

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

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 March 31, 2010, 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)

| (Dollars in thousands) | March 31, 2010 (unaudited) | December 31, 2009 | March 31, 2009 (unaudited) |
|---|----------------------------------|----------------------|----------------------------------|
| ASSETS | | | |
| Cash and due from banks | \$ 19,359 | \$ 18,433 | \$ 21,394 |
| Federal funds sold | 36,000 | 27,000 | - |
| Cash and cash equivalents | 55,359 | 45,433 | 21,394 |
| Interest-bearing deposits in other financial institutions | 700 | 678 | 569 |
| Securities available for sale | 36,841 | 46,513 | 51,071 |
| Federal Home Loan Bank stock | 3,794 | 3,794 | 3,794 |
| Loans: | | | |
| Commercial | 296,271 | 305,670 | 295,595 |
| Mortgage | 76,996 | 74,350 | 71,554 |
| Consumer | 4,044 | 4,290 | 3,627 |
| Total Loans | 377,311 | 384,310 | 370,776 |
| Allowance for loan losses | (4,737) | (5,225) | (4,793) |
| Net loans | 372,574 | 379,085 | 365,983 |
| Premises and equipment | 10,060 | 10,165 | 11,134 |
| Other real estate held for sale | 7,723 | 5,804 | 2,199 |
| Other assets | 15,376 | 23,905 | 10,231 |
| TOTAL ASSETS | \$ 502,427 | \$ 515,377 | \$ 466,375 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| LIABILITIES: | | | |
| Deposits: | | | |
| Noninterest bearing deposits | \$ 30,356 | \$ 35,878 | \$ 31,541 |
| NOW, money market, checking | 109,374 | 95,790 | 75,026 |
| Savings | 20,675 | 18,207 | 19,585 |
| CDs <\$100,000 | 75,822 | 59,953 | 70,708 |
| CDs >\$100,000 | 30,173 | 36,385 | 26,886 |
| Brokered | 138,812 | 175,176 | 162,011 |
| Total deposits | 405,212 | 421,389 | 385,757 |
| Borrowings: | | | |
| Federal Home Loan Bank | 35,000 | 35,000 | 35,000 |
| Other | 1,140 | 1,140 | 1,210 |
| Total borrowings | 36,140 | 36,140 | 36,210 |
| Other liabilities | 2,353 | 2,549 | 2,544 |
| Total liabilities | 443,705 | 460,078 | 424,511 |
| Shareholders' equity: | | | |
| Preferred stock - No par value: | | | |
| Authorized 500,000 shares, 11,000 shares issued and outstanding | 10,562 | 10,514 | - |
| Common stock and additional paid in capital - No par value | | | |
| Authorized - 18,000,000 shares | | | |
| Issued and outstanding - 3,419,736 shares | 43,502 | 43,493 | 42,833 |
| Retained earnings (accumulated deficit) | 3,724 | 199 | (1,619) |
| Accumulated other comprehensive income | 934 | 1,093 | 650 |
| Total shareholders' equity | 58,722 | 55,299 | 41,864 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 502,427 | \$ 515,377 | \$ 466,375 |

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 March 31, | |
|---|---|--------------|
| (Dollars in thousands except per share data) | 2010 | 2009 |
| | (Unaudited) | (Unaudited) |
| INTEREST INCOME: | | |
| Interest and fees on loans: | | |
| Taxable | \$ 5,191 | \$ 5,002 |
| Tax-exempt | 52 | 90 |
| Interest on securities: | | |
| Taxable | 397 | 459 |
| Tax-exempt | 7 | 1 |
| Other interest income | 40 | 2 |
| Total interest income | 5,687 | 5,554 |
| INTEREST EXPENSE: | | |
| Deposits | 1,457 | 1,778 |
| Borrowings | 208 | 281 |
| Total interest expense | 1,665 | 2,059 |
| Net interest income | 4,022 | 3,495 |
| Provision for loan losses | 900 | 550 |
| Net interest income after provision for loan losses | 3,122 | 2,945 |
| OTHER INCOME: | | |
| Service fees | 223 | 243 |
| Net security gains | 215 | - |
| Net gains on sale of secondary market loans | 316 | 58 |
| Other | 53 | 90 |
| Total other income | 807 | 391 |
| OTHER EXPENSE: | | |
| Salaries and employee benefits | 1,720 | 1,597 |
| Occupancy | 345 | 378 |
| Furniture and equipment | 194 | 189 |
| Data processing | 189 | 220 |
| Professional service fees | 173 | 153 |
| Loan and deposit | 395 | 136 |
| FDIC insurance assessment | 222 | 125 |
| Telephone | 47 | 43 |
| Advertising | 72 | 78 |
| Other | 272 | 320 |
| Total other expense | 3,629 | 3,239 |
| Income before provision for income taxes | 300 | 97 |
| Provision for (benefit of) income taxes | (3,411) | 7 |
| NET INCOME | 3,711 | 90 |
| Preferred dividend and accretion of discount | 185 | - |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | \$ 3,526 | \$ 90 |
| INCOME PER COMMON SHARE: | | |
| Basic | \$ 1.03 | \$.03 |
| Diluted | \$ 1.03 | \$.03 |

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 | |
|---|--------------------|-----------|
| | March 31, | |
| | 2010 | 2009 |
| Balance, beginning of period | \$ 55,299 | \$ 41,552 |
| Net income for period | 3,711 | 90 |
| Net unrealized gain (loss) on securities available for sale | (159) | 204 |
| Total comprehensive income | 3,552 | 294 |
| Dividend on preferred stock and accretion of discount | (185) | - |
| Stock option compensation | 8 | 18 |
| Accretion of preferred stock discount | 48 | - |
| Balance, end of period | \$ 58,722 | \$ 41,864 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | |
|---|---------------------------|------------------|
| | March 31, | |
| | 2010 | 2009 |
| <u>Cash Flows From Operating Activities:</u> | | |
| Net income | \$ 3,711 | \$ 90 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 396 | 448 |
| Provision for (benefit of) deferred taxes | (3,411) | 7 |
| Provision for loan losses | 900 | 550 |
| (Gain) on sales/calls of securities available for sale | (215) | - |
| Loss on sales of premises, equipment, and other real estate | 20 | 1 |
| Writedown of other real estate | 128 | - |
| Stock option compensation | 8 | 18 |
| Change in other assets | 12,021 | (292) |
| Change in other liabilities | (196) | (28) |
| Net cash provided by operating activities | <u>13,362</u> | <u>794</u> |
| <u>Cash Flows From Investing Activities:</u> | | |
| Net (increase) decrease in loans | 2,704 | (541) |
| Net (increase) decrease in interest-bearing deposits in other financial institutions | (22) | 13 |
| Purchase of securities available for sale | - | (4,683) |
| Proceeds from sales, maturities or calls of securities available for sale | 9,560 | 1,253 |
| Capital expenditures | (156) | (251) |
| Proceeds from sale of premises, equipment, and other real estate | 840 | 37 |
| Net cash provided by (used in) investing activities | <u>12,926</u> | <u>(4,172)</u> |
| <u>Cash Flows From Financing Activities:</u> | | |
| Net increase (decrease) in deposits | (16,177) | 14,660 |
| Dividend on preferred stock and accretion of discount | (185) | - |
| Net increase (decrease) in federal funds purchased | - | - |
| Net increase (decrease) in line of credit | - | - |
| Principal payments on borrowings | - | - |
| Net cash provided by (used in) investing activities | <u>(16,362)</u> | <u>14,660</u> |
| Net increase in cash and cash equivalents | 9,926 | 11,282 |
| Cash and cash equivalents at beginning of period | <u>45,433</u> | <u>10,112</u> |
| Cash and cash equivalents at end of period | <u>\$ 55,359</u> | <u>\$ 21,394</u> |
| <u>Supplemental Cash Flow Information:</u> | | |
| Cash paid during the year for: | | |
| Interest | \$ 1,658 | \$ 2,143 |
| Income taxes | - | 30 |
| <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) | 2,907 | 485 |

See accompanying notes to condensed consolidated financial statements.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements of Mackinac Financial Corporation (the "Corporation") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. 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, 2009.

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 was not changed due to these reclassifications.

Allowance for Loan Losses

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

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

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

Stock Option Plans

The Corporation sponsors three stock option plans. One plan was approved during 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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 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. All three option plans have expired, and therefore no new shares may be granted. 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.

2. RECENT ACCOUNTING DEVELOPMENTS

In June 2009, the FASB issued Statements No. 166, *Accounting for Transfers of Financial Assets*, (ASC 860-10) and No. 167, *Amendments to FASB Interpretation No. 46(R)*, (ASC 810-10). ASC 860-10 will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures.

ASC 810-10 replaces the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with a qualitative approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity (VIE) that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. ASC 860-10 and ASC 810-10 will be effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009, or January 1, 2010, for a calendar year entity. The adoption of this ASC did not have an impact at the date of adoption.

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 three month period. The issuance of shares as a result of the common stock warrants issued under the TARP Capital Purchase Program would not have a dilutive effect on earnings for the three month period in 2010.

The following shows the computation of basic and diluted earnings per share for the three months ended March 31, 2010 and 2009 (dollars in thousands, except per share data):

| | Three Months Ended March 31, | |
|---|------------------------------|-----------|
| | 2010 | 2009 |
| Net income | \$ 3,711 | \$ 90 |
| Preferred stock dividends and accretion of discount | 185 | - |
| Net income available to common shareholders | \$ 3,526 | \$ 90 |
| Weighted average shares outstanding | 3,419,736 | 3,419,736 |
| Effect of dilutive stock options outstanding | - | - |
| Effect of dilutive common stock warrants | - | - |
| Diluted weighted average shares outstanding | 3,419,736 | 3,419,736 |
| Earnings per common share: | | |
| Basic | \$ 1.03 | \$.03 |
| Diluted | \$ 1.03 | \$.03 |

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

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2010, December 31, 2009, and March 31, 2009 are as follows (dollars in thousands):

| | <u>March 31, 2010</u> | | <u>December 31, 2009</u> | | <u>March 31, 2009</u> | |
|--|-----------------------|-----------------------------|--------------------------|-----------------------------|-----------------------|-----------------------------|
| | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> |
| US Agencies - MBS | \$ 34,220 | \$ 35,546 | \$ 43,651 | \$ 45,238 | \$ 44,904 | \$ 45,915 |
| Asset backed - government guaranteed | - | - | - | - | 4,684 | 4,610 |
| Obligations of states and political subdivisions | <u>1,206</u> | <u>1,295</u> | <u>1,207</u> | <u>1,275</u> | <u>498</u> | <u>546</u> |
| Total securities available for sale | <u>\$ 35,426</u> | <u>\$ 36,841</u> | <u>\$ 44,858</u> | <u>\$ 46,513</u> | <u>\$ 50,086</u> | <u>\$ 51,071</u> |

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were \$17.087 million and \$17.989 million respectively at March 31, 2010.

5. LOANS

The composition of loans at March 31, 2010, December 31, 2009, and March 31, 2009 is as follows (dollars in thousands):

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|--|-----------------------|--------------------------|-----------------------|
| Commercial real estate | \$ 198,439 | \$ 208,895 | \$ 191,721 |
| Commercial, financial and agricultural | 69,797 | 72,184 | 77,216 |
| One to four family residential real estate | 70,087 | 67,232 | 65,792 |
| Construction: | | | |
| Commercial | 28,035 | 24,591 | 26,658 |
| Consumer | 6,909 | 7,118 | 5,762 |
| Consumer | <u>4,044</u> | <u>4,290</u> | <u>3,627</u> |
| Total loans | <u>\$ 377,311</u> | <u>\$ 384,310</u> | <u>\$ 370,776</u> |

LOANS – Allowance for loan losses

An analysis of the allowance for loan losses for the three months ended March 31, 2010, the year ended December 31, 2009, and the three months ended March 31, 2009 is as follows (dollars in thousands):

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|--------------------------------|-----------------------|--------------------------|-----------------------|
| Balance at beginning of period | \$ 5,225 | \$ 4,277 | \$ 4,277 |
| Recoveries on loans | 19 | 66 | 39 |
| Loans charged off | (1,407) | (2,818) | (73) |
| Provision for loan losses | <u>900</u> | <u>3,700</u> | <u>550</u> |
| Balance at end of period | <u>\$ 4,737</u> | <u>\$ 5,225</u> | <u>\$ 4,793</u> |

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

5. **LOANS** (Continued)

In the first quarter of 2010, net charge-off activity of \$1.388 million equated to .36% of average loans outstanding compared to net charge-offs of \$34,000, or .01% of average loans, in the first quarter of 2009. In the first quarter of 2010, the Corporation recorded a provision for loan loss in the amount of \$.900 million, 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.

Information regarding impaired loans as of March 31, 2010, December 31, 2009, and March 31, 2009 is as follows (dollars in thousands):

| | March 31, 2010 | December 31, 2009 | March 31, 2009 | Valuation Reserve | | |
|---|-------------------|----------------------|-------------------|-------------------|----------------------|-------------------|
| | | | | March 31, 2010 | December 31, 2009 | March 31, 2009 |
| Balances, at period end | | | | | | |
| Impaired loans with specific valuation reserve | \$ 3,215 | \$ 11,348 | \$ 11,065 | \$ 1,619 | \$ 2,705 | \$ 2,162 |
| Impaired loans with no specific valuation reserve | 6,681 | 3,889 | 1,396 | - | - | - |
| Total impaired loans | <u>\$ 9,896</u> | <u>\$ 15,237</u> | <u>\$ 12,461</u> | <u>\$ 1,619</u> | <u>\$ 2,705</u> | <u>\$ 2,162</u> |
| Impaired loans on nonaccrual basis | \$ 9,027 | \$ 14,368 | \$ 12,461 | \$ 1,619 | \$ 2,705 | \$ 2,162 |
| Impaired loans on accrual basis | 869 | 869 | - | - | - | - |
| Total impaired loans | <u>\$ 9,896</u> | <u>\$ 15,237</u> | <u>\$ 12,461</u> | <u>\$ 1,619</u> | <u>\$ 2,705</u> | <u>\$ 2,162</u> |
| Average investment in impaired loans | \$ 12,497 | \$ 10,449 | \$ 8,323 | | | |
| Interest income recognized during impairment | 6 | 40 | 6 | | | |
| Interest income that would have been recognized on an accrual basis | 150 | 700 | 153 | | | |
| Cash-basis interest income recognized | - | - | 6 | | | |

Additional discussion on impaired loans is presented in the “Management’s Discussion and Analysis” section of this report.

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.

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

5. **LOANS** (Continued)

Activity in such loans is summarized below (dollars in thousands):

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|---|---------------------------|------------------------------|---------------------------|
| Loans outstanding, beginning of period | \$ 8,552 | \$ 6,516 | \$ 6,516 |
| New loans | 1,087 | 2,160 | - |
| Net activity on revolving lines of credit | 1,938 | 1,189 | 356 |
| Repayment | (2,104) | (1,610) | (104) |
| Change in related party interest | - | 297 | - |
| | <u> </u> | <u> </u> | <u> </u> |
| Loans outstanding, end of period | <u>\$ 9,473</u> | <u>\$ 8,552</u> | <u>\$ 6,768</u> |

There were no loans to related parties classified substandard at March 31, 2010, December 31, 2009, and March 31, 2009 respectively. In addition to the outstanding balances above, there were unused commitments of \$.543 million to related parties at March 31, 2010.

6. **BORROWINGS**

Borrowings consist of the following at March 31, 2010, December 31, 2009 and March 31, 2009 (dollars in thousands):

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|--|---------------------------|------------------------------|---------------------------|
| Federal Home Loan Bank fixed rate advances at rates ranging from 4.98% to 5.16% maturing in December 2010 | \$ 15,000 | \$ 15,000 | \$ 15,000 |
| Federal Home Loan Bank variable rate advances at rates ranging of .27% maturing in January and February 2011 | 20,000 | 20,000 | 20,000 |
| Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024 interest payable at 1% | <u>1,140</u> | <u>1,140</u> | <u>1,210</u> |
| | <u>\$ 36,140</u> | <u>\$ 36,140</u> | <u>\$ 36,210</u> |

The Federal Home Loan Bank borrowings are collateralized at March 31, 2010 by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$30.255 million; mortgage related and municipal securities with an amortized cost and estimated fair value of \$16.387 million and \$17.231 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 March 31, 2010.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling \$.266 million originated and held by the Corporation's wholly owned subsidiary, First Rural Relending; an assignment of a demand deposit account in the amount of \$.960 million and guaranteed by the Corporation.

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

7. STOCK OPTION PLANS

A summary of stock option transactions for the three months ended March 31, 2010 and 2009 and the year ended December 31, 2009, is as follows:

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|--|---------------------------|------------------------------|---------------------------|
| Outstanding shares, at beginning of period | 411,057 | 446,237 | 446,237 |
| Granted during the period | - | - | - |
| Expired/forfeited during the period | - | (35,180) | (35,000) |
| Outstanding shares at end of period | <u>411,057</u> | <u>411,057</u> | <u>411,237</u> |
| Weighted average exercise price per share at end of period | <u>\$ 12.03</u> | <u>\$ 12.03</u> | <u>\$ 12.20</u> |
| Shares available for grant, at end of period | <u>-</u> | <u>24,780</u> | <u>24,780</u> |

There were no options granted or exercised in the first quarter of 2010 or 2009. All option plans under which the above outstanding shares were granted have expired; therefore, no further shares can be granted.

Following is a summary of the options outstanding and exercisable at March 31, 2010:

| Exercise Price Range | Number of Shares | | Weighted Average Remaining Contractual Life-Years | Weighted Average Exercise Price |
|-------------------------|------------------|----------------|---|--|
| | Outstanding | Exercisable | | |
| \$9.16 | 12,500 | 5,000 | 5.71 | \$ 9.16 |
| \$9.75 | 257,152 | 120,861 | 4.71 | 9.75 |
| \$10.65 | 57,500 | 11,500 | 6.71 | 10.65 |
| \$11.50 | 40,000 | 8,000 | 5.50 | 11.50 |
| \$12.00 | 40,000 | 8,000 | 5.21 | 12.00 |
| \$156.00-\$240.00 | 3,545 | 3,545 | .98 | 186.75 |
| \$300.00-\$400.00 | 360 | 360 | .04 | 300.00 |
| | <u>411,057</u> | <u>157,266</u> | <u>5.36</u> | <u>\$ 12.03</u> |

8. 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 March 31, 2010, the Corporation evaluated the valuation allowance against the net deferred tax asset which would require future taxable income in order to be utilized and record a \$3.500 million deferred tax benefit related to the utilization of the NOL carryforward. The Corporation, as of March 31, 2010 had a net operating loss and tax credit carryforwards for tax purposes of approximately \$28.0 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 million 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.

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8. 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 \$18.0 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.

9. FAIR VALUE MEASUREMENTS

In June 2009, the FASB issued authoritative guidance to improve the information a reporting entity provides in its financial statements about transfers of financial assets, including the effect of a transfer on an entity’s financial position, financial performance and cash flows and the transferor’s continuing involvement in the transferred assets. The guidance eliminates the concept of a qualifying special-purpose entity and changes the guidance for evaluation for consolidation. This guidance became effective January 1, 2010 and did not have significant impact on the Corporation’s financial position, results of operations or cash flows.

In 2010, the FASB issued authoritative guidance expanding disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. The new guidance further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) disclosures should be provided about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required beginning January 1, 2011. The remaining disclosure requirements and clarifications made by the new guidance became effective on January 1, 2010.

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9. FAIR VALUE MEASUREMENTS (Continued)

The following table presents information for financial instruments at March 31, 2010 and December 31, 2009 (dollars in thousands):

| | March 31, 2010 | | December 31, 2009 | |
|------------------------------------|--------------------|-------------------------|--------------------|-------------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$ 55,359 | \$ 55,359 | \$ 45,433 | \$ 45,433 |
| Interest bearing deposits | 700 | 700 | 678 | 678 |
| Securities available for sale | 36,841 | 36,841 | 46,513 | 46,513 |
| Federal Home Loan Bank stock | 3,794 | 3,794 | 3,794 | 3,794 |
| Net loans | 372,574 | 374,854 | 379,085 | 382,352 |
| Accrued interest receivable | 1,434 | 1,434 | 1,413 | 1,413 |
| Total financial assets | \$ 470,702 | \$ 472,982 | \$ 476,916 | \$ 480,183 |
| Financial liabilities: | | | | |
| Deposits | \$ 405,212 | \$ 405,236 | \$ 421,389 | \$ 421,124 |
| Borrowings | 36,140 | 36,372 | 36,140 | 36,447 |
| Accrued interest payable | 332 | 332 | 325 | 325 |
| Total financial liabilities | \$ 441,684 | \$ 441,940 | \$ 457,854 | \$ 457,896 |

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

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

Securities - Fair values are based on quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

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

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

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

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

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

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9. FAIR VALUE MEASUREMENTS (Continued)

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

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

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

Limitations - The authoritative accounting guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The authoritative accounting guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable outputs. The fair value hierarchy is as follows:

- 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 at the measurement date.
- 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 2 investments consist primarily of obligations of U.S. government sponsored enterprises and agencies, obligations of state and municipal subdivisions, corporate bonds and mortgage backed securities.
- 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.

MACKINAC FINANCIAL CORPORATION
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9. FAIR VALUE MEASUREMENTS (Continued)

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

The following tables present information about the Corporation's assets and liabilities measured at fair value on a recurring basis at March 31, 2010, and the valuation techniques used by the Corporation to determine those fair values (dollars in thousands).

The fair value of all investment securities at December 31, 2009 and March 31, 2010 were based on level 2 inputs. There are no other assets or liabilities measured on a recurring basis at fair value.

The Corporation had no Level 3 assets or liabilities on a recurring basis as of December 31, 2009 or March 31, 2010.

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 at March 31, 2010

| (dollars in thousands) | Balance at March 31, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Losses for Three Months Ended March 31, 2010 |
|-------------------------|------------------------------|---|--|--|--|
| Assets | | | | | |
| Impaired loans | \$ 4,658 | \$ - | \$ - | \$ 4,658 | \$ 86 |
| Other real estate owned | 7,723 | - | - | 7,723 | 149 |
| | | | | | <u>\$ 235</u> |

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2009

| (dollars in thousands) | Balance at December 31, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Losses for Year Ended December 31, 2009 |
|-------------------------|---------------------------------|---|--|--|---|
| Assets | | | | | |
| Impaired loans | \$ 13,621 | \$ - | \$ - | \$ 13,621 | \$ 1,300 |
| Other real estate owned | 5,804 | - | - | 5,804 | 399 |
| | | | | | <u>\$ 1,699</u> |

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

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. 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).

10. SHAREHOLDERS' EQUITY

Participation in the TARP Capital Purchase Program

On April 24, 2009, the Corporation entered into and closed a Letter Agreement, including the Securities Purchase Agreement-Standard Terms (collectively, the "Securities Purchase Agreement"), related to the CPP. Pursuant to the Securities Purchase Agreement, the Corporation issued and sold to the Treasury (i) 11,000 shares of the Corporation's Series A Preferred Shares, and (ii) the Warrant to purchase 379,310 shares of the Corporation's Common Shares, at an exercise price of \$4.35 per share (subject to certain anti-dilution and other adjustments), for an aggregate purchase price of \$11.000 million in cash. The Warrant has a ten-year term.

As a result of the CPP transaction, the Corporation is required to take certain actions, for so long as the Treasury holds any securities acquired from the Corporation pursuant to the CPP (excluding any period in which the Treasury holds only the Warrant to purchase Common Shares of the Corporation) (the "CPP Period"), to ensure that its executive compensation and benefit plans with respect to Senior Executive Officers (as defined in the relevant agreements) comply with Section 111(b) of Emergency Economic Stabilization Act of 2008 ("EESA"), as implemented by any guidance or regulations issued under Section 111(b) of EESA, and not adopt any benefit plans with respect to, or which cover, the Corporation's Senior Executive Officers that do not comply with EESA, as amended by the American Recovery and Reinvestment Act of 2009 (the "ARRA"), which was passed by Congress and signed by the President on February 17, 2009. The applicable executive compensation standards generally remain in effect during the CPP Period and apply to the Corporation's Senior Executive Officers (which for purposes of the ARRA and the CPP agreements, includes the Corporation's Chief Executive Officer, its Chief Financial Officer, and the next three most highly-compensated executive officers, even though the Corporation's senior executive officers consist of a smaller group of executives for purposes of the other compensation disclosures in this proxy statement).

Amounts recorded for Preferred Stock and Warrant Common Stock were estimated based on an allocation of the total proceeds from the issuance on the relative fair values of both instruments. Fair value of the Preferred Stock was determined based on assumptions regarding the discount rate (market rate) on the Preferred Stock (estimated 12%). Fair value of the Warrant Common Stock is based on the value of the underlying Preferred Stock based on an estimate for a three year term. The allocation of the proceeds received resulted in the recording of a discount on the Preferred Stock and a premium on the Warrant Common Stock. The discount on the preferred will be accreted on an effective yield basis over a three-year term. The allocated carrying value of the Preferred Stock and Warrant Common Stock on the date of issuance (based on their relative fair values) was \$10.382 million and \$.618 million, respectively. Cumulative dividends on the Preferred Stock are payable at 5% annum for the first five years and at a rate of 9% per annum thereafter on the liquidation preference of \$1,000 per share. The Company is prohibited from paying any dividend with respect to shares of common stock unless all accrued and unpaid dividends are paid in full on the Preferred Stock for all past dividend periods. The Preferred Stock is non-voting, other than class voting rights on matters that could adversely affect the Preferred Stock. The Preferred Stock may be redeemed at any time with regulatory approval. The Treasury may also transfer the Preferred Stock to a third party at any time. The preferred stock qualifies as Tier 1 Capital for regulatory purposes at the holding company.

The Corporation has the right to redeem the Series A Preferred Shares at any time after consulting with its primary regulator, in which case the executive compensation standards would no longer apply to the Corporation.

This capital may be used to increase the strong capital position of the Bank. The Bank would then use the capital to grow loans. In addition, the capital will allow the Corporation to consider acquisitions of deposit franchisees that would enhance funding mix.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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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.

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):

| | <u>March 31,</u> <u>2010</u> | December 31, 2009 | March 31, 2009 |
|---|---------------------------------|----------------------|-------------------|
| Commitments to extend credit: | | | |
| Variable rate | \$ 26,629 | \$ 24,839 | \$ 34,801 |
| Fixed rate | 9,853 | 6,039 | 9,059 |
| Standby letters of credit - Variable rate | 1,170 | 1,279 | 1,589 |
| Credit card commitments - Fixed rate | <u>2,761</u> | <u>2,714</u> | <u>2,477</u> |
| | <u>\$ 40,413</u> | <u>\$ 34,871</u> | <u>\$ 47,926</u> |

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. See Part II, Item 1, "Legal Proceedings" in this report.

MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank's most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at March 31, 2010 represents \$49.753 million, or 16.79%, compared to \$40.457 million, or 13.69%, of the commercial loan portfolio on March 31, 2009. 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. Additional discussion regarding the concentration of credit risk is presented in the "Management's Discussion and Analysis" section of this report.

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 level and volatility of interest rates which may negatively affect the Corporation’s interest margin;
- 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;
- An increase in the Corporation’s FDIC insurance premiums, or the collection of special assessments by the FDIC.

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, 2009. Throughout this discussion, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

Consolidated net income available to common shareholders for the first quarter of 2010 was \$3.526 million or \$1.03 per share compared to \$.090 million, or \$.03 per share for the first quarter of 2009. Weighted average shares outstanding amounted to 3,419,736 in the first quarter of 2010 and 2009.

Net interest margin in the first quarter of 2010 increased to \$4.022 million, 3.51%, compared to \$3.495 million, or 3.35%, in the first quarter of 2009. The interest margin declined from 3.74% in the fourth quarter of 2009 largely due to the sale of approximately \$40 million of investment securities late in 2009, the proceeds of which will be used to pay off brokered deposit maturities but is currently in overnight funds yielding .25%. During 2009, the Corporation experienced margin improvement from decreased rates on wholesale funding and also benefitted from disciplined loan pricing that included establishing interest rate floors on new and renewing loans. The temporary decline in the net interest margin is due to the decision, late in the 2009 fourth quarter, to deleverage the balance sheet in anticipation of narrowing interest rate spreads. This margin improvement is expected to continue through the year reducing current excess liquidity by funding new loans and payment of maturing brokered deposits.

Noninterest income, at \$.807 million in the first quarter of 2010, increased \$.416 million from the first quarter 2009 level of \$.391 million. The most significant reason for the increase between periods was the increased activity in the sale of loans, which totaled \$.316 million in 2010 versus \$.058 million in the same period in 2009. Noninterest income in the first quarter of 2010 also includes \$.215 million of security gains.

Noninterest expense totaled \$3.629 million in the first quarter of 2010, an increase of \$.390 million, or 12.04%. Increased expenses in the first quarter reflect the added cost of aggressive nonperforming asset remediation, along with an increase in FDIC insurance premiums of \$.097 million. The expenses related to nonperforming assets include increased legal costs and expenses associated with OREO, which contributed to the overall increase in this expense category from \$.136 million in the first quarter of 2009 to \$.395 million in the 2010 first quarter.

Total assets of the Corporation at March 31, 2010 were \$502.427 million, an increase of \$36.052 million, or 7.73% from the \$466.375 million in total assets reported at March 31, 2009 and decreased \$12.950 million, or 2.51%, from total assets of \$515.377 million at year-end 2009.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased \$9.926 million in the first quarter of 2010. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale decreased \$9.672 million, or 20.79%, from December 31, 2009 to March 31, 2010, with the balance on March 31, 2010, totaling \$36.841 million. Securities sold in the 2010 first quarter resulted in a gain of \$.215 million. As of March 31, 2010, investment securities with an estimated fair value of \$17.989 million were pledged.

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

Loans

Through the first quarter of 2010, loan balances decreased by \$6.999 million, or 1.82% from December 31, 2009 balances of \$384.310 million. During the first quarter of 2010, the Bank had total loan production of \$14.953 million. This loan production, however, was significantly offset by normal principal runoff and amortization, \$10.541 million, and large paydowns and refinancing, which totaled \$12.239 million. The reductions included \$3.2 million in SBA loan sales, and the move of \$2.1 million of nonperforming loans to OREO and a reduction of \$4.5 million on another nonperforming loan relationship that was sold. 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.

Following is a summary of the loan portfolio at March 31, 2010, December 31, 2009, and March 31, 2009 (dollars in thousands):

| | <u>March 31, 2010</u> | <u>Percent of Total</u> | December 31, 2009 | Percent of Total | March 31, 2009 | Percent of Total |
|--|---------------------------|-----------------------------|----------------------|---------------------|-------------------|---------------------|
| Commercial real estate | \$ 198,439 | 52.59 % | \$ 208,895 | 54.36 % | \$ 191,721 | 51.71 % |
| Commercial, financial, and agricultural | 69,797 | 18.50 | 72,184 | 18.78 | 77,216 | 20.83 |
| One to four family residential real estate | 70,087 | 18.58 | 67,232 | 17.49 | 65,792 | 17.74 |
| Consumer | 4,044 | 1.07 | 4,290 | 1.12 | 3,627 | .98 |
| Construction | | | | | | |
| Commercial | 28,035 | 7.43 | 24,591 | 6.40 | 26,658 | 7.19 |
| Consumer | 6,909 | 1.83 | 7,118 | 1.85 | 5,762 | 1.55 |
| Total loans | \$ 377,311 | 100.00 % | \$ 384,310 | 100.00 % | \$ 370,776 | 100.00 % |

Following is a table showing the significant industry types in the commercial loan portfolio as of March 31, 2010, December 31, 2009, and March 31, 2009 (dollars in thousands):

| | March 31, 2010 | | | December 31, 2009 | | | March 31, 2009 | | |
|---|-------------------|-----------------|---------------|-------------------|-----------------|---------------|-------------------|-----------------|---------------|
| | Outstanding | Percent of | Percent of | Outstanding | Percent of | Percent of | Outstanding | Percent of | Percent of |
| | Balance | Commercial | Shareholders' | Balance | Commercial | Shareholders' | Balance | Commercial | Shareholders' |
| | | Loans | Equity | | Loans | Equity | | Loans | Equity |
| Real estate - operators of nonres bldgs | \$ 49,753 | 16.79 % | 84.73 % | \$ 48,689 | 15.93 % | 88.05 % | \$ 40,457 | 13.69 % | 96.64 % |
| Hospitality and tourism | 44,820 | 15.13 | 76.33 | 45,315 | 14.82 | 81.95 | 35,224 | 11.91 | 84.14 |
| Commercial construction | 28,035 | 9.46 | 47.74 | 24,591 | 8.04 | 44.47 | 26,658 | 9.02 | 63.68 |
| Real estate agents and managers | 21,529 | 7.27 | 36.66 | 24,242 | 7.93 | 43.84 | 28,012 | 9.48 | 66.91 |
| Other | 152,134 | 51.34 | 284.39 | 162,833 | 53.27 | 294.46 | 165,244 | 55.90 | 394.72 |
| Total Commercial Loans | \$ 296,271 | 100.00 % | | \$ 305,670 | 100.00 % | | \$ 295,595 | 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 March 31, 2010. The current concentration of real estate related loans represents a broad customer base composed of a high percentage of owner occupied developments.

Our residential real estate portfolio predominantly includes one-to-four family adjustable rate mortgages that have repricing terms generally from one to three years, construction loans to individuals and bridge financing loans for qualifying customers. As of March 31, 2010, our residential loan portfolio totaled \$76.996 million, or 20.41% of our total outstanding loans.

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

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 three months ended March 31, 2010 amounted to \$1.388 million, or .36% of average loans outstanding, compared to \$34,000, 0.01% of average loans outstanding, for the same period in 2009. The current reserve balance is representative of the relevant risk inherent within the Corporation's loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity.

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

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> | <u>March 31, 2009</u> |
|---------------------------------------|---------------------------|------------------------------|---------------------------|
| Nonperforming Assets: | | | |
| Nonaccrual loans | \$ 9,027 | \$ 14,368 | \$ 12,461 |
| Loans past due 90 days or more | - | - | - |
| Restructured loans | <u>869</u> | <u>869</u> | <u>592</u> |
| Total nonperforming loans | <u>9,896</u> | <u>15,237</u> | <u>13,053</u> |
| Other real estate owned | <u>7,723</u> | <u>5,804</u> | <u>2,199</u> |
| Total nonperforming assets | <u>\$ 17,619</u> | <u>\$ 21,041</u> | <u>\$ 15,252</u> |
| Nonperforming loans as a % of loans | <u>2.62</u> % | <u>3.96</u> % | <u>3.52</u> % |
| Nonperforming assets as a % of assets | <u>3.51</u> % | <u>4.08</u> % | <u>3.27</u> % |
| Reserve for Loan Losses: | | | |
| At period end | <u>\$ 4,737</u> | <u>\$ 5,225</u> | <u>\$ 4,793</u> |
| As a % average of loans | <u>1.26</u> % | <u>1.36</u> % | <u>1.29</u> % |
| As a % of nonperforming loans | <u>47.87</u> % | <u>34.29</u> % | <u>36.72</u> % |
| As a % of nonaccrual loans | <u>52.48</u> % | <u>36.37</u> % | <u>38.46</u> % |

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

| | At Period End | | |
|--|-----------------------------|---------------------|--------------------|
| | March 31, 2010 | December 31, 2009 | March 31, 2009 |
| | | | |
| Total loans, at period end | \$ 377,311 | \$ 384,310 | \$ 370,776 |
| Average loans for the year | <u>384,640</u> | <u>374,796</u> | <u>370,943</u> |
| Allowance for loan losses | <u>4,737</u> | <u>5,225</u> | <u>4,793</u> |
| Allowance to total loans at period end | <u>1.26</u> % | <u>1.36</u> % | <u>1.29</u> % |
| | For the Period Ended | | |
| | Three Months Ended | Twelve Months Ended | Three Months Ended |
| | March 31, 2010 | December 31, 2009 | March 31, 2009 |
| Net charge-offs during the period | \$ 1,388 | \$ 2,752 | \$ 34 |
| Net charge-offs to average loans | <u>.36</u> % | <u>.73</u> % | <u>.01</u> % |
| Net charge-offs to beginning allowance balance | <u>26.57</u> % | <u>64.34</u> % | <u>.79</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 in 2009 provided findings similar to management on the overall adequacy of the reserve. Management will engage this same consultant for loan review in 2010.

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

Following is the allocation of the allowance for loan losses as of March 31, 2010, December 31, 2009, and March 31, 2009 (dollars in thousands):

| | <u>March 31,</u> <u>2010</u> | <u>December 31,</u> <u>2009</u> | <u>March 31,</u> <u>2009</u> |
|--|---------------------------------|------------------------------------|---------------------------------|
| Commercial, financial, and agricultural loans | \$ 4,168 | \$ 4,805 | \$ 4,315 |
| One to four family residential real estate loans | 27 | 23 | 35 |
| Consumer loans | 4 | 13 | 13 |
| Unallocated and general reserves | <u>538</u> | <u>384</u> | <u>430</u> |
| Totals | <u>\$ 4,737</u> | <u>\$ 5,225</u> | <u>\$ 4,793</u> |

As of March 31, 2010, the allowance for loan losses represented 1.26% 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.

As part of the process of resolving problem credits, the Corporation may acquire ownership of real estate collateral which secured such credits. The Corporation carries this collateral in other real estate 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>March 31, 2010</u> | <u>Year Ended</u> <u>December 31, 2009</u> | <u>Three Months Ended</u> <u>March 31, 2009</u> |
|---|--|---|--|
| Balance at beginning of period | \$ 5,804 | \$ 2,189 | \$ 2,189 |
| Other real estate transferred from loans due to foreclosure | 2,907 | 4,879 | 485 |
| Reclassification of redemption OREO | - | (475) | (475) |
| Other real estate sold/written down | <u>(988)</u> | <u>(789)</u> | <u>-</u> |
| Balance at end of period | <u>\$ 7,723</u> | <u>\$ 5,804</u> | <u>\$ 2,199</u> |

During the first three months of 2010, the Corporation received real estate in lieu of loan payments of \$2.907 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balances and any additional reductions in the fair value result in a write-down of other real estate.

Deposits

Total deposits decreased by \$16.177 million, or 3.84%, in the first quarter of 2010. The overall reduction in deposits for the first quarter of 2010 is comprised of a decrease in noncore deposits of \$42.576 million which was partially offset with increased core deposits of \$26.399 million.

In 2009, a primary objective and accomplishment was core deposit growth. In the first quarter of 2010, this growth of core deposits continued, allowing a reduction in the overall dependency on wholesale deposits. The Corporation has an aggressive 2010 plan for increasing deposits by actively promoting extremely attractive transactional deposit products along with competitive core deposit pricing on our CD products. The Corporation has been quite successful in the growth of core deposits thus far in 2010 and continued deposit growth is expected for the remainder of the year.

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

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

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

| | <u>March 31,</u> <u>2010</u> | <u>% of Total</u> | | <u>December 31,</u> <u>2009</u> | <u>% of Total</u> | | <u>March 31,</u> <u>2009</u> | <u>% of Total</u> |
|------------------------------------|---------------------------------|-------------------|----|------------------------------------|-------------------|----|---------------------------------|-------------------|
| Noninterest bearing | \$ 30,356 | 7.49 % | \$ | 35,878 | 8.51 % | \$ | 31,541 | 8.17 % |
| NOW, money market, checking | 109,374 | 26.99 | | 95,790 | 22.73 | | 75,026 | 19.45 |
| Savings | 20,675 | 5.10 | | 18,207 | 4.32 | | 19,585 | 5.08 |
| Certificates of Deposit <\$100,000 | 75,822 | 18.71 | | 59,953 | 14.23 | | 70,708 | 18.33 |
| Total core deposits | <u>236,227</u> | <u>58.30</u> | | 209,828 | 49.79 | | 196,860 | 51.03 |
| Certificates of Deposit >\$100,000 | 30,173 | 7.45 | | 36,385 | 8.63 | | 26,886 | 6.97 |
| Brokered CDs | 138,812 | 34.26 | | 175,176 | 41.57 | | 162,011 | 42.00 |
| Total non-core deposits | <u>168,985</u> | <u>41.70</u> | | 211,561 | 50.21 | | 188,897 | 48.97 |
| Total deposits | <u>\$ 405,212</u> | <u>100.00 %</u> | \$ | <u>421,389</u> | <u>100.00 %</u> | \$ | <u>385,757</u> | <u>100.00 %</u> |

Borrowings

The Corporation historically used alternative funding sources to provide long-term, stable sources of funds. Current FHLB borrowings total \$35.000 million with stated maturities ranging through February 2011. FHLB 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. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending that has a fixed interest rate of 1% and matures in August 2024.

Shareholders' Equity

Total shareholders' equity increased \$3.423 million from December 31, 2009 to March 31, 2010. The increase is comprised of net income, contributed capital of \$8,000 in recognition of stock option expense a decrease in the market value of securities of \$.159 million and the accretion of the discount on preferred stock of \$48,000. For further discussion on Shareholders' Equity, please refer to the "Capital and Regulatory" section of this report.

RESULTS OF OPERATIONS

Summary

The Corporation reported net income available to common shareholders of \$3.526 million, or \$1.03 per share, in the first quarter of 2010, compared to net income of \$.090 million, or \$.03 per share for the first quarter of 2009. Operating results for the first quarter of 2010 included the recognition of a \$3.500 million deferred tax benefit related to NOL carry-forwards. This deferred tax benefit was recognized in accordance with GAAP accounting which requires the benefit to be recognized when "it is more likely than not" that the NOL will be utilized within the carry-forward period.

In the first quarter of 2010 a provision for loan losses of \$.900 million was booked in comparison to a provision of \$.550 million in the first quarter of 2009. The 2010 first quarter also includes the preferred dividend and accretion of discount of \$.185 million.

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.

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

Net interest margin on a fully taxable equivalent basis increased to \$4.052 million, 3.53 % of average earning assets, in the first quarter of 2010, compared to \$3.542 million, and 3.40% of average earning assets, in the first quarter of 2009. For the three month period in 2010, net interest margin increased to \$4.022 million, 3.51% of average earning assets, compared to \$3.495 million, and 3.35% of average earning assets, for the same period in 2009. Margin improvement in first quarter of 2010 was primarily due to a reduction in funding costs between periods as average interest rates on brokered deposits declined more than rates on earning assets.

The Corporation's commercial loan portfolio, with balances of \$312 million at March 31, 2010, is composed of approximately 63% variable rate and 37% fixed rate pricing. Included in the 63% variable rate loans are approximately \$120 million loan balances with interest rate floors. The established floor on these loan balances will delay the repricing when and if rates increase in future periods. Repricing of approximately \$41 million of these "floor rate" loans will occur with a 100 basis point upward move and another \$60 million will reprice with the second 100 basis point upward move of rates.

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. The amount of interest income on nontaxable securities and loans has been adjusted to a tax equivalent basis, using a 34% tax rate. All average balances are daily average balances.

| (dollars in thousands) | Three Months Ended | | | | | | | | | | | |
|---|--------------------|------------|-------------------------|---------------|--------|-----------|----------|--------------------------------|--------------------|------------------|-----------------------------|--|
| | Average Balances | | | Average Rates | | Interest | | 2010-2009 | | | | |
| | March 31, | | Increase/ (Decrease) | March 31, | | March 31, | | Income/ Expense Variance | Volume Variance | Rate Variance | Rate/ Volume Variance | |
| | 2010 | 2009 | | 2010 | 2009 | 2010 | 2009 | | | | | |
| Loans (1,2,3) | \$ 384,640 | \$ 370,943 | \$ 13,697 | 5.56 % | 5.62 % | \$ 5,270 | \$ 5,138 | \$ 132 | \$ 190 | \$ (56) | \$ (2) | |
| Taxable securities | 37,393 | 47,495 | (10,102) | 4.31 | 3.92 | 397 | 459 | (62) | (98) | 45 | (9) | |
| Nontaxable securities (2) | 844 | 68 | 776 | 4.81 | 11.93 | 10 | 2 | 8 | 23 | (1) | (14) | |
| Federal funds sold | 37,833 | - | 37,833 | 0.25 | - | 23 | - | 23 | - | - | 23 | |
| Other interest-earning assets | 4,470 | 4,367 | 103 | 1.54 | 0.19 | 17 | 2 | 15 | - | 15 | - | |
| Total earning assets | 465,180 | 422,873 | 42,307 | 4.98 | 5.37 | 5,717 | 5,601 | 116 | 115 | 3 | (2) | |
| Reserve for loan losses | (5,073) | (4,405) | (668) | | | | | | | | | |
| Cash and due from banks | 19,772 | 13,345 | 6,427 | | | | | | | | | |
| Intangible assets | - | 35 | (35) | | | | | | | | | |
| Other assets | 28,616 | 22,892 | 5,724 | | | | | | | | | |
| Total assets | \$ 508,495 | \$ 454,740 | \$ 53,755 | | | | | | | | | |
| NOW and money market deposits | \$ 87,700 | \$ 68,252 | \$ 19,448 | 1.04 | 0.78 | 225 | 131 | 94 | 37 | 44 | 13 | |
| Interest checking | 15,475 | 4,354 | 11,121 | 1.73 | 1.96 | 66 | 21 | 45 | 54 | (2) | (7) | |
| Savings deposits | 18,378 | 19,718 | (1,340) | .66 | .82 | 30 | 40 | (10) | (3) | (8) | 1 | |
| CDs <\$100,000 | 66,187 | 71,677 | (5,490) | 2.21 | 3.13 | 361 | 553 | (192) | (42) | (162) | 12 | |
| CDs >\$100,000 | 33,112 | 25,752 | 7,360 | 1.71 | 2.77 | 140 | 176 | (36) | 50 | (67) | (19) | |
| Brokered deposits | 159,501 | 151,955 | 7,546 | 1.61 | 2.29 | 635 | 857 | (222) | 43 | (252) | (13) | |
| Borrowings | 36,140 | 36,648 | (508) | 2.33 | 3.11 | 208 | 281 | (73) | (4) | (70) | 1 | |
| Total interest-bearing liabilities | 416,493 | 378,356 | 38,137 | 1.62 | 2.21 | 1,665 | 2,059 | (394) | 135 | (517) | (12) | |
| Demand deposits | 33,544 | 30,961 | 2,583 | | | | | | | | | |
| Other liabilities | 3,349 | 3,610 | (261) | | | | | | | | | |
| Shareholders' equity | 55,109 | 41,813 | 13,296 | | | | | | | | | |
| Total liabilities and shareholders' equity | \$ 508,495 | \$ 454,740 | \$ 53,755 | | | | | | | | | |
| Rate spread | | | | 3.36 % | 3.16 % | | | | | | | |
| Net interest margin/revenue, tax equivalent basis | | | | 3.53 % | 3.40 % | \$ 4,052 | \$ 3,542 | \$ 510 | \$ (20) | \$ 520 | \$ 10 | |

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
- (2) The amount of interest income on nontaxable securities and loans has been adjusted to a tax equivalent basis, using 34% tax rate.
- (3) Interest income on loans includes loan fees.

Throughout 2009 and the first quarter of 2010 there have been no changes to the prime rate. The Corporation, during this period, repriced all of its brokered deposits along with the majority of its bank time deposits. This repricing of liabilities is the primary reason for the increased interest margin from 3.40% in the first quarter of 2009 to 3.53% in the first quarter of 2010.

During this relatively low interest environment, the Corporation has also repriced a significant portion of its loan portfolio. Management has been diligent when repricing maturing or new loans in establishing interest rate floors in order to maintain our improved interest rate spread.

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

MACKINAC FINANCIAL CORPORATION
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OF OPERATIONS (Continued)

identified levels of risk in the loan portfolio, changes in the mix of loans in the portfolio, loan growth, and other economic factors. During the first three months of 2010, the Corporation recorded a \$.900 million provision for loan loss. During the first three months of 2009, the Corporation recorded a \$.550 million provision for loan loss. In future periods, loan loss provisions may be required if there is further market deterioration that impacts the credit quality on the existing portfolio.

Other Income

Other income increased by \$.416 million for the quarter ended March 31, 2010, compared to the quarter ended March 31, 2009. Revenue due to mortgage loans produced and sold in the secondary market amounted to \$.215 million compared to \$.058 million a year ago. We expect to continue to benefit from secondary market activity in future periods as the refinancing boom continues. The Corporation is also expecting to increase other income from other sources such as fees from the sale of SBA guaranteed loans. Other noninterest income in the first quarter amounted to \$.070 million, a decrease of \$.020 million from the first quarter of 2009.

The following table details noninterest income for the three months ended March 31, 2010, and March 31, 2009 (dollars in thousands):

| | Three Months Ended | | | | |
|---|--------------------|---------------|---------------------|-----------------|--|
| | March 31, | | | | |
| | 2010 | 2009 | Increase/(Decrease) | | |
| | | Dollars | Percent | | |
| Service fees | \$ 223 | \$ 243 | \$ (20) | (8.23) % | |
| Net gains on sale of secondary market loans | 316 | 58 | 258 | 444.83 | |
| Other noninterest income | 53 | 90 | (37) | (41.11) | |
| Subtotal | 592 | 391 | 201 | 51.41 | |
| Net security gain (loss) | 215 | - | 215 | - | |
| Total noninterest income | <u>\$ 807</u> | <u>\$ 391</u> | <u>\$ 416</u> | <u>106.39</u> % | |

Other Expense

Other expense increased by \$.390 million for the quarter ended March 31, 2010, compared to the quarter ended March 31, 2009. The most significant increases in other expenses for the first quarter of 2010 were FDIC insurance premiums and loan and deposit expenses related to nonperforming assets. FDIC insurance premiums increased from \$.125 million in 2009 to \$.222 million in 2010, a 78% increase. These premiums are expected to increase in future periods based upon the need to replenish the deposit insurance fund for charges due to increased bank failures. Loan and deposit expenses increased from \$.136 million in 2009 to \$.395 million in 2010. Management expects that costs associated with carrying nonperforming loans will continue to be above historical norms. Salaries and employee benefits also increased between periods, largely reflective of annual salary increases along with increased incentive pay related to compensation plans in place for 2010 that incent employees for core deposit growth.

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The following table details noninterest expense for the three months ended March 31, 2010 and March 31, 2009 (dollars in thousands):

| | Three Months Ended | | | | |
|--------------------------------|--------------------|-----------------|---------------------|--------------|----------|
| | March 31, | | | | |
| | 2010 | 2009 | Increase/(Decrease) | | |
| | | Dollars | Percent | | |
| Salaries and employee benefits | \$ 1,720 | \$ 1,597 | \$ 123 | 7.70 | % |
| Occupancy | 345 | 378 | (33) | (8.73) | |
| Furniture and equipment | 194 | 189 | 5 | 2.65 | |
| Data processing | 189 | 220 | (31) | (14.09) | |
| Professional service fees | 173 | 153 | 20 | 13.07 | |
| Loan and deposit : | | | | | |
| FDIC insurance premiums | 222 | 125 | 97 | 77.60 | |
| Other loan and deposit | 395 | 136 | 259 | 190.44 | |
| Telephone | 47 | 43 | 4 | 9.30 | |
| Advertising | 72 | 78 | (6) | (7.69) | |
| Other | 272 | 320 | (48) | (15.00) | |
| Total noninterest expense | <u>\$ 3,629</u> | <u>\$ 3,239</u> | <u>\$ 390</u> | <u>12.04</u> | <u>%</u> |

Federal Income Taxes

Current Federal Tax Provision

In the first quarter of 2010, management evaluated the deferred tax benefits associated with the net operating loss and tax credit carryforwards based upon the Corporation's foreseen ability to utilize the benefits of these carryforwards prior to their expiration. As a part of this analysis, management considered, among other things, current asset levels and projected loan and deposit growth, current interest rate spreads and projected net interest income levels, and noninterest income and expense, along with management's ability to control expenses and the potential for increasing contributions of noninterest income. Management also considered the impact of nonperforming assets and future period charge-off activity relative to projected provisions. Based upon the analysis of projected taxable income and the probability of achieving these projected taxable income levels, a portion, \$3.500 million of the remaining deferred tax benefit was recognized. This \$3.500 million deferred tax benefit, along with taxes on current net operating results, income before taxes resulted in a total net benefit in the first quarter of \$3.411 million compared to the \$7,000 tax expense recorded in the first quarter of 2009.

Deferred Tax Benefit – Historical Commentary

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 million, 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, 2010, the Corporation had an NOL carryforward of approximately \$28.0 million along 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 \$18.0 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.

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ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
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LIQUIDITY

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

Current balance sheet liquidity consists of \$19.359 million in cash and due from balances, \$36.000 million in federal funds sold and \$18.852 million of unpledged investment securities. The overall balance sheet liquidity results from the late 2009 and early 2010 sale of approximately \$40 million of investment securities. The Corporation has also experienced significant deposit inflows during the first quarter of 2010. Management anticipates reducing liquidity levels in future periods through payments of maturing brokered deposits and funding loan growth.

During the first three months of 2010, the Corporation increased cash and cash equivalents by \$9.926 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was impacted by cash provided by investing activities, with a net decrease in investment securities of \$9.650 million and a net decrease in loans of \$2.704 million. Offsetting the increases provided by investing activities were uses in financing activities, with a net decrease in deposits of \$16.177 million. The decrease in deposits was composed of a decrease in brokered deposits of \$36.364 million combined with an increase in bank deposits of \$20.187 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 2010, the Corporation will fund anticipated loan production by reducing current balances of liquidity.

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.

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 explains the degree of reliance on non-core liabilities to fund long-term assets. Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under \$100,000. Noncore funding consists of certificates of deposit greater than \$100,000, brokered deposits, and FHLB and Farmers' Home Administration borrowings. At March 31, 2010, the Bank's core deposits in relation to total funding were 53.52% compared to 46.65% at March 31, 2009. These ratios indicated at March 31, 2010, that the Bank has decreased its reliance on noncore deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. The bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of March 31, 2010, the Bank had \$15.875 million of unsecured lines available and another \$7.085 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.

From a long-term perspective, the Corporation's liquidity plan for 2010 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 2010 calls for augmenting local deposit growth efforts with wholesale CD funding, to the extent necessary.

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OF OPERATIONS (Continued)

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 March 31, 2010, the Corporation and Bank were well capitalized. During the first quarter of 2010, total capitalization increased by \$3.423 million.

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

| | <u>March 31,</u> <u>2010</u> | <u>December 31,</u> <u>2009</u> | <u>March 31,</u> <u>2009</u> |
|---|---------------------------------|------------------------------------|---------------------------------|
| Capital Structure | | | |
| Shareholders' equity | \$ 58,722 | \$ 55,299 | \$ 41,864 |
| Total capitalization | <u>\$ 58,722</u> | <u>\$ 55,299</u> | <u>\$ 41,864</u> |
| Tangible capital | <u>\$ 58,722</u> | <u>\$ 55,299</u> | <u>\$ 41,838</u> |
| Intangible Assets | | | |
| Core deposit premium | \$ - | \$ - | \$ 26 |
| Other identifiable intangibles | - | - | - |
| Total intangibles | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 26</u> |
| Regulatory capital | | | |
| Tier 1 capital: | | | |
| Shareholders' equity | \$ 58,722 | \$ 55,299 | \$ 41,864 |
| Net unrealized (gains) losses on available for sale securities | (934) | (1,093) | (650) |
| Less: disallowed deferred tax asset | (8,700) | (4,800) | (6,000) |
| Less: intangibles | - | - | (26) |
| Total Tier 1 capital | <u>\$ 49,088</u> | <u>\$ 49,406</u> | <u>\$ 35,188</u> |
| Tier 2 Capital: | | | |
| Allowable reserve for loan losses | \$ 4,737 | \$ 5,181 | \$ 4,724 |
| Qualifying long-term debt | - | - | - |
| Total Tier 2 capital | <u>4,737</u> | <u>5,181</u> | <u>4,724</u> |
| Total capital | <u>\$ 53,825</u> | <u>\$ 54,587</u> | <u>\$ 39,912</u> |
| Risk-adjusted assets | <u>\$ 393,226</u> | <u>\$ 414,440</u> | <u>\$ 377,861</u> |
| Capital ratios: | | | |
| Tier 1 Capital to average assets | 9.85 % | 9.75 % | 7.86 % |
| Tier 1 Capital to risk weighted assets | 12.48 % | 11.92 % | 9.31 % |
| Total Capital to risk weighted assets | 13.69 % | 13.17 % | 10.56 % |

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:

| | Equity to Period-end Assets | Tangible Equity to Period-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: | | | | | |
| March 31, 2010 | 11.69% | 11.69% | 9.85% | 12.48% | 13.69% |
| March 31, 2009 | 8.98% | 8.97% | 7.86% | 9.31% | 10.56% |
| The Bank: | | | | | |
| March 31, 2010 | 10.34% | 10.34% | 8.43% | 10.67% | 11.86% |
| March 31, 2009 | 9.04% | 9.03% | 7.96% | 9.41% | 10.66% |

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

INTEREST RATE RISK

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

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

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

The Corporation has established interest rate floors on approximately \$120 million, or 38% of its variable rate commercial loans. These interest rate floors will result in a "lag" on the repricing of these variable rate loans when and if interest rates increase in future periods. Approximately \$40 million of the "floor rate" loan balances will reprice with a 100 basis point increase on the prime rate, with another \$60 million repricing in the next 100 basis point prime rate increase.

The Corporation also has \$36.841 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation has \$160 million of transactional accounts, of which \$33 million consists of non interest bearing demand deposit balances. Transaction account balances have increased significantly in the last year due in part to the Corporation's focus on these low costs accounts by developing new attractive products and increased sales efforts to municipalities, schools and businesses. These transactional account balances provide additional repricing flexibility in changing interest rate environments since they have no scheduled maturities and interest rates can be reset at any time.

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

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

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

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

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.

The following is the Corporation's repricing opportunities at March 31, 2010 (dollars in thousands):

| | 1-90 Days | 91 - 365 Days | >1-5 Years | Over 5 Years | Total |
|---|------------------|--------------------|--------------------|------------------|------------------|
| Interest-earning assets: | | | | | |
| Loans | \$ 256,055 | \$ 12,478 | \$ 28,305 | \$ 80,473 | \$ 377,311 |
| Securities | 6 | 10,642 | 25,375 | 818 | 36,841 |
| Other ⁽¹⁾ | 36,700 | - | - | 3,794 | 40,494 |
| Total interest-earning assets | <u>292,761</u> | <u>23,120</u> | <u>53,680</u> | <u>85,085</u> | <u>454,646</u> |
| Interest-bearing obligations: | | | | | |
| NOW, money market, savings, and interest checking | 130,049 | - | - | - | 130,049 |
| Time deposits | 27,261 | 51,174 | 26,932 | 628 | 105,995 |
| Brokered CDs | 27,706 | 47,764 | 60,614 | 2,728 | 138,812 |
| Borrowings | 20,000 | 15,000 | - | 1,140 | 36,140 |
| Total interest-bearing obligations | <u>205,016</u> | <u>113,938</u> | <u>87,546</u> | <u>4,496</u> | <u>410,996</u> |
| Gap | <u>\$ 87,745</u> | <u>\$ (90,818)</u> | <u>\$ (33,866)</u> | <u>\$ 80,589</u> | <u>\$ 43,650</u> |
| Cumulative gap | <u>\$ 87,745</u> | <u>\$ (3,073)</u> | <u>\$ (36,939)</u> | <u>\$ 43,650</u> | |

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at March 31, 2010, the Corporation had a cumulative asset sensitivity gap position of \$3.073 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates continue to decline in the next twelve months, the Corporation has the potential to increase net interest income. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity.

At December 31, 2009, the Corporation had a cumulative liability sensitivity gap position of \$17.977 million within the one-year time frame.

The borrowings in the gap analysis include \$15.000 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.

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

Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. The Corporation's interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. In evaluating the quantitative level of interest rate risk, the Corporation assesses the existing and potential future effects of changes in interest rates on its financial condition, including capital adequacy, earnings, liquidity, and asset quality. In addition to changes in interest rates, the level of future net interest income is also dependent on a number of variables, including: the growth, composition and levels of loans, deposits, and other earning assets and interest-bearing obligations, and economic and competitive conditions; potential changes in lending, investing, and deposit strategies; customer preferences; and other factors.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation provides foreign exchange services, makes loans to, and accepts deposits from, Canadian customers primarily at its banking offices in Sault Ste. Marie, Michigan. To protect against foreign exchange risk, the Corporation monitors the volume of Canadian deposits it takes in and then invests these Canadian funds in Canadian commercial loans and securities. Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

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

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

IMPACT OF INFLATION AND CHANGING PRICES

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

MACKINAC FINANCIAL CORPORATION
ITEM 4. CONTROLS AND PROCEDURES

As of March 31, 2010, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officers, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Our management, which includes our principal executive officer and our principal financial officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints; additionally, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, but collusion of two or more people, or by management override of the controls. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated foals under all potential future conditions. Over time, controls may become inadequate due to changes in conditions; also the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Our principal executive officer and principal accounting officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures, as defined, under Rule 13a-15 of the Securities Exchange Act of 1934 are effective at the reasonable assurance levels as of March 31, 2010.

Item 1. Legal Proceedings

The Corporation and its subsidiaries are subject to routine litigation incidental to the business of banking.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

- | | |
|----------------|---|
| Exhibit 3.1 | Articles of Incorporation and all amendments (most recent amendment filed December 14, 2004) (incorporated by reference to Exhibit 3.1 to the Corporation's Form 10-K filed March 31, 2009) |
| Exhibit 3.2 | Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series A of Mackinac Financial Corporation dated April 21, 2009 (incorporated by reference to Exhibit 3.1 to the Corporation's Form 8-K filed April 24, 2009) |
| Exhibit 3.2(a) | Amended and Restated Bylaws as revised June 27, 2001(incorporated by reference to Exhibit 3.2(a) to the Corporation's Form 10-K filed March 31, 2009) |
| Exhibit 3.2(b) | Amendment to the Amended and Restated Bylaws adopted August 9, 2004(incorporated by reference to Exhibit 3.2(b) to the Corporation's Form 10-K filed March 31, 2009) |
| Exhibit 3.2(c) | Second Amendment to the Amended and Restated Bylaws adopted December 2007 (incorporated by reference to Exhibit 3.2(c) to the Corporation's Form 10-K filed March 31, 2009) |
| Exhibit 3.3 | Amendment to the Amended and Restated Bylaws adopted October 6, 2004 (incorporated by reference to Exhibit 3.3 to the Corporation's Form 10-K filed March 31, 2008) |
| 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: May 14, 2010

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)

MACKINAC FINANCIAL CORPORATION

CERTIFICATION

Exhibit 31.1

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

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present, in all material respects, the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2010

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

MACKINAC FINANCIAL CORPORATION

CERTIFICATION

Exhibit 31.2

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: May 14, 2010

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

Exhibit 32.1

MACKINAC FINANCIAL CORPORATION

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 March 31, 2010, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

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

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

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

Date: May 14, 2010

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 March 31, 2010, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Ernie R. Krueger, Executive Vice President of the Issuer, certify that:

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

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

Date: May 14, 2010