FENTURA FINANCIAL INC
Form 10-Q
August 15, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from to

Commission file number 000-23550

Fentura Financial, Inc.

(Exact name of registrant as specified in its charter)

Michigan	**38-2806518**
(State or other jurisdiction of incorporation or organization)	**(IRS Employee Identification No.)**

175 N Leroy, P.O. Box 725, Fenton, Michigan 48430

(Address of Principal Executive Offices)

(810) 629-2263

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) x Yes ¨ No

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: August 1, 2012

Class Common Stock	Shares Outstanding 2,424,644

Table of Contents

Fentura Financial, Inc.

Index to Form 10-Q

	Page
Part I Financial Information	3
Item 1 Consolidated Financial Statements (Unaudited)	3-32
Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations	33-45
Item 3 Quantitative and Qualitative Disclosures about Market Risk	45-47
Item 4 Controls and Procedures	47
Part II Other Information	48
Item 1 Legal Proceedings	48
Item 1A Risk Factors	48
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds	48
Item 3 Defaults Upon Senior Securities	48
Item 4 Reserved	48
Item 5 Other Information	48
Item 6 Exhibits	48
Signatures	49
Exhibit Index	50

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

FENTURA FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(000s omitted except share and per share data)

	June 30, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$ 16,529	$ 18,634
Securities:		
Securities available for sale	56,846	58,687
Securities held to maturity	2,692	2,963
Total securities	59,538	61,650
Loans held for sale	309	123
Loans:		
Commercial	41,960	33,956
Commercial real estate	111,501	118,984
Residential real estate	28,808	26,829
Consumer	24,511	25,998
Total loans	206,780	205,767
Less: Allowance for loan losses	(7,083)	(8,164)
Net loans	199,697	197,603
Bank owned life insurance	6,006	5,941
Bank premises and equipment	10,330	10,202
Federal Home Loan Bank stock	661	661
Accrued interest receivable	1,005	1,039
Other real estate owned	2,887	1,949
Other assets	909	1,059
Total assets	$ 297,871	$ 298,861
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing	$ 70,830	$ 62,713
Interest bearing	194,396	203,168
Total deposits	265,226	265,881
Federal Home Loan Bank advance	891	923
Subordinated debentures	14,000	14,000
Accrued taxes, interest and other liabilities	3,408	3,397
Total liabilities	283,525	284,201

Stockholders equity		
Common stock no par value, 5,000,000 shares authorized 2,424,644 shares issued and outstanding at June 30, 2012 (2,388,225 at December 31, 2011)	43,270	43,191
Accumulated deficit	(29,149)	(28,554)
Accumulated other comprehensive income	225	23
Total stockholders equity	14,346	14,660
Total liabilities and stockholders equity	$ 297,871	$ 298,861

See accompanying notes to interim consolidated financial statements.

Table of Contents

FENTURA FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(000s omitted except share and per share data)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest income				
Loans, including fees	$ 2,685	$ 2,894	$ 5,442	$ 5,975
Interest and dividends on securities:				
Taxable	334	339	654	618
Tax-exempt	28	39	58	84
Interest on federal funds sold	11	13	19	22
Total interest income	3,058	3,285	6,173	6,699
Interest expense				
Deposits	400	654	896	1,376
Borrowings	133	126	265	252
Total interest expense	533	780	1,161	1,628
Net interest income	2,525	2,505	5,012	5,071
Provision for loan losses	80	730	943	1,525
Net interest income after provision for loan losses	2,445	1,775	4,069	3,546
Non-interest income				
Service charges on deposit accounts	225	290	452	586
Trust and investment services income	293	230	512	518
Gain on sale of mortgage loans	153	31	369	99
Gain on sale of securities	0	0	18	5
Other income and fees	635	638	1,291	1,304
Total non-interest income	1,306	1,189	2,642	2,512
Non-interest expense				
Salaries and employee benefits	1,608	1,623	3,332	3,296
Occupancy	265	276	534	560
Furniture and equipment	274	278	527	570
Loan and collection	171	272	321	433
Advertising and promotional	47	44	77	63
Other operating expenses	1,242	904	2,639	1,913
Total non-interest expense	3,607	3,397	7,430	6,835
Income (loss) from continuing operations before income tax	144	(433)	(719)	(777)
Federal income tax benefit	0	(156)	(124)	(368)
Income (loss) from continuing operations	$ 144	$ (277)	$ (595)	$ (409)
Discontinued operations, net of tax				
Income (loss) from discontinued operations	0	(437)	0	5

Gain from sale of discontinued operations	0	469	0	469
Income from discontinued operations	0	32	0	474
Net income (loss)	$ 144	$ (245)	$ (595)	$ 65
Net income (loss) per share from continuing operations				
Basic and diluted	$ 0.06	$ (0.12)	$ (0.25)	$ (0.18)
Net income per share from discontinued operations				
Basic and diluted	$ 0.00	$ 0.01	$ 0.00	$ 0.21
Net income (loss) per share				
Basic and diluted	$ 0.06	$ (0.11)	$ (0.25)	$ 0.03

See accompanying notes to interim consolidated financial statements.

Table of Contents

FENTURA FINANCIAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

(000s omitted except share and per share data)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Common Stock		
Balance, beginning of period	$ 43,191	$ 43,036
Issuance of shares under		
Director stock purchase plan and dividend reinvestment program (36,419 and 40,286 shares)	79	63
Balance, end of period	43,270	43,099
Accumulated Deficit		
Balance, beginning of period	(28,554)	(27,042)
Net (loss) income	(595)	65
Balance, end of period	(29,149)	(26,977)
Accumulated Other Comprehensive Income		
Balance, beginning of period	23	61
Change in unrealized gain on securities, net of tax	202	228
Balance, end of period	225	289
Total stockholders equity	$ 14,346	$ 16,411

See accompanying notes to interim consolidated financial statements.

Table of Contents

FENTURA FINANCIAL, INC

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(000s omitted)	Six Months Ended June 30, 2012	2011
OPERATING ACTIVITIES:		
Net (loss) income	$ (595)	$ 65
Adjustments to reconcile net (loss) income to cash		
Provided by operating activities:		
Depreciation	329	355
Amortization and accretion	(305)	(141)
Provision for loan losses	943	1,525
Loans originated for sale	(20,546)	(6,377)
Proceeds from the sale of loans	20,729	6,457
Gain on sales of loans	(369)	(99)
Loss (gain) on other real estate owned	28	(4)
Write downs on other real estate owned	12	68
Net gain on sale of securities	(18)	(5)
Net earnings from bank owned life insurance	(65)	(69)
Net increase in interest receivable & other assets	184	417
Net increase in interest payable & other liabilities	11	218
Net change in discontinued operations operating activities	0	10,638
Total Adjustments	933	12,983
Net cash (used in) provided by operating activities	338	13,048
CASH FLOWS FROM INVESTING ACTIVITES:		
Proceeds from maturities of securities - HTM	270	701
Proceeds from maturities of securities AFS	5,733	2,930
Proceeds from calls of securities AFS	5,150	2,000
Proceeds from sales of securities AFS	9,570	2,024
Purchases of securities AFS	(18,086)	(17,714)
Origination of loans, net of principal repayments	5,972	8,428
Proceeds from sale of bank subsidiary	0	711
Acquisition of loans	(10,531)	0
Sales of other real estate owned	544	1,480
Repurchase of FHLB stock	0	79
Acquisition of premises and equipment, net	(457)	(246)
Net change in discontinued operations investing activities	0	92,575
Net cash (used in) provided by investing activities	(1,835)	92,968
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(655)	(7,865)
Net decrease in short term borrowings	(32)	(252)
Net proceeds from stock issuance	79	63
Repayment of FHLB advance	0	(31)
Net change in discontinued operations financing activities	0	(103,942)
Net cash used in financing activities	(608)	(112,027)

Net change in cash and cash equivalents	$	(2,105)	$	(6,011)
Cash and cash equivalents Beginning of period	$	18,634	$	33,492
Cash and cash equivalents Ending of period	$	16,529	$	27,481
Cash paid (received from) for:				
Interest	$	948	$	1,216
Income taxes	$	209	$	(104)
Non-cash Disclosures:				
Transfers from loans to other real estate	$	1,464	$	1,490
Loans provided for sales of other real estate owned	$	58	$	0

See accompanying notes to interim consolidated financial statements.

Table of Contents

FENTURA FINANICIAL, INC

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(000s omitted)	**2012**	**2011**	**2012**	**2011**
Net income (loss)	$ 144	$ (245)	$ (595)	$ 65
Other comprehensive (loss) income, net of tax:				
Reclassification adjustment for net gains included in income	0	0	(18)	(5)
Unrealized holding (losses) gains related to available-for-sale securities arising during period	(9)	413	220	233
Other comprehensive (loss) income, net of tax	(9)	413	202	228
Comprehensive income (loss)	$ 135	$ 168	$ (393)	$ 293

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The interim consolidated financial statements include Fentura Financial, Inc. (the Corporation) and its wholly owned subsidiaries Fentura Holdings LLC (FHLLC) and The State Bank in Fenton (the Bank), Michigan and the other subsidiaries of the Bank. Intercompany transactions and balances are eliminated in consolidation.

As announced at the 2011 Shareholder Meeting, the Corporation had entered into an agreement to sell West Michigan Community Bank to a third-party investor group. The sale closed on January 31, 2011. West Michigan Community Bank is reported as discontinued operations.

Financial statements are presented with discontinued operations sequestered on the balance sheet, statement of operations and statement of cash flows, as applicable. The presentations have been updated for June 30, 2011 to reflect the discontinued operations results to the extent applicable (see Note 8).

During the third quarter of 2011 management decided the Corporation no longer intended to dispose of the residual assets remaining from the sale of West Michigan Community Bank. As a result of the change in intent, amounts and results of operations for the three and six month periods ended June 30, 2011, as well as balance sheet data as of June 30, 2011 were reclassified to reflect this change in intent.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2011.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage- backed securities, where prepayments are anticipated. Gains and losses on sales are based on the amortized cost of the security sold.

Table of Contents

NOTE 1 BASIS OF PRESENTATION (continued)

Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

In determining OTTI management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Consumer loans are typically charged off no later than 120 days past due.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segments and is based on the actual loss history experienced by the Corporation. Rolling eight quarter periods of historical charge off experience is considered when calculating the current required level of the allowance for loan losses. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: commercial, commercial real estate, residential mortgage, installment loans and home equity loans.

A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows

NOTE 1 BASIS OF PRESENTATION (continued)

using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Troubled debt restructurings: Under certain circumstances, the Corporation will provide borrowers relief through loan restructurings and modifications. A loan restructuring constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the borrower s financial difficulties the Corporation grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and are measured for impairment as described above.

Other Real Estate Owned and Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination including the appeals process. For tax positions not meeting the more likely than not test, no tax benefit is recorded. The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

The liability recorded at December 31, 2011 has been settled with the IRS.

Dividend Restrictions: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Banks to the Corporation or by the Corporation to shareholders. The State Bank has been restricted from dividend payments due to the signing of a Consent Order with the Federal Deposit Insurance Corporation (FDIC). The Holding Company has been placed under restrictions by the Federal Reserve regarding the declaration or payment of any dividends and the receipt of dividends from the subsidiary Bank.

Stock Option Plans: Compensation cost is recognized for stock options, restricted stock awards issued to employees, and stock appreciation rights based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options and stock appreciation rights, while the market price of the Corporation s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Table of Contents

NOTE 1 BASIS OF PRESENTATION (continued)

The Nonemployee Director Stock Option Plan provides for granting options to nonemployee directors to purchase the Corporation s common stock. The purchase price of the shares is the fair market value at the date of the grant, and there is a three-year vesting period before options may be exercised. Options to acquire no more than 8,131 shares of stock may be granted under the Plan in any calendar year and options to acquire not more than 73,967 shares in the aggregate may be outstanding at any one time. No options were granted in 2012 or 2011.

The Employee Stock Option Plan grants options to eligible employees to purchase the Corporation s common stock at a purchase price at or above the fair market value of the stock at the date of the grant. Awards granted under this plan are limited to an aggregate of 86,936 shares. The administrator of the plan is a committee of directors. The administrator has the power to determine the number of options to be granted, the exercise price of the options and other terms of the options, subject to consistency with the terms of the Plan.

The following table summarizes stock option activity:

	Number of Options	Weighted Average Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at January 1, 2012	13,786	$ 29.60		
Options forfeited during 2012	(2,670)	23.23		
Options outstanding and exercisable at June 30, 2012	11,116	$ 31.13	1.56	$ 0

	Number of Options	Weighted Average Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at January 1, 2011	18,872	$ 29.32		
Options forfeited during 2011	(5,086)	28.57		
Options outstanding and exercisable at December 31, 2011	13,786	$ 29.60	1.73	$ 0

On February 24, 2011, the Corporation s board of directors granted 25,000 Stock Appreciation Rights (SARs) to five executives. The terms of the Stock Appreciation Rights Agreements (the SAR Agreements) provide that the SARs will be paid in cash on one or two fixed dates, which are determined as certain performance conditions are met. The conditions include the Corporation s wholly owned subsidiary, The State Bank, no longer being subject to terms, conditions and restrictions of the consent order dated December 31, 2009 (the Consent Order) and the Corporation no longer being subject to terms, conditions and restrictions of the agreement between the Corporation and the Federal Reserve Board, which was effective November 4, 2010 (the FRB Agreement). The first payment date under the agreement is the later of February 24, 2014, the date on which the State Bank is no longer subject to the terms, conditions and restrictions of the Consent Order, and the date on which the Corporation is no longer subject to the terms, conditions and restrictions of the FRB Agreement. On the first SAR payment date a participant shall receive an amount equal to the product of the number of stock appreciation rights granted and the excess of the fair market value of one share of the Corporation s common stock over $2.00. If the first SAR payment date does not occur prior to February 24, 2016, then the SARs shall be cancelled without any payment to the participant. If the first SAR payment date occurs prior to February 24, 2016, then the second SAR payment date shall be February 24, 2016. On the second payment date a participant shall receive an amount equal to the number of stock appreciation rights granted and the excess of the fair market value of one share of the Corporation s common stock on the second SAR payment date over the value of one share of the Corporation s common stock on the first SAR payment

10

Table of Contents

NOTE 1 BASIS OF PRESENTATION (continued)

date. If the fair market value of one share of the Corporation s common stock on the second SAR payment date does not exceed the fair market value of one share of the Corporation s common stock on the first SAR payment date, then no payment shall be made to the participant on the second SAR payment date. There were 20,000 SAR s outstanding at June 30, 2012 as a result of this issuance as 5,000 SAR s were forfeited during the first quarter of 2012 as a result of one of the executive s departure.

On March 13, 2012, the Corporation s board of directors granted 10,000 Stock Appreciation Rights to a new executive officer. The terms of this Stock Appreciation Rights Agreement is the same as those previously discussed except that the first and second payment dates are March 12, 2015 and March 13, 2017, respectively.

On May 14, 2012, the Corporation s board of directors granted 5,000 Stock Appreciation Rights to a new executive officer. The terms of this Stock Appreciation Rights Agreement is the same as those previously discussed except that the first and second payment dates are May 14, 2015 and May 14, 2017, respectively. As a result of all issuances, 35,000 SAR s were outstanding at June 30, 2012.

Generally accepted accounting principles require plans settled in cash to be accounted for as liabilities only when the liability is probable and reasonably estimable and to be re-measured at each reporting period. Management has determined that as of June 30, 2012, it is not probable that the performance criteria will be met and as such no liability for the compensatory element of the awards has been recorded in the consolidated financial statements.

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

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

NOTE 2 SECURITIES

Securities are as follows:

(000s omitted) **Available for Sale**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2012				
U.S. Government and federal agency	$ 5,993	$ 25	$ 0	$ 6,018
Mortgage-backed residential	14,820	226	(1)	15,045
Collateralized mortgage obligations-agencies	31,900	421	(63)	32,258
Collateralized mortgage obligations-private label	1,753	0	(239)	1,514
Equity securities	2,155	88	(232)	2,011
	$ 56,621	$ 760	$ (535)	$ 56,846
December 31, 2011				
U.S. Government and federal agency	$ 6,144	$ 23	$ (2)	$ 6,165
Mortgage-backed residential	15,625	312	(15)	15,922
Collateralized mortgage obligations-agencies	31,002	457	(5)	31,454
Collateralized mortgage obligations-private label	3,725	0	(702)	3,023
Equity securities	2,155	100	(132)	2,123
	$ 58,651	$ 892	$ (856)	$ 58,687

Table of Contents

NOTE 2 SECURITIES (continued)

(000s omitted) **Held to Maturity**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2012				
State and municipal	$ 2,692	$ 78	$ 0	$ 2,770
	$ 2,692	$ 78	$ 0	$ 2,770
December 31, 2011				
State and municipal	$ 2,963	$ 90	$ 0	$ 3,053
	$ 2,963	$ 90	$ 0	$ 3,053

Contractual maturities of securities at June 30, 2012 were as follows. Securities not due at a single maturity date, mortgage-backed, collateralized mortgage obligations and equity securities are shown separately.

	Available for Sale		**Held to Maturity**	
(000s omitted)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
U.S. government and federal agency				
Due in one year or less	$ 0	$ 0	$ 405	$ 410
Due from one to five years	0	0	1,431	1,455
Due from five to ten years	3,000	3,019	856	905
Due after ten years	2,993	2,999	0	0
Mortgage backed residential	14,820	15,045	0	0
Collateralized mortgage obligations-agencies	31,900	32,258	0	0
Collateralized mortgage obligations-private label	1,753	1,514	0	0
Equity securities	2,155	2,011	0	0
	$ 56,621	$ 56,846	$ 2,692	$ 2,770

At June 30, 2012, one holding totaling $1,753,000 in a security issued by Bear Stearns exceeded 10% of stockholders equity. At December 31, 2011, two holdings totaling $3,023,000 in securities issued by Wells Fargo and Bear Stearns exceeded 10% of stockholders equity. The Corporation sold the Wells Fargo security during the first quarter of 2012.

Sales of available for sale securities, for the six month periods, were as follows:

(000s omitted)	June 30, 2012	June 30, 2011
Proceeds	$ 9,570	$ 2,024
Gross gains	196	5
Gross losses	(178)	0

The cost basis used to determine the unrealized gains or losses of securities sold was the amortized cost of the individual investment security as of the trade date.

Table of Contents

NOTE 2 SECURITIES (continued)

Securities with unrealized losses are aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position is as follows:

June 30, 2012 (000s omitted)	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
Description of Securities						
Mortgage-backed residential	$ 1,543	$ (1)	$ 0	$ 0	$ 1,543	$ (1)
Collateralized mortgage obligations-agencies	10,523	(56)	1,536	(7)	12,059	(63)
Collateralized mortgage obligations-private label	0	0	1,514	(239)	1,514	(239)
Equity securities	0	0	682	(232)	682	(232)
Total temporarily impaired	$ 12,066	$ (57)	$ 3,732	$ (478)	$ 15,798	$ (535)

December 31, 2011 (000s omitted)	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
Description of Securities						
US government and federal agencies	$ 0	$ 0	$ 1,498	$ (2)	$ 1,498	$ (2)
Mortgage-backed residential	6,766	(15)	0	0	6,766	(15)
Collateralized mortgage obligations-agencies	0	0	4,985	(5)	4,985	(5)
Collateralized mortgage obligations-private label	0	0	3,023	(702)	3,023	(702)
Equity securities	771	(128)	1	(4)	772	(132)
Total temporarily impaired	$ 7,537	$ (143)	$ 9,507	$ (713)	$ 17,044	$ (856)

As of June 30, 2012, the Corporation s security portfolio consisted of 84 securities, 13 of which were in an unrealized loss position. The majority of unrealized losses are related to the Corporation s collateralized mortgage obligations (CMOs) and equity securities, as discussed below.

Collateralized Mortgage Obligations

The decline in fair value of the Corporation s private label collateralized mortgage obligation is primarily attributable to the lack of liquidity and the financial crisis affecting these markets and not necessarily the expected cash flows of the individual security. The Standard and Poors rating held on the private label security is A-. The underlying collateral of this CMO is comprised largely of 1-4 family residences. In this security, the Corporation holds the senior tranche and receives payments before other tranches. For the private label security, management completes an analysis to review the recent performance of the mortgage pools underlying the instruments. At June 30, 2012, the private label security has an amortized cost of $1,753,000 and an unrealized loss of $239,000.

The Corporation has been closely monitoring the performance of the CMO and MBS portfolios. Management evaluates items such as payment streams and underlying default rates, and did not recognize a material adverse change in these items. On a quarterly basis, management uses multiple assumptions to project the expected future cash flows of the private label CMO with prepayment speeds, projected default rates and loss severity rates. The cash flows are then discounted using the effective rate on the securities determined at acquisition. Recent historical experience is the base for determining the cash flow assumptions and is adjusted when appropriate after considering characteristics of the underlying loans collateralizing the private label CMO security.

The Corporation has three agency collateralized mortgage obligations with an unrealized loss of $63,000. The decline in value is primarily due to changes in interest rates and other market conditions.

NOTE 2 SECURITIES (continued)

Equity securities

The Corporation s equity investments with unrealized losses are investments in three non-public bank holding companies in Michigan. These securities receive a multi-faceted review utilizing call report data. Management reviews such performance indicators as earnings, ROE, ROA, non-performing assets, brokered deposits and capital ratios. Management draws conclusions from this information, as well as any published information or trading activity received from the individual institutions, to assist in determining if any unrealized loss is other than temporary impairment.

Additionally management considers the length of time the investments have been at an unrealized loss. At the end of the second quarter, management performed its review and determined that no additional other-than-temporary impairment was necessary on the equity securities in the portfolio.

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In evaluating OTTI, management considers the factors presented in Note 1.

NOTE 3 LOANS AND ALLOWANCE FOR LOAN LOSSES

Major categories of loans are as follows:

(000s omitted)	June 30, 2012	December 31, 2011
Commercial	$ 41,960	$ 33,956
Commercial real estate	111,501	118,984
Residential real estate	28,808	26,829
Consumer	24,511	25,998
Total loans	206,780	205,767
Less allowance for loan losses	(7,083)	(8,164)
Net loans	$ 199,697	$ 197,603

The Corporation originates primarily residential and commercial real estate loans, commercial and installment loans. The Corporation estimates that the majority of their loan portfolio is based in Genesee, Oakland and Livingston counties within southeast Michigan with the remainder of the portfolio distributed throughout Michigan. The ability of the Corporation s debtors to honor their contracts is dependent upon the real estate and general economic conditions in these areas.

Activity in the allowance for loan losses, by classification, for the three month periods ended June 30, 2012 and 2011 are as follows:

(000s omitted)	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses							
Balance April 1, 2012	$ 534	$ 6,176	$ 491	$ 175	$ 295	$ 4	$ 7,675
Provision for loan losses	16	(173)	90	(20)	130	37	80
Loans charged off	0	(555)	(149)	(8)	(43)	0	(755)

Loan recoveries	17	49	1	4	12	0	83
Balance June 30, 2012	$ 567	$ 5,497	$ 433	$ 151	$ 394	$ 41	$ 7,083

Table of Contents

NOTE 3 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

(000s omitted)	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses							
Balance April 1, 2011	$ 717	$ 7,136	$ 397	$ 190	$ 573	$ 2	$ 9,015
Provision for loan losses	452	(171)	(10)	39	61	359	730
Loans charged off	(134)	(752)	0	(4)	(21)	0	(911)
Loan recoveries	14	71	1	6	2	0	94
Balance June 30, 2011	$ 1,049	$ 6,284	$ 388	$ 231	$ 615	$ 361	$ 8,928

Activity in the allowance for loan losses, by classification, for the six month periods ended June 30, 2012 and 2011 are as follows:

(000s omitted)	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses							
Balance January 1, 2012	$ 891	$ 5,759	$ 476	$ 215	$ 482	$ 341	$ 8,164
Provision for loan losses	197	895	164	(57)	44	(300)	943
Loans charged off	(551)	(1,235)	(209)	(18)	(148)	0	(2,161)
Loan recoveries	30	78	2	11	16	0	137
Balance June 30, 2012	$ 567	$ 5,497	$ 433	$ 151	$ 394	$ 41	$ 7,083

(000s omitted)	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses							
Balance January 1, 2011	$ 871	$ 9,155	$ 411	$ 233	$ 508	$ 46	$ 11,224
Provision for loan losses	293	699	(13)	43	188	315	1,525
Loans charged off	(136)	(3,766)	(11)	(57)	(98)	0	(4,068)
Loan recoveries	21	196	1	12	17	0	247
Balance June 30, 2011	$ 1,049	$ 6,284	$ 388	$ 231	$ 615	$ 361	$ 8,928

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method at:

(000s omitted) June 30, 2012	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							

Individually evaluated for impairment	$ 207	$ 2,554	$ 185	$ 48	$ 221	$ 0	$ 3,215
Collectively evaluated for impairment	360	2,943	248	103	173	41	3,868
Total ending allowance balance	$ 567	$ 5,497	$ 433	$ 151	$ 394	$ 41	$ 7,083
Loans:							
Loans individually evaluated for impairment	$ 1,470	22,960	$ 778	$ 93	$ 616	$ 0	$ 25,917
Loans collectively evaluated for impairment	40,490	88,541	28,030	5,464	18,338	0	180,863
Total ending loans balance	41,960	111,501	28,808	5,557	18,954	0	206,780
Accrued interest receivable	335	141	89	34	55	0	654
Total recorded investment in loans	$ 42,295	$ 111,642	$ 28,897	$ 5,591	$ 19,009	$ 0	$ 207,434

Table of Contents

NOTE 3 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

(000s omitted) December 31, 2011	Commercial	Commercial Real Estate	Residential Real Estate	Installment Loans	Home Equity	Unallocated	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 714	$ 2,907	$ 201	$ 60	$ 275	$ 0	$ 4,157
Collectively evaluated for impairment	177	2,852	275	155	207	341	4,007
Total ending allowance balance	$ 891	$ 5,759	$ 476	$ 215	$ 482	$ 341	$ 8,164
Loans:							
Loans individually evaluated for impairment	$ 3,823	$ 24,797	$ 844	$ 133	$ 494	$ 0	$ 30,091
Loans collectively evaluated for impairment	30,133	94,187	25,985	6,270	19,101	0	175,676
Total ending loans balance	$ 33,956	$ 118,984	$ 26,829	$ 6,403	$ 19,595	$ 0	