

FENTURA FINANCIAL INC  
Form 10-Q  
November 15, 2011  
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**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 September 30, 2011

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)

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**Michigan**  
(State or other jurisdiction of  
incorporation or organization)

**38-2806518**  
(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.  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.)  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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: October 31, 2011

Class	Common Stock	Shares Outstanding
		2,367,257

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**Fentura Financial, Inc.**

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****FENTURA FINANCIAL, INC.****CONSOLIDATED BALANCE SHEETS**

(000s omitted except share data)

	September 30, 2011	December 31, 2010
<b>ASSETS</b>		
Cash and due from banks	\$ 17,168	\$ 11,592
Federal funds sold	5,000	21,900
Total cash and cash equivalents	22,168	33,492
Securities available for sale	63,904	41,875
Securities held to maturity	3,423	4,350
Total securities	67,327	46,225
Loans held for sale	489	850
Loans:		
Commercial	52,706	44,057
Real estate loans commercial	103,394	125,672
Real estate loans residential	22,953	19,249
Consumer loans	26,437	29,153
Total loans	205,490	218,131
Less: Allowance for loan losses	(9,119)	(11,224)
Net loans	196,371	206,907
Bank owned life insurance	5,906	5,800
Bank premises and equipment	10,304	10,335
Federal Home Loan Bank stock	661	740
Accrued interest receivable	1,014	1,050
Other real estate owned	1,966	3,407
Assets of discontinued operations	0	113,314
Other assets	895	2,108
Total assets	\$ 307,101	\$ 424,228
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing	\$ 65,950	\$ 55,044
Interest bearing	206,315	220,933
Total deposits	272,265	275,977
Short term borrowings	647	879
Federal Home Loan Bank advances	923	954
Subordinated debentures	14,000	14,000
Liabilities of discontinued operations	0	113,321
Accrued taxes, interest and other liabilities	3,589	3,042

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Total liabilities	291,424	408,173
Shareholders' equity		
Common stock - no par value, 5,000,000 shares authorized, 2,367,257 shares outstanding at September 30, 2011 (2,308,765 at December 31, 2010)	43,146	43,036
Retained deficit	(27,677)	(27,042)
Accumulated other comprehensive income	208	61
Total shareholders' equity	15,677	16,055
Total liabilities and shareholders' equity	\$ 307,101	\$ 424,228

See accompanying notes to consolidated financial statements.

**Table of Contents****FENTURA FINANCIAL, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(000s omitted except share data)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Interest income				
Loans, including fees	\$ 2,890	\$ 3,623	\$ 8,804	\$ 11,173
Interest and dividends on securities:				
Taxable	388	224	1,006	668
Tax-exempt	35	46	119	250
Interest on federal funds sold	8	9	30	19
<b>Total interest income</b>	<b>3,321</b>	<b>3,902</b>	<b>9,959</b>	<b>12,110</b>
Interest expense				
Deposits	570	985	1,946	3,176
Borrowings	126	135	378	388
<b>Total interest expense</b>	<b>696</b>	<b>1,120</b>	<b>2,324</b>	<b>3,564</b>
<b>Net interest income</b>	<b>2,625</b>	<b>2,782</b>	<b>7,635</b>	<b>8,546</b>
Provision for loan losses	1,017	2,796	2,542	7,435
<b>Net interest income after provision for loan losses</b>	<b>1,608</b>	<b>(14)</b>	<b>5,093</b>	<b>1,111</b>
Non-interest income				
Service charges on deposit accounts	294	341	880	1,125
Trust and investment services income	224	192	742	655
Gain on sale of mortgage loans	96	214	195	418
Gain on sale of fixed assets	349	0	349	0
Gain on sale of securities	0	0	5	71
Other than temporary loss	0	(307)	0	(307)
Other income and fees	577	498	1,625	1,427
<b>Total non-interest income</b>	<b>1,540</b>	<b>938</b>	<b>3,796</b>	<b>3,389</b>
Non-interest expense				
Salaries and employee benefits	1,789	1,573	5,085	4,787
Occupancy	289	309	849	941
Furniture and equipment	237	340	807	968
Loan and collection	393	391	990	1,096
Advertising and promotional	36	22	99	89
Other operating expenses	959	767	2,466	2,236
<b>Total non-interest expense</b>	<b>3,703</b>	<b>3,402</b>	<b>10,296</b>	<b>10,117</b>
<b>Loss from continuing operations before income tax</b>	<b>(555)</b>	<b>(2,478)</b>	<b>(1,407)</b>	<b>(5,617)</b>
Federal income tax expense (benefit)	145	(235)	(300)	(128)
<b>Net loss from continuing operations</b>	<b>\$ (700)</b>	<b>\$ (2,243)</b>	<b>\$ (1,107)</b>	<b>\$ (5,489)</b>
Discontinued operations, net of tax				
Net loss from discontinued operations	0	(94)	3	(111)
Gain from sale of discontinued operations	0	0	469	0

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Net (loss) income from discontinued operations	0	(94)	472	(111)
Net loss	\$ (700)	\$ (2,337)	\$ (635)	\$ (5,600)
Net loss per share from continuing operations				
Basic and diluted	\$ (0.30)	\$ (0.98)	\$ (0.48)	\$ (2.42)
Net (loss) income per share from discontinued operations				
Basic and diluted	\$ 0.00	\$ (0.05)	\$ 0.21	\$ 0.05
Net loss per share				
Basic and diluted	\$ (0.30)	\$ (1.03)	\$ (0.27)	\$ (2.47)
Cash Dividends declared	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

**See accompanying notes to consolidated financial statements.**

**Table of Contents****FENTURA FINANCIAL, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)**

	Nine Months Ended September 30,	
	2011	2010
<b>(000s omitted except share data)</b>		
<b>Common Stock</b>		
Balance, beginning of period	\$ 43,036	\$ 42,913
Issuance of shares under Director stock purchase plan and dividend reinvestment program (58,492 and 41,359 shares)	110	89
Balance, end of period	43,146	43,002
<b>Retained Deficit</b>		
Balance, beginning of period	(27,042)	(21,657)
Net loss	(635)	(5,600)
Balance, end of period	(27,677)	(27,257)
<b>Accumulated Other Comprehensive Income (Loss)</b>		
Balance, beginning of period	61	(724)
Change in unrealized gain (loss) on securities, net of tax	147	1,051
Balance, end of period	208	327
Total shareholders equity	\$ 15,677	\$ 16,072

**See accompanying notes to consolidated financial statements.**



**Table of Contents****FENTURA FINANCIAL, INC****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(000s omitted)	Nine Months Ended September 30,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (635)	\$ (5,600)
Adjustments to reconcile net income (loss) to cash		
Provided by Operating Activities:		
Depreciation, amortization and accretion	293	1,031
Provision for loan losses	2,542	7,435
Loans originated for sale	(12,133)	(26,099)
Proceeds from the sale of loans	12,689	24,869
Gain on sales of loans	(195)	(418)
(Gain) loss on other real estate owned	(30)	50
Write downs on other real estate owned	520	142
Gain on sale of fixed assets	(349)	0
Gain on sale of securities	(5)	(71)
(Gain)/loss on security impairment	0	307
Earnings from bank owned life insurance	(106)	(114)
Net (increase) decrease in interest receivable & other assets	1,173	6,529
Net increase (decrease) in interest payable & other liabilities	547	(242)
Net change in discontinued operations operating activities	9,995	6,379
<b>Net cash provided by operating activities</b>	<b>14,306</b>	<b>14,198</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities of securities HTM	925	225
Proceeds from maturities of securities AFS	4,784	9,420
Proceeds from calls of securities HTM	0	751
Proceeds from calls of securities AFS	4,000	1,500
Proceeds from sales of securities AFS	2,024	6,765
Purchases of securities AFS	(32,380)	(20,472)
Proceeds from sale of bank subsidiary	711	0
Origination of loans, net of principal repayments	6,172	18,106
Repurchase of FHLB Stock	79	0
Proceeds from bank owned life insurance	0	297
Sales of other real estate owned	2,773	1,924
Acquisition of premises and equipment, net	(140)	(589)
Net change in discontinued operations investing activities	93,229	46,496
<b>Net cash provided by investing activities</b>	<b>82,177</b>	<b>64,423</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net decrease in deposits	(3,712)	(17,505)
Net decrease in short term borrowings	(232)	(48)
Repayments of Federal Home Loan Bank advances	(31)	(27)
Net proceeds from stock issuance and purchase	110	89
Net change in discontinued operations financing activities	(103,942)	(49,016)
<b>Net cash used in financing activities</b>	<b>(107,807)</b>	<b>(66,507)</b>
Net change in cash and cash equivalents	\$ (11,324)	\$ 12,114
Cash and cash equivalents Beginning	\$ 33,492	\$ 31,460

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Cash and cash equivalents	Ending	\$ 22,168	\$ 43,754
Less cash and cash equivalents of discontinued operations		0	10,733
Cash and cash equivalents of continuing operations		\$ 22,168	\$ 33,021

**See accompanying notes to consolidated financial statements.**

**Table of Contents****FENTURA FINANCIAL, INC****CONSOLIDATED STATEMENT OF CASH FLOWS CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(000s omitted)	Nine Months Ended September 30,	
	2011	2010
Cash paid for:		
Interest	\$ 2,024	\$ 3,241
Income taxes	\$ 232	\$ 0
Non-cash disclosures:		
Transfers from loans to other real estate	\$ 1,822	\$ 1,693

**FENTURA FINANCIAL, INC****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

(000s omitted)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	\$ (700)	\$ (2,337)	\$ (635)	\$ (5,600)
Other comprehensive income (loss), net of tax:				
Reclassification adjustment for investment gains included in income	0	0	5	82
Unrealized holding (losses) gains related to available-for-sale securities arising during period	(123)	1,101	218	1,817
Impairment loss recognized during period	0	(307)	0	(307)
Tax effect	42	(308)	(76)	(541)
Other comprehensive (loss) income	(81)	486	147	1,051
Comprehensive loss	\$ (781)	\$ (1,851)	\$ (488)	\$ (4,549)

**FENTURA FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****NOTE 1 BASIS OF PRESENTATION**

The consolidated financial statements include Fentura Financial, Inc. (the Corporation) and its wholly owned subsidiaries Fentura Holdings LLC ( FHLCC ) and The State Bank ( the Bank ) in Fenton, Michigan; and reported as discontinued operations, Davison State Bank in Davison, Michigan and West Michigan Community Bank in Hudsonville, Michigan and the other subsidiaries of the Banks. Intercompany transactions and balances are eliminated in consolidation.

In 2009, the Corporation entered into an agreement to sell one of its bank subsidiaries, Davison State Bank, to a private, nonaffiliated investor group. This sale closed on April 30, 2010. Additionally, the Corporation entered into an agreement to sell West Michigan Community Bank to a third-party investor group. This sale closed on January 31, 2011. Both subsidiaries are reported as discontinued operations. See Note 9 for further discussion.

Financial statements are presented with discontinued operations sequestered on the balance sheet, income statement and statement of cash flows. The presentations have been updated for September 30, 2011, December 31, 2010 and September 30, 2010 to reflect the discontinued operations results.



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**NOTE 1 BASIS OF PRESENTATION (continued)**

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 nine month periods ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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, 2010.

**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.

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 it is or more likely than not it 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.

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**NOTE 1 BASIS OF PRESENTATION (continued)**

Loan losses are charged against the allowance when management believes the uncollectibility 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 over the most recent three years. 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 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: Loans for which the terms have been modified and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and are classified as impaired. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loans effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral less costs to sell.

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. 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. There was no such interest or penalties in 2011 or 2010.

**Table of Contents****NOTE 1 BASIS OF PRESENTATION** (continued)

**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 its subsidiary Bank.

**Stock Option Plans:** Compensation cost is recognized for stock options and restricted stock awards issued to employees, 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, 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.

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 2011 or 2010.

The Employee Stock Option Plan grants options to eligible employees to purchase the Corporation's common stock 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
Options outstanding and exercisable at January 1, 2011	18,872	\$ 29.32
Options forfeited in 2011	4,965	\$ 28.57
Options outstanding and exercisable at September 30, 2011	13,907	\$ 29.59

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 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. 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 September 30, 2011, 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 interim consolidated financial statements.





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**NOTE 1 BASIS OF PRESENTATION (continued)**

**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 (commercial and retail banking).

**Reclassifications:** Some items in the prior year financial statements were reclassified to conform to the current presentation. During the period, management decided the Corporation no longer intends 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 periods ended September 30, 2011 and 2010, as well as balance sheet data as of December 31, 2010 have been reclassified to reflect this change in intent. Assets reported as discontinued operations as of December 31, 2010 were reduced by \$9,654,000. Results of operations of discontinued operations for the nine month periods ended September 30, 2011 and 2010 were reduced by \$123,000 and \$1,465,000 respectively and classified as continuing operations. Results of operations from discontinued operations for the three month period ended September 30, 2010 was reduced by \$185,000 and classified as continuing operations.

**NOTE 2 ACCOUNTING STANDARDS UPDATES**

*ASU No. 2010-20, Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.* ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 became effective for the Corporation's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period became effective for the Corporation's financial statements beginning on January 1, 2011. ASU 2011-01, *Receivables (Topic 310) Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings* in Update No. 2010-20, temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of the then proposed ASU 2011-02, *Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, which is further discussed below.

**Table of Contents****NOTE 2 ACCOUNTING STANDARDS UPDATES (continued)**

*ASU No. 2011-02, Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring.* ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 became effective for the Corporation on July 1, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. This accounting change increased the volume of loans that the Corporation classified as troubled debt restructurings during the period ended September 30, 2011 and required additional disclosures (See Note 4 Loans and Allowance for Loan Losses).

*ASU 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs.* ASU 2011-04 amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principals and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principals in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements.

*ASU 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income.* ASU 2011-05 amends Topic 220, Comprehensive Income, to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate by consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. ASU 2011-05 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements.

**NOTE 3 SECURITIES**

Securities are as follows:

(000s omitted)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for Sale</b>				
<b>September 30, 2011</b>				
U.S. Government and federal agency	\$ 8,143	\$ 35	\$ 0	\$ 8,178
Mortgage-backed residential	16,959	313	(43)	17,229
Collateralized mortgage obligations-agencies	32,531	579	(6)	33,104
Collateralized mortgage obligations-private label	3,797	0	(564)	3,233
Equity securities	2,155	112	(107)	2,160
	\$ 63,585	\$ 1,039	\$ (720)	\$ 63,904
<b>December 31, 2010</b>				
U.S. Government and federal agency	\$ 4,005	\$ 6	\$ (11)	\$ 4,000
Mortgage-backed residential	7,342	126	(36)	7,432
Collateralized mortgage obligations-agencies	24,758	258	(114)	24,902
Collateralized mortgage obligations-private label	4,215	0	(344)	3,871
Equity securities	1,655	49	(34)	1,670
	\$ 41,975	\$ 439	\$ (539)	\$ 41,875



**Table of Contents****NOTE 3 SECURITIES** (continued)

(000s omitted)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Held to Maturity</b>				
September 30, 2011				
State and municipal	\$ 3,423	\$ 83	\$ 0	\$ 3,506
	\$ 3,423	\$ 83	\$ 0	\$ 3,506
December 31, 2010				
State and municipal	\$ 4,350	\$ 41	\$ (8)	\$ 4,383
	\$ 4,350	\$ 41	\$ (8)	\$ 4,383

Contractual maturities of securities at September 30, 2011 were as follows. Securities not due at a single maturity date, mortgage-backed, collateralized mortgage obligations and equity securities are shown separately.

(000s omitted)	Available for Sale	
	Amortized Cost	Fair Value
U.S. Government and federal agency		
Due from one to five years	\$ 2,000	\$ 2,000
Due from five to ten years	6,143	6,178
Mortgage-backed residential	16,959	17,229
Collateralized mortgage obligations-agencies	32,531	33,104
Collateralized mortgage obligations-private label	3,797	3,233
Equity securities	2,155	2,160
	\$ 63,585	\$ 63,904

(000s omitted)	Held to Maturity	
	Amortized Cost	Fair Value
Due in one year or less	\$ 490	\$ 493
Due from one to five years	1,552	1,582
Due from five to ten years	1,381	1,431
	\$ 3,423	\$ 3,506

At September 30, 2011, there were 2 private label CMO securities, with aggregate holdings totaling \$3,233,000, which exceeded 10% of shareholders' equity. At September 30, 2010, there were 3 private label CMO securities, with aggregate holdings totaling \$4,079,000 of private label CMO securities which exceeded 10% of shareholders' equity.

Sales of available for sale securities were as follows:

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(000s omitted)	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Proceeds	\$ 2,024	\$ 6,765
Gross gains	5	97
Gross losses	0	(26)

The 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 3 SECURITIES (continued)**

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

**September 30, 2011**

(000s omitted)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed residential	\$ 8,256	\$ (43)	\$ 0	\$ 0	\$ 8,256	\$ (43)
Collateralized mortgage obligations-agencies	0	0	1,824	(6)	1,824	(6)
Collateralized mortgage obligations-private label	0	0	3,233	(564)	3,233	(564)
Equity securities	359	(103)	1	(4)	360	(107)
<b>Total temporarily impaired</b>	<b>\$ 8,615</b>	<b>\$ (146)</b>	<b>\$ 5,058</b>	<b>\$ (574)</b>	<b>\$ 13,673</b>	<b>\$ (720)</b>

**December 31, 2010**

(000s omitted)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
US Government and federal agency	\$ 1,989	\$ (11)	\$ 0	\$ 0	\$ 1,989	\$ (11)
State and municipal	365	(3)	245	(5)	610	(8)
Mortgage-backed residential	2,062	(36)	0	0	2,062	(36)
Collateralized mortgage obligations-agencies	6,085	(114)	0	0	6,085	(114)
Collateralized mortgage obligations-private label	0	0	3,871	(344)	3,871	(344)
Equity securities	186	(14)	439	(20)	625	(34)
<b>Total temporarily impaired</b>	<b>\$ 10,687</b>	<b>\$ (178)</b>	<b>\$ 4,555</b>	<b>\$ (369)</b>	<b>\$ 15,242</b>	<b>\$ (547)</b>

**Collateralized Mortgage Obligations**

The decline in fair value of the Corporation's private label collateralized mortgage obligations is primarily attributable to the lack of liquidity and the financial crisis affecting these markets and not the expected cash flows of the individual securities. The ratings held on the private label securities held are Baa3 and B1. The underlying collateral of these CMOs is comprised largely of 1-4 family residences. In each of these securities, the Corporation holds the senior tranche and receives payments before other tranches. For private label securities, management completes an analysis to review the recent performance of the mortgage pools underlying the instruments. At September 30, 2011, the two private label securities having an amortized cost of \$3,797,000 have an unrealized loss of \$564,000.

The Corporation has also been closely monitoring the performance of the CMO and MBS portfolios. Management monitors items such as payment streams and underlying default rates, and did not determine a severe change in these items. On a quarterly basis, management uses multiple assumptions to project the expected future cash flows of the private label CMOs 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.

**Table of Contents****NOTE 3 SECURITIES** (continued)

The Corporation has 19 agency collateralized mortgage obligations at September 30, 2011 with one having an unrealized loss of \$6,000. The remaining 18 instruments have unrealized gains totaling \$579,000 at September 30, 2011.

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 third 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.

As of September 30, 2011, the Corporation's security portfolio consisted of 92 securities, 10 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, previously discussed. At the end of the third quarter, management performed its review and determined that no additional other-than-temporary impairment was necessary on the equity securities in the portfolio.

During the period ending September 30, 2010 \$307,000 of additional OTTI losses were recognized through earnings.

**NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES**

Major categories of loans are as follows:

(000s omitted)	September 30, 2011	December 31, 2010
Commercial	\$ 52,706	\$ 44,057
Real estate commercial	103,394	125,672
Real estate mortgage	22,953	19,249
Consumer	26,437	29,153
	205,490	218,131
Allowance for loan losses	(9,119)	(11,224)
	\$ 196,371	\$ 206,907

The Corporation has originated primarily residential and commercial real estate loans, commercial, construction 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.





**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

Activity in the allowance for loan losses, by classification, for the three month period ended September 30, 2011 is as follows:

(000s omitted)	Commercial		Residential		Installment Loans	Home Equity	Unallocated	Total
	Commercial	Real Estate	Real Estate					
Balance July 1, 2011								
Allowance for loan losses	\$ 1,049	\$ 6,284	\$ 388	\$ 231	\$ 615	\$ 361	\$ 8,928	
Provision for loan losses	(176)	1,053	206	459	(258)	(267)	1,017	
Loans charged off	(67)	(752)	(8)	(55)	(20)	0	(902)	
Loan recoveries	6	48	2	18	2	0	76	
Balance September 30, 2011	\$ 812	\$ 6,633	\$ 588	\$ 653	\$ 339	\$ 94	\$ 9,119	

Activity in the allowance for loan losses, by classification, for the nine month period ended September 30, 2011 is as follows:

(000s omitted)	Commercial		Residential		Installment Loans	Home Equity	Unallocated	Total
	Commercial	Real Estate	Real Estate					
Balance January 1, 2011								
Allowance for loan losses	\$ 869	\$ 7,942	\$ 411	\$ 233	\$ 508	\$ 64	\$ 10,027	
Provision for loan losses	117	1,769	193	502	(69)	30	2,542	
Loans charged off	(201)	(3,322)	(19)	(112)	(118)	0	(3,772)	
Loan recoveries	27	244	3	30	18	0	322	
Balance September 30, 2011	\$ 812	\$ 6,633	\$ 588	\$ 653	\$ 339	\$ 94	\$ 9,119	

Activity in the allowance for loan losses, for the three and nine month periods ended September 2010 is as follows:

(000s omitted)	Three Months	Nine Months
Balance, beginning of period,	\$ 11,665	\$ 8,589
Provision for loan losses	2,796	7,435
Loans charged off:		
Commercial	(102)	(282)
Commercial real estate	(3,699)	(5,359)
Installment	(8)	(165)
Home equity	0	(96)
Residential real estate	(6)	(168)
Total loans charged off	(3,815)	(6,070)
Loan recoveries:		
Commercial	23	99
Commercial real estate	70	623

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Installment	16	74
Home equity	1	6
Residential real estate	1	1
Total loan recoveries	111	803
Balance, end of period	\$ 10,757	\$ 10,757

**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

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)	Commercial	Commercial	Residential	Installment Loans	Home Equity	Unallocated	Total
		Real Estate	Real Estate				
<b>September 30, 2011</b>							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 240	\$ 4,293	\$ 209	\$ 154	\$ 355	\$ 0	\$ 5,251
Collectively evaluated for impairment	572	2,340	379	258	225	94	3,868
Total ending allowance balance	\$ 812	\$ 6,633	\$ 588	\$ 412	\$ 580	\$ 94	\$ 9,119
Loans:							
Loans individually evaluated for impairment	\$ 3,521	\$ 25,965	\$ 824	\$ 224	\$ 643	\$ 0	\$ 31,177
Loans collectively evaluated for impairment	49,185	77,429	22,129	11,747	13,823	0	174,313
Total ending loans balance	52,706	103,394	22,953	11,971	14,466	0	205,490
Accrued interest receivable	62	358	78	39	57	0	594
Total recorded investment in loans	\$ 52,768	\$ 103,752	\$ 23,031	\$ 12,010	\$ 14,523	\$ 0	\$ 206,084

(000s omitted)	Commercial	Commercial	Residential	Installment Loans	Home Equity	Unallocated	Total
		Real Estate	Real Estate				
<b>December 31, 2010</b>							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 186	\$ 7,175	\$ 95	\$ 69	\$ 160	\$ 0	\$ 7,685
Collectively evaluated for impairment	685	1,980	316	164	348	46	3,539
Total ending allowance balance	\$ 871	\$ 9,155	\$ 411	\$ 233	\$ 508	\$ 46	\$ 11,224
Loans:							
Loans individually evaluated for impairment	\$ 1,845	\$ 34,893	\$ 1,272	\$ 228	\$ 357	\$ 0	\$ 38,595
Loans collectively evaluated for impairment	42,212	90,779	17,977	7,798	20,770	0	179,536
Total ending loans balance	\$ 44,057	\$ 125,672	\$ 19,249	\$ 8,026	\$ 21,127	\$ 0	\$ 218,131
Accrued interest receivable	358	657	115	55	58	0	1,243
Total recorded investment in loans	\$ 44,415	\$ 126,329	\$ 19,364	\$ 8,081	\$ 21,185	\$ 0	\$ 219,374



**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

The following table presents loans individually evaluated for impairment by class of loans as of:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
<b>September 30, 2011</b>			
With no related allowances recorded:			
Commercial	\$ 2,102	\$ 2,103	\$ 0
Commercial Real Estate	9,256	9,311	0
Residential real estate	73	73	0
Consumer			
Installment Loans	20	20	0
Home Equity	86	86	0
With an allowance recorded:			
Commercial	1,419	1,420	240
Commercial real estate:	16,709	16,759	4,293
Residential real estate	751	751	209
Consumer			
Installment loans	204	243	154
Home equity	557	614	355
Total	\$ 31,177	\$ 31,380	\$ 5,251

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
<b>December 31, 2010</b>			
With no related allowances recorded:			
Commercial	\$ 1,098	\$ 1,098	\$ 0
Commercial real estate	10,268	10,318	0
Residential real estate	747	786	0
Consumer			
Installment Loans	116	116	0
Home Equity	74	75	0
With an allowance recorded:			
Commercial	747	751	186
Commercial real estate	24,625	24,895	7,175
Residential real estate	525	529	95
Consumer			
Installment loans	112	112	69
Home equity	283	284	160
Total	\$ 38,595	\$ 38,964	\$ 7,685

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.



**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans at:

**September 30, 2011**

(000s omitted)	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Commercial	\$ 2,222	\$ 0
Commercial real estate	14,980	530
Consumer		
Home Equity	85	0
Installment loans	110	0
Residential real estate	243	0
<b>Total</b>	<b>\$ 17,640</b>	<b>\$ 530</b>

**December 31, 2010**

(000s omitted)	Nonaccrual	Loans Past Due Over 90 Days Still Accruing (1)
Commercial	\$ 1,847	\$ 0
Commercial real estate	15,116	0
Consumer		
Installment loans	121	0
Residential real estate	495	135
<b>Total</b>	<b>\$ 17,579</b>	<b>\$ 135</b>

(1) - Includes accrued interest receivable of \$2

The following table presents the aging of the recorded investment in past due loans by class of loans at:

(000s omitted)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due
<b>September 30, 2011</b>				
Commercial	\$ 1,098	\$ 32	\$ 614	\$ 1,744
Commercial real estate:	4,637	1,457	6,618	12,712
Consumer:				
Installment loans	160	85	103	348
Home Equity	74	0	0	74
Residential real estate				
Traditional	351	200	0	551

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Total	\$ 6,320	\$ 1,774	\$ 7,335	\$ 15,429
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(000s omitted)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due
<b>December 31, 2010</b>				
Commercial	\$ 26	\$ 235	\$ 1,209	\$ 1,470
Commercial real estate:	1,740	310	10,013	12,063
Consumer:				
Installment loans	46	4	96	146
Home Equity	118	5	0	123
Residential real estate				
Traditional	156	0	630	786
Total	\$ 2,086	\$ 554	\$ 11,948	\$ 14,588



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**NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

**Modifications:**

A modification of a loan constitutes a troubled debt restructuring ( TDR ) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Corporation offers various types of concessions when modifying a loan or lease, however, forgiveness of principal is rarely granted. Commercial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial real estate loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Residential real estate loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs through a reduction of interest rate and/or extension of the maturity date. Installment loans modified in a TDR are primarily comprised of loans where the Corporation has lowered monthly payments by extending the term.

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases been taken against the outstanding loan balance. As a result, loans modified in a TDR for the Corporation may have the financial effect of increasing the specific allowance associated with the loan.

As a result of adopting the amendments in ASU No. 2011-02, the Corporation reassessed all loan restructurings that occurred on or after January 1, 2011 for identification as troubled debt restructurings (TDRs). The Corporation identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance for loan losses methodology. Upon identifying these loans as TDRs, the Corporation classified them as impaired. The amendments in ASU No. 2011-02 require retrospective application of the impairment measurement guidance for those loans newly identified as impaired during the period. The Corporation's recorded investment in TDRs as a result of the guidance set forth in ASU No. 2011-02 is \$3,357,000, with a specific valuation allowance of \$773,000, as of September 30, 2011. This specific valuation is an allocated portion of the total allowance for loan losses.

Modified loans totaled \$7,682,000 at September 30, 2011 compared to \$6,246,000 at December 31, 2010.

The Corporation allocated \$1,310,000 and \$1,413,000 of specific reserves to customers whose loan terms have been modified in TDRs as of September 30, 2011 and December 31, 2010. Modified loans are also included with impaired loans. The Corporation has no additional amounts committed to these customers.

**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

The following presents by class, information related to loans modified in a TDR during the three and nine month periods ended September 30, 2011:

	Loans Modified as a TDR for the			Loans Modified as TDR for the		
	Three Months Ended			Nine Months Ended		
	September 30, 2011			September 30, 2011		
	Number	Pre-	Post-	Number	Pre-	Post-
(000s omitted)	of	Modification	Modification	of	Modification	Modification
	Loans	Recorded	Recorded	Loans	Recorded	Recorded
		Investment	Investment		Investment	Investment
Commercial	0	\$ 0	\$ 0	3	\$ 353	\$ 353
Commercial- Real Estate	2	936	936	11	2,759	2,759
Residential-						
Real Estate	1	204	204	1	204	204
Installment						
loans	1	7	7	2	41	41
<b>Total</b>	<b>4</b>	<b>\$ 1,147</b>	<b>\$ 1,147</b>	<b>17</b>	<b>\$ 3,357</b>	<b>\$ 3,357</b>

The following presents by class, defaults (i.e. 30 days or more past due following a modification) on any loans that were modified as troubled debt restructurings during the preceding twelve months in the three and nine month periods ended September 30, 2011:

	Loans Modified as a TDR since		Loans Modified as a TDR since	
	July 1, 2010		January 1, 2010	
	That Subsequently Defaulted During		That Subsequently Defaulted During the	
	Number	Recorded Investment	Number	Recorded Investment
(000s omitted)	of	(as of period	of	(as of period
	Contracts	end) <sup>(1)</sup>	Contracts	end) <sup>(1)</sup>
Commercial	1	\$ 45	1	\$ 45
Commercial- Real Estate	3	224	4	463
<b>Total</b>	<b>4</b>	<b>\$ 269</b>	<b>5</b>	<b>\$ 508</b>

- (1) The period end balances are inclusive of all partial paydowns and charge-offs since the modification date, if any. Loans modified in a TDR that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES** (continued)

Based on the Corporation's historical loss experience, losses associated with TDRs are not significantly different than other impaired loans within the same loan segment. As such, TDRs are analyzed in the same manner as other impaired loans within their respective loan segment.

The following presents by class, the type of modification made in a TDR from January 1, 2011 through September 30, 2011:

(000s omitted)	Loans modified through reduction of interest rate as of September 30, 2011			
	Three month period		Nine month period	
	Number of Loans	Recorded Investment (as of period end) <sup>(1)</sup>	Number of Loans	Recorded Investment (as of period end) <sup>(1)</sup>
Residential-Real Estate	1	\$ 204	1	\$ 204
Installment loans	0	0	1	34
<b>Total</b>	<b>1</b>	<b>\$ 204</b>	<b>2</b>	<b>\$ 238</b>

- (1) The period end balances are inclusive of all partial paydowns and charge-offs since the modification date, if any. Loans modified in a TDR that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

(000s omitted)	Loans modified through extension of term as of September 30, 2011			
	Three month period		Nine month period	
	Number of Loans	Recorded Investment (as of period end) <sup>(1)</sup>	Number of Loans	Recorded Investment (as of period end) <sup>(1)</sup>
Commercial			3	\$ 353
Commercial-Real Estate	2	\$ 936	11	2,759
Residential-Real Estate				
Installment loans	1	7	1	7
<b>Total</b>	<b>3</b>	<b>\$ 943</b>	<b>15</b>	<b>\$ 3,119</b>

- (1) The period end balances are inclusive of all partial paydowns and charge-offs since the modification date, if any. Loans modified in a TDR that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

**Credit Quality Indicators:**

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debts such as: current financial information, historical payment experience; credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Corporation uses the following definitions for classified risk ratings:

**Prime.** Loans classified as prime are well seasoned borrowers displaying strong financial condition, consistently superior earning performance, and access to a range of financing alternatives. The borrower's trends and outlook, as well as those of its industry are positive.

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**Pass.** Loans classified as pass have a moderate to average risk to established borrowers that display sound financial condition and operating results. The capacity to service debt is stable and demonstrated at a level consistent with or above the industry norms. Borrower and industry trends and outlook are considered good.

**Watch.** Loans classified as watch have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The Corporation does not classify loans as doubtful. Loans that approach this status are charged-off.

**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)**

Based on the most recent analysis performed, the recorded investment by risk category of loans by class of loans is as follows:

(000s omitted)	Prime	Pass	Watch	Substandard	Total
<b>September 30, 2011</b>					
Commercial	\$ 6,123	\$ 41,498	\$ 1,624	\$ 3,523	\$ 52,768
Commercial real estate	0	65,777	11,865	26,110	103,752
Total	\$ 6,123	\$ 107,275	\$ 13,489	\$ 29,633	\$ 156,520

(000s omitted)	Prime	Pass	Watch	Substandard	Total
<b>December 31, 2010</b>					
Commercial	\$ 3,174	\$ 33,871	\$ 3,585	\$ 3,785	\$ 44,415
Commercial real estate	0	82,494	14,404	29,431	126,329
Total	\$ 3,174	\$ 116,365	\$ 17,989	\$ 33,216	\$ 170,744

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of:

(000s omitted)	Consumer		Residential	Total
	Home Equity	Installment	Real Estate	
<b>September 30, 2011</b>				
Performing	\$ 13,823	\$ 11,747	\$ 22,207	\$ 47,777
Non-performing	700	263	824	1,787
Total	\$ 14,523	\$ 12,010	\$ 23,031	\$ 49,564

(000s omitted)	Consumer		Residential	Total
	Home Equity	Installment	Real Estate	
<b>December 31, 2010</b>				
Performing	\$ 21,128	\$ 7,553	\$ 18,053	\$ 46,734
Non-performing	57	528	1,311	1,896
Total	\$ 21,185	\$ 8,081	\$ 19,364	\$ 48,630

**Loans in discontinued operations:**

As part of the terms of the sale of West Michigan Community Bank, certain non performing assets were transferred to a newly formed subsidiary of the Corporation. The subsidiary acquired \$1,100,000 of substandard loans, \$4,400,000 of non-accrual loans and \$800,000 of real estate in redemption. The loans were recorded at book value on the date of transfer. Additionally \$2,900,000 of watch credit grade loans was transferred to The State Bank. The total of all loans transferred and originally included in discontinued operations was \$9,200,000.

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As of July 1, 2011, \$4,498,000 of loans and \$1,246,000 of real estate owned were transferred back into continuing operations. This reclassification reflects a change in management's intent related to these accounts, to be a part of continuing operations on a going forward basis.

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**NOTE 5 FAIR VALUE**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values.

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The remaining fair values of securities (Level 3 inputs) are based on the reporting entity's own assumptions and basic knowledge of market conditions and individual investment performance. The Corporation reviews the performance of the securities that comprise level 3 on a quarterly basis.

**Impaired Loans:** The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

**Other Real Estate Owned:** Non-recurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available, which results in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

**Table of Contents****NOTE 5 FAIR VALUE (continued)**Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

(000s omitted)	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2011</b>				
<u>Available for sale securities</u>				
U.S. Government and federal agency	\$ 8,178	\$ 0	\$ 8,178	\$ 0
Mortgage-backed residential	17,229	0	17,229	0
Collateralized mortgage obligations-agency	33,104	0	33,104	0
Collateralized mortgage obligations-private label	3,233	0	3,233	0
Equity securities	2,160	0	1,049	1,111
	\$ 63,904	\$ 0	\$ 62,793	\$ 1,111

(000s omitted)	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2010</b>				
<u>Available for sale securities</u>				
U.S. Government and federal agency	\$ 4,000	\$ 0	\$ 4,000	\$ 0
Mortgage-backed residential	7,432	0	7,432	0
Collateralized mortgage obligations-agency	24,902	0	24,902	0
Collateralized mortgage obligations-private label	3,871	0	3,871	0
Equity securities	1,670	0	523	1,147
	\$ 41,875	\$ 0	\$ 40,728	\$ 1,147



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**NOTE 5 FAIR VALUE (continued)**

The table below presents a reconciliation including the respective income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3). The Corporation did not hold any level 3 assets during the first nine months of 2010.

(000s omitted)	Equity Securities 2011
Beginning balance, January 1,	\$ 1,147
Total gains or losses (realized / unrealized)	
Included in other comprehensive income	(36)
Ending balance, September 30,	\$ 1,111

**Assets Measured on a Non-Recurring Basis**

Assets measured at fair value on a non-recurring basis are summarized below:

(000s omitted)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>At September 30, 2011</b>				
<b>Impaired loans</b>				
Commercial	\$ 63	\$ 0	\$ 0	\$ 63
Commercial real estate	8,690	0	0	8,690
Residential real estate	695	0	0	695
Consumer	357	0	0	357
<b>Total impaired loans</b>	<b>\$ 9,805</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 9,805</b>
<b>Other real estate owned</b>				
Commercial real estate	627	\$ 0	\$ 0	\$ 627
<b>Total other real estate owned</b>	<b>\$ 627</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 627</b>

(000s omitted)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>At December 31, 2010</b>				

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Impaired loans				
Commercial	\$ 599	\$ 0	\$ 0	\$ 599
Commercial real estate	9,268	0	0	9,268
Residential real estate	716	0	0	716
Consumer	355	0	0	355
<b>Total impaired loans</b>	<b>\$ 10,938</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 10,938</b>
Other real estate owned				
Commercial real estate	\$ 235	\$ 0	\$ 0	\$ 235
Residential real estate	60	0	0	60
<b>Total other real estate owned</b>	<b>\$ 295</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 295</b>

**Table of Contents****NOTE 5 FAIR VALUE** (continued)

At September 30, 2011, impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal amount of \$13,150,000 with a valuation allowance of \$3,345,000. This resulted in additional specific provision for loan losses of \$1,096,000 for the three month period and \$1,473,000 for the nine month period ended September 30, 2011. This is compared to December 31, 2010 when the principal amount of impaired loans was \$15,836,000 with a valuation allowance of \$4,698,000.

Other real estate owned which is measured at the lower of carrying value or fair value less costs to sell, had a net carrying amount of \$1,966,000, of which \$627,000 was at fair value at September 30, 2011, resulting from write-downs totaling \$229,000 for the three month period and \$520,000 for the nine month period. At December 31, 2010, other real estate owned had a net carrying amount of \$3,407,000, of which \$295,000 was at fair value.

Carrying amount and estimated fair value of financial instruments, not previously presented were as follows:

(000s omitted)	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Assets:</b>				
Cash and cash equivalents	\$ 22,168	\$ 22,168	\$ 33,492	\$ 33,492
Securities held to maturity	3,423	3,506	4,350	4,383
Loans held for sale	489	489	850	850
Loans (including impaired loans), net	196,371	196,410	206,907	204,378
FHLB stock	661	661	740	740
Accrued interest receivable	1,014	1,014	1,050	1,050
<b>Liabilities:</b>				
Deposits	\$ 272,265	\$ 268,917	\$ 275,977	\$ 272,223
Short-term borrowings	647	647	879	879
FHLB advances	923	1,183	954	1,369
Subordinated debentures	14,000	12,591	14,000	12,613
Accrued interest payable	1,464	1,464	1,166	1,166

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

**Cash and cash equivalents:** The carrying amounts reported in the balance sheet for cash and short-term instruments approximate their fair values.

**Securities:** Fair values for securities held to maturity are based on similar information previously presented for securities available for sale.

**Loans held for sale:** The fair values of these loans are determined in the aggregate on the basis of existing forward commitments or fair values attributable to similar loans.

**Loans:** For variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for other loans is estimated using discounted cash flow analysis.

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### **NOTE 5 FAIR VALUE (continued)**

**FHLB Stock:** It was not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

**Accrued interest:** The carrying amount of accrued interest approximates its fair value.

**Off-balance-sheet instruments:** The fair value of off-balance sheet items is not considered material.

**Deposit liabilities:** The fair values disclosed for demand deposits are, by definition equal to the amount payable on demand at the reporting date. The carrying amounts for variable rate, fixed term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed certificates of deposit are estimated using discounted cash flow calculation that applies interest rates currently being offered on similar certificates.

**Short-term borrowings:** The carrying amounts of federal funds purchased and other short-term borrowings approximate their fair values.

**FHLB advances:** Rates currently available for FHLB debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

**Subordinated Debentures:** The estimated fair value of the existing subordinated debentures is calculated by comparing a current market rate for the instrument compared to the book rate. The difference between these rates computes the fair value.

**Limitations:** Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Corporation's financial instruments, fair value estimates are based on management's judgments regarding future expected loss experience, current economic conditions, risk characteristics and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### **NOTE 6 INCOME TAXES**

The provision (benefit) for federal income taxes is computed by applying the statutory federal income tax rate to income (loss) before income taxes as reported in the consolidated financial statements after deducting non-taxable items, principally income on bank-owned life insurance, and deducting credits related to certain investments.

A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position for the Corporation at September 30, 2011 and December 31, 2010. The Corporation's evaluation of taxable events, losses in recent years and the continuing deterioration of the Michigan economy led management to conclude that it was more likely than not that the benefit would not be realized. As a result, the Corporation maintained a full valuation allowance at September 30, 2011 and December 31, 2010.

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**Table of Contents****NOTE 6 INCOME TAXES** (continued)

An income tax benefit associated with continuing operations in the amount of \$300,000 was recorded for the nine month period ending September 30, 2011. For the three month period ended September 30, 2010 an income tax benefit associated with continuing operations of \$235,000 was recorded. For the nine month period ended September 30, 2010 an income tax benefit associated with continuing operations of \$128,000 was recorded. The benefit recorded considers the results of current period adjustments to other comprehensive income and discontinued operations. Generally, the calculation for income tax expense (benefit) does not consider the tax effects of changes in other comprehensive income or loss, which is a component of shareholders' equity on the balance sheet. However, an exception is provided in certain circumstances when there is a pre-tax loss from continuing operations and income from other categories such as other comprehensive income or discontinued operations. In such case, pre-tax income from other categories is included in the tax expense (benefit) calculation for the current period.

In the ordinary course of business, the Corporation enters into certain transactions that have tax consequences. From time to time, the Internal Revenue Service (IRS) questions and/or challenges the tax position taken by the Corporation with respect to those transactions. The Corporation believes that its tax returns were filed based upon applicable statutes, regulations and case law in effect at the time of the transactions. The IRS, an administrative authority of a court, if presented with the transactions, could disagree with the Corporation's interpretation of the tax law. After evaluating the risks and opportunities, the best outcome may result in a settlement. The ultimate outcome for each position is not known.

At September 30, 2011, net unrecognized tax benefits were \$125,000. There were no unrecognized tax benefits recorded in any previously reported periods presented. The increase of \$125,000 in unrecognized tax benefits from June 30, 2011 was the result of an item noted in the Corporation's on-going IRS examination related to a deduction taken associated with the write off and subsequent recovery of a loan. Accrued interest and penalties were not considered to be significant. The Corporation continues to engage in discussions with the IRS related to its ongoing examinations for the 2008 and 2009 tax years and based upon current knowledge the Corporation does not believe that it is more likely than not that other positions taken will not be sustained upon ultimate resolution and/or appeal. The Corporation does not expect the total amount of unrecognized tax benefits to change within the next twelve months. The aforementioned item would not be expected to have a significant impact on the Corporation's effective tax rate in any one reporting period if and when recognized.

Based on current knowledge and probability assessment of various potential outcomes, the Corporation believes that accrued tax liabilities and valuation allowance are adequate to absorb the effect, if any, relating to the ultimate resolution of the uncertain tax position in the matter outlined above.

The Corporation and its subsidiaries are subject to U.S federal income taxes as well as income tax of the state of Michigan. The Corporation is no longer subject to examination by taxing authorities for years before 2007.

**NOTE 7 LOSS PER COMMON SHARE**

A reconciliation of the numerators and denominators used in the computation of basic earnings per common share and diluted earnings per common share is presented below. Earnings per common share are presented below for the three month and nine month periods ended September 30, 2011 and 2010:

**Table of Contents****NOTE 7 EARNINGS PER COMMON SHARE (continued)**

The factors in the earnings per share computation follow:

(000s omitted except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Basic</b>				
Net loss	\$ (700)	\$ (2,337)	\$ (635)	\$ (5,600)
<b>Weighted average common shares outstanding</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Basic loss per common share	\$ (0.30)	\$ (1.03)	\$ (0.27)	\$ (2.47)
<b>Diluted</b>				
Net loss	\$ (700)	\$ (2,337)	\$ (635)	\$ (5,600)
<b>Weighted average common shares outstanding for basic earnings per common share</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Add: Dilutive effects of assumed exercises of stock options	0	0	0	0
<b>Average shares and dilutive potential common shares</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Diluted loss per common share	\$ (0.30)	\$ (1.03)	\$ (0.27)	\$ (2.47)

The factors in the earnings per share of continuing operations follow:

(000s omitted except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Basic</b>				
Net loss of continuing operations	\$ (700)	\$ (2,243)	\$ (1,107)	\$ (5,489)
<b>Weighted average common shares outstanding</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Basic loss per common share from continuing operations	\$ (0.30)	\$ (0.98)	\$ (0.48)	\$ (2.42)
<b>Diluted</b>				
Net loss of continuing operations	\$ (700)	\$ (2,243)	\$ (1,107)	\$ (5,489)
<b>Weighted average common shares outstanding for basic earnings per common share</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Add: Dilutive effects of assumed exercises of stock options	0	0	0	0
<b>Average shares and dilutive potential common shares</b>	<b>2,349,249</b>	<b>2,277,406</b>	<b>2,326,837</b>	<b>2,265,472</b>
Diluted loss per common share from continuing operations	\$ (0.30)	\$ (0.98)	\$ (0.48)	\$ (2.42)

Stock options of 13,907 and 16,755 shares of common stock outstanding at September 30, 2011 and September 30, 2010, respectively were not considered in computing diluted earnings per common share for 2011 and 2010, because they were antidilutive.

**NOTE 8 COMMITMENTS AND CONTINGENCIES**

There are various contingent liabilities that are not reflected in the financial statements including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, there are no matters which are expected to have a material effect on the Corporation's consolidated financial condition or results of operations.

**Table of Contents****NOTE 9 DISCONTINUED OPERATIONS**

On April 28, 2010, at the Annual Shareholder Meeting, a formal announcement was made regarding the signing of a definitive agreement to sell West Michigan Community Bank ( WMCB ). The transaction was consummated on January 31, 2011, and the Corporation received \$10,500,000 from the sale of West Michigan Community Bank (a 10% premium to book). As a condition of the sale, the Corporation assumed certain non-performing assets of West Michigan Community Bank which totaled \$9,900,000. The assets were housed in a newly formed real estate holding company subsidiary of the Corporation. In addition, The State Bank assumed \$2,900,000 of watch rated credits.

As of July 1, 2011, due to a change in intent of the Corporation, the remaining balances of the assets described above and previously classified as discontinued operations at June 30, 2011 were reclassified into continuing operations; therefore there is no balance sheet for presentation at September 30, 2011. Assets also were reclassified for all periods presented. See Note 1 for further discussion.

As of April 30, 2010, Davison State Bank ( DSB ) was sold to an independent financial group. As a result, there is no balance sheet for presentation at September 30, 2011 or December 30, 2010. As of January 31, 2011, West Michigan Community Bank was sold to a third party investor group as a result there is no balance sheet presentation at September 30, 2011.

A condensed balance sheet of discontinued operations is presented below at December 31, 2010.

**CONDENSED BALANCE SHEET OF DISCONTINUED OPERATIONS****(Unaudited)**

(000s omitted)

	WMCB Dec 31, 2010
<b>ASSETS</b>	
Cash and cash equivalents	\$ 9,506
Securities available for sale	15,080
Loans, net of allowance (\$4,740-2010)	77,134
Other assets	11,594
 Total assets	 \$ 113,314
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>	
Deposits:	
Non-interest bearing	\$ 13,751
Interest bearing	93,546
 Total deposits	 107,297
Federal Home Loan Bank advances	5,000
Accrued taxes, interest and other liabilities	1,024
Shareholders equity	(7)
 Total liabilities and shareholders equity	 \$ 113,314

A condensed statement of income of discontinued operations related to loans and other real estate assumed upon the sale of West Michigan Community Bank is presented for the nine months ended September 30, 2011. Due to the transfer of loans at January 31, 2011, only one month of income and expense are presented for West Michigan Community Bank.

A condensed statement of income of discontinued operations is presented for the nine months ended September 30, 2010. Due to the sale of Davison State Bank, there is no income statement for presentation for the three or nine months period ended September 30, 2011.





**Table of Contents****NOTE 9 DISCONTINUED OPERATIONS** (continued)

As of July 1, 2011, the assets previously described as discontinued operations at June 30, 2011 were reclassified into continuing operations. The nine month income statement for the period ended September 30, 2011 is presented below:

**CONDENSED STATEMENT OF INCOME OF DISCONTINUED OPERATIONS****Unaudited****(000s omitted)**

	Three Months Ended September 30, 2011				Nine Months Ended September 30, 2011			
	Assumed Loans and Other Real				Assumed Loans and Other Real			
	Estate	DSB	WMCB	Total	Estate	DSB	WMCB	Total
Interest income	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 515	\$ 515
Interest expense	0	0	0	0	0	0	129	129
Net interest income	0	0	0	0	0	0	386	386
Provision for loan losses	0	0	0	0	0	0	(50)	(50)
Net interest income (loss) after provision for loan losses	0	0	0	0	0	0	436	436
Non-interest income	0	0	0	0	0	0	121	121
Non-interest expense	0	0	0	0	82	0	415	497
Income (loss) before federal income tax	0	0	0	0	(82)	0	142	60
Federal income tax expense (benefit)	0	0	0	0	0	0	57	57
Gain on sale of subsidiary	0	0	0	0	0	0	469	469
Net income (loss)	\$ 0	\$ 0	\$ 0	\$ 0	\$ (82)	\$ 0	\$ 554	\$ 472

In connection with the sale of West Michigan Community Bank, the Corporation recognized a gross gain of \$711,000. Net of tax the net gain amounted to \$469,000.

**Table of Contents****NOTE 9 DISCONTINUED OPERATIONS** (continued)**CONDENSED STATEMENT OF INCOME OF DISCONTINUED OPERATIONS****Unaudited****(000s omitted)**

	Three Months Ended September 30, 2010				Nine Months Ended September 30, 2010			
	Assumed Loans and Other Real				Assumed Loans and Other Real			
	Estate	DSB	WMCB	Total	Estate	DSB	WMCB	Total
Interest income	\$ 0	\$ 0	\$ 1,533	\$ 1,533	\$ 0	\$ 607	\$ 4,663	\$ 5,270
Interest expense	0	0	533	533	0	116	1,896	2,012
Net interest income	0	0	1,000	1,000	0	491	2,767	3,258
Provision for loan losses	0	0	109	109	0	(5)	878	873
Net interest income (loss) after provision for loan losses	0	0	891	891	0	496	1,889	2,385
Non-interest income	0	0	245	245	0	178	699	877
Non-interest expense	0	0	1,246	1,246	0	121	3,649	3,770
Income (loss) before federal income tax	0	0	(110)	(110)	0	553	(1,061)	(508)
Federal income tax expense (benefit)	0	0	(16)	(16)	0	181	(578)	(397)
Gain on sale of subsidiary	0	0	0	0	0	0	0	0
Net income (loss)	\$ 0	\$ 0	\$ (94)	\$ (94)	\$ 0	\$ 372	\$ (483)	\$ (111)

During the first quarter of 2010, the Corporation reversed a previously recorded gross estimated loss of \$700,000 related to the sale of Davison State Bank.

**NOTE 10 REGULATORY MATTERS**

The Corporation (on a consolidated basis) and its Bank subsidiaries are subject to various regulatory capital requirements administered by the federal and state regulatory agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Banks must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items that are calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require FDIC insured Banks to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of September 30, 2011 and December 31, 2010, the most recent notifications from Federal Deposit Insurance Corporation categorized the subsidiary Bank as adequately capitalized in accordance with standards.

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West Michigan Community Bank was placed under a Consent Order with federal and state banking regulators containing provisions to foster improvement in West Michigan Community Bank's earnings, reduce non performing loan levels, and increase capital. The Consent Order required West Michigan Community Bank to retain a Tier 1 capital to average assets ratio of a minimum of 8.0%. As of December 31, 2010, West Michigan Community Bank had a Tier 1 capital to average assets ratio of 7.5%. West Michigan Community Bank was not in compliance with the Consent Order requirements. As previously mentioned, West Michigan Community Bank was sold on January 31, 2011.

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**NOTE 10-REGULATORY MATTERS (continued)**

In January 2010, The State Bank entered into a Consent Order with federal and state banking regulators containing provisions to foster improvement in The State Bank's earnings, reduce nonperforming loan levels, increase capital, and require revisions to various policies. The Consent Order requires The State Bank to maintain a Tier 1 capital to average asset ratio of a minimum of 8.0%. It also requires The State Bank to maintain a total capital to risk weighted asset ratio of 12.0%. At September 30, 2011, The State Bank had a Tier 1 capital to average assets ratio of 8.1% and a total capital to risk-weighted assets ratio of 12.1%. While these ratios are compliant with the Consent Order requirements, additional requirements are not yet attained, and therefore The State Bank cannot be considered well capitalized.

The Consent Orders restrict the Bank from issuing or renewing brokered deposits. The Consent Orders also restrict dividend payments from The State Bank to the Corporation. The Corporation, the Board of Directors and management continue to work on plans to come into compliance with the Consent Orders recent actions included the injection of capital into The State Bank resulting from the sale of West Michigan Community Bank. On January 31, 2011, \$900,000 of capital was injected into The State Bank. Additional capital injections were made on June 2, 2011 in the amount of \$2,862,000 and on July 27, 2011 in the amount of \$850,000. These injections were the result of the sale of non-performing assets from the subsidiary of the Corporation. Following these injections, the Bank has attained capital levels that can be considered well capitalized by regulatory standards. Future non-compliance with Consent Order requirements may cause the Bank to be subject to further enforcement actions by the FDIC.

Effective in November 2010, the Corporation received a notice from The Federal Reserve which defined restrictions being placed upon the holding company. The restrictions include the declaration or payment of any dividends, the receipt of dividends from subsidiary banks, the repayment of any principal or interest on subordinated debentures or Trust Preferred securities, restrictions on debt, any changes in Executive or Senior Management or change in the role of Senior Management. In addition, the notice provided an expectation that the Corporation maintain sufficient capital levels.

As illustrated in the table below, at September 30, 2011, the Consolidated Corporation's total capital to risk weighted assets ratio indicates that it is adequately capitalized. The Corporation's total capital to risk weighted assets ratio of 10.4% at September 30, 2011 was above the minimum requirement to be adequately capitalized of 8.0%. This is compared to December 31, 2010 when the total capital to risk weighted assets for the Corporation was at 7.8% and was under capitalized. The improvement in capital ratios was largely driven by the sale of West Michigan Community Bank. Despite the improvements and current capital levels, the Corporation continues to be required to obtain written approval prior to payments of any dividends or for any increase or decrease to outstanding debt.

The Corporation's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the limitations described above.

**Table of Contents****NOTE 10 REGULATORY MATTERS** (continued)

	Actual		Purposes		Requirements	
(000s omitted)	Amount	Ratio	Amount	Ratio	Amount	Ratio
					For Capital	Regulatory
					Adequacy	Agreement
<b>As of September 30, 2011</b>						
Total Capital						
(to Risk Weighted Assets)						
Consolidated	\$ 23,460	10.4%	\$ 18,013	8.0%	NA	NA
The State Bank	27,157	12.4	17,509	8.0	\$ 21,887	12.0%
Tier 1 Capital						
(to Risk Weighted Assets)						
Consolidated	20,625	9.2	9,007	4.0	NA	NA
The State Bank	24,322	11.1	8,755	4.0	13,132	NA
Tier 1 Capital						
(to Average Assets)						
Consolidated	20,625	6.2	13,328	4.0	NA	NA
The State Bank	24,322	8.1	12,000	4.0	24,000	8.0
					For Capital	Regulatory
					Adequacy	Agreement
(000s omitted)						
<b>As of December 31, 2010</b>						
Total Capital						
(to Risk Weighted Assets)						
Consolidated	\$ 25,443	7.8%	\$ 26,073	8.0%	NA	NA
The State Bank	22,670	10.0	18,152	8.0	\$ 27,228	12.0%
West Michigan Community Bank	10,722	11.0	7,794	8.0	NA	NA
Tier 1 Capital						
(to Risk Weighted Assets)						
Consolidated	21,261	6.5	13,036	4.0	NA	NA
The State Bank	19,735	8.7	9,076	4.0	NA	NA
West Michigan Community Bank	9,475	9.7	3,897	4.0	NA	NA
Tier 1 Capital						
(to Average Assets)						
Consolidated	21,261	4.9	17,330	4.0	NA	NA
The State Bank	19,735	6.5	12,204	4.0	24,408	8.0
West Michigan Community Bank	9,475	7.5	5,025	4.0	10,050	8.0



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**Table of Contents****ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Certain of the Corporation's accounting policies are important to the portrayal of the Corporation's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances, which could affect these judgments, include, but without limitation, changes in interest rates, in the performance of the economy or in the financial condition of borrowers.

**Results of Operations**

As indicated in the income statement, the loss for the nine months ended September 30, 2011 was (\$635,000) compared to a loss of (\$5,600,000) for the same period in 2010. Net interest income in the third quarter of 2011, was \$157,000 below net interest income for the same quarter in 2010. The third quarter 2011 provision for loan losses was reduced \$1,799,000 compared to the third quarter of 2010. Management feels the allowance for loan losses is appropriate and has decreased \$2,105,000 when comparing the balance as of September 30, 2011 to December 31, 2010.

The banking industry uses standard performance indicators to help evaluate a banking institution's performance. Return on average assets is one of these indicators. For the three months ended September 30, 2011, the Corporation's return on average assets (annualized) was (0.23%) compared to (0.51%) for the same period in 2010. For the nine months ended September 30, 2011, the Corporation's return on average equity (annualized) was (4.21%) compared to (12.79%) for the same period in 2010. Net loss per share, basic and diluted, was (\$0.30) in the third quarter 2011 compared to (\$1.03) net loss per share basic and diluted for the same period in 2010. Net loss per share, basic and diluted, was (\$0.27) in the nine month period ended September 30, 2011 compared to (\$2.47) net loss per share basic and diluted for the same period in 2010.

**Net Interest Income**

Net interest income and average balances and yields on major categories of interest-earning assets and interest-bearing liabilities for the nine months ended September 30, 2011 and 2010 are summarized in Table 1. Net interest income and average balances and yields on major categories of interest-earning assets and interest-bearing liabilities for the three months ended September 30, 2011 and 2010 are summarized in Table 2.

During the nine months ended September 30, 2011, net interest income decreased compared to the same period in 2010. The volume of loans decreased over the past year resulting in a decrease in loan yield. To mitigate the decrease in interest income deposit interest rates were reduced on time deposits, which assisted in discouraging high rate instruments from renewing, with some funds exiting, thus reducing interest bearing liability costs.

As indicated in Table 1, for the nine months ended September 30, 2011, the Corporation's net interest margin (with consideration of full tax equivalency) was 3.81% compared with 3.73% for the same period in 2010. The increase in net interest margin was due to a steeper decline in the average interest bearing liability rate when comparing the nine month period ended September 30, 2011 to September 30, 2010, over the decline in the rate of average earning assets. The average interest bearing liability rate decreased 0.48% from 1.85% at September 30, 2010 to 1.37% at September 30, 2011. This was largely attributable to downward re-pricing on the time deposit portfolio; along with a decrease in volume in the time deposit portfolio. The rate paid on total average earning assets decreased 0.41% from 5.37% at September 30, 2010 to 4.96% at September 30, 2011. This can be attributed to a decline in the average balance of the overall loan portfolio volume year over year. A further contribution to the net interest margin increase was an increase of \$6,250,000 in non-interest bearing DDA accounts when comparing the nine month period ended September 30, 2011 to September 30, 2010.



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Average earning assets decreased 7.2% or \$21,002,000 when comparing the nine month period ended September 30, 2011 to the same time period in 2010. Loans, the highest yielding component of earning assets, represented 74.9% of earning assets in 2011 compared to 79.6% in 2010. Average interest bearing liabilities decreased 11.7% or \$30,148,000 comparing the first nine months of 2011 to the same time period in 2010. Non-interest bearing deposits amounted to 22.6% of average earning assets in the first nine months of 2011 compared with 18.8% in the same time period of 2010.

Net interest income (displayed with consideration of full tax equivalency), average balance sheet amounts, and the corresponding yields for the three months ended September 30, 2011 and 2010 are shown in Table 2. Net interest income for the three months ended September 30, 2011 was \$2,652,000, an increase of \$4,000, or 0.2%, from the same period in 2010. Net interest margin increased as a result of a large decrease in the interest bearing liability yield.

Management reviews economic forecasts and statistics on a monthly basis. Accordingly, the Corporation will continue to strategically manage the balance sheet structure in an effort to optimize net interest income. The Corporation expects to continue to selectively seek out new loan opportunities while continuing to maintain sound credit quality.

Management continually monitors the Corporation's balance sheet in an effort to insulate net interest income from significant swings caused by interest rate volatility. If market rates change in 2011, corresponding changes in funding costs will be considered to avoid the potential negative impact on net interest income. The Corporation's policies in this regard are further discussed in the section titled Interest Rate Sensitivity Management.

**Table of Contents****Table 1 Average Balance and Rates**

(000s omitted) (Annualized)	NINE MONTHS ENDED SEPTEMBER 30,					
	AVERAGE BALANCE	2011 INCOME/ EXPENSE	YIELD/ RATE	AVERAGE BALANCE	2010 INCOME/ EXPENSE	YIELD/ RATE
<b>ASSETS</b>						
Securities:						
U.S. Treasury and Government Agencies	\$ 48,526	\$ 967	2.66%	\$ 26,458	\$ 644	3.25%
State and Political (1)	3,901	180	6.17%	8,290	379	6.11%
Other	2,843	39	1.83%	2,330	24	1.38%
Total Securities	55,270	1,186	2.87%	37,078	1,047	3.78%
Fed Funds Sold	11,933	30	0.34%	21,433	19	0.12%
Loans:						
Commercial	152,700	6,634	5.81%	176,208	8,094	6.14%
Tax Free (1)	1,810	86	6.35%	2,282	111	6.50%
Real Estate-Mortgage	20,138	876	5.82%	22,055	1,025	6.21%
Consumer	27,502	1,183	5.75%	30,951	1,359	5.87%
Total loans	202,150	8,779	5.81%	231,496	10,589	6.12%
Allowance for Loan Losses	(9,431)			(9,731)		
Net Loans	192,719	8,779	6.09%	221,765	10,589	6.38%
Loans Held for Sale	506	18	4.76%	854	32	5.01%
<b>TOTAL EARNING ASSETS</b>	<b>\$ 269,859</b>	<b>\$ 10,013</b>	<b>4.96%</b>	<b>\$ 290,861</b>	<b>\$ 11,687</b>	<b>5.37%</b>
Cash Due from Banks	22,298			13,577		
Assets of Discontinued Operations	13,444			158,790		
All Other Assets	24,242			29,484		
<b>TOTAL ASSETS</b>	<b>\$ 320,412</b>			<b>\$ 482,981</b>		
<b>LIABILITIES &amp; SHAREHOLDERS EQUITY:</b>						
Deposits:						
Interest Bearing DDA	\$ 47,226	\$ 41	0.12%	\$ 49,508	\$ 80	0.22%
Savings Deposits	68,754	48	0.09%	64,257	63	0.13%
Time CDs \$100,000 and Over	40,981	1,139	3.72%	63,980	1,915	4.00%
Other Time CDs	55,064	718	1.74%	64,469	1,118	2.32%
Total Deposits	212,025	1,946	1.23%	242,214	3,176	1.75%
Other Borrowings	15,374	378	3.29%	15,333	388	3.38%
<b>INTEREST BEARING LIABILITIES</b>	<b>\$ 227,399</b>	<b>\$ 2,324</b>	<b>1.37%</b>	<b>\$ 257,547</b>	<b>\$ 3,564</b>	<b>1.85%</b>
Non-Interest bearing DDA	61,049			54,797		
Liabilities of Discontinued Operations	12,337			147,595		
All Other Liabilities	3,184			3,432		
Shareholders Equity	16,443			19,610		
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS EQUITY</b>	<b>\$ 320,412</b>			<b>\$ 482,981</b>		

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Net Interest Rate Spread		3.58%		3.52%
Net Interest Income /Margin	\$ 7,689	3.81%	\$ 8,123	3.73%

(1) Presented on a fully taxable equivalent basis using a federal income tax rate of 34%.

**Table of Contents****Table 2 Average Balance and Rates**

(000s omitted) (Annualized)	THREE MONTHS ENDED SEPTEMBER 30,					
	AVERAGE BALANCE	2011 INCOME/ EXPENSE	YIELD/ RATE	AVERAGE BALANCE	2010 INCOME/ EXPENSE	YIELD/ RATE
<b>ASSETS</b>						
Securities:						
U.S. Treasury and Government Agencies	\$ 56,152	\$ 373	2.64%	\$ 30,533	\$ 217	2.82%
State and Political (1)	3,450	53	6.09%	4,498	70	6.17%
Other	2,836	15	2.10%	2,331	7	1.19%
Total Securities	62,438	441	2.80%	37,362	294	3.12%
Fed Funds Sold	5,000	8	0.63%	28,725	9	0.12%
Loans:						
Commercial	153,005	2,184	5.66%	169,363	2,655	6.22%
Tax Free (1)	1,637	27	6.54%	2,202	36	6.49%
Real Estate-Mortgage	21,392	298	5.53%	21,218	316	5.91%
Consumer	26,812	385	5.70%	30,214	443	5.82%
Total loans	202,846	2,894	5.66%	222,997	3,450	6.14%
Allowance for Loan Losses	(9,012)			(10,480)		
Net Loans	193,834	2,894	5.92%	212,517	3,450	6.44%
Loans Held for Sale	434	5	4.57%	1,173	15	5.07%
<b>TOTAL EARNING ASSETS</b>	<b>\$ 270,718</b>	<b>\$ 3,348</b>	<b>4.91%</b>	<b>\$ 290,257</b>	<b>\$ 3,768</b>	<b>5.15%</b>
Cash Due from Banks	22,943			13,565		
Assets of Discontinued Operations	0			136,616		
All Other Assets	21,501			28,028		
<b>TOTAL ASSETS</b>	<b>\$ 306,150</b>			<b>\$ 457,986</b>		
<b>LIABILITIES &amp; SHAREHOLDERS EQUITY:</b>						
Deposits:						
Interest Bearing DDA	\$ 47,581	\$ 13	0.11%	\$ 50,155	\$ 23	0.18%
Savings Deposits	69,984	17	0.10%	66,359	22	0.13%
Time CDs \$100,000 and Over	35,324	316	3.55%	57,593	599	4.13%
Other Time CDs	53,212	224	1.67%	63,294	341	2.14%
Total Deposits	206,101	570	1.10%	237,401	985	1.65%
Other Borrowings	15,304	126	3.27%	15,392	135	3.48%
<b>INTEREST BEARING LIABILITIES</b>	<b>\$ 221,405</b>	<b>\$ 696</b>	<b>1.25%</b>	<b>\$ 252,793</b>	<b>\$ 1,120</b>	<b>1.76%</b>
Non-Interest bearing DDA	64,925			55,536		
Liabilities of Discontinued Operations	0			127,105		
All Other Liabilities	3,190			4,292		
Shareholders Equity	16,630			18,260		
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS EQUITY</b>	<b>\$ 306,150</b>			<b>\$ 457,986</b>		

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Net Interest Rate Spread		3.66%		3.39%
Net Interest Income /Margin	\$ 2,652	3.89%	\$ 2,648	3.62%

(1) Presented on a fully taxable equivalent basis using a federal income tax rate of 34%.

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**Allowance and Provision For Loan Losses**

The Corporation maintains formal policies and procedures to control and monitor credit risk. Management believes the allowance for loan losses is appropriate to provide for probable incurred losses in the loan portfolio. While the Corporation's loan portfolio has no significant concentrations in any one industry or any exposure in foreign loans, the loan portfolio has a concentration connected with commercial real estate loans. Specific strategies have been deployed to reduce the concentration levels and limit exposure to this type of lending in the future. The Michigan economy, employment levels and other economic conditions in the Corporation's local markets may have a significant impact on the level of credit losses. Management continues to identify and devote attention to credits that are not performing as agreed. Of course, deterioration of economic conditions could have an impact on the Corporation's credit quality, which could impact the need for greater provision for loan losses and the level of the allowance for loan losses as a percentage of gross loans. Non-performing loans are discussed further in the section titled "Non-Performing Assets."

The allowance for loan losses reflects management's judgment as to the level considered appropriate to absorb probable losses in the loan portfolio. The Corporation's methodology in determining the appropriateness of the allowance is based on ongoing quarterly assessments and relies on several key elements, which include specific allowances for identified problem loans and a formula-based risk-allocated allowance for the remainder of the portfolio. This includes a review of individual loans, size, and composition of the loan portfolio, historical loss experience, current economic conditions, financial condition of borrowers, the level and composition of non-performing loans, portfolio trends, estimated net charge-offs and other pertinent factors. While we consider the allowance for loan losses to be appropriate based on information currently available, future adjustments to the allowance may be necessary due to changes in economic conditions, delinquencies, or loss rates. Although portions of the allowance have been allocated to various portfolio segments, the allowance is general in nature and is available for the portfolio in its entirety.

While the allowance for loan losses has decreased substantially, the funds provided remains historically high as a result of continued weaknesses in the national and local economies, elevated amounts of non-performing loans and elevated charge-off levels over the past three years. Rolling twelve quarter periods of historical charge off experience is considered when calculating the current required level of the allowance for loan losses. The amount of the allowance for loan losses specifically allocated to impaired loans decreased by \$2,434,000 during the first nine months of 2011 as a result of charge offs incurred on loans for which specific allocations were previously recorded.

At September 30, 2011, the allowance was \$9,119,000, or 4.44% of total loans compared to \$11,224,000, or 5.13%, at December 31, 2010, a decrease of \$2,105,000 during the first nine months of 2011. Non performing loan levels, remained relatively unchanged when comparing amounts outstanding at September 30, 2011 to December 31, 2010. Net charge-offs decreased to \$3,450,000 during the first nine months of 2011 compared to \$5,267,000 during the first nine months of 2010. As discussed above, a majority of the charge-offs in 2011 relate to loans for which specific allocations were recorded at December 31, 2010.

During the first nine months of 2011, the Corporation experienced net charge-offs of \$3,450,000 compared with net charge-offs of \$5,267,000 in the first nine months of 2010. The provision for loan loss was \$2,542,000 in the first nine months of 2011 and \$7,435,000 for the same time period in 2010. Continuing declines in appraised values of properties in Michigan along with additional loans migrating to watch status due to economic conditions, have contributed to the ongoing elevated level of provision for loan losses. The application of historical loss rates to the current portfolio has the potential to be a lagging indicator and management evaluates whether these allocations should be adjusted. While there are indications that asset quality is improving, uncertain current economic conditions justify the use of high historical loss rates in estimating the required level of allowance for loan losses.

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**Table of Contents****Non-Interest Income**

Non-interest income increased during the three months ended September 30, 2011 as compared to the same period in 2010. Overall non-interest income was \$1,540,000 for the three months ended September 30, 2011 compared to \$938,000 for the same period in 2010. This represents an increase of 64.2%. A component of the increase was that the Corporation recorded a loss on equity investment of \$307,000, in 2010, which did not occur in 2011. In addition, in the third quarter of 2011, the Bank sold a former retail office location and accordingly recorded a gain on sale of \$349,000. On a year to date basis, non-interest income at September 30, 2011 was \$3,796,000 compared with \$3,389,000 at September 30, 2010; an increase of 12.0%.

Service charges on deposit accounts are approximately 19.1% of non-interest income. These fees from service charges were \$294,000 in the third quarter of 2011, compared to \$341,000 for the same period in 2010. This represents a decrease of 13.8% from year to year, with the majority of the decline in NSF charges collected. On a year to date basis, service charges on deposit accounts, decreased 21.8% to \$880,000 at September 30, 2011.

Trust, investment and financial planning services income increased \$32,000 or 16.7% in the third quarter of 2011 compared to the same period in the prior year. The increase is attributable to favorable changes in market value, which resulted in higher fee income. On a year to date basis, trust and wealth management income has increased 13.3% from the first nine months of 2010.

Gain on the sale of mortgage loans originated by the Bank and sold into the secondary market decreased by \$118,000 or 55.1% to \$96,000 in the third quarter of 2011 compared to \$214,000 for the same period in 2010. Management believes for the remainder of 2011, mortgage income will remain relatively flat as governmental purchase incentives have expired and property values remain under stress. On a year to date basis, the gain on the sale of mortgage loans has decreased 53.3% from the first nine months of 2010.

Other operating income increased by \$79,000 or 15.9% in the third quarter of 2011 compared to the same time period in 2010. The increases consist of increased interchange income from debit cards, an increase in gain on sale of real estate owned, and increases in charges related to providing support services to other banks. On a year to date basis, other operating income increased \$198,000 or 13.9%.

**Non-Interest Expense**

Total non-interest expense increased 8.8% to \$3,703,000 in the three months ended September 30, 2011, compared with \$3,402,000 in the same period of 2010. The increase is attributable to increases in salaries and benefits, along with other insurance costs. These increases were partially offset by decreases in occupancy and furniture and equipment expenses; and loan and collection expenses. Total non-interest expense increased 1.8% to \$10,296,000 in the nine months ended September 30, 2011, compared with \$10,117,000 in the same period of 2010. The increase is attributable to increases in salaries and benefits and other insurance costs which were nearly offset by decreases in loan and collection expenses; occupancy and furniture and equipment expenses.

Salary and benefit costs, the Corporation's largest non-interest expense category, were \$1,789,000 in the third quarter of 2011, compared with \$1,573,000, or an increase of 13.7%, for the same time period in 2010. Salary and benefits expense increased due to pension accruals associated with an early retirement of an executive officer. For the nine months ended September 30, 2011, salary and benefit costs were \$5,085,000, compared with \$4,787,000 for the same time period in 2010. This increase of 6.2% or \$298,000 was related to pension accruals associated with an early retirement of an executive officer, along with increases in benefits cost.

Occupancy expenses, at \$289,000, were significantly reduced in the three months ended September 30, 2011 compared to the same period in 2010 with a decrease of \$20,000 or 6.5%. Decreases of occupancy expenses were in property insurance, depreciation, utility costs and reductions in building repairs and maintenance. For the nine month period ended September 30, 2011, occupancy expenses were \$849,000, compared to \$941,000 for the same time period in 2010. This represents a decrease of 9.8%. For the nine month period ended September 30, 2011, the decrease in occupancy expenses is related to reductions in building repairs and maintenance, primarily due to lower snow removal costs in 2011.

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During the three months ended September 30, 2011, furniture and equipment expenses were \$237,000 compared to \$340,000 for the same period in 2010, a decrease of 30.3%. The decrease was due to the lower depreciation, rental and maintenance expense on equipment and furnishings in 2011. For the nine month period ended September 30, 2011, furniture and equipment expenses were \$807,000 compared to \$968,000 for the same period in 2010. This represents a decrease of 16.6% for the nine month period comparison. This was the result of declining depreciation expense along with lower equipment rental expenses.

Loan and collection expenses, at \$393,000 were up \$2,000 or 0.5% during the three months ended September 30, 2011 compared to \$391,000 for the same time period in 2010. The expenses remained nearly flat from year to year and were related to expenses for other real estate owned, in the form of property taxes and property maintenance and expenses related to troubled loans. For the nine month period ended September 30, 2011, loan and collection expenses totaled \$990,000 compared to \$1,096,000 for the same period in 2010. This represents a decrease of 9.7%. The decrease during the nine month period was related to decreases in write downs of other real estate owned.

Advertising expenses increased \$14,000 for the three months ended September 30, 2011 compared to the same period in 2010. For the three months ended September 30, 2011, advertising expenses were \$36,000 compared to \$22,000 for the same period in 2010. This is an increase of 63.6%. The Corporation has resumed advertising campaigns with the goal of attracting new customers for lending and deposit products, while also strengthening our presence in local communities through sponsorships of community events. For the nine month period ended September 30, 2011, advertising expenses totaled \$99,000, compared to \$89,000 for the same time in 2010. This is an increase of 11.2%.

Other operating expenses were \$959,000 in the three months ended September 30, 2011 compared to \$767,000 in the same time period in 2010, an increase of \$192,000 or 25.0%. Increases year over year include increases in our general insurance from third quarter 2010 totals, higher legal costs, higher outside services and an increase in miscellaneous operating expense, pertaining to the costs associated with the sale of a bank facility. Partially offsetting these increases were reductions in FDIC assessment, supplies expense, and ATM/Debit card expenses. In the nine months ended September 30, 2011, other operating expenses were \$2,466,000 compared to \$2,236,000 in the same time period in 2010, an increase of \$230,000 or 10.3%. The increase was comprised of increases in telephone and communication expenses; legal fees, audit and exam fees, bank director retainer fees, general insurances, and miscellaneous operating expenses. Partially offsetting these increases were decreases in supplies expense, postage expense, FDIC assessment, and other losses.

**Financial Condition**

Proper management of the volume and composition of the Corporation's earning assets and funding sources is essential for ensuring strong and consistent earnings performance, maintaining adequate liquidity and limiting exposure to risks caused by changing market conditions. The Corporation's securities portfolio is structured to provide a source of liquidity through maturities and to generate an income stream with relatively low levels of principal risk. The Corporation does not engage in securities trading. Loans comprise the largest component of earning assets and are the Corporation's highest yielding assets. Customer deposits are the primary source of funding for earning assets while short-term debt and other sources of funds could be further utilized if market conditions and liquidity needs change.

The Corporation's total assets were \$307,101,000 at September 30, 2011 compared to total assets of \$424,228,000 at December 31, 2010. This includes assets from discontinued operations \$113,314,000, in connection with the sale of West Michigan Community Bank at December 31, 2010. At September 30, 2011, there were no assets classified as discontinued operations. Gross loans comprised 66.9% of total assets at September 30, 2011 compared to 51.4% at December 31, 2010. Gross loans decreased \$12,641,000 during the first nine months of 2011.



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Bank premises and equipment decreased \$31,000 to \$10,304,000 at September 30, 2011 compared to \$10,335,000 at December 31, 2010. The decrease was the result of normal depreciation along with the sale of a bank facility and the purchase of a bank property which was previously leased.

Other assets, which include accrued interest receivable and prepaid expenses, decreased \$1,249,000 when comparing September 30, 2011 to December 31, 2010. Other assets totaled \$1,909,000 at September 30, 2011 compared to \$3,158,000 at December 31, 2010. The decrease is mainly attributable to a decrease of \$549,000 in prepaid expenses due to normal amortization of contracts. In addition, at December 31, 2010, \$828,000 of REO in redemption was included in other assets. At September 30, 2011, assets similar in nature have been classified into the loan portfolio on the balance sheet.

On the liability side of the balance sheet, the ratio of non-interest bearing deposits to total deposits was 24.2% at September 30, 2011 and 19.9% at December 31, 2010. Interest bearing deposit liabilities totaled \$206,315,000 at September 30, 2011 compared to \$220,933,000 at December 31, 2010. Total deposits decreased \$3,712,000 with non-interest bearing demand deposits increasing \$10,906,000 and interest bearing deposits decreasing \$14,618,000. The increase in non-interest bearing demand is due primarily to seasonal deposits related to property tax payments collected by municipalities. The largest decrease in interest bearing deposits was in time deposits. Short-term borrowings decreased \$232,000 due to the decrease in treasury tax and loan payments outstanding at the end of the two periods. FHLB advances decreased \$31,000 at September 30, 2011 compared to December 31, 2010. This was due to the annual payment on a long-term advance held at the Bank.

**Non-Performing Assets**

Non-performing assets include loans on which interest accruals have ceased, loans past due 90 days or more and still accruing, loans that have been renegotiated, and real estate acquired through foreclosure or deed-in-lieu of foreclosure.

Total non performing assets decreased from December 31, 2010 to September 30, 2011, along with the ratio of non-performing loans to the allowance for loan losses. The recorded investment in non-performing assets decreased \$930,000 from December 31, 2010 to September 30, 2011. Non-accrual loans increased \$61,000 to \$17,640,000 at September 30, 2011. Modified loans increased \$1,436,000 to \$7,682,000 at September 30, 2011 and other real estate decreased \$1,441,000 to \$1,966,000. REO in redemption decreased \$864,000 to \$768,000. See Note 4 for additional information.

The level and composition of non-performing assets is affected by economic conditions in the Corporation's local markets. Non-performing assets, charge-offs, and provisions for loan losses tend to decline in a strong economy and increase in a weak economy, potentially impacting the Corporation's operating results. In addition to non-performing loans, management carefully monitors other credits that are current in terms of principal and interest payments but, in management's opinion, may deteriorate in quality if economic conditions change.

Certain portions of the Corporation's non-performing loans are considered impaired. The Corporation measures impairment on all large balance non-accrual commercial loans. Certain large balance accruing loans rated watch or monitor are also analyzed for possible impairment. Impairment losses are believed to be appropriately covered by the allowance for loan losses.

The Corporation maintains policies and procedures to identify and monitor non-accrual loans. A loan is placed on non-accrual when there is doubt regarding collection of principal or interest, or when principal or interest is past due 90 days or more. Accrued but uncollected interest is reversed against income for the current quarter when a loan is placed on non-accrual. At September 30, 2011, there were \$530,000 of loans past due 90 days or more and still accruing. Management is not aware of any loans that have not been moved to non-accrual or not been reclassified to troubled debt restructurings at September 30, 2011. The potential, however, remains that a borrower may become financially distressed in the future and management may place that loan into non-accrual, but this is difficult to predict.

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### Liquidity and Interest Rate Risk Management

Asset/Liability management is designed to assure liquidity and reduce interest rate risks. The goal in managing interest rate risk is to maintain a strong and relatively stable net interest margin. It is the responsibility of the Asset/Liability Management Committee (ALCO) to set policy guidelines and to establish short-term and long-term strategies with respect to interest rate exposure and balance sheet liquidity. The ALCO, which is comprised of key members of management, meets regularly to review financial performance and soundness, including interest rate risk and liquidity in relation to present and prospective markets and business conditions. Accordingly, the committee adopts funding and balance sheet management strategies that are intended to maximize earnings, maintain liquidity, and achieve balance sheet composition objectives.

Liquidity maintenance together with a solid capital base and strong earnings performance are key objectives of the Corporation. The Corporation's liquidity is derived from a strong deposit base comprised of individual and business deposits. Deposit accounts of customers in the mature market represent a substantial portion of deposits of individuals. The Bank's deposit base plus other funding sources (federal funds purchased, short-term borrowings, FHLB advances, other liabilities and shareholders' equity) provided primarily all funding needs in the first nine months of 2011. While these sources of funds are expected to continue to be available to provide funds in the future, the mix and availability of funds will depend upon future economic conditions. The Corporation does not foresee any difficulty in meeting its funding requirements.

Primary liquidity is provided through short-term investments or borrowings (including federal funds sold and purchased) while the securities portfolio provides secondary liquidity. The securities portfolio has increased \$21,102,000 since December 31, 2010 due to purchases in the available for sale investment portfolio. Multiple available for sale securities with elevated credit risk were sold and the proceeds used to purchase mortgage backed instruments with lower credit risk during the fourth quarter of 2010. The Corporation has re-invested some of the funds, from the call and maturities of these securities, back into the securities portfolio to increase yield and manage the asset ratios on the balance sheet. The Corporation regularly monitors liquidity to ensure adequate cash flows to cover unanticipated reductions in the availability of funding sources.

Interest rate risk is managed by controlling and limiting the level of earnings volatility arising from rate movements. The Corporation regularly performs reviews and analysis of those factors impacting interest rate risk. Factors include maturity and re-pricing frequency of balance sheet components, impact of rate changes on interest margin and prepayment speeds, market value impacts of rate changes, and other issues. Both actual and projected performance are reviewed, analyzed, and compared to policy and objectives to assure present and future financial viability.

The Corporation had cash used in financing activities resulting from the decrease of deposits, a decrease in short term borrowings and the sale of a subsidiary bank. In the first nine months of 2011 deposits decreased \$3,712,000, while short term borrowings decreased \$232,000. Cash provided by investing activities was \$82,177,000 in first nine months of 2011 compared to \$64,423,000 in first nine months of 2010. The change in investing activities was due to the sale of a subsidiary bank.

### Capital Resources

Management closely monitors bank capital levels to provide for current and future business needs and to comply with regulatory requirements. Regulations prescribed under the Federal Deposit Insurance Corporation Improvement Act of 1991 have defined adequately capitalized institutions as those having total risk-based ratios, tier 1 risk-based capital ratios and tier 1 leverage ratios of at least 8%, 4%, and 4%, respectively. At September 30, 2011, The State Bank was in excess of the minimum adequately capitalized capital and leverage requirements as defined by federal law and was in compliance with the capital requirements prescribed by the Consent Order.

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Total shareholders' equity decreased 2.4% to \$15,677,000 at September 30, 2011 compared with \$16,055,000 at December 31, 2010. The decrease was due to the net loss in the first nine months of 2011, partially offset by increases in other comprehensive income as noted below. The Corporation's equity to asset ratio was 5.1% at September 30, 2011 and 3.8% at December 31, 2010.

As indicated on the balance sheet at December 31, 2010, the Corporation had an accumulated other comprehensive income of \$61,000 compared to \$208,000 at September 30, 2011. The fluctuation in the income position is attributable to a combination of the fluctuation of the market price of securities held in the available for sale portfolio resulting from purchases made in the third quarter of 2011.

For additional information on the Corporation's capital resources please refer to Note 10 to the financial statements which is incorporated herein by this reference.

## Regulatory Orders and Trust Preferred

The Corporation's primary source of cash to service its subordinated debt is dividends from the subsidiary banks. Since the subsidiary banks have suspended dividends to the holding company, the Corporation has elected to defer interest payments for five years on \$14,000,000 of subordinated debentures. The reason for the interest deferral is to maintain liquidity at the Holding Company. The Corporation is not in default under either of the indentures. During this five year period, the Corporation is precluded from paying shareholder dividends on its outstanding common stock. The Corporation subsequently may give notice that it elects to shorten the deferral period, pay accrued interest and return to the normal course of shareholder dividend payments.

On October 27, 2010, management received a notice from The Federal Reserve which defined restrictions being placed upon the Holding Company. The restrictions include the declaration or payment of any dividends, the receipt of dividends from subsidiary Banks, the repayment of any principal or interest on subordinated debentures or Trust Preferred securities, restrictions on debt, any changes in Executive or Senior Management or change in the role of Senior Management. In addition, the notice provided an indication for the Corporation to maintain sufficient capital levels.

## Critical Accounting Policies and Estimates

The Management's Discussion and Analysis of financial condition and results of operations are based on the Corporation's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, income taxes, other real estate owned, and investment securities valuation. Actual results could differ from those estimates. Management believes that its critical accounting policies include determining the allowance for loan losses and determining the fair value of securities, carrying value of deferred tax assets and other financial instruments.

The allowance for loan losses is maintained at a level we believe is appropriate to absorb probable losses identified and inherent in the loan portfolio. Our evaluation of the appropriateness of the allowance for loan losses is an estimate based on reviews of individual loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. The allowance for loan losses represents management's best estimate, but significant downturns in circumstances relating to loan quality or economic conditions could result in a requirement for an increased allowance for loan losses in the near future. Likewise, an upturn in loan quality or improved economic conditions may result in a decline in the required allowance for loan losses. In either instance unanticipated changes could have a significant impact on operating earnings.

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The allowance for loan losses is increased through a provision charged to operating expense. Uncollectible loans are charged-off through the allowance for loan losses. Recoveries of loans previously charged-off are added to the allowance for loan losses. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement.

Our accounting for income taxes involves the valuation of deferred tax assets and liabilities primarily associated with differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position for the Corporation at September 30, 2011 and December 31, 2010. During the second quarter of 2009, the Corporation recognized a full valuation allowance. The valuation allowance against our deferred tax assets may be reversed to income in future periods to the extent that the related deferred income tax assets are realized or the valuation allowance is otherwise no longer required. Management will continue to monitor our deferred tax assets quarterly for changes affecting their realizability.

Other Real Estate Owned and Foreclosed Assets are acquired through or as an alternative to loan foreclosure. Such properties 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 expensed as are costs after acquisition.

The Corporation evaluates securities for other-than-temporary impairment ( OTTI ) at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In determining other-than-temporary impairment ( 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 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.

**Off Balance Sheet Arrangements**

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk was as follows at:

(000s omitted)	September 30, 2011	December 31, 2010
Commitments to make loans (at market rates)	\$ 12,274	\$ 8,403
Unused lines of credit and letters of credit	28,490	29,746

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The information concerning quantitative and qualitative disclosures about market risk contained on page 62 in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010, is incorporated herein by reference.

Fentura Financial, Inc. faces market risk to the extent that both earnings and the fair value of its financial instruments are affected by changes in interest rates. The Corporation manages this risk with static GAP analysis and simulation modeling. For the first nine months of 2011, the results of these measurement techniques were within the Corporation's policy guidelines. The Corporation does not believe that there has been a material change in the nature of the Corporation's primary market risk exposures, including the categories of market risk to which the Corporation is exposed and the particular markets that present the primary risk of loss to the Corporation, or in how those exposures have been managed in 2011 compared to 2010.

The Corporation's market risk exposure is mainly comprised of its vulnerability to interest rate risk. Prevailing interest rates and interest rate relationships in the future will be primarily determined by market factors, which are outside of the Corporation's control. All information provided in this section consists of forward-looking statements. Reference is made to the section captioned "Forward Looking Statements" in this quarterly report for a discussion of the limitations on the Corporation's responsibility for such statements.

**Interest Rate Sensitivity Management**

Interest rate sensitivity management seeks to maximize net interest income as a result of changing interest rates, within prudent ranges of risk. The Corporation attempts to accomplish this objective by structuring the balance sheet so that re-pricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these re-pricing opportunities at any point in time constitute a bank's interest rate sensitivity. The Corporation currently does not utilize derivatives in managing interest rate risk.

An indicator of the interest rate sensitivity structure of a financial institution's balance sheet is the difference between rate sensitive assets and rate sensitive liabilities, and is referred to as "GAP." Table 3 sets forth the distribution of re-pricing of the Corporation's earning assets and interest bearing liabilities as of September 30, 2011, the interest rate sensitivity GAP, as defined above, the cumulative interest rate sensitivity GAP, the interest rate sensitivity GAP ratio (i.e. interest rate sensitive assets divided by interest rate sensitive liabilities) and the cumulative sensitivity GAP ratio. The table also sets forth the time periods in which earning assets and liabilities will mature or may re-price in accordance with their contractual terms.

**Table of Contents****Table 3 GAP Analysis September 30, 2011**

	Within Three Months	Three Months to One Year	One to Five Years	After Five Years	Total
(000s omitted)					
<b>Earning Assets:</b>					
Federal Funds Sold	\$ 5,000	\$ 0	\$ 0	\$ 0	\$ 5,000
Securities	16,051	23,522	21,437	6,317	67,327
Loans	37,864	38,467	57,869	71,290	205,490
Loans Held for Sale	489	0	0	0	489
FHLB Stock	661	0	0	0	661
<b>Total Earning Assets</b>	<b>\$ 60,065</b>	<b>\$ 61,989</b>	<b>\$ 79,306</b>	<b>\$ 77,607</b>	<b>\$ 278,967</b>
<b>Interest Bearing Liabilities:</b>					
Interest Bearing Demand Deposits	\$ 45,723	\$ 0	\$ 0	\$ 0	\$ 45,723
Savings Deposits	73,201	0	0	0	73,201
Time Deposits Less than \$100,000	8,728	25,864	16,485	1,574	52,651
Time Deposits Greater than \$100,000	5,521	16,009	11,899	1,311	34,740
Short term borrowings	647	0	0	0	647
Other Borrowings	0	33	74	816	923
Subordinated debentures	14,000	0	0	0	14,000
<b>Total Interest Bearing Liabilities</b>	<b>\$ 147,820</b>	<b>\$ 41,906</b>	<b>\$ 28,458</b>	<b>\$ 3,701</b>	<b>\$ 221,885</b>
<b>Interest Rate Sensitivity GAP</b>	<b>(\$ 87,755)</b>	<b>\$ 20,083</b>	<b>\$ 50,848</b>	<b>\$ 73,906</b>	<b>\$ 57,082</b>
<b>Cumulative Interest Rate Sensitivity GAP</b>	<b>(\$ 87,755)</b>	<b>(67,672)</b>	<b>(16,824)</b>	<b>57,082</b>	
<b>Interest Rate Sensitivity GAP Ratio</b>	<b>0.41</b>	<b>1.48</b>	<b>2.79</b>	<b>20.97</b>	
<b>Cumulative Interest Rate Sensitivity GAP Ratio</b>	<b>0.41</b>	<b>0.64</b>	<b>0.92</b>	<b>1.26</b>	

As indicated in Table 3, the short-term (one year and less) cumulative interest rate sensitivity gap is negative. Accordingly, if market interest rates increase, this negative gap position could have a short-term negative impact on interest margin. Conversely, if market rates decline this should theoretically have a short-term positive impact. However, gap analysis is limited and may not provide an accurate indication of the impact of general interest rate movements on the net interest margin since the re-pricing of various categories of assets and liabilities is subject to the Corporation's needs, competitive pressures, and the needs of the Corporation's customers. In addition, various assets and liabilities indicated as re-pricing within the same period may in fact re-price at different times within such period and at different rate indices. The Prime Rate has remained steady over the past twelve months. This steadiness allowed management to close the gap related to interest rate sensitivity. Management was able to reduce liquid interest bearing liability rates to extremely low rates, while maintaining relatively similar volumes. The Banks were also able to re-price maturing time deposits, usually in a downward fashion as longer term certificates at higher rates matured during the year. On the asset side of the balance sheet, rates on the investment portfolios remained relatively steady and the yields on loans increased slightly. Management worked to re-price loans favorably as they renewed and were priced accordingly for risk, however overall loan yields decreased. This was due to increases in non-performing loans. The Corporation expects to continue to make strides in managing interest rate sensitivity.

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### **Forward Looking Statements**

This report includes forward-looking statements as that term is used in the securities laws. All statements regarding our expected financial position, business and strategies are forward-looking statements. In addition, the words anticipates, believes, estimates, seeks, expects, intends, and similar expressions, as they relate to us or our management, are intended to identify forward-looking statements. The presentation and discussion of the provision and allowance for loan losses and statements concerning future profitability or future growth or increases, are examples of inherently forward looking statements in that they involve judgments and statements of belief as to the outcome of future events. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and our future prospects include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in our market area and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning us and our business, including additional factors that could materially affect our financial results, is included in our other filings with the Securities and Exchange Commission.

### **ITEM 4: CONTROLS AND PROCEDURES**

- (a) **Evaluation of Disclosure Controls and Procedures.** The Corporation's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Corporation's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Form 10-Q Quarterly Report, have concluded that the Corporation's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Corporation would be made known to them by others within the Corporation, particularly during the period in which this Form 10-Q was being prepared.
  
- (b) **Changes in Internal Controls.** During the period covered by this report, there have been no changes in the Corporation's internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Corporation's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings. None**

**Item 1A. Risk Factors This item is not applicable to smaller reporting companies.**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds. None**

**Item 3. Defaults Upon Senior Securities. None**

**Item 4. [Reserved]**

**Item 5. Other Information. None**

**Item 6. Exhibits.**

(a) Exhibits

- 31.1 Certificate of the President and Chief Executive Officer of Fentura Financial, Inc. pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certificate of the Chief Financial Officer of Fentura Financial, Inc. pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certificate of the Chief Executive Officer of Fentura Financial, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certificate of the Chief Financial Officer of Fentura Financial, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive data files



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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.

Fentura Financial, Inc.

Dated: November 14, 2011

Donald L. Grill  
President & CEO

Dated: November 14, 2011

Douglas J. Kelley  
Chief Financial Officer and Principal Accounting Officer

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**EXHIBIT INDEX**

Exhibit	Description
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101	Interactive data files