FENTURA FINANCIAL INC
Form 10-Q
November 12, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from _______________ to _______________

Commission file number 000-23550

Fentura Financial, Inc.

(Exact name of registrant as specified in its charter)

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

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

(Address of Principal Executive Offices)

(810) 629-2263

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes o 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.)
o Yes o 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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: October 23, 2009

Class Common Stock Shares Outstanding 2,225,214

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PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

Fentura Financial, Inc.

Consolidated Balance Sheets

(000s omitted except share data)	September 30, 2009 (unaudited)	Dec 31, 2008
ASSETS		
Cash and due from banks	$ 18,814	$ 13,626
Federal funds sold	27,250	0
Total cash & cash equivalents	46,064	13,626
Securities-available for sale	49,405	47,065
Securities-held to maturity, (fair value of $5,636 at September 30, 2009 and $6,784 at December 31, 2008)	5,577	6,765
Total securities	54,982	53,830
Loans held for sale	1,434	690
Loans:		
Commercial	270,542	289,523
Real estate loans construction	34,072	48,777
Real estate loans mortgage	30,829	37,828
Consumer loans	50,438	52,910
Total loans	385,881	429,038
Less: Allowance for loan losses	(14,485)	(10,455)
Net loans	371,396	418,583
Bank owned life insurance	7,138	7,282
Bank premises and equipment	16,111	16,879
Federal Home Loan Bank stock	1,900	1,900
Accrued interest receivable	2,020	2,231
Acquisition intangibles	189	293
Equity investment	0	1,360
Other real estate owned	6,856	5,983
Assets of held for sale operations	41,195	45,650
Other assets	5,707	10,297
Total assets	$554,992	$578,604
LIABILITIES		
Deposits:		
Non-interest bearing deposits	$ 63,786	$ 64,325
Interest bearing deposits	405,080	405,039
Total deposits	468,866	469,364

Short term borrowings	34	1,500
Federal Home Loan Bank advances	9,981	12,707
Subordinated debentures	14,000	14,000
Note payable	0	1,000
Liabilities of held for sale operations	38,164	42,174
Accrued taxes, interest and other liabilities	4,400	1,735
Total liabilities	535,445	542,480
SHAREHOLDERS EQUITY		
Common stock no par value 2,225,214 shares issued (2,185,765 at Dec. 31, 2008)	42,883	42,778
Retained deficit	(22,548)	(4,677)
Accumulated other comprehensive loss	(788)	(1,977)
Total shareholders equity	19,547	36,124
Total liabilities and shareholders equity	$554,992	$578,604

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Income (Unaudited)

(000s omitted except per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
INTEREST INCOME				
Interest and fees on loans	$ 5,936	$ 7,013	$ 18,399	$ 21,364
Interest and dividends on securities:				
Taxable	404	458	1,213	1,503
Tax-exempt	135	148	418	403
Interest on federal funds sold	1	31	1	139
Total interest income	6,476	7,650	20,031	23,409
INTEREST EXPENSE				
Deposits	2,277	2,892	7,503	9,702
Borrowings	227	350	829	1,259
Total interest expense	2,504	3,242	8,332	10,961
NET INTEREST INCOME	3,972	4,408	11,699	12,448
Provision for loan losses	1,940	700	11,306	5,155
Net interest income after provision for loan losses	2,032	3,708	393	7,293
NON-INTEREST INCOME				
Service charges on deposit accounts	519	651	1,435	1,871
Gain on sale of mortgage loans	100	42	612	260
Trust and investment services income	458	456	1,285	1,428
Gain on sale of securities	12	0	12	0
Loss on equity investment	0	(239)	(1,360)	(696)
Other income and fees	391	270	1,461	1,089
Total non-interest income	1,480	1,180	3,445	3,952
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,129	2,534	6,752	8,126
Occupancy	428	453	1,378	1,450
Furniture and equipment	385	453	1,212	1,432
Loan and collection	984	135	2,302	504
Advertising and promotional	39	108	126	323
Loss on security impairment	0	233	200	843
Loss on impairment of held for sale operations	0	0	700	0
Other operating expenses	1,015	861	3,458	2,424
Total non-interest expense	4,980	4,777	16,128	15,102
Income/(loss) from continuing operations before income tax	(1,468)	111	(12,290)	(3,857)

Federal income tax expense/(benefit)	(332)	(101)	5,028	(1,490)
Net income/(loss) from continuing operations	$ (1,136)	$ 212	$ (17,318)	$ (2,367)
Net income/(loss) from held for sale operations, net of tax	289	83	(553)	(134)
Net income/(loss)	$ (847)	$ 295	$ (17,871)	$ (2,501)
Income/(loss) per share from continuing operations				
Basic	$ (0.51)	$ 0.10	$ (7.88)	$ (1.09)
Diluted	$ (0.51)	$ 0.10	$ (7.88)	$ (1.09)
Net income/(loss) per share				
Basic	$ (0.38)	$ 0.14	$ (8.13)	$ (1.15)
Diluted	$ (0.38)	$ 0.14	$ (8.13)	$ (1.15)
Cash Dividends declared	$ 0.00	$ 0.00	$ 0.00	$ 0.00

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Changes in Shareholders Equity (Unaudited)

	Nine Months Ended September 30,	
(000s omitted)	**2009**	**2008**
COMMON STOCK		
Balance, beginning of period	$ 42,778	$ 42,478
Issuance of shares under		
Director stock purchase plan & Dividend reinvestment program (39,449 and 17,187 shares)	105	254
Stock compensation expense	0	6
Balance, end of period	42,883	42,738
RETAINED DEFICIT		
Balance, beginning of period	(4,677)	7,488
Net loss	(17,871)	(2,501)
Balance, end of period	(22,548)	4,987
ACCUMULATED OTHER COMPREHENSIVE LOSS		
Balance, beginning of period	(1,977)	(470)
Change in unrealized gain (loss) on securities, net of tax	1,189	(1,054)
Balance, end of period	(788)	(1,524)
Total Shareholders Equity	$ 19,547	$ 46,201

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Cash Flows (Unaudited)

(000s omitted)	Nine Months Ended September 30, 2009	2008
OPERATING ACTIVITIES:		
Net loss	$(17,871)	$ (2,501)
Adjustments to reconcile net income (loss) to cash Provided by Operating Activities:		
Stock compensation expense	0	6
Depreciation and amortization	811	610
Establishment of deferred tax asset valuation allowance	5,924	0
Provision for loan losses	11,306	5,155
Loans originated for sale	(49,629)	(19,918)
Proceeds from the sale of loans	49,497	20,372
(Gain) on sales of loans	(612)	(260)
(Gain) Loss on sale of securities	(12)	0
(Gain) Loss on sale of fixed assets	0	(118)
(Gain) Loss on other real estate owned	645	(70)
Loss on security impairment	200	843
Loss on equity investment	1,360	697
Earnings from bank owned life insurance	(59)	(159)
Net (increase) decrease in interest receivable & other assets	(1,347)	(21,774)
Net increase (decrease) in interest payable & other liabilities	(3,783)	1,972
Total Adjustments	14,301	(12,644)
Net cash (used in) operating activities	(3,570)	(15,145)
CASH FLOWS FROM INVESTING ACTIVITES:		
Proceeds from maturities of securities HTM	1,183	1,326
Proceeds from maturities of securities AFS	7,714	6,961
Proceeds from sales of securities AFS	4,000	1,999
Proceeds from calls of securities AFS	2,000	11,112
Purchases of securities AFS	(14,560)	(7,067)
Net decrease in loans	41,379	14,912
Proceeds from bank owned life insurance	203	0
Sales of other real estate owned	1,876	2,613
Acquisition of premises and equipment, net	(79)	76
Net cash provided by investing activities	43,716	31,932
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) in deposits	(498)	(33,513)
Net increase (decrease) in borrowings	(1,466)	1,726
Net (decrease) in repurchase agreements	0	(5,000)
Repayment of notes payable	(1,000)	0
Purchase of advances from FHLB	55,495	25,001

Repayments of advances from FHLB	(58,221)	(23,024)
Net proceeds from stock issuance and purchase	105	255
Net cash (used in) financing activities	(5,585)	(34,555)
Net Change in Cash and Cash Equivalents	$ 32,438	$(14,154)
Change in cash and cash equivalents of held for sale operations	(2,123)	3,614
Cash and cash equivalents Beginning	$ 13,626	$ 27,041
Cash and cash equivalents Ending	$ 46,064	$ 12,887
Cash paid for:		
Interest	$ 8,506	$ 11,043
Income Taxes	$ 3,981	$ 0
Noncash Disclosures:		
Transfers from loans to other real estate	$ 3,394	$ 6,917

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Fentura Financial, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(000s Omitted)	2009	2008	2009	2008
Net loss	$ (847)	$ 295	$(17,871)	$(2,501)
Other comprehensive income (loss), net of tax:				
Unrealized holding gains (losses) arising during period	547	(75)	764	332
Impairment loss recognized during period	0	(233)	(200)	(843)
Reclassification adjustment for gains included in income	12	0	12	0
Tax effect	593	(328)	613	(543)
Other comprehensive income (loss)	1,152	(636)	1,189	(1,054)
Comprehensive income (loss)	$ 305	$(341)	$(16,682)	$(3,555)

Fentura Financial, Inc.
Notes to Consolidated Financial Statements (Unaudited)
NOTE 1 BASIS OF PRESENTATION

The consolidated financial statements at December 31, 2008, September 30, 2008 and September 30, 2009 include Fentura Financial, Inc. (the Corporation) and its wholly owned subsidiaries, The State Bank in Fenton, Michigan; Davison State Bank in Davison, Michigan; and West Michigan Community Bank in Hudsonville, Michigan (the Banks), as well as Fentura Mortgage Company, West Michigan Mortgage Company, LLC, and the other subsidiaries of the Banks. Intercompany transactions and balances are eliminated in consolidation.

On March 17, 2009, The Corporation entered into an agreement to sell all of the stock of one of its bank subsidiaries, Davison State Bank, to a private, non-affiliated, investor group. The transaction is expected to close during the fourth quarter of 2009. At September 30, 2009, Davison had assets of $41.2 million, loans of $25.6 million; deposits of $36.1 million, equity of $3.0 million and a year-to-date net loss of $553,000. The agreement calls for consideration to be received of $3.0 million plus or minus certain closing equity adjustments. The Corporation recorded an estimated loss on the sale of Davison State Bank of $700,000 in the first quarter of 2009. The agreement also provides for a termination payment of $150,000 if either party breaches the agreement.

Financial statements are presented with held for sale operations separately presented on the balance sheet and income statement. The presentations have been updated for September 30, 2009, December 31, 2008 and September 30, 2008 to reflect the held for sale operations results.

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 (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the

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NOTE 1 BASIS OF PRESENTATION (continued)

consolidated financial statements and footnotes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2008.

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

A loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage, consumer, and on an individual loan basis for other loans. 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.

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.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Dividend Restriction: 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 Banks have been restricted from dividend payments in efforts of preserving their individual capital levels.

Stock Option Plans: The Nonemployee Director Stock Option Plan provides for granting options to nonemployee directors to purchase the Corporation s common stock. No options have been granted in 2009. 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.

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 fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based

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NOTE 1 BASIS OF PRESENTATION (continued)

on historical volatilities of the Corporation s common stock. The Corporation uses historical data to estimate option exercise and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Shares that are issued upon option exercise come from authorized but unissued shares.

The following table summarizes stock option activity:

	Number of Options	Weighted Average Price
Options outstanding at December 31, 2008	26,597	$ 29.85
Options granted 2009	0	$ 0.00
Options forfeited 2009	(2,592)	$ 30.31
Options outstanding at September 30, 2009	24,005	$ 29.80

NOTE 2 ADOPTION OF NEW ACCOUNTING STANDARDS

New Accounting Pronouncements:

In December 2007, the FASB issued statements regarding *Business Combinations*, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. This statement is effective for fiscal years beginning on or after December 15, 2008. The adoption of this standard did not have an impact on the Corporation s results of operations or financial position.

In December 2007, the FASB issued a statement regarding *Non-controlling Interest in Consolidated Financial Statements*, which changed the accounting and reporting for minority interests, re-characterizing them as non-controlling interests and classifying them as a component of equity within the consolidated balance sheets. This is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. The adoption of this statement did not have a significant impact on the Corporation s results of operations or financial position.

In June 2008, the FASB issued a statement regarding *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* This addresses whether these types of instruments are participating prior to vesting and, therefore need to be included in the earning allocation in computing earnings per share under the two class method described in the statement regarding *Earnings Per Share.* This statement is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period earnings per share data presented shall be adjusted retrospectively. The adoption of this statement on January 1, 2009 had no effect on the Corporation s results of operations or financial position.

In April 2009, the FASB issued a statement regarding the *Recognition and Presentation of Other-Than-Temporary Impairments,* which amends existing guidance for determining whether impairment is other-than-temporary for debt securities. This statement requires an entity to assess whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet the

NOTE 2 ADOPTION OF NEW ACCOUNTING STANDARDS (continued)

aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

Additionally, the statement expands and increases the frequency of existing disclosures about other-than-temporary impairments for debt and equity securities. This statement is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Corporation adopted this statement in the second quarter. The adoption did not have any effect on the results of operations or financial position.

In April 2009, the FASB issued a statement regarding determining fair value when the volume and level of activity for the asset and liability have significantly decreased and identifying transactions that are not orderly. This statement emphasizes that even if there has been a significant decrease in the volume and level of activity, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants. The statement provides a number of factors to consider when evaluating whether there has been a significant decrease in the volume and level of activity for an asset or liability in relation to normal market activity. In addition, when transactions or quoted prices are not considered orderly, adjustments to those prices based on the weight of available information may be needed to determine the appropriate fair value. The statement also requires increased disclosures. This statement is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The Corporation adopted this statement in the second quarter. The adoption did not have any effect on the results of operations or financial position.

In April 2009, the FASB issued statements regarding interim disclosures about fair value of financial instruments. This statement amends the FASB statement regarding disclosures about fair value of financial instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies that were previously only required in annual financial statements. This statement is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Corporation adopted this statement in the second quarter and the relevant disclosures have been added to Note 3.

In July 2009, the FASB issued a statement regarding the codification of financial accounting standards and the hierarchy of generally accepted accounting principles. The objective of this statement is to replace the statement previously titled, The Hierarchy of Generally Accepted Accounting Principles , and to establish the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

In February 2008, FASB issued a statement regarding the effective date of fair value disclosures. This statement delays the effective date of the, Fair Value measure for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this statement on January 1, 2009 did not have a material impact on our consolidated financial statements.

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NOTE 2 ADOPTION OF NEW ACCOUNTING STANDARDS (continued)

In May, 2009, the FASB issued a statement regarding subsequent events. This SFAS adopts part of the auditing literature regarding subsequent event transactions into the accounting standards. Though the criteria used to measure subsequent events did not change, the relevant terms of Type 1 and Type 2 subsequent events were changed to recognized subsequent events and nonrecognized subsequent events respectively. This standard also requires public companies to disclose the date upon which subsequent events were measured, which is the date the financial statements are filed with the Securities and Exchange Commission (SEC).

The Corporation evaluated subsequent events as of and through the date November 11, 2009.

NOTE 3 SECURITIES

The following table summarizes the amortized cost and fair value of the available for sale and held to maturity securities portfolio at September 30, 2009 and the corresponding amounts of unrealized gains and losses therein:

(000s omitted) **Available for Sale** 2009	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. Government & federal agency	$ 7,558	$ 58	$ (52)	$ 7,564
State and municipal	7,868	290	(15)	8,143
Mortgage-backed residential	15,909	275	(9)	16,175
Collateralized mortgage obligations	16,616	201	(1,123)	15,694
Equity securities	2,363	36	(570)	1,829
	$ 50,314	$ 860	$ (1,769)	$ 49,405

(000s omitted) **Held to Maturity** 2009	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
State and municipal	$ 5,575	$ 74	$ (15)	$ 5,634
Mortgage-backed residential	2	0	0	2
	$ 5,577	$ 74	$ (15)	$ 5,636

The amortized cost and fair value of the securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities of securities at September 30, 2009 were as follows:

	Available for Sale	
(000s omitted)	Amortized Cost	Fair Value
Due in one year or less	$ 7,094	$ 7,121
Due from one to five years	4,529	4,552
Due from five to ten years	3,803	4,034
Mortgage-backed securities	15,909	16,175
Collateralized mortgage obligations	16,616	15,694
Equity securities	2,363	1,829
	$ 50,314	$ 49,405

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NOTE 3 SECURITIES (continued)

(000s omitted)	Held to Maturity Amortized Cost	Fair Value
Due in one year or less	$ 2,642	$ 2,650
Due from one to five years	2,166	2,180
Due from five to ten years	767	804
Due after ten years	0	0
Mortgage-backed securities	2	2
	$ 5,577	$ 5,636

At September 30, 2009, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders equity.

For the nine months ended September 30, 2008, the Corporation had $1,999,000 in proceeds from the sales of securities and no gain or loss on securities. For the nine months ended September 30, 2009, the Corporation had $4,000,000 in proceeds from the sale of securities with a gain of $12,000.

Securities with unrealized losses at September 30, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are as follows:

2009

Available for Sale (000s omitted)	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
US Government & federal agency	$ 3,506	$ (52)	$ 0	$ 0	$ 3,506	$ (52)
State & municipal	0	0	685	(15)	685	(15)
Mortgage-backed	1,276	(9)	0	0	1,276	(9)
Collateralized mortgage obligations	0	0	5,042	(1,123)	5,042	(1,123)
Equity securities	0	0	1,315	(570)	1,315	(570)
Total available for sale	$ 4,782	$ (61)	$ 7,042	$ (1,708)	$ 11,824	$ (1,769)

2009

Held to Maturity (000s omitted)	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State & municipal	$ 321	$ (1)	$ 641	$ (14)	$ 962	$ (15)
Total held to maturity	$ 321	$ (1)	$ 641	$ (14)	$ 962	$ (15)

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NOTE 3 SECURITIES (continued)
2008

Available for Sale

(000s omitted) Description of Securities	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or More Fair Value	12 Months or More Unrealized Loss	Total Fair Value	Total Unrealized Loss
State & municipal	$ 2,790	$ (91)	$ 1,583	$ (80)	$ 4,373	$ (171)
Mortgage-backed	3,968	(83)	19,550	(2,310)	23,518	(2,393)
Equity securities	1,049	(598)	188	(228)	1,237	(826)
Total available for sale	$ 7,807	$ (772)	$ 21,321	$ (2,618)	$ 29,128	$ (3,390)

2008

Held to Maturity

(000s omitted) Description of Securities	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or More Fair Value	12 Months or More Unrealized Loss	Total Fair Value	Total Unrealized Loss
State & municipal	$ 0	$ 0	$ 682	$ (29)	$ 682	$ (29)
Total held to maturity	$ 0	$ 0	$ 682	$ (29)	$ 682	$ (29)

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

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

As of September 30, 2009, the Corporation s security portfolio consisted of 127 securities, 25 of which were in an unrealized loss position. The majority of unrealized losses are related to the Corporation s collateralized mortgage obligations (CMOs) and equity securities, as discussed below:

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NOTE 3 SECURITIES (continued)

Collateralized Mortgage Obligations (CMOs) and Equity Securities

The Corporation s unrealized losses relate primarily to its investment in collateralized mortgage obligation securities. The decline in fair value is primarily attributable to temporary illiquidity and the financial crisis affecting these markets and not necessarily the expected cash flows of the individual securities. These nine investments total $16.6 million of book value. The majority of these securities were issued by U.S. government sponsored agencies, Ginnie Mae and Federal Home Loan Bank, all of which hold AAA ratings by a major rating agency. In addition, the portfolio contains four private label securities. The ratings held on the private label securities are AAA on two of the securities, BB on one and CCC on the fourth. The underlying collateral of these CMOs is comprised largely of 1-4 family residences located in geographically diverse locations. In each of these securities the Corporation lies in 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. Management reviews historical and payment streams, delinquency ratios, geographic distribution, ratings, projected future cash flows and general market conditions. Following the September 30, 2009 analysis, managements review did not indicate other-than-temporary impairment on these securities.

The Corporation also holds investments in equity securities. The majority of the equity securities are investments into bank holding companies within Michigan. One equity investment is held in a Community Reinvestment Act (CRA) money market instrument. On a quarterly basis, management reviews the Corporation s investment in these equity securities. Management reviews current market prices on publicly traded equity securities and compares the current price to the book price. Any difference is adjusted as a temporary valuation difference, unless other resources provide other information. Equity securities that are not publicly traded 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 a temporary valuation adjustment is warranted. The equity securities portfolio has an amortized cost of $2,363,000. Currently, the equity securities have a net unrecognized loss of $534,000, for a fair value of $1,829,000. As of the end of the second quarter, management performed its review and determined that an other than temporary impairment was necessary on one equity security in the portfolio.

The determination was made based on the age of the denovo, unfavorable changes in performance of their loan portfolio and decreases in capital ratios. The impairment taken on the individual security totaled $200,000. At September 30, 2009, management performed its quarterly review of the equity securities portfolio. Management concluded that the performance of the underlying banks remained relatively stable and did not provide other-than-temporary impairment as management anticipates improved performance of these institutions as economic conditions stabilize.

Other Securities

At September 30, 2009, approximately 81% of the mortgage-backed securities held by the Corporation were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Corporation does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at September 30, 2009.

The Corporation s mortgage-backed securities portfolio includes non-agency collateralized mortgage obligations with a market value of $5.0 million which had unrealized losses of approximately $1.1 million at September 30, 2009. The Corporation monitors to insure it has adequate credit support and as of

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NOTE 3 SECURITIES (continued)

September 30, 2009, the Corporation believes there is no OTTI and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

Major categories of loans at September 30, 2009 and December 31, 2008, are as follows:

(000s omitted)	September 30, 2009	December 31, 2008
Commercial	$ 268,438	$ 289,523
Real estate construction	34,072	48,777
Real estate mortgage	30,829	37,828
Consumer	50,438	52,910
	383,777	429,038
Less allowance for loan losses	14,485	10,455
	$ 369,292	$ 418,583

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; in Kent and Ottawa counties in west Michigan, with the remainder of the portfolio distributed throughout Michigan. The ability of the Corporation s debtors to honor their contracts is dependent upon the real estate and general economic conditions in these areas.

Activity in the allowance for loan losses, for the nine month periods ended September 30, 2009 and September 30, 2008 is as follows:

(000s omitted)	September 30, 2009	September 30, 2008
Balance, January 1,	$ 10,455	$ 7,592
Provision for loan losses	11,306	5,155
Loans charged off	(7,524)	(3,182)
Loan recoveries	248	457
Balance, end of period	$ 14,485	$ 10,022

Activity in the allowance for loan losses, for the three month periods ended September 30, 2009 and September 30, 2008 is as follows:

(000s omitted)	September 30, 2009	September 30, 2008
Balance, July 1,	$ 13,970	$ 11,380
Provision for loan losses	1,940	700
Loans charged off	(1,567)	(2,253)
Loan recoveries	142	195
Balance, end of period	$ 14,485	$ 10,022

Loan impairment is measured by valuing the underlying collateral or by estimating the expected future cash flows and discounting them at the respective effective interest rate.

The recorded investment in these loans is as follows at September 30:

(000s omitted)	September 30, 2009	December 31, 2008
Period end loans not requiring allocation	$ 6,798	$ 19,086
Period end loans requiring allocation	40,838	29,090
	$ 47,636	$ 48,176
Amount of the allowance for loan losses allocated	$ 8,504	$ 5,642

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NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

Nonaccrual loans and loans past due 90 days still on accrual were as follows:

(000s omitted)	September 30, 2009	December 31, 2008
Loans past due over 90 days still on accrual	$ 193	$ 667
Renegotiated loans	$ 2,568	$ 942
Nonaccrual loans	$ 23,052	$ 24,325

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.

NOTE 5 FAIR VALUE

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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 and 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.

Assets and Liabilities Measured on a Recurring Basis

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

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NOTE 5 FAIR VALUE (continued)

(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)
Assets:				
Available for sale securities				
US Gov t and federal agency	$ 7,563	$ 0	$ 7,563	$ 0
State and municipal	8,143	0	8,143	0
Mortgage backed/CMO securities	31,856	0	31,856	0
Equity securities	1,843	20	1,823	0
September 30, 2009	$49,405	$ 20	$49,385	$ 0
Available for sale securities				
US Gov t and federal agency	$ 8,186	$ 0	$ 8,186	$ 0
State and municipal	7,762	0	7,762	0
Mortgage backed/CMO securities	$29,380	0	29,380	0
Equity securities	$ 1,737	$ 9	0	$ 1,728
December 31, 2008	$47,065	$ 9	$45,328	$ 1,728

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2009:

(000s omitted)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Asset	Liability	Total
Beginning balance, Jan. 1, 2009	$ 1,229	$ 0	$ 1,229
Total gains or losses (realized / unrealized)			
Included in earnings	108		108
Loss on security impairment	(200)	0	(200)
Included in other comprehensive income	248	0	248
Purchases, issuances, and settlements			
Transfers in and / or out of Level 3	(1,385)	0	(1,385)
Ending balance, September 30, 2009	$ 0	$ 0	$ 0

At June 30, 2009, $1,385,000 of equity securities were transferred from level 3 inputs to level 2 inputs due to the existence of observable trades in markets that are not active.

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NOTE 5 FAIR VALUE (continued)

Assets and Liabilities Measured on a Non-Recurring Basis

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

			Fair Value Measurements Using		
(000s omitted)		Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Impaired loans	September 30, 2009	$32,334	$0	$ 0	$32,334
Other real estate owned	September 30, 2009	$ 976	$0	$ 0	$ 976
Impaired loans	December 31, 2008	$19,970	$0	$ 0	$19,970

The following represent impairment charges recognized during the period: At September 30, 2009, impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $40,838,000 with a valuation allowance of $8,504,000 resulting in an additional provision for loan losses of $1,300,000 for the period. This is compared to December 31, 2008 when the fair value of the collateral dependent impaired loans was $29,090,000 with a valuation allowance of $5,642,000.

At September 30, 2009, other real estate owned measured at fair value using collateral valuation methods (Level 3 inputs) has a carrying value of $976,000. During the period ended September 30, 2009, other real estate owned incurred valuation losses totaling $462,000.

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

	September 30, 2009		December 31, 2008	
(000s omitted)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	$ 46,064	$ 46,064	$ 13,626	$ 13,626
Securities held to maturity	5,577	5,636	6,765	6,784
FHLB stock	1,900	n/a	1,900	n/a
Loans held for sale	1,434	1,434	690	690
Loans	383,777	364,670	429,038	408,387
Accrued interest receivable	2,020	2,020	2,231	2,231
Liabilities:				
Deposits	$468,866	$463,403	$469,364	$433,398
Short-term borrowings	34	34	1,500	1,500
FHLB advances	9,981	9,670	12,707	12,505
Subordinated debentures	14,000	12,656	14,000	14,061
Accrued interest payable	855	855	590	590

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NOTE 5 FAIR VALUE (continued)

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 (including mortgage-backed securities)

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

FHLB Stock

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

Loans held for sale

The market value of these loans represents estimated fair value. The market value is 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. The carrying amount of accrued interest receivable 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. The carrying amount of accrued interest payable approximates its fair value.

Short-term borrowings

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

Note Payable

The carrying amount of the note payable approximates its fair value.

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.

Repurchase agreements

Rates currently available for repurchase agreements with similar terms and remaining maturities are used to estimate the fair value of the existing repurchase agreements.

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NOTE 5 FAIR VALUE (Continued)

Subordinated Debentures

The estimated the 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

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. The deferred tax position has been impacted by several significant transactions in the past few years. These transactions included other than temporary impairment write-offs of certain investments, goodwill impairment, and continued elevated levels of provision for loan losses. As a result, the Corporation is in a cumulative loss position over the past few years and under the applicable accounting guidance, has concluded that it is not more likely than not that we will be able to realize our deferred tax assets and accordingly have established a full valuation allowance against our deferred tax asset at June 30, 2009. As a result, our net deferred tax asset of $6.6 million at December 31, 2008 was reduced to $0 at June 30, 2009 and remains at $0 at September 30, 2009. The valuation allowance will be analyzed quarterly for changes affecting the deferred tax assets, and as financial conditions improve and we return to consistent profitability, portions may be reduced or eliminated.

The income tax benefit, from continuing operations, for the third quarter of 2009 was $332,000. As compared to a benefit of $101,000 for the third quarter of 2008. For the nine months ending September 30, 2009, the income tax expense, from continuing operations, is $5,028,000 compared to the nine months ended September 30, 2008 which resulted in a benefit of $1,490,000. The 2009 figures include adjustments to the tax asset valuation allowance as a result of changes in other comprehensive income.

Normally, the calculation for the income tax expense (benefit) does not consider the tax effects of changes in other comprehensive income (OCI), which is a component of shareholders equity on the balance sheet. However, an exception is warranted when there is a pre-tax loss in continuing operations. When this is the case, pre-tax income from other categories, such as changes in OCI, are included in the calculation of the tax expense or benefit for the current year. For the third quarter of 2009, this resulted in an increase to the income tax benefit.

NOTE 7 EARNINGS 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 and nine months ended September 30, 2009 and 2008:

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NOTE 7 EARNINGS PER COMMON SHARE (continued)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(000s omitted except share and per share data)	**2009**	**2008**	**2009**	**2008**
Basic				
Net income (loss)	$ (847)	$ 295	$ (17,871)	$ (2,501)
Weighted average common shares outstanding	2,210,613	2,175,186	2,198,233	2,171,758
Basic income (loss) per common share	$ (0.38)	$ 0.14	$ (8.13)	$ (1.15)
Diluted				
Net income (loss)	$ (847)	$ 295	$ (17,871)	$