23.230 million. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of June 30, 2008, investment securities with an estimated fair value of \$21.260 million were pledged.

Loans

Through the first half of 2008, loan balances increased by \$7.043 million, or 1.98%, from December 31, 2007 balances of \$355.079 million. During the first six months of 2008, the Bank had total loan production of \$34.234 million. This loan production, however, was significantly offset by normal principal runoff and amortization, \$15.26 million, and large paydowns and refinancing, which totaled \$24.470 million. Management continues to actively manage the loan portfolio, seeking to identify and resolve problem assets at an early stage. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with changes to the loan approval process and exception reporting, management can effectively manage the risk in the loan portfolio. Management intends to continue loan growth within its markets for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

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

Following is a summary of the loan portfolio at June 30, 2008, December 31, 2007 and June 30, 2007 (dollars in thousands):

| | June 30, 2008 | Percent of Total | December 31, 2007 | Percent of Total | June 30, 2007 | Percent of Total |
|--|--------------------------|-----------------------------|----------------------|---------------------|------------------|---------------------|
| Commercial real estate | \$ 186,108 | 51.39 % | \$ 171,695 | 48.35 % | \$ 161,823 | 47.75 % |
| Commercial, financial, and agricultural | 77,473 | 21.39 | 78,192 | 22.02 | 76,390 | 22.54 |
| One to four family residential real estate | 60,882 | 16.81 | 57,613 | 16.23 | 55,090 | 16.26 |
| Consumer | 3,608 | 1.00 | 3,537 | 1.00 | 3,538 | 1.04 |
| Construction | | | | | | |
| Commercial | 29,064 | 8.03 | 38,952 | 10.97 | 36,570 | 10.79 |
| Consumer | 4,987 | 1.38 | 5,090 | 1.43 | 5,485 | 1.62 |
| Total loans | \$ 362,122 | 100.00 % | \$ 355,079 | 100.00 % | \$ 338,896 | 100.00 % |

Following is a table showing the significant industry types in the commercial loan portfolio as of June 30, 2008, December 31, 2007 and June 30, 2007 (dollars in thousands):

| | June 30, 2008 | | | December 31, 2007 | | | June 30, 2007 | | |
|--------------------------------------|------------------------|-----------------------------------|---------------------------------------|------------------------|-----------------------------------|---------------------------------------|------------------------|-----------------------------------|---------------------------------------|
| | Outstanding Balance | Percent of Commercial Loans | Percent of Shareholders' Equity | Outstanding Balance | Percent of Commercial Loans | Percent of Shareholders' Equity | Outstanding Balance | Percent of Commercial Loans | Percent of Shareholders' Equity |
| R/E - oper. of nonresidential bldgs. | \$ 41,778 | 15.85 % | 101.96 % | \$ 41,597 | 14.40 % | 105.79 % | \$ 41,662 | 17.49 % | 136.66 % |
| Hospitality and tourism | 35,053 | 13.30 | 85.55 | 37,604 | 13.02 | 95.63 | 37,286 | 15.65 | 122.31 |
| Real estate agents and managers | 27,495 | 10.43 | 67.10 | 29,571 | 10.24 | 75.20 | 31,937 | 13.41 | 104.76 |
| Commercial construction | 10,716 | 4.07 | 26.15 | 38,952 | 13.49 | 99.06 | 10,270 | 4.31 | 33.69 |
| Other | 148,539 | 56.35 | 362.51 | 141,115 | 48.85 | 358.88 | 117,058 | 49.14 | 383.99 |
| Total Commercial Loans | \$ 263,581 | 100.00 % | | \$ 288,839 | 100.00 % | | \$ 238,213 | 100.00 % | |

Management recognizes the additional risk presented by the concentration in certain segments of the portfolio. On a historical basis, the Corporation's highest concentration of credit risk was the hospitality and tourism industry. Management does not consider the current loan concentrations in hospitality and gaming to be problematic, and has no intention of further reducing loans to this industry segment. Management does not believe that its current portfolio composition has increased exposure related to any specific industry concentration as of June 30, 2008. The current concentration of real estate related loans represents a broad customer base composed of a high percentage of owner occupied developments.

Credit Quality

Management analyzes the allowance for loan losses in detail on a monthly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs for the first half of 2008 amounted to \$1.311 million, or 0.36% of average loans outstanding, compared to \$.086 million, .03% of average loans outstanding, for the first half of 2007. Current period charge-offs reflect the writedown of three commercial loans, totaling \$.862 million, in the second quarter which were reserved for in prior periods. The current reserve balance is representative of the relevant risk inherent within the Corporation's loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity.

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

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

| | <u>June 30,</u> <u>2008</u> | <u>December 31,</u> <u>2007</u> | <u>June 30,</u> <u>2007</u> |
|---------------------------------------|--------------------------------|------------------------------------|--------------------------------|
| Nonperforming Assets: | | | |
| Nonaccrual Loans | \$ 4,613 | \$ 3,298 | \$ 4,758 |
| Loans past due 90 days or more | - | 710 | 291 |
| Total nonperforming loans | <u>4,613</u> | <u>4,008</u> | <u>5,049</u> |
| Other real estate owned | 3,395 | 1,226 | 77 |
| Total nonperforming assets | <u>\$ 8,008</u> | <u>\$ 5,234</u> | <u>\$ 5,126</u> |
| Nonperforming loans as a % of loans | <u>1.27</u> % | <u>1.13</u> % | <u>1.49</u> % |
| Nonperforming assets as a % of assets | <u>1.83</u> % | <u>1.28</u> % | <u>1.30</u> % |
| Reserve for Loan Losses: | | | |
| At period end | <u>\$ 3,585</u> | <u>\$ 4,146</u> | <u>\$ 4,920</u> |
| As a % of loans | <u>.99</u> % | <u>1.17</u> % | <u>1.45</u> % |
| As a % of nonperforming loans | <u>77.72</u> % | <u>103.44</u> % | <u>97.45</u> % |
| As a % of nonaccrual loans | <u>77.72</u> % | <u>125.71</u> % | <u>103.41</u> % |

The following ratios assist management in the determination of the Corporation's credit quality:

| | <u>June 30,</u> <u>2008</u> | <u>December 31,</u> <u>2007</u> | <u>June 30,</u> <u>2007</u> |
|--|--------------------------------|------------------------------------|--------------------------------|
| Total loans, at period end | <u>\$ 362,122</u> | <u>\$ 355,079</u> | <u>\$ 338,896</u> |
| Average loans for the year | <u>360,176</u> | <u>333,415</u> | <u>321,414</u> |
| Allowance for loan losses | <u>3,585</u> | <u>4,146</u> | <u>4,920</u> |
| Allowance to total loans at period end | <u>.99</u> % | <u>1.17</u> % | <u>1.45</u> % |
| Net charge-offs during the period | <u>\$ 1,311</u> | <u>\$ 1,260</u> | <u>\$ 86</u> |
| Net charge-offs to average loans | <u>.36</u> % | <u>.38</u> % | <u>.03</u> % |
| Net charge-offs to beginning allowance balance | <u>31.62</u> % | <u>25.17</u> % | <u>1.72</u> % |

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and the bank regulatory examinations, management reviews the Corporation's loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes a loan review consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review, early in 2008, provided findings similar to management on the overall adequacy of the reserve.

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

The following table will provide additional information with respect to our nonperforming assets as of June 30, 2008 (dollars in thousands):

| <u>Collateral Type</u> | <u>Balance</u> | <u>Estimated Liquidation Value</u> | <u>(Deficiency) Surplus</u> | <u>Reserve Allocation</u> | <u>Estimated Net Surplus/ (Exposure)</u> |
|--|-----------------|--|---------------------------------|-------------------------------|--|
| | (a) | (b) | (c) = (b)-(a) | (d) | (e) = (c)-(d) |
| Nonaccrual Loans | | | | | |
| Land Development | \$ 2,754 | \$ 2,134 | \$ (620) | \$ 620 | \$ - |
| Land Development / Condo | 1,042 | 1,080 | 38 | 300 | 338 |
| Cabins / Land | 414 | 414 | - | - | - |
| 1-4 Family | 203 | 197 | (6) | 6 | - |
| Non-Farm/Non-Residential | 117 | 97 | (20) | 20 | - |
| Business Equipment | 50 | 50 | - | - | - |
| Land | 34 | 88 | 54 | - | 54 |
| Total nonaccrual loans | <u>4,614</u> | <u>4,060</u> | <u>(554)</u> | <u>946</u> | <u>392</u> |
| Other Real Estate | | | | | |
| Conv 5+ Residential | 1,746 | 1,225 | (521) | 521 | - |
| Land Development | 511 | 511 | - | - | - |
| Motel / Hotel | 387 | 387 | - | - | - |
| Cabins / Land | 260 | 260 | - | - | - |
| 1-4 Family | 217 | 198 | (19) | 19 | - |
| Equipment Storage Building | 150 | 150 | - | - | - |
| Downtown Store Frontage / 2 / 1-4 Family | 77 | 77 | - | - | - |
| Non-Farm/Non-Residential | 46 | 46 | - | - | - |
| Total other real estate owned | <u>3,394</u> | <u>2,854</u> | <u>(540)</u> | <u>540</u> | <u>-</u> |
| Total Nonperforming Assets | <u>\$ 8,008</u> | <u>\$ 6,914</u> | <u>\$ (1,094)</u> | <u>\$ 1,486</u> | <u>\$ 392</u> |

The schedule above shows the detail of nonperforming assets categorized by type of loan/collateral. In determining estimated liquidation value, management considered existing appraisals, the date of the appraisals, and current market conditions, along with related selling costs. Personal guarantees are also in place for various nonperforming assets, which will also help mitigate losses.

Following is the allocation for loan losses as of June 30, 2008, December 31, 2007, and June 30, 2007 (dollars in thousands):

| | <u>June 30, 2008</u> | <u>December 31, 2007</u> | <u>June 30, 2007</u> |
|--|--------------------------|------------------------------|--------------------------|
| Commercial, financial and agricultural loans | \$ 3,276 | \$ 3,808 | \$ 4,261 |
| One to four family residential real estate loans | 27 | 22 | 60 |
| Consumer loans | 15 | 20 | - |
| Unallocated and general reserves | <u>267</u> | <u>296</u> | <u>599</u> |
| Totals | <u>\$ 3,585</u> | <u>\$ 4,146</u> | <u>\$ 4,920</u> |

As of June 30, 2008, the allowance for loan losses represented 0.99% of total loans. 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.

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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):

| | <u>Three Months Ended</u> <u>June 30, 2008</u> | <u>Year Ended</u> <u>December 31, 2007</u> | <u>Three Months Ended</u> <u>June 30, 2007</u> |
|---|---|---|---|
| Balance at beginning of period | \$ 1,226 | \$ 26 | \$ 26 |
| Other real estate transferred from loans due to foreclosure | 2,439 | 1,218 | 69 |
| Other real estate sold/written down | <u>(270)</u> | <u>(18)</u> | <u>(18)</u> |
| Balance at end of period | <u>\$ 3,395</u> | <u>\$ 1,226</u> | <u>\$ 77</u> |

During the first six months of 2008, the Corporation received real estate in lieu of loan payments of \$2.439 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balance. Any additional reduction in the fair value results in a write-down of other real estate.

Deposits

The Corporation had an increase in deposits in the first six months of 2008. Total deposits increased by \$36.149 million, or 11.27%, in the first six months of 2008. Core deposits increased from \$199.809 million at 2007 year end to \$200.293 million, an increase of \$.484 million. Noncore deposits increased by \$35.665 million during the first six months of 2008, largely due to increased liquidity needs. Approximately \$20 million of the increase in brokered deposits was due to a "pre-funding" of two issues of brokered CD's which matured early in the month of July. Management continues to monitor existing deposit products in order to stay competitive, as to both terms and pricing. It is the intent of management to be aggressive in our markets to grow core deposits, with an emphasis placed on transactional accounts.

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

| | <u>June 30,</u> <u>2008</u> | <u>% of Total</u> | | <u>December 31,</u> <u>2007</u> | <u>% of Total</u> | | <u>June 30,</u> <u>2007</u> | <u>% of Total</u> |
|------------------------------------|--------------------------------|-------------------|----|------------------------------------|-------------------|----|--------------------------------|-------------------|
| Non-interest-bearing | \$ 27,741 | 7.77 % | \$ | 25,557 | 7.97 % | \$ | 28,811 | 8.97 % |
| NOW, money market, checking | 78,703 | 22.05 | | 81,160 | 25.30 | | 73,994 | 23.03 |
| Savings | 15,171 | 4.25 | | 12,485 | 3.89 | | 12,422 | 3.87 |
| Certificates of Deposit <\$100,000 | <u>78,678</u> | <u>22.04</u> | | <u>80,607</u> | <u>25.12</u> | | <u>96,546</u> | <u>30.05</u> |
| Total core deposits | <u>200,293</u> | <u>56.11</u> | | 199,809 | 62.28 | | 211,773 | 65.92 |
| Certificates of Deposit >\$100,000 | 28,252 | 7.91 | | 22,355 | 6.97 | | 24,879 | 7.75 |
| Brokered CDs | <u>128,431</u> | <u>35.98</u> | | 98,663 | 30.75 | | 84,594 | 26.33 |
| Total non-core deposits | <u>156,683</u> | <u>43.89</u> | | 121,018 | 37.72 | | 109,473 | 34.08 |
| Total deposits | <u>\$ 356,976</u> | <u>100.00 %</u> | \$ | <u>320,827</u> | <u>100.00 %</u> | \$ | <u>321,246</u> | <u>100.00 %</u> |

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Borrowings

The Corporation historically used alternative funding sources to provide long-term, stable sources of funds. Current borrowings total \$35.000 million with stated maturities ranging through 2011. Borrowings at quarter end include \$20.000 million with adjustable rates that reprice quarterly based upon the three month LIBOR. The FHLB has the option to convert the remaining \$15.000 million fixed-rate advances to adjustable rate advances on the original call date and quarterly thereafter.

Shareholders' Equity

Total shareholders' equity increased \$1.654 million from December 31, 2007 to June 30, 2008. The increase is comprised of net income, contributed capital of \$42,000 in recognition of stock option expense, a decrease in the market value of securities of \$.186 million and the cost of a one-time oddlot share buyback in the amount of \$.110 million.

RESULTS OF OPERATIONS

Summary

The Corporation reported income of \$1.908 million for the first half of 2008, \$.56 per share, compared to net income of \$1.581 million, \$.46 per share, in the first half of 2007. In the second quarter of 2008, net income was \$1.769, \$.52 per share, compared to \$.546 million, \$.16 per share, in the second quarter of 2007.

The Corporation is experiencing net interest margin pressure due to an asset sensitive position, since 65% of its commercial loan portfolio, approximately \$245 million, reprices with interest rate changes. The Corporation is also reliant on brokered deposits, and rates have not declined in line with asset repricing.

Net Interest Income

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

Net interest income before the provision for loan loss for the six months ended June 30, 2008 decreased \$.284 million, or 4.41% compared to the same period in 2007.

Net interest income declined to \$3.118 million in the second quarter of 2008, compared to \$3.269 million in the second quarter of 2007. The decrease in net interest income for 2008 was primarily the result of prime rate reductions that have translated into lower yields on the Corporation's earning assets, specifically variable rate commercial loans and short-term investments which reprice immediately. Offering rates on brokered certificates of deposit are influenced by other factors, such as overall market liquidity. Reliance upon wholesale funding and further rate reductions in the near term will unfavorably impact the net interest margin of the Corporation.

While a majority of the Corporation's loan portfolio is repriced with each prime rate change due to floating rate loans, interest paid on similar rate changes does not impact the pricing of interest bearing liabilities to nearly the same degree. The mix of time deposits reflects the Corporation's need to utilize the brokered certificate of deposit markets for loan funding when core deposits did not provide adequate sources.

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

| | Three Months Ended | | | | | | | | | | |
|--|--------------------|------------|-------------------------|---------------|--------|----------|----------|--------------------------------|--------------------|------------------|-----------------------------|
| | Average Balances | | | Average Rates | | Interest | | 2008-2007 | | | |
| | June 30, | | Increase/ (Decrease) | June 30, | | June 30, | | Income/ Expense Variance | Volume Variance | Rate Variance | Rate/ Volume Variance |
| | 2008 | 2007 | | 2008 | 2007 | 2008 | 2007 | | | | |
| (dollars in thousands) | | | | | | | | | | | |
| Loans (1,2,3) | \$ 362,574 | \$ 324,721 | \$ 37,853 | 6.39 % | 8.23 % | \$ 5,759 | \$ 6,664 | \$ (905) | \$ 775 | \$ (1,489) | (191) |
| Taxable securities | 23,960 | 25,971 | (2,011) | 4.58 | 4.53 | 273 | 293 | (20) | (23) | 4 | (1) |
| Nontaxable securities (2) | 69 | - | 69 | 5.83 | - | 1 | - | 1 | - | - | 1 |
| Federal funds sold | 1,923 | 7,756 | (5,833) | 2.09 | 5.27 | 10 | 102 | (92) | (77) | (61) | 46 |
| Other interest-earning assets | 4,183 | 5,934 | (1,751) | 6.73 | 4.33 | 70 | 64 | 6 | (19) | 36 | (11) |
| Total earning assets | 392,709 | 364,382 | 28,327 | 6.26 | 7.84 | 6,113 | 7,123 | (1,010) | 656 | (1,510) | (156) |
| Reserve for loan losses | (3,886) | (4,972) | 1,086 | | | | | | | | |
| Cash and due from banks | 6,053 | 5,976 | 77 | | | | | | | | |
| Intangible assets | 94 | 172 | (78) | | | | | | | | |
| Other assets | 23,276 | 16,507 | 6,769 | | | | | | | | |
| Total assets | \$ 418,246 | \$ 382,065 | \$ 36,181 | | | | | | | | |
| NOW and money market deposits | \$ 80,379 | \$ 72,371 | \$ 8,008 | 1.53 | 3.49 | 306 | 629 | (323) | 69 | (352) | (40) |
| Savings deposits | 13,310 | 13,288 | 22 | .94 | 1.63 | 31 | 54 | (23) | - | (23) | - |
| CDs <\$100,000 | 81,746 | 96,442 | (14,696) | 4.25 | 5.00 | 863 | 1,202 | (339) | (183) | (181) | 25 |
| CDs >\$100,000 | 26,773 | 24,350 | 2,423 | 3.97 | 5.02 | 264 | 305 | (41) | 30 | (64) | (7) |
| Brokered deposits | 104,187 | 79,301 | 24,886 | 4.20 | 5.45 | 1,087 | 1,077 | 10 | 337 | (247) | (80) |
| Borrowings | 42,430 | 39,209 | 3,221 | 3.71 | 5.25 | 391 | 513 | (122) | 41 | (150) | (13) |
| Total interest-bearing liabilities | 348,825 | 324,961 | 23,864 | 3.39 | 4.67 | 2,942 | 3,780 | (838) | 294 | (1,017) | (115) |
| Demand deposits | 26,331 | 23,717 | 2,614 | | | | | | | | |
| Other liabilities | 2,691 | 2,975 | (284) | | | | | | | | |
| Shareholders' equity | 40,399 | 30,412 | 9,987 | | | | | | | | |
| Total liabilities and shareholders' equity | \$ 418,246 | \$ 382,065 | \$ 36,181 | | | | | | | | |
| Rate spread | | | | 2.87 % | 3.17 % | | | | | | |
| Net interest margin/revenue | | | | 3.25 % | 3.68 % | \$ 3,171 | \$ 3,343 | \$ (172) | \$ 362 | \$ (493) | \$ (41) |

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
(2) Interest income on loans includes loan fees.
(3) Interest income on loans includes fees

| | Six Months Ended | | | | | | | | | | |
|--|------------------|------------|-------------------------|---------------|--------|-----------|-----------|--------------------------------|--------------------|------------------|-----------------------------|
| | Average Balances | | | Average Rates | | Interest | | 2008-2007 | | | |
| | June 30, | | Increase/ (Decrease) | June 30, | | June 30, | | Income/ Expense Variance | Volume Variance | Rate Variance | Rate/ Volume Variance |
| | 2008 | 2007 | | 2008 | 2007 | 2008 | 2007 | | | | |
| (dollars in thousands) | | | | | | | | | | | |
| Loans (1,2,3) | \$ 360,176 | \$ 321,415 | \$ 38,761 | 6.71 % | 8.15 % | \$ 12,022 | \$ 13,157 | \$ (1,135) | \$ 1,591 | \$ (2,465) | (261) |
| Taxable securities | 23,930 | 27,703 | (3,773) | 4.51 | 4.32 | 537 | 594 | (57) | (81) | 26 | (2) |
| Nontaxable securities | 70 | - | 70 | 11.49 | - | 4 | - | 4 | - | - | 4 |
| Federal funds sold | 3,641 | 9,103 | (5,462) | 2.93 | 5.32 | 53 | 240 | (187) | (144) | (108) | 65 |
| Other interest-earning assets | 4,436 | 5,450 | (1,014) | 5.30 | 4.66 | 117 | 126 | (9) | (24) | 17 | (2) |
| Total earning assets | 392,253 | 363,671 | 28,582 | 6.53 | 7.74 | 12,733 | 14,117 | (1,384) | 1,342 | (2,530) | (196) |
| Reserve for loan losses | (3,982) | (4,985) | 1,003 | | | | | | | | |
| Cash and due from banks | 6,127 | 5,911 | 216 | | | | | | | | |
| Intangible assets | 104 | 183 | (79) | | | | | | | | |
| Other assets | 23,462 | 16,459 | 7,003 | | | | | | | | |
| Total assets | \$ 417,964 | \$ 381,239 | \$ 36,725 | | | | | | | | |
| NOW and money market deposits | \$ 81,107 | \$ 72,282 | \$ 8,825 | 1.85 | 3.48 | 748 | 1,249 | (501) | 153 | (586) | (68) |
| Savings deposits | 12,668 | 13,284 | (616) | 0.89 | 1.64 | 56 | 108 | (52) | (5) | (50) | 3 |
| CDs <\$100,000 | 82,146 | 94,243 | (12,097) | 4.44 | 4.95 | 1,813 | 2,312 | (499) | (254) | (283) | 38 |
| CDs >\$100,000 | 24,962 | 24,117 | 845 | 4.25 | 4.98 | 527 | 596 | (69) | 21 | (88) | (2) |
| Brokered deposits | 107,105 | 82,022 | 25,083 | 4.64 | 5.47 | 2,471 | 2,225 | 246 | 682 | (339) | (97) |
| Borrowings | 40,906 | 38,795 | 2,111 | 4.15 | 5.29 | 845 | 1,018 | (173) | 56 | (219) | (10) |
| Total interest-bearing liabilities | 348,894 | 324,743 | 24,151 | 3.72 | 4.66 | 6,460 | 7,508 | (1,048) | 653 | (1,565) | (136) |
| Demand deposits | 26,383 | 23,596 | 2,787 | | | | | | | | |
| Other liabilities | 2,742 | 3,064 | (322) | | | | | | | | |
| Shareholders' equity | 39,945 | 29,836 | 10,109 | | | | | | | | |
| Total liabilities and shareholders' equity | \$ 417,964 | \$ 381,239 | \$ 36,725 | | | | | | | | |
| Rate spread | | | | 2.81 % | 3.08 % | | | | | | |
| Net interest margin/revenue | | | | 3.22 % | 3.57 % | \$ 6,273 | \$ 6,609 | \$ (336) | \$ 689 | \$ (965) | \$ (60) |

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
(2) Interest income on loans includes loan fees.
(3) Interest income includes fees on loans

The rate reductions on approximately 65% of the Corporation's loan portfolio repriced with prime rate reductions from 8.25% in September of 2007 to 5.00% in June 2008. The reduced rates of the Corporation's loan portfolio is reflected in the overall decrease in rates on earning assets from 8.23% in the second quarter of 2007 to 6.39% in the second quarter of 2008. During this period of prime rate reductions, the Corporation reduced bank deposit rates in order to mitigate the impact on earnings. The Corporation is somewhat reliant on wholesale funding sources, specifically brokered deposits. The Corporation had average balances of \$104.187 million in the second quarter of 2008 with an average cost of 4.20% compared to \$79.301 million at 5.45% in the second quarter of 2007. In the six months ended June 30, 2008, the Corporation had average balances of brokered deposits totaling \$107.105 million at a weighted average cost of 4.64% compared to \$82.022 million at 5.47% for the same six month period in 2007.

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These deposits have not repriced in line with rate reductions on earning assets, which significantly contributed to the Corporation's reduced net interest income. The Corporation expects to see less pressure on its interest margin as these wholesale deposits reprice.

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 second quarter of 2008, the Corporation recorded a \$750,000 provision for loan loss. In future periods, loan loss provisions will be required if there is further market deterioration that impacts the credit quality on the existing portfolio.

Other Income

Other income increased by \$2.802 million for the six months ended June 30, 2008, compared to the six months ended June 30, 2007. The Corporation recognized a benefit from the settlement of a shareholder lawsuit in the first half of 2008, which amounted to \$3.475 million. Service fees increased \$22,000 in the first six months of 2008, while other noninterest income decreased \$.188 million. Revenue due to loans produced and sold in the secondary market amounted to \$.097 million compared to \$.199 million a year ago. Poor overall market conditions, caused by a declining economy and a housing slump, have limited our ability to expand our revenues from fee income during the first six months of 2008. We do expect to generate increased fee income during the later part of 2008 and in future periods as the housing market improves and home buyers look to more traditional lenders for their borrowing needs. The Corporation recognized a benefit from the settlement of a lawsuit against its former accountants in the first half of 2007, which amounted to \$.470 million.

During the second quarter of 2008, the Corporation recognized \$3.747 million in other income, compared to \$.342 million for the second quarter of 2007. The second quarter noninterest income includes the \$3.475 million lawsuit settlement. Service fees increased for the second quarter of 2008 by \$9,000 to \$.194 million when compared to \$.185 million in the second quarter of 2007. 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 noninterest income for the three and six months ended June 30, 2008 and 2007 (dollars in thousands):

| | Three Months Ended | | % Increase (Decrease) | Six Months Ended | | % Increase (Decrease) |
|---|--------------------|--------|--------------------------|------------------|----------|--------------------------|
| | June 30, | | | June 30, | | |
| | 2008 | 2007 | 2008-2007 | 2008 | 2007 | 2008-2007 |
| Service fees | \$ 194 | \$ 185 | 4.86 | \$ 368 | \$ 346 | 6.36 |
| Net gains on sale of secondary market loans | 49 | 91 | (46.15) | 97 | 199 | (51.26) |
| Proceeds from lawsuit settlements | 3,475 | - | 100.00 | 3,475 | 470 | 639.36 |
| Other noninterest income | 29 | 66 | (56.06) | 52 | 240 | (78.33) |
| Subtotal | 3,747 | 342 | 995.61 | 3,992 | 1,255 | 218.09 |
| Net security gain (loss) | - | - | 0.00 | 65 | - | 100.00 |
| Total other income | \$ 3,747 | \$ 342 | 995.61 | \$ 4,057 | \$ 1,255 | 223.27 |

Other Expenses

Other expenses increased \$.541 million for the six months ended June 30, 2008, compared to the same period in 2007. Salaries and employee benefits increased \$.472 million, during the first six months of 2008, compared to the first six months of 2007. The Corporation recorded a \$.425 million expense related to a severance payment in the second quarter of 2008, which accounted for the majority of the increase in salaries and employee benefits. The \$56,000 increase in data processing costs is the result of increased deposit balances and activity, along with added data processing services. The \$.103 million increase in loan and deposit expense is due in large part to carrying costs associated with nonperforming assets. In the second quarter of 2008, the Corporation settled a long standing

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derivative shareholder lawsuit. As a part of this settlement, the Corporation received funds amounting to \$3.475 million, recorded as other income, and a dismissal of unpaid legal fees, totaling \$95,000, related to the defense of prior directors of the Corporation. The reversal of the accrual for these fees contributed to the reduction in professional service fees for the three and six month periods in 2008, compared to the same periods in 2007. Management continually reviews all areas of noninterest expense for cost reduction opportunities that will not impact service quality and employee morale.

Telephone expenses for the three and six month periods in 2008 are lower than the same periods in 2007, as a result of the installation of a new phone system which reduced long distance service costs. Advertising expenses have decreased in 2008, as the Corporation has initiated cost controls.

The Corporation recognized other expense in the second quarter of 2008 totaling \$3.471 million, compared to \$3.065 million in the second quarter of 2007. The increase in noninterest expense between periods was composed of increases in salary and employee benefits, due primarily to the severance agreement noted above. These increased expenses were partially offset by reductions in professional service fees. Early in 2008, the Corporation implemented several cost reduction initiatives in order to mitigate the impact of reduced interest income. Specific initiatives included nonessential staff reductions, decreases in incentive and bonus plan programs and advertising expense. The Corporation expects to realize an annualized benefit from these reductions of approximately \$.750 million.

The following table details noninterest expense for the three and six months ended June 30, 2008 and June 30, 2007 (dollars in thousands):

| | Three Months Ended | | % Increase (Decrease) 2008-2007 | Six Months Ended | | % Increase (Decrease) 2008-2007 |
|--------------------------------|--------------------|-----------------|---------------------------------------|------------------|-----------------|---------------------------------------|
| | June 30, | | | June 30, | | |
| | 2008 | 2007 | | 2008 | 2007 | |
| Salaries and employee benefits | \$ 2,075 | \$ 1,672 | 24.10 | \$ 3,882 | \$ 3,410 | 13.84 |
| Occupancy | 348 | 327 | 6.42 | 703 | 661 | 6.35 |
| Furniture and equipment | 190 | 166 | 14.46 | 368 | 323 | 13.93 |
| Data processing | 216 | 210 | 2.86 | 437 | 381 | 14.70 |
| Professional service fees | 79 | 174 | (54.60) | 232 | 325 | (28.62) |
| Loan and deposit | 144 | 79 | 82.28 | 254 | 151 | 68.21 |
| Telephone | 39 | 59 | (33.90) | 84 | 117 | (28.21) |
| Advertising | 60 | 91 | (34.07) | 120 | 183 | (34.43) |
| Other | 320 | 287 | 11.50 | 582 | 570 | 2.11 |
| Total noninterest expense | <u>\$ 3,471</u> | <u>\$ 3,065</u> | <u>13.25</u> | <u>\$ 6,662</u> | <u>\$ 6,121</u> | <u>8.84</u> |

Federal Income Taxes

Current Federal Tax Provision

The Corporation recorded a current period federal tax provision of \$900,000 in the first half of 2008, compared to no provision in the same period a year earlier.

Deferred Tax Benefit

The Corporation recognized a federal deferred tax benefit of \$7.500 million in the third quarter of 2007. The recognition of this deferred tax benefit relates to the generally accepted accounting principles applicable to the probability of utilizing the NOL and tax credit carryforwards of the Corporation. The Corporation, based upon current profitability trends largely supported by expansion of the net interest margin and controlled expenses, determined that the utilization of the NOL carryforward was probable. This tax benefit was recorded by reducing the valuation allowance that was recorded against the deferred tax assets of the Corporation. In 2006, the Corporation recognized a portion of this benefit, \$500,000, based upon the then current probabilities. The \$7.500 million recognition is based upon assumptions of a sustained level of taxable income within the NOL carryforward period and takes into account Section 382, establishing annual limitations. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized. As of March 31, 2008, the Corporation had an NOL carryforward of approximately \$34.2 million along

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with various credit carryforwards of \$2.1 million. This NOL and credit carryforward benefit is dependent upon the future profitability of the Corporation. A portion of the NOL, approximately \$22 million, and all of the tax credit carryforwards are also subject to the use limitations of Section 382 of the Internal Revenue Code since they originated prior to the December 2004 recapitalization of the Corporation. The Corporation intends to further evaluate the utilization of the NOL and credit carryforwards in subsequent periods to determine if any further adjustment to the valuation allowance is necessary. The determination criteria for recognition of deferred tax benefits will include the assumption of future period taxable income based upon the projected profitability of the Corporation.

LIQUIDITY

Liquidity is defined as the ability to generate cash at a reasonable cost to fulfill lending commitments and support asset growth, while satisfying the withdrawal demands of customers and make payments on existing borrowing commitments. The Bank's principal sources of liquidity are core deposits and loan and investment payments and prepayments. Providing a secondary source of liquidity is the available for sale investment portfolio. As a final source of liquidity, the Bank can exercise existing credit arrangements.

During the first half of 2008, the Corporation increased cash and cash equivalents by \$20.027 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was primarily impacted by cash provided by financing activities, with a net increase in deposits of \$36.419 million, partially offset by a decrease in federal funds purchased of \$7.710 million. The net increases in liabilities were partially offset by an increase in loans of \$10.792 million. This increase in deposits was composed of an increase in brokered deposits of \$29.768 million combined with an increase in bank deposits of \$.484 million. The management of bank liquidity for funding of loans and deposit maturities and withdrawals includes monitoring projected loan fundings and scheduled prepayments and deposit maturities within a 30 day period, a 30 to 90 day period and from 90 days until the end of the year. This funding forecast model is completed weekly.

It is anticipated that during the remainder of 2008, the Corporation will fund anticipated loan production with a combination of core deposit growth and noncore funding, primarily brokered CDs.

The Corporation's primary source of liquidity on a stand-alone basis is dividends from the Bank. The Bank is currently prohibited from paying dividends because of a deficit in retained earnings. The Bank, in order to pay dividends in future periods, will need to restate its capital accounts, which requires the approval of the Office of Financial and Insurance Services of the State of Michigan. The Corporation has a \$6 million correspondent bank line of credit available for short-term liquidity. This line of credit has no outstanding balance as of June 30, 2008. The Corporation is currently exploring alternative opportunities for longer term sources of liquidity and permanent equity to support projected asset growth.

Liquidity is managed by the Corporation through its Asset and Liability Committee ("ALCO"). The ALCO Committee meets monthly to discuss asset and liability management in order to address liquidity and funding needs to provide a process to seek the best alternatives for investments of assets, funding costs, and risk management. The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank's liquidity is best illustrated by the mix in the Bank's core and non-core funding dependence ratio, which explain the degree of reliance on non-core liabilities to fund long-term assets.

Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under \$100,000. Non-core funding consists of certificates of deposit greater than \$100,000, brokered deposits, and FHLB and Farmers' Home Administration borrowings. At June 30, 2008, the Bank's core deposits in relation to total funding were 51.1% compared to 59.6% at June 30, 2007. These ratios indicated at June 30, 2008, that the Bank has decreased its reliance on non-core deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. The Bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of June 30, 2008, the Bank had \$18.375 million of unsecured lines available and another \$10.500 million available if secured. The Bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank's liquidity.

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From a long-term perspective, the Corporation's liquidity plan for 2008 includes strategies to increase core deposits in the Corporation's local markets. The new deposit products and strategic advertising is expected to aid in efforts of management in growing core deposits to reduce the dependency on non-core deposits, while also reducing interest costs. The Corporation's liquidity plan for 2008 calls for augmenting local deposit growth efforts with wholesale CD funding, to the extent necessary.

CAPITAL AND REGULATORY

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of June 30, 2008, the Corporation and Bank were well capitalized. The Corporation is currently exploring its alternatives for the possible issuance of equity or debt in order to provide a broader base to support future asset growth. During the first half of 2008, total capitalization increased by \$1.654 million, primarily from an increase in retained earnings from net income earned during the period.

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

| | <u>June 30,</u> <u>2008</u> | December 31, <u>2007</u> | June 30, <u>2007</u> |
|--|--------------------------------|-----------------------------|-------------------------|
| Capital Structure | | | |
| Shareholders' equity | \$ 40,975 | \$ 39,321 | \$ 30,485 |
| Total capitalization | <u>\$ 40,975</u> | <u>\$ 39,321</u> | <u>\$ 30,485</u> |
| Tangible capital | <u>\$ 40,890</u> | <u>\$ 39,197</u> | <u>\$ 30,323</u> |
| Intangible Assets | | | |
| Core deposit premium | \$ 85 | \$ 124 | \$ 162 |
| Other identifiable intangibles | - | - | - |
| Total intangibles | <u>\$ 85</u> | <u>\$ 124</u> | <u>\$ 162</u> |
| Regulatory capital | | | |
| Tier 1 capital: | | | |
| Shareholders' equity | \$ 40,975 | \$ 39,321 | \$ 30,485 |
| Net unrealized (gains) losses on available for sale securities | 126 | (60) | 133 |
| Less: disallowed deferred tax asset | (5,731) | (6,990) | - |
| Less: intangibles | (85) | (124) | (162) |
| Total Tier 1 capital | <u>\$ 35,285</u> | <u>\$ 32,147</u> | <u>\$ 30,456</u> |
| Tier 2 Capital: | | | |
| Allowable reserve for loan losses | \$ 3,585 | \$ 4,146 | \$ 4,309 |
| Qualifying long-term debt | - | - | - |
| Total Tier 2 capital | <u>3,585</u> | <u>4,146</u> | <u>4,309</u> |
| Total capital | <u>\$ 38,870</u> | <u>\$ 36,293</u> | <u>\$ 34,765</u> |
| Risk-adjusted assets | <u>\$ 372,139</u> | <u>\$ 358,410</u> | <u>\$ 344,120</u> |
| Capital ratios: | | | |
| Tier 1 Capital to average assets | 8.56 % | 8.05 % | 7.97 % |
| Tier 1 Capital to risk weighted assets | 9.48 % | 8.97 % | 8.85 % |
| Total Capital to risk weighted assets | 10.45 % | 10.13 % | 10.10 % |

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.

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

Presented below is a summary of the capital position in comparison to generally applicable regulatory requirements:

| | Shareholders' Equity to Quarter-end Assets | Tangible Equity to Quarter-end Assets | Tier 1 Capital to Average Assets | Tier 1 Capital to Risk-Weighted Assets | Total Capital to Risk-Weighted Assets |
|--|---|--|---|---|--|
| Regulatory minimum for capital adequacy purposes | N/A | N/A | 4.00% | 4.00% | 8.00% |
| Regulatory defined well capitalized guideline | N/A | N/A | 5.00% | 6.00% | 10.00% |
| The Corporation: | | | | | |
| June 30, 2008 | 9.37% | 9.35% | 8.56% | 9.48% | 10.45% |
| June 30, 2007 | 7.75% | 7.71% | 7.97% | 8.85% | 10.10% |
| The Bank: | | | | | |
| June 30, 2008 | 9.27% | 9.26% | 8.26% | 9.13% | 10.08% |
| June 30, 2007 | 8.13% | 8.09% | 8.37% | 9.30% | 10.56% |

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

INTEREST RATE RISK

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

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

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

The Corporation also has \$23.230 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation offers deposit products with a variety of terms ranging from deposits whose interest rates can change on a weekly basis to certificates of deposit with repricing terms of up to five years. Longer term deposits generally include penalty provisions for early withdrawal.

Beyond general efforts to shorten the loan pricing periods and extend deposit maturities, management can manage interest rate risk by the maturity periods of securities purchased, selling securities available for sale, and borrowing funds with targeted maturity periods, among other strategies. Also, the rate of interest rate changes can impact the actions taken since the rate environment affects borrowers and depositors differently.

Exposure to interest rate risk is reviewed on a regular basis. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect of interest rate changes on net interest income and to structure the composition of the balance sheet to minimize interest rate risk and at the same time maximize income. Management realizes certain risks are inherent and that the goal is to identify and minimize the risks. Tools used by management include maturity and repricing analysis and interest rate sensitivity analysis. The Bank has monthly asset/liability meetings with an outside consultant to review its current position and strategize about future opportunities on risks relative to pricing and positioning of assets and liabilities.

The difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of repriceable assets over liabilities is referred to as a positive gap. An excess of repriceable 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 repriceable are reported in the 1- to 90-day time frame. The estimates of principal amortization and prepayments are assigned to the following time frames.

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

The following is the Corporation's opportunities at June 30, 2008 (dollars in thousands):

| | 1-90 Days | 91 - 365 Days | >1-5 Years | Over 5 Years | Total |
|---|------------------|---------------------|--------------------|------------------|------------------|
| Interest-earning assets: | | | | | |
| Loans | \$ 249,817 | \$ 9,441 | \$ 28,927 | \$ 73,937 | \$ 362,122 |
| Securities | - | 5 | 22,650 | 575 | 23,230 |
| Other (1) | 19,661 | - | - | 3,794 | 23,455 |
| Total interest-earning assets | <u>269,478</u> | <u>9,446</u> | <u>51,577</u> | <u>78,306</u> | <u>408,807</u> |
| Interest-bearing obligations: | | | | | |
| NOW, money market, savings, interest checking | 93,874 | - | - | - | 93,874 |
| Time deposits | 35,749 | 57,653 | 12,624 | 904 | 106,930 |
| Brokered deposits | 71,905 | 56,526 | - | - | 128,431 |
| Borrowings | 20,000 | - | 15,000 | 1,280 | 36,280 |
| Total interest-bearing obligations | <u>221,528</u> | <u>114,179</u> | <u>27,624</u> | <u>2,184</u> | <u>365,515</u> |
| Gap | <u>\$ 47,950</u> | <u>\$ (104,733)</u> | <u>\$ 23,953</u> | <u>\$ 76,122</u> | <u>\$ 43,292</u> |
| Cumulative gap | <u>\$ 47,950</u> | <u>\$ (56,783)</u> | <u>\$ (32,830)</u> | <u>\$ 43,292</u> | |

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at June 30, 2008, the Corporation had a cumulative liability sensitivity gap position of \$56.783 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates increase in the next twelve months, the Corporation has the potential to earn less net interest income. 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, money markets and interest checking accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity.

At December 31, 2007, the Corporation had a cumulative liability sensitivity gap position of \$43.774 million within the one-year time frame.

The borrowings in the gap analysis include \$15 million of the FHLB advances as fixed-rate advances. These advances give the FHLB the option to convert from a fixed-rate advance to an adjustable rate advance with quarterly repricing at three-month LIBOR Flat. The exercise of this conversion feature by the FHLB would impact the repricing dates currently assumed in the analysis.

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.

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

In addition to changes in interest rates, the level of future net interest income is also dependent on a number of variables, including: the growth, composition and levels of loans, deposits, and other earning assets and interest-bearing obligations, and economic and competitive conditions; potential changes in lending, investing, and deposit strategies; customer preferences; and other factors.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation provides foreign exchange services, makes loans to, and accepts deposits from, Canadian customers primarily at its banking offices in Sault Ste. Marie, Michigan. To protect against foreign exchange risk, the Corporation monitors the volume of Canadian deposits it takes in and then invests these Canadian funds in Canadian commercial loans and securities. As of June 30, 2008, the Corporation had excess Canadian assets of \$75,000 (or \$74,000 in U.S. dollars). Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

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

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

IMPACT OF INFLATION AND CHANGING PRICES

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

MACKINAC FINANCIAL CORPORATION
ITEM 4 CONTROLS AND PROCEDURES

An evaluation was performed under the supervision of and with the participation of the Corporation's management, including the Chairman and Chief Executive Officer, and the Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, the Corporation's management, including the Chairman and Chief Executive Officer, have concluded that, as of the end of such period, the Corporation's disclosure controls and procedures were effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be disclosed by the Corporation in the reports that it files or submits under the Exchange Act.

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Corporation's fiscal quarter ended June 30, 2008 that has materially affected, or is 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. The litigation that is not routine and incidental to the business of banking is described below.

Shareholder's Derivative Litigation

Damon Trust v. Bittner, et al.

This matter has been resolved and concluded with the Corporation receiving \$3.475 million in settlement proceeds during the second quarter of 2008.

Damon Trust v. Wipfli

This matter has been resolved and concluded with the Corporation receiving \$470,000 in settlement proceeds during the first quarter of 2007. Please refer to the Annual Report for a more detailed description and explanation of this litigation.

Item 4. Submission of Matters to a Vote of Security Holders

The annual meeting of the Registrant's shareholders was held on May 28, 2008. The purpose of the meeting was to elect directors, as shown below, each for a three-year term expiring in 2011. The number of shares voted is presented in the table below.

| <u>Director</u> | <u>For</u> | <u>Withheld</u> |
|---------------------|------------|-----------------|
| Dennis B. Bittner | 2,455,097 | 38,071 |
| Joseph D. Garea | 2,480,127 | 13,041 |
| Kelly W. George | 2,480,076 | 13,092 |
| L. Brooks Patterson | 2,453,692 | 39,476 |

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 3.1 Articles of Incorporation, as amended, incorporated herein by reference to exhibit 3.1 of the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.

Exhibit 3.2 Amended and Restated Bylaws, incorporated herein by reference to exhibit 3.1 of the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001.

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.

MACKINAC FINANCIAL CORPORATION

SIGNATURES

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

MACKINAC FINANCIAL CORPORATION

(Registrant)

Date: August 14, 2008

By: /s/ Paul D. Tobias

PAUL D. TOBIAS,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
(principal executive officer)

By: /s/ Ernie R. Krueger

ERNIE R. KRUEGER,
EVP / CHIEF FINANCIAL OFFICER
(principal accounting officer)

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: August 14, 2008

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

CERTIFICATION

I, Ernie R. Krueger, 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: August 14, 2008

/s/ Ernie R. Krueger
Ernie R. Krueger
Executive Vice President/
Chief Financial Officer
(principal financial officer)

CERTIFICATION PURSUANT 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 June 30, 2008, (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)
August 14, 2008

CERTIFICATION PURSUANT 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 June 30, 2008, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Ernie R. Krueger, Executive Vice President and Chief Financial 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.

Ernie R. Krueger
Executive Vice President and Chief Financial Officer
(principal financial officer)
August 14, 2008