MBT FINANCIAL CORP
Form 10-Q
November 14, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended September 30, 2014

Or

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 000-30973

MBT FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

| Michigan | 38-3516922 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

102 E. Front Street

Monroe, Michigan 48161

(Address of principal executive offices)

(Zip Code)

(734) 241-3431

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter 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 þ 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

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

Large accelerated filer ¨ Accelerated Filer ¨
Non-accelerated filer ¨ 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 ¨ No þ

As of November 14, 2014, there were 22,696,547 shares of the Company's Common Stock outstanding.

Part I Financial Information

Item 1. Financial Statements

**MBT FINANCIAL CORP.**

CONSOLIDATED BALANCE SHEETS

| Dollars in thousands | September 30, 2014 (Unaudited) | December 31, 2013 |
|---|---|---|
| ASSETS | | |
| Cash and Cash Equivalents | | |
| Cash and due from banks | | |
| Non-interest bearing | $ 13,891 | $ 15,448 |
| Interest bearing | 39,050 | 62,350 |
| Total cash and cash equivalents | 52,941 | 77,798 |
| | | |
| Securities - Held to Maturity | 31,744 | 34,846 |
| Securities - Available for Sale | 467,465 | 394,956 |
| Federal Home Loan Bank stock - at cost | 10,605 | 10,605 |
| | | |
| Loans held for sale | 382 | 668 |
| | | |
| Loans | 585,770 | 597,590 |
| Allowance for Loan Losses | (13,130) | (16,209) |
| Loans - Net | 572,640 | 581,381 |
| | | |
| Accrued interest receivable and other assets | 29,783 | 34,094 |
| Other Real Estate Owned | 6,036 | 9,628 |
| Bank Owned Life Insurance | 51,471 | 50,493 |
| Premises and Equipment - Net | 28,745 | 28,213 |
| Total assets | $ 1,251,812 | $ 1,222,682 |
| | | |
| LIABILITIES | | |
| Deposits: | | |
| Non-interest bearing | $ 209,731 | $ 215,844 |
| Interest-bearing | 879,753 | 853,874 |
| Total deposits | 1,089,484 | 1,069,718 |
| | | |
| Federal Home Loan Bank advances | - | 12,000 |
| Repurchase agreements | 15,000 | 15,000 |
| Interest payable and other liabilities | 16,676 | 15,356 |

| | | |
|---|---|---|
| Total liabilities | 1,121,160 | 1,112,074 |
| STOCKHOLDERS' EQUITY | | |
| Common stock (no par value; 50,000,000 shares authorized, 22,694,906 and 20,605,493 shares issued and outstanding) | 22,946 | 14,671 |
| Retained earnings | 111,983 | 106,817 |
| Unearned compensation | (8) | (7) |
| Accumulated other comprehensive loss | (4,269) | (10,873) |
| Total stockholders' equity | 130,652 | 110,608 |
| Total liabilities and stockholders' equity | $ 1,251,812 | $ 1,222,682 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME - UNAUDITED

| | Three Months Ended Sept. 30, | | Nine Months Ended Sept. 30, | |
|---|---|---|---|---|
| Dollars in thousands, except per share data | 2014 | 2013 | 2014 | 2013 |
| Interest Income | | | | |
| Interest and fees on loans | $ 7,255 | $ 7,605 | $ 21,355 | $ 23,106 |
| Interest on investment securities- | | | | |
| Tax-exempt | 288 | 313 | 892 | 946 |
| Taxable | 2,222 | 1,821 | 6,540 | 5,383 |
| Interest on balances due from banks | 32 | 25 | 86 | 131 |
| Total interest income | 9,797 | 9,764 | 28,873 | 29,566 |
| | | | | |
| Interest Expense | | | | |
| Interest on deposits | 767 | 1,033 | 2,423 | 3,361 |
| Interest on borrowed funds | 178 | 192 | 551 | 1,533 |
| Total interest expense | 945 | 1,225 | 2,974 | 4,894 |
| | | | | |
| Net Interest Income | 8,852 | 8,539 | 25,899 | 24,672 |
| Provision For Loan Losses | (700) | 200 | (500) | 2,100 |
| | | | | |
| Net Interest Income After Provision For Loan Losses | 9,552 | 8,339 | 26,399 | 22,572 |
| | | | | |
| Other Income | | | | |
| Income from wealth management services | 1,194 | 1,078 | 3,496 | 3,256 |
| Service charges and other fees | 1,054 | 1,128 | 2,954 | 3,228 |
| Debit card income | 557 | 513 | 1,588 | 1,521 |
| Net gain (loss) on sales of securities available for sale | (1,020) | 142 | (744) | 306 |
| Net loss on sales of Other Real Estate Owned | (634) | (632) | (964) | (1,339) |
| Origination fees on mortgage loans sold | 80 | 133 | 230 | 606 |
| Bank owned life insurance income | 357 | 363 | 1,062 | 1,117 |
| Rent income on Other Real Estate Owned | 99 | 347 | 364 | 639 |
| Other | 438 | 412 | 1,387 | 1,420 |
| Total other income | 2,125 | 3,484 | 9,373 | 10,754 |
| | | | | |
| Other Expenses | | | | |
| Salaries and employee benefits | 5,631 | 5,310 | 17,163 | 15,847 |
| Occupancy expense | 626 | 737 | 2,040 | 2,146 |
| Equipment expense | 723 | 650 | 2,002 | 2,024 |
| Marketing expense | 225 | 180 | 640 | 548 |
| Professional fees | 681 | 527 | 1,620 | 1,578 |
| Other Real Estate Owned expenses | 187 | 162 | 887 | 829 |
| FDIC Deposit Insurance Assessment | 275 | 695 | 1,535 | 2,078 |

| | | | | |
|---|---|---|---|---|
| Bonding and other insurance expense | 258 | 267 | 777 | 802 |
| Telephone expense | 108 | 212 | 355 | 455 |
| Other | 648 | 591 | 1,833 | 1,917 |
| Total other expenses | 9,362 | 9,331 | 28,852 | 28,224 |
| | | | | |
| Income Before Income Taxes | 2,315 | 2,492 | 6,920 | 5,102 |
| Income Tax Expense | 603 | (18,795) | 1,754 | (18,795) |
| Net Income | $ 1,712 | $ 21,287 | $ 5,166 | $ 23,897 |
| | | | | |
| Other Comprehensive Income (Loss) - Net of Tax | | | | |
| Unrealized gains (losses) on securities | (649) | 463 | 6,353 | (8,437) |
| | | | | |
| Reclassification adjustment for gains (losses) included in net income | 673 | (94) | 491 | (202) |
| Postretirement benefit liability | 26 | 31 | (240) | 92 |
| Total Other Comprehensive Income (Loss) - Net of Tax | 50 | 400 | 6,604 | (8,547) |
| | | | | |
| Comprehensive Income (Loss) | $ 1,762 | $ 21,687 | $ 11,770 | $ 15,350 |
| | | | | |
| Basic Earnings Per Common Share | $ 0.08 | $ 1.19 | $ 0.24 | $ 1.34 |
| | | | | |
| Diluted Earnings Per Common Share | $ 0.07 | $ 1.18 | $ 0.23 | $ 1.33 |
| | | | | |
| Common Stock Dividends Declared Per Share | $ - | $ - | $ - | $ - |

The accompanying notes to consolidated financial statements are an integral part of these statements.

**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY - UNAUDITED

| Dollars in thousands | Common Stock | Retained Earnings | Unearned Compensation | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| Balance - January 1, 2014 | $ 14,671 | $ 106,817 | $ (7 ) | $ (10,873 ) | $ 110,608 |
| Issuance of Common Stock | | | | | |
| SOSARs exercised (7,287 shares) | 1 | - | - | - | 1 |
| Restricted stock awards (6,000 shares) | 29 | - | (29 ) | - | - |
| Other stock issued (2,076,126 shares) | 8,838 | - | - | - | 8,838 |
| Stock Offering Expense | (754 ) | - | - | - | (754 ) |
| Equity Compensation | 161 | - | 28 | - | 189 |
| Net income | - | 5,166 | - | - | 5,166 |
| Other comprehensive income - net of tax | - | - | - | 6,604 | 6,604 |
| Balance - September 30, 2014 | $ 22,946 | $ 111,983 | $ (8 ) | $ (4,269 ) | $ 130,652 |

| Dollars in thousands | Common Stock | Retained Earnings | Unearned Compensation | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| Balance - January 1, 2013 | $ 2,397 | $ 81,280 | $ (27 ) | $ (76 ) | $ 83,574 |
| Issuance of Common Stock | | | | | |
| SOSARs exercised (936 shares) | 4 | - | - | - | 4 |
| Other stock issued (520,397 shares) | 1,814 | - | - | - | 1,814 |
| Stock Offering Expense | (18 ) | - | - | - | (18 ) |
| Equity Compensation | 83 | - | 17 | - | 100 |
| Net income | - | 23,897 | - | - | 23,897 |
| Other comprehensive loss - net of tax | - | - | - | (8,547 ) | (8,547 ) |
| Balance - September 30, 2013 | $ 4,280 | $ 105,177 | $ (10 ) | $ (8,623 ) | $ 100,824 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

| | Nine Months Ended September 30, | |
|---|---|---|
| Dollars in thousands | 2014 | 2013 |
| Cash Flows from Operating Activities | | |
| Net Income | $ 5,166 | $ 23,897 |
| Adjustments to reconcile net income to net cash from operating activities | | |
| Provision for loan losses | (500) | 2,100 |
| Depreciation | 1,210 | 1,416 |
| (Increase) decrease in net deferred federal income tax asset | 1,684 | (18,795) |
| Net amortization of investment premium and discount | 677 | 1,415 |
| Writedowns of Other Real Estate Owned | 959 | 1,539 |
| Net increase in interest payable and other liabilities | 957 | 2,140 |
| Net increase in interest receivable and other assets | (772) | (739) |
| Equity based compensation expense | 190 | 209 |
| Net (gain) loss on sale/settlement of securities | 744 | (306) |
| Increase in cash surrender value of life insurance | (978) | (1,032) |
| Net cash provided by operating activities | $ 9,337 | $ 11,844 |
| | | |
| Cash Flows from Investing Activities | | |
| Proceeds from maturities and redemptions of investment securities held to maturity | $ 7,692 | $ 18,214 |
| Proceeds from maturities and redemptions of investment securities available for sale | 19,453 | 65,077 |
| Proceeds from sales of investment securities available for sale | 93,321 | 56,433 |
| Net decrease in loans | 7,003 | 10,840 |
| Proceeds from sales of other real estate owned | 5,113 | 6,345 |
| Proceeds from sales of other assets | 40 | 245 |
| Purchase of investment securities held to maturity | (4,590) | (11,309) |
| Purchase of investment securities available for sale | (176,334) | (145,382) |
| Purchase of bank premises and equipment | (1,742) | (1,358) |
| Net cash used for investing activities | $ (50,044) | $ (895) |
| | | |
| Cash Flows from Financing Activities | | |
| Net increase in deposits | $ 19,766 | $ 5,313 |
| Repayment of long term debt | - | (135) |
| Repayment of Federal Home Loan Bank borrowings | (12,000) | (95,000) |
| Proceeds from issuance of common stock | 8,084 | 1,800 |
| Net cash provided by (used for) financing activities | $ 15,850 | $ (88,022) |
| | | |
| Net Decrease in Cash and Cash Equivalents | $ (24,857) | $ (77,073) |
| | | |
| Cash and Cash Equivalents at Beginning of Period | 77,798 | 112,507 |
| Cash and Cash Equivalents at End of Period | $ 52,941 | $ 35,434 |

| | | |
|---|---|---|
| Supplemental Cash Flow Information | | |
| Cash paid for interest | $ 2,993 | $ 5,055 |
| Cash paid for federal income taxes | $ 69 | $ - |
| | | |
| Supplemental Schedule of Non Cash Investing Activities | | |
| Transfer of loans to other real estate owned | $ 2,482 | $ 4,078 |
| Transfer of loans to other assets | $ 42 | $ 124 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

MBT FINANCIAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

The unaudited consolidated financial statements include the accounts of MBT Financial Corp. (the “Company”) and its subsidiary, Monroe Bank & Trust (the “Bank”). The Bank includes the accounts of its wholly owned subsidiary, MB&T Financial Services, Inc. The Bank operates seventeen branches in Monroe County, Michigan, seven branches in Wayne County, Michigan, and a loan and wealth management office in Lenawee County. The Bank’s primary source of revenue is from providing loans to customers, who are predominantly small and middle-market businesses and middle-income individuals. The Company’s sole business segment is community banking.

The accounting and reporting policies of the Bank conform to practice within the banking industry and are in accordance with accounting principles generally accepted in the United States. Preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term are the determination of the allowance for loan losses, the valuation of other real estate owned, and the fair value of investment securities.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of Management, necessary for fair statement of results for the interim periods.

The significant accounting policies are as follows:

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiary. All material intercompany transactions and balances have been eliminated.

### COMPREHENSIVE INCOME

Accounting principles generally require that revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, however, such as unrealized gains and losses on securities available for sale and amounts recognized related to postretirement benefit plans (gains and losses, prior service costs, and transition assets or obligations), are reported as a direct adjustment to the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

BUSINESS SEGMENTS

While the Company's chief decision makers monitor the revenue streams of various products and services, operations are managed and financial performance is evaluated on a company wide basis. Accordingly, all of the Company’s operations are considered by management to be aggregated in one reportable segment.

FAIR VALUE

The Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for assets and liabilities that are elected to be accounted for under The Fair Value Option as well as for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value.

When determining the fair value measurements for assets and liabilities required or permitted to be recorded at and/or marked to fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to market observable data for similar assets or liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets and the Company must use alternative valuation techniques to derive a fair value measurement.

RECENT DEVELOPMENTS

On October 29, 2014, the Bank conducted an auction of Other Real Estate Owned. Following the auction, the Bank offered to sell some of the properties that did not sell at the auction at prices below the carrying values. As a result, the September 30, 2014 financial statements include the effect of writing down the values of these properties by $500,000.

ACCOUNTING PRONOUNCEMENTS

In January 2014, the FASB issued ASU 2014-04, “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs. The ASU also requires additional related interim and annual disclosures. The guidance in this ASU is effective for annual and interim periods beginning after December 15, 2014. The adoption of this ASU is not expected to have a material effect on our financial position or results of operations.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers.” ASU 2014-09 establishes a comprehensive revenue recognition standard for virtually all industries under US GAAP. The standard’s core principle is built on the contract between a vendor and a customer for the provision of goods and services. This ASU is effective for annual and interim periods beginning after December 15, 2016. The Company may choose to apply the new standard either retrospectively or through a cumulative effect adjustment. Adoption of this ASU is not expected

to have a material effect on our financial position or results of operations.

2. EARNINGS PER SHARE

The calculations of earnings per common share are as follows:

| | For the three months ended Sept. 30, | | For the nine months ended Sept. 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Basic | | | | |
| Net income | $ 1,712,000 | $ 21,287,000 | $ 5,166,000 | $ 23,897,000 |
| Average common shares outstanding | 22,691,593 | 17,912,946 | 21,911,996 | 17,779,924 |
| Earnings per common share - basic | $ 0.08 | $ 1.19 | $ 0.24 | $ 1.34 |
| | | | | |
| Diluted | | | | |
| Net income | $ 1,712,000 | $ 21,287,000 | $ 5,166,000 | $ 23,897,000 |
| Average common shares outstanding | 22,691,593 | 17,912,946 | 21,911,996 | 17,779,924 |
| Equity compensation | 194,090 | 164,533 | 192,573 | 155,416 |
| Average common shares outstanding - diluted | 22,885,683 | 18,077,479 | 22,104,569 | 17,935,340 |
| Earnings per common share - diluted | $ 0.07 | $ 1.18 | $ 0.23 | $ 1.33 |

3. STOCK BASED COMPENSATION

*Stock Options* - The following table summarizes the options that had been granted to certain key executives in accordance with the Long-Term Incentive Compensation Plan that was approved by shareholders at the Annual Meeting of Shareholders on April 6, 2000.

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Options Outstanding, January 1, 2014 | 283,900 | $ 18.41 |
| Granted | - | - |
| Exercised | - | - |
| Forfeited | 1,500 | 15.33 |
| Expired | 77,000 | 16.69 |
| Options Outstanding, September 30, 2014 | 205,400 | $ 19.08 |
| Options Exercisable, September 30, 2014 | 205,400 | $ 19.08 |

*Stock Only Stock Appreciation Rights (SOSARs)* - On March 7, 2014, 110,000 Stock Only Stock Appreciation Rights (SOSARs) were awarded to certain executives in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008. The SOSARs have a term of ten years and vest in three equal annual installments beginning on December 31, 2014. The fair value of $2.98 for the SOSARs was estimated at the date of the grant, using the Black-Scholes option pricing model, with the following assumptions: expected option lives of 7 years, expected volatility of 60.11%, a risk free interest rate of 2.27% and dividend yield of 0.00%.

The following table summarizes the SOSARs that have been granted:

| | SOSARs | Weighted Average Base Price |
|---|---|---|
| SOSARs Outstanding, January 1, 2014 | 472,271 | $ 3.23 |
| Granted | 110,000 | 4.90 |
| Exercised | 18,998 | 2.15 |
| Forfeited | 5,834 | 4.91 |
| SOSARs Outstanding, September 30, 2014 | 557,439 | $ 3.58 |
| SOSARs Exercisable, September 30, 2014 | 352,062 | $ 3.53 |

The exercise of a SOSAR results in the issuance of a number of shares of common stock of the Company based on the appreciation of the market price of the stock over the base price, which is equal to the market value of the underlying stock on the date of the grant of the SOSAR. The market value of the Company’s common stock on September 30, 2014 was $4.78. The intrinsic value of the exercisable SOSARs as of September 30, 2014 was $353,000, and exercise of those SOSARs on that date would have resulted in the issuance of 73,839 shares of common stock.

*Restricted Stock Unit Awards* – On March 7, 2014, performance restricted stock units were awarded to certain key executive officers in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008. Each Restricted Stock Unit (RSU) is equivalent to one share of MBT Financial Corp. common stock. Stock will be issued to the participants following a two year performance period that ends on December 31, 2015. Up to 50% of the aggregate RSUs granted may be earned in each year of the performance period subject to satisfying weighted performance thresholds. Earned RSUs vest on December 31, 2016.

*Restricted Stock Awards* – On March 7, 2014, 1,000 restricted shares were awarded to each non-executive member of the board of directors in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008. The restricted shares vest on December 31, 2014. The expense for the restricted stock is based on the grant date value per share of $4.90 and is recognized over the vesting period. The unrecognized compensation cost related to the non-vested restricted stock awards was $8,000 as of September 30, 2014.

The total expense for equity based compensation was $72,000 in the third quarter of 2014 and $71,000 in the third quarter of 2013. The total expense for equity based compensation was $218,000 in the first nine months of 2014 and $216,000 in the first nine months of 2013.

4. LOANS

The Bank makes commercial, consumer, and mortgage loans primarily to customers in Monroe County, Michigan, southern and western Wayne County, Michigan, and surrounding areas. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the automotive, manufacturing, and real estate development economic sectors.

Loans consist of the following (000s omitted):

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Residential real estate loans | $ 224,130 | $ 228,024 |
| Commercial and Construction real estate loans | 265,951 | 280,579 |
| Agriculture and agricultural real estate loans | 18,113 | 14,997 |
| Commercial and industrial loans | 62,318 | 59,440 |
| Loans to individuals for household, family,and other personal expenditures | 15,258 | 14,550 |
| Total loans, gross | $ 585,770 | $ 597,590 |
| Less: Allowance for loan losses | 13,130 | 16,209 |
| | $ 572,640 | $ 581,381 |

Loans are placed in a nonaccrual status when, in the opinion of Management, the collection of additional interest is doubtful. All loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are reviewed for impairment each quarter. Allowances for loans determined to be impaired are included in the allowance for loan losses. All cash received on nonaccrual loans is applied to the principal balance. Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due, restructured loans, nonaccrual investment securities, and other real estate owned. Other real estate owned includes real estate that has been acquired in full or partial satisfaction of loan obligations or upon foreclosure and real estate that the bank has purchased but no longer intends to use for bank premises.

The following table summarizes nonperforming assets (000's omitted):

| ` | September 30, 2014 | December 31, 2013 |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| Nonaccrual loans | $ 13,351 | | $ 23,710 | |
| Loans 90 days past due and accruing | 7 | | 46 | |
| Restructured loans | 24,094 | | 32,450 | |
| Total nonperforming loans | $ 37,452 | | $ 56,206 | |
| | | | | |
| Other real estate owned | 6,036 | | 9,628 | |
| Other assets | 7 | | 10 | |
| Nonperforming investment securities | - | | 3,259 | |
| Total nonperforming assets | $ 43,495 | | $ 69,103 | |
| | | | | |
| Nonperforming assets to total assets | 3.47 | % | 5.65 | % |
| Allowance for loan losses to nonperforming loans | 35.06 | % | 28.84 | % |

5. ALLOWANCE FOR LOAN LOSSES

The Company separates its loan portfolio into segments to perform the calculation and analysis of the allowance for loan losses. The six segments analyzed are Agriculture and Agricultural Real Estate, Commercial, Commercial Real Estate, Construction Real Estate, Residential Real Estate, and Consumer and Other. The Agriculture and Agricultural Real Estate segment includes all loans to finance agricultural production and all loans secured by agricultural real estate. This segment does not include loans to finance agriculture that are secured by residential real estate, which are included in the Residential Real Estate segment. The Commercial segment includes loans to finance commercial and industrial businesses that are not secured by real estate. The Commercial Real Estate segment includes loans secured by non-farm, non-residential real estate. The Construction Real Estate segment includes loans to finance construction and land development. This includes residential and commercial construction and land development. The Residential Real Estate segment includes all loans, other than construction loans, that are secured by single family and multi family residential real estate properties. The Consumer and Other segment includes all loans not included in any other segment. These are primarily loans to consumers for household, family, and other personal expenditures, such as autos, boats, and recreational vehicles.

Activity in the allowance for loan losses during the three and nine months ended September 30, 2014 was as follows (000s omitted):

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: For the three months ended September 30, 2014 | | | | | | | |
| Beginning Balance | $ 214 | $ 1,288 | $ 7,535 | $ 1,147 | $ 4,280 | $ 537 | $ 15,001 |
| Charge-offs | (3) | (62) | (2,267) | (44) | (976) | (1) | (3,353) |
| Recoveries | - | 115 | 939 | 794 | 271 | 63 | 2,182 |
| Provision | 14 | (22) | 390 | (1,290) | (259) | 467 | (700) |
| Ending balance | $ 225 | $ 1,319 | $ 6,597 | $ 607 | $ 3,316 | $ 1,066 | $ 13,130 |
| Allowance for loan losses: For the nine months ended September 30, 2014 | | | | | | | |
| Beginning Balance | $ 171 | $ 1,989 | $ 7,030 | $ 1,397 | $ 4,606 | $ 1,016 | $ 16,209 |
| Charge-offs | (3) | (688) | (3,478) | (254) | (1,187) | (79) | (5,689) |
| Recoveries | 5 | 204 | 1,215 | 1,047 | 509 | 130 | 3,110 |
| Provision | 52 | (186) | 1,830 | (1,583) | (612) | (1) | (500) |
| Ending balance | $ 225 | $ 1,319 | $ 6,597 | $ 607 | $ 3,316 | $ 1,066 | $ 13,130 |
| Allowance for loan losses as of September 30, 2014 | | | | | | | |
| Ending balance individually evaluated for impairment | $ 36 | $ 528 | $ 1,290 | $ 480 | $ 649 | $ 257 | $ 3,240 |
| Ending balance collectively evaluated for impairment | 189 | 791 | 5,307 | 127 | 2,667 | 809 | 9,890 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Ending balance | $ 225 | $ 1,319 | $ 6,597 | $ 607 | $ 3,316 | $ 1,066 | $ 13,130 |
| | | | | | | | |
| Loans as of September 30, 2014 | | | | | | | |
| Ending balance individually evaluated for impairment | $ 946 | $ 1,445 | $ 20,257 | $ 2,138 | $ 11,901 | $ 573 | $ 37,260 |
| Ending balance collectively evaluated for impairment | 17,167 | 60,873 | 233,268 | 10,288 | 212,229 | 14,685 | 548,510 |
| Ending balance | $ 18,113 | $ 62,318 | $ 253,525 | $ 12,426 | $ 224,130 | $ 15,258 | $ 585,770 |

Activity in the allowance for loan losses during the three and nine months ended September 30, 2013 was as follows (000s omitted):

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: For the three months ended September 30, 2013 | | | | | | | |
| Beginning Balance | $ 109 | $ 2,442 | $ 7,556 | $ 1,889 | $ 4,787 | $ 412 | $ 17,195 |
| Charge-offs | - | (162 ) | (728 ) | (30 ) | (351 ) | (53 ) | (1,324 ) |
| Recoveries | - | 24 | 427 | 49 | 162 | 33 | 695 |
| Provision | 28 | (409 ) | 453 | (278 ) | 24 | 382 | 200 |
| Ending balance | $ 137 | $ 1,895 | $ 7,708 | $ 1,630 | $ 4,622 | $ 774 | $ 16,766 |
| Allowance for loan losses: For the nine months ended September 30, 2013 | | | | | | | |
| Beginning Balance | $ 76 | $ 2,224 | $ 7,551 | $ 2,401 | $ 4,715 | $ 332 | $ 17,299 |
| Charge-offs | - | (564 ) | (2,596 ) | (67 ) | (1,167 ) | (190 ) | (4,584 ) |
| Recoveries | - | 287 | 717 | 337 | 481 | 129 | 1,951 |
| Provision | 61 | (52 ) | 2,036 | (1,041 ) | 593 | 503 | 2,100 |
| Ending balance | $ 137 | $ 1,895 | $ 7,708 | $ 1,630 | $ 4,622 | $ 774 | $ 16,766 |
| Allowance for loan losses as of September 30, 2013 | | | | | | | |
| Ending balance individually evaluated for impairment | $ 1 | $ 1,133 | $ 2,893 | $ 1,333 | $ 1,750 | $ 110 | $ 7,220 |
| Ending balance collectively evaluated for impairment | 136 | 762 | 4,815 | 297 | 2,872 | 664 | 9,546 |
| Ending balance | $ 137 | $ 1,895 | $ 7,708 | $ 1,630 | $ 4,622 | $ 774 | $ 16,766 |
| Loans as of September 30, 2013 | | | | | | | |
| Ending balance individually evaluated for impairment | $ 424 | $ 3,175 | $ 35,769 | $ 5,704 | $ 16,122 | $ 363 | $ 61,557 |
| Ending balance collectively evaluated for impairment | 14,898 | 62,078 | 232,999 | 9,360 | 215,422 | 14,614 | 549,371 |
| Ending balance | $ 15,322 | $ 65,253 | $ 268,768 | $ 15,064 | $ 231,544 | $ 14,977 | $ 610,928 |

Each period the provision for loan losses in the income statement results from the combination of an estimate by Management of loan losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods.

The provision for loan losses increases the allowance for loan losses, a valuation account which appears on the consolidated balance sheets. As the specific customer and amount of a loan loss is confirmed by gathering additional information, taking collateral in full or partial settlement of the loan, bankruptcy of the borrower, etc., the loan is

charged off, reducing the allowance for loan losses. If, subsequent to a charge off, the Bank is able to collect additional amounts from the customer or sell collateral worth more than earlier estimated, a recovery is recorded.

To serve as a basis for making this provision, the Bank maintains an extensive credit risk monitoring process that considers several factors including: current economic conditions affecting the Bank's customers, the payment performance of individual loans and pools of homogeneous loans, portfolio seasoning, changes in collateral values, and detailed reviews of specific loan relationships.

The Company utilizes an internal loan grading system to assign a risk grade to all commercial loans, all renegotiated loans, and each commercial credit relationship. Grades 1 through 4 are considered "pass" credits and grades 5 and 6 are considered "watch" credits and are subject to greater scrutiny. Loans with grades 7, 8, and 9 and considered "doubtful" or "loss" and have generally been charged off. A description of the general characteristics of each grade is as follows:

- Grade 1 – Excellent – Loans secured by marketable collateral, with adequate margin, or supported by strong financial statements, including substantial levels of tangible net worth. Probability of serious financial deterioration is unlikely. Possess a sound repayment source and a secondary source. This classification will also include individual loans backed by liquid personal assets, established history and unquestionable character. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans.
- Grade 2 – Above Average – Loans that exhibit less than average risk and clearly demonstrate debt service coverage that is consistently above average as well as a strong capital base. These loans may have some deficiency or vulnerability, but with offsetting features and are considered to be fully collectable.
- Grade 3 – Satisfactory – Loans that have an acceptable amount of risk but may exhibit vulnerability to deterioration if adverse circumstances are encountered. These loans should demonstrate adequate debt service coverage and adequate levels of capital support but warrant periodic monitoring to ensure that weaknesses do not materialize or advance.
- Grade 4 – Pass – Loans that are considered "pass credits" and typically demonstrate adequate debt service coverage. The level of risk is considered acceptable but these loans warrant ongoing monitoring to ensure that adverse trends or other credit deficiencies have not materialized or advanced. The level of risk is considered acceptable so long as the loan is given adequate and ongoing management supervision.
- Grade 5 – Watch – Loans that possess some credit deficiency or potential weakness that deserves close attention. The primary source of loan repayment is sufficient but may be considered inadequate by the Bank's standards.
- Grade 6 – Substandard – Loans that exhibit one or more of the following characteristics: (1) a defined credit weakness, financial deterioration is underway, and uncertainty about the likelihood that the loan will be paid from the primary source of repayment; (2) inadequately protected by the current net worth and paying capacity of the obligor; (3) reliance on secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility the Bank will sustain loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain a high probability of repayment; (6) insufficient cash flow to repay principal but continuing to pay interest; (7) the Bank is subordinated or unsecured due to flaws in documentation; (8) loans are restructured or are on nonaccrual status due to concessions to the borrower when compared to normal loan terms; (9) the Bank is contemplating foreclosure or legal action due to the apparent deterioration in the loan; or (10) there is deterioration in the market conditions and the borrower is highly vulnerable to these conditions.
- Grade 7 – Doubtful – Loans that exhibit one or more of the following characteristics: (1) loans with all the weaknesses of Substandard loans and collection or liquidation is not probable to result in payment in full; (2) the primary source of repayment is gone and there is considerable doubt as to the quality of the secondary source of repayment; or (3) the possibility of loss is high, but certain important pending factors may strengthen the loan and loss classification is deferred.
- Grades 8 & 9 - Loss – Loans are considered uncollectible and of such little value that continuing to carry them on the Bank's financial statements is not feasible.

The assessment of compensating factors may result in a rating plus or minus one grade from those listed above. These factors include, but are not limited to collateral, guarantors, environmental conditions, history, plan/projection reasonableness, quality of information, and payment delinquency.

The portfolio segments in each credit risk grade as of September 30, 2014 are as follows (000s omitted):

**Credit Quality Indicators as of September 30, 2014**

Credit Risk by Internally Assigned Grade

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Not Rated | $ 126 | $ 1,554 | $ - | $ 4,779 | $ 140,212 | $ 10,717 | $157,388 |
| 1 | - | 2,992 | - | - | - | 366 | 3,358 |
| 2 | 280 | 297 | 857 | - | 134 | - | 1,568 |
| 3 | 190 | 6,595 | 9,643 | - | 874 | - | 17,302 |
| 4 | 15,641 | 41,982 | 177,887 | 4,478 | 50,559 | 3,355 | 293,902 |
| 5 | 808 | 6,881 | 37,280 | 2,449 | 15,982 | 190 | 63,590 |
| 6 | 1,068 | 2,017 | 27,858 | 720 | 16,369 | 630 | 48,662 |
| 7 | - | - | - | - | - | - | - |
| 8 | - | - | - | - | - | - | - |
| 9 | - | - | - | - | - | - | - |
| Total | $ 18,113 | $ 62,318 | $ 253,525 | $ 12,426 | $ 224,130 | $ 15,258 | $585,770 |
| | | | | | | | |
| Performing | $ 17,087 | $ 60,808 | $ 234,708 | $ 10,214 | $ 211,067 | $ 14,434 | $548,318 |
| Nonperforming | 1,026 | 1,510 | 18,817 | 2,212 | 13,063 | 824 | 37,452 |
| Total | $ 18,113 | $ 62,318 | $ 253,525 | $ 12,426 | $ 224,130 | $ 15,258 | $585,770 |

The portfolio segments in each credit risk grade as of December 31, 2013 are as follows (000s omitted):

**Credit Quality Indicators as of December 31, 2013**

Credit Risk by Internally Assigned Grade

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Not Rated | $ 144 | $ 2,151 | $ - | $ 3,643 | $ 141,102 | $ 9,656 | $156,696 |
| 1 | - | 4,054 | - | - | - | 194 | 4,248 |
| 2 | 31 | 153 | 931 | - | 142 | - | 1,257 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 3 | 788 | 4,000 | 10,755 | 99 | 1,040 | - | 16,682 |
| 4 | 12,304 | 34,130 | 172,592 | 4,825 | 53,047 | 3,743 | 280,641 |
| 5 | 838 | 11,594 | 41,914 | 2,525 | 9,005 | 251 | 66,127 |
| 6 | 892 | 3,358 | 39,720 | 3,575 | 23,688 | 706 | 71,939 |
| 7 | - | - | - | - | - | - | - |
| 8 | - | - | - | - | - | - | - |
| 9 | - | - | - | - | - | - | - |
| Total | $ 14,997 | $ 59,440 | $ 265,912 | $ 14,667 | $ 228,024 | $ 14,550 | $597,590 |
| | | | | | | | |
| Performing | $ 14,428 | $ 56,941 | $ 235,531 | $ 9,732 | $ 211,149 | $ 13,603 | $541,384 |
| Nonperforming | 569 | 2,499 | 30,381 | 4,935 | 16,875 | 947 | 56,206 |
| Total | $ 14,997 | $ 59,440 | $ 265,912 | $ 14,667 | $ 228,024 | $ 14,550 | $597,590 |

Loans are considered past due when contractually required payment of interest or principal has not been received. The amount classified as past due is the entire principal balance outstanding of the loan, not just the amount of payments that are past due. The following is a summary of past due loans as of September 30, 2014 and December 31, 2013 (000s omitted):

| September 30, 2014 | 30-59 Days Past Due | 60-89 Days Past Due | >90 Days Past Due | Total Past Due | Current | Total Loans | Recorded Investment >90 Days Past Due and Accruing |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Agriculture and Agricultural Real Estate | $ 250 | $ - | $ 80 | $ 330 | $ 17,783 | $ 18,113 | $ - |
| Commercial | 83 | 26 | 57 | 166 | 62,152 | 62,318 | 7 |
| Commercial Real Estate | 1,590 | 1,176 | 1,457 | 4,223 | 249,302 | 253,525 | - |
| Construction Real Estate | 81 | - | - | 81 | 12,345 | 12,426 | - |
| Residential Real Estate | 4,497 | 1,035 | 640 | 6,172 | 217,958 | 224,130 | - |
| Consumer and Other | 61 | 30 | 70 | 161 | 15,097 | 15,258 | - |
| Total | $ 6,562 | $ 2,267 | $ 2,304 | $ 11,133 | $ 574,637 | $ 585,770 | $ 7 |

| December 31, 2013 | 30-59 Days Past Due | 60-89 Days Past Due | >90 Days Past Due | Total Past Due | Current | Total Loans | Recorded Investment >90 Days Past Due and Accruing |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Agriculture and Agricultural Real Estate | $ 210 | $ - | $ 171 | $ 381 | $ 14,616 | $ 14,997 | $ - |
| Commercial | 87 | 93 | 210 | 390 | 59,050 | 59,440 | 46 |
| Commercial Real Estate | 1,640 | 535 | 3,506 | 5,681 | 260,231 | 265,912 | - |
| Construction Real Estate | 90 | 265 | 1,177 | 1,532 | 13,135 | 14,667 | - |
| Residential Real Estate | 2,612 | 803 | 2,342 | 5,757 | 222,267 | 228,024 | - |
| Consumer and Other | 150 | 52 | 153 | 355 | 14,195 | 14,550 | - |
| Total | $ 4,789 | $ 1,748 | $ 7,559 | $ 14,096 | $ 583,494 | $ 597,590 | $ 46 |

Loans are placed on non-accrual status when, in the opinion of Management, the collection of additional interest is doubtful. Loans are automatically placed on non-accrual status upon becoming ninety days past due, however, loans may be placed on non-accrual status regardless of whether or not they are past due. All cash received on non-accrual loans is applied to the principal balance. Loans are considered for return to accrual status on an individual basis when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following is a summary of non-accrual loans as of September 30, 2014 and December 31, 2013 (000s omitted):

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Agriculture and Agricultural Real Estate | $ 80 | $ 172 |
| Commercial | 298 | 1,035 |
| Commercial Real Estate | 6,234 | 13,289 |
| Construction Real Estate | 424 | 2,009 |
| Residential Real Estate | 6,064 | 6,865 |
| Consumer and Other | 251 | 340 |
| Total | $ 13,351 | $ 23,710 |

For loans deemed to be impaired due to an expectation that all contractual payments will probably not be received, impairment is measured by comparing the Bank’s recorded investment in the loan to the present value of expected cash flows discounted at the loan’s effective interest rate, the fair value of the collateral, or the loan’s observable market price.

The following is a summary of impaired loans as of September 30, 2014 and 2013 (000s omitted):

| September 30, 2014 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment for the Three Months Ended | Interest Income Recognized in the Three Months Ended | Average Recorded Investment for the Nine Months Ended | Interest Income Recognized in the Nine Months Ended |
|---|---|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | | | |
| Agriculture and Agricultural Real Estate | $ 258 | $ 257 | $ - | $ 258 | $ 4 | $ 259 | $ 7 |
| Commercial | 396 | 559 | - | 500 | 7 | 580 | 25 |
| Commercial Real Estate | 9,979 | 11,299 | - | 10,461 | 111 | 10,565 | 352 |
| Construction Real Estate | 302 | 1,019 | - | 610 | 2 | 668 | 17 |
| Residential Real Estate | 6,311 | 7,046 | - | 6,674 | 84 | 6,763 | 234 |
| Consumer and Other | 29 | 32 | - | 30 | 1 | 31 | 2 |
| With an allowance recorded: | | | | | | | |
| Agriculture and Agricultural Real Estate | 688 | 687 | 36 | 687 | 9 | 700 | 28 |
| Commercial | 1,049 | 1,056 | 528 | 1,071 | 13 | 1,098 | 40 |
| Commercial Real Estate | 10,278 | 12,459 | 1,290 | 11,845 | 115 | 11,941 | 352 |
| Construction Real Estate | 1,836 | 1,864 | 480 | 1,855 | 22 | 1,869 | 66 |
| Residential Real Estate | 5,590 | 5,831 | 649 | 5,807 | 63 | 5,868 | 191 |
| Consumer and Other | 544 | 544 | 257 | 548 | 6 | 586 | 20 |
| Total: | | | | | | | |
| Agriculture and Agricultural Real Estate | $ 946 | $ 944 | $ 36 | $ 945 | $ 13 | $ 959 | $ 35 |
| Commercial | 1,445 | 1,615 | 528 | 1,571 | 20 | 1,678 | 65 |
| Commercial Real Estate | 20,257 | 23,758 | 1,290 | 22,306 | 226 | 22,506 | 704 |
| Construction Real Estate | 2,138 | 2,883 | 480 | 2,465 | 24 | 2,537 | 83 |
| Residential Real Estate | 11,901 | 12,877 | 649 | 12,481 | 147 | 12,631 | 425 |
| Consumer and Other | 573 | 576 | 257 | 578 | 7 | 617 | 22 |

| | Recorded Investment as of December 31, 2013 | Unpaid Principal Balance as of December 31, 2013 | Related Allowance as of December 31, 2013 | Average Recorded Investment for the Three Months Ended | Interest Income Recognized in the Three Months Ended September | Average Recorded Investment for the Nine Months Ended September 30, | Interest Income Recognized in the Nine Months Ended September 30, 2013 |
|---|---|---|---|---|---|---|---|

| | | | | September 30, 2013 | 30, 2013 | 2013 | |
|---|---|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | | | |
| Agriculture and Agricultural Real Estate | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Commercial | 869 | 966 | - | 1,728 | 21 | 1,562 | 55 |
| Commercial Real Estate | 19,567 | 23,005 | - | 19,544 | 228 | 20,004 | 629 |
| Construction Real Estate | 1,165 | 2,408 | - | 2,302 | 23 | 2,452 | 91 |
| Residential Real Estate | 7,929 | 9,035 | - | 8,586 | 97 | 8,656 | 293 |
| Consumer and Other | 33 | 36 | - | 31 | 1 | 31 | 3 |
| With an allowance recorded: | | | | | | | |
| Agriculture and Agricultural Real Estate | 398 | 397 | 1 | 424 | 4 | 724 | 28 |
| Commercial | 1,540 | 1,627 | 1,031 | 1,695 | 16 | 1,739 | 53 |
| Commercial Real Estate | 16,025 | 20,032 | 2,697 | 18,660 | 148 | 19,226 | 594 |
| Construction Real Estate | 3,615 | 4,236 | 1,194 | 4,077 | 191 | 4,197 | 292 |
| Residential Real Estate | 8,745 | 9,194 | 1,809 | 8,141 | 91 | 8,347 | 264 |
| Consumer and Other | 585 | 581 | 265 | 332 | 5 | 339 | 14 |
| Total: | | | | | | | |
| Agriculture and Agricultural Real Estate | $ 398 | $ 397 | $ 1 | $ 424 | $ 4 | $ 724 | $ 28 |
| Commercial | 2,409 | 2,593 | 1,031 | 3,423 | 37 | 3,301 | 108 |
| Commercial Real Estate | 35,592 | 43,037 | 2,697 | 38,204 | 376 | 39,230 | 1,223 |
| Construction Real Estate | 4,780 | 6,644 | 1,194 | 6,379 | 214 | 6,649 | 383 |
| Residential Real Estate | 16,674 | 18,229 | 1,809 | 16,727 | 188 | 17,003 | 557 |
| Consumer and Other | 618 | 617 | 265 | 363 | 6 | 370 | 17 |

The Bank may agree to modify the terms of a loan in order to improve the Bank's ability to collect amounts due. These modifications may include reduction of the interest rate, extension of the loan term, or in some cases, reduction of the principal balance. Modifications that are performed due to the debtor's financial difficulties are considered Troubled Debt Restructurings ("TDRs").

Loans that have been classified as TDRs during the three and nine month periods ended September 30, 2014 and September 30, 2013 are as follows (000s omitted from dollar amounts):

| | Three months ended September 30, 2014 | | | Nine months ended September 30, 2014 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance |
| Agriculture and Agricultural Real Estate | - | $ - | $ - | 1 | $ 314 | $ 314 |
| Commercial | - | - | - | 4 | 295 | 54 |
| Commercial Real Estate | 2 | 743 | 649 | 6 | 1,990 | 1,508 |
| Construction Real Estate | 3 | 43 | 22 | 3 | 43 | 22 |
| Residential Real Estate | 4 | 203 | 57 | 14 | 1,047 | 730 |
| Consumer and Other | - | - | - | - | - | - |
| Total | 9 | $ 989 | $ 728 | 28 | $ 3,689 | $ 2,628 |

| | Three months ended September 30, 2013 | | | Nine months ended September 30, 2013 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance |
| Agriculture and Agricultural Real Estate | - | $ - | $ - | - | $ - | $ - |
| Commercial | 6 | 1,044 | 636 | 13 | 1,398 | 787 |
| Commercial Real Estate | 3 | 480 | 301 | 10 | 2,527 | 1,646 |
| Construction Real Estate | - | - | - | - | - | - |
| Residential Real Estate | 8 | 685 | 665 | 24 | 2,131 | 1,801 |
| Consumer and Other | 1 | 10 | 9 | 5 | 276 | 34 |
| Total | 18 | $ 2,219 | $ 1,611 | 52 | $ 6,332 | $ 4,268 |

The Bank considers TDRs that become past due under the modified terms as defaulted. There were no loans that became TDRs during the three and nine month periods ended September 30, 2014 and September 30, 2013 that subsequently defaulted during the three month periods ended September 30, 2014 and September 30, 2013, respectively.

The Company has allocated $3,006,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings at September 30, 2014. In addition, there are no commitments to lend additional amounts to borrowers that are classified as troubled debt restructurings as of September 30, 2014 and September 30, 2013.

6. INVESTMENT SECURITIES

The following is a summary of the Bank's investment securities portfolio as of September 30, 2014 and December 31, 2013 (000's omitted):

| | Held to Maturity September 30, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Obligations of States and Political Subdivisions | $31,244 | $ 1,251 | $ (72 ) | $ 32,423 |
| Corporate Debt Securities | 500 | - | - | 500 |
| | $31,744 | $ 1,251 | $ (72 ) | $ 32,923 |

| | Available for Sale September 30, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Obligations of U.S. Government Agencies | $370,077 | $ 646 | $ (5,070 ) | $365,653 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 78,464 | 340 | (897 ) | 77,907 |
| Obligations of States and Political Subdivisions | 15,389 | 433 | (64 ) | 15,758 |
| Corporate Debt Securities | 5,973 | 51 | - | 6,024 |
| Equity Securities | 2,044 | 79 | - | 2,123 |
| | $471,947 | $ 1,549 | $ (6,031 ) | $467,465 |

| | Held to Maturity December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Obligations of States and Political Subdivisions | $34,346 | $ 557 | $ (364 ) | $ 34,539 |
| Corporate Debt Securities | 500 | - | - | 500 |
| | $34,846 | $ 557 | $ (364 ) | $ 35,039 |

| | Available for Sale December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Obligations of U.S. Government Agencies | $277,383 | $ 1,147 | $ (11,817 ) | $266,713 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 97,168 | 995 | (1,637 ) | 96,526 |
| Obligations of States and Political Subdivisions | 15,197 | 289 | (123 ) | 15,363 |
| Trust Preferred CDO Securities | 9,509 | - | (3,758 ) | 5,751 |
| Corporate Debt Securities | 7,967 | 104 | - | 8,071 |
| Equity Securities | 2,584 | 43 | (95 ) | 2,532 |
| | $409,808 | $ 2,578 | $ (17,430 ) | $394,956 |

The amortized cost and estimated market values of securities by contractual maturity as of September 30, 2014 are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Held to Maturity | | Available for Sale | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Market Value | Amortized Cost | Estimated Market Value |
| Contractual maturity in | | | | |
| 1 year or less | $4,107 | $ 4,135 | $7,505 | $7,535 |
| After 1 year through five years | 13,416 | 13,766 | 90,049 | 89,218 |
| After 5 years through 10 years | 11,346 | 11,832 | 274,252 | 271,259 |
| After 10 years | 2,875 | 3,190 | 19,633 | 19,423 |
| Total | 31,744 | 32,923 | 391,439 | 387,435 |
| Mortgage Backed Securities | - | - | 78,464 | 77,907 |
| Securities with no stated maturity | - | - | 2,044 | 2,123 |
| Total | $31,744 | $ 32,923 | $471,947 | $467,465 |

The investment securities portfolio is evaluated for impairment throughout the year. Impairment is recorded against individual securities, unless the decrease in fair value is attributable to interest rates or the lack of an active market, and Management determines that the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before a recovery of their amortized costs bases, which may be maturity. The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013.

**September 30, 2014**

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses |
| Obligations of United States Government Agencies | $ 110,074 | $ 735 | $ 161,414 | $ 4,335 | $ 271,488 | $ 5,070 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 16,662 | 68 | 42,403 | 829 | 59,065 | 897 |
| Obligations of States and Political Subdivisions | 3,633 | 28 | 4,333 | 108 | 7,966 | 136 |
| | $ 130,369 | $ 831 | $ 208,150 | $ 5,272 | $ 338,519 | $ 6,103 |

**December 31, 2013**

| Less than 12 months | 12 months or longer | Total |
|---|---|---|

| | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses |
|---|---|---|---|---|---|---|
| Obligations of United States Government Agencies | $ 234,264 | $ 10,828 | $ 13,614 | $ 989 | $ 247,878 | $ 11,817 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 49,202 | 1,005 | 14,544 | 632 | 63,746 | 1,637 |
| Obligations of States and Political Subdivisions | 10,384 | 321 | 3,113 | 166 | 13,497 | 487 |
| Trust Preferred CDO Securities | - | - | 5,751 | 3,758 | 5,751 | 3,758 |
| Equity Securities | - | - | 445 | 95 | 445 | 95 |
| | $ 293,850 | $ 12,154 | $ 37,467 | $ 5,640 | $ 331,317 | $ 17,794 |

The amount of investment securities issued by government agencies, states, and political subdivisions with unrealized losses and the amount of unrealized losses on those investment securities are primarily the result of market interest rates and not the result of the credit quality of the issuers of the securities. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at September 30, 2014. As of September 30, 2014 and December 31, 2013, there were 119 and 175 securities in an unrealized loss position, respectively.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value, as defined in ASC Topic 820, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for market activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is used on a recurring basis for Available for Sale Securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value.

The Company applied the following fair value hierarchy:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. The Company’s mutual fund investments where quoted prices are available in an active market generally are classified within Level 1 of the fair value hierarchy.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. The Company’s borrowed funds and investments in U.S. government agency securities,

government sponsored mortgage backed securities, corporate debt securities, and obligations of states and political subdivisions are generally classified in Level 2 of the fair value hierarchy. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Private equity investments and trust preferred collateralized debt obligations are classified within Level 3 of the fair value hierarchy. Fair values are initially valued based on transaction price and are adjusted to reflect exit values.

The following tables present information about the Company's financial assets and liabilities measured at fair value on a recurring basis at September 30, 2014 and December 31, 2013, and the valuation techniques used by the Company to determine those fair values.

| September 30, 2014 | Carrying Value | Level 1 | Level 2 | Level 3 | Total Estimated Fair Value |
|---|---|---|---|---|---|
| Financial Assets: | | | | | |
| Cash and due from banks | $52,941 | $52,941 | $- | $- | $52,941 |
| Securities - Held to Maturity | | | | | |
| Obligations of States and Political Subdivisions | 31,244 | - | 32,423 | - | 32,423 |
| Corporate Debt Securities | 500 | - | 500 | - | 500 |
| | | | | | |
| Securities - Available for Sale | | | | | |
| Obligations of U.S. Government Agencies | 365,653 | - | 365,653 | - | 365,653 |
| MBS issued by U.S. Government Agencies | 77,907 | - | 77,907 | - | 77,907 |
| Obligations of States and Political Subdivisions | 15,758 | - | 15,758 | - | 15,758 |
| Corporate Debt Securities | 6,024 | - | 6,024 | - | 6,024 |
| Other Securities | 2,123 | 2,123 | - | - | 2,123 |
| | | | | | |
| Federal Home Loan Bank Stock | 10,605 | - | 10,605 | - | 10,605 |
| Loans Held for Sale | 382 | - | - | 382 | 382 |
| Loans, net | 572,640 | - | - | 581,770 | 581,770 |
| Accrued Interest Receivable | 4,133 | - | - | 4,133 | 4,133 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Noninterest Bearing Deposits | 209,731 | 209,731 | - | - | 209,731 |
| Interest Bearings Deposits | 879,753 | - | 881,906 | - | 881,906 |
| Borrowed funds | | | | | |
| FHLB Advances | - | - | - | - | - |
| Repurchase Agreements | 15,000 | - | 15,974 | - | 15,974 |
| Accrued Interest Payable | 160 | - | - | 160 | 160 |

| December 31, 2013 | Carrying Value | Level 1 | Level 2 | Level 3 | Total Estimated Fair Value |
|---|---|---|---|---|---|
| Financial Assets: | | | | | |
| Cash and due from banks | $77,798 | $77,798 | $- | $- | $77,798 |
| Securities - Held to Maturity | | | | | |
| Obligations of States and Political Subdivisions | 34,346 | - | 34,539 | - | 34,539 |
| Corporate Debt Securities | 500 | - | 500 | - | 500 |
| | | | | | |
| Securities - Available for Sale | | | | | |
| Obligations of U.S. Government Agencies | 266,713 | - | 266,713 | - | 266,713 |
| MBS issued by U.S. Government Agencies | 96,526 | - | 96,526 | - | 96,526 |
| Obligations of States and Political Subdivisions | 15,363 | - | 15,363 | - | 15,363 |
| Trust Preferred CDO Securities | 5,751 | - | - | 5,751 | 5,751 |
| Corporate Debt Securities | 8,071 | - | 8,071 | - | 8,071 |
| Other Securities | 2,532 | 2,087 | 445 | - | 2,532 |

| | | | | | |
|---|---|---|---|---|---|
| Federal Home Loan Bank Stock | 10,605 | - | 10,605 | - | 10,605 |
| Loans Held for Sale | 668 | - | - | 668 | 668 |
| Loans, net | 581,381 | - | - | 591,471 | 591,471 |
| Accrued Interest Receivable | 3,502 | - | - | 3,502 | 3,502 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Noninterest Bearing Deposits | 215,844 | 215,844 | - | - | 215,844 |
| Interest Bearings Deposits | 853,874 | - | 857,149 | - | 857,149 |
| Borrowed funds | | | | | |
| FHLB Advances | 12,000 | - | 12,000 | - | 12,000 |
| Repurchase Agreements | 15,000 | - | 16,352 | - | 16,352 |
| Accrued Interest Payable | 179 | - | - | 179 | 179 |

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

The changes in Level 3 assets measured at fair value on a recurring basis were (000's omitted):

| Investment Securities - Available for Sale | 2014 | 2013 |
| --- | --- | --- |
| Balance at January 1 | $5,751 | $5,406 |
| Total realized and unrealized losses included in income | (2,599) | (12 ) |
| Total unrealized gains included in other comprehensive income | 3,758 | 467 |
| Net purchases, sales, calls and maturities | (6,910) | - |
| Net transfers in/out of Level 3 | - | - |
| Balance at September 30 | $- | $5,861 |

The Company sold its portfolio of Level 3 available for sale securities during the quarter ended September 30, 2014.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets. As a result, the unrealized gains and losses for these assets presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

The Company also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include loans and Other Real Estate Owned. The Company estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets measured at fair value on a nonrecurring basis are as follows (000's omitted):

| | Balance at Sept. 30, 2014 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| --- | --- | --- | --- | --- |
| Impaired loans | $ 37,260 | $ - | $ - | $ 37,260 |
| Other Real Estate Owned | $ 6,036 | $ - | $ - | $ 6,036 |

| | Balance at December 31, 2013 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Impaired loans | $ 60,471 | $ - | $ - | $ 60,471 |
| Other Real Estate Owned | $ 9,628 | $ - | $ - | $ 9,628 |

Impaired loans categorized as Level 3 assets consist of non-homogenous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals). Other Real Estate Owned (OREO) consists of property received in full or partial satisfaction of a receivable. The Company utilizes independent appraisals to estimate the fair value of OREO properties.

9. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

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

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for its other lending activities.

Financial instruments whose contractual amounts represent off-balance sheet credit risk were as follows (000s omitted):

| | Contractual Amount | |
|---|---|---|
| | September 30, 2014 | December 31, 2013 |
| Commitments to extend credit: | | |
| Unused portion of commercial lines of credit | $ 61,534 | $ 68,159 |
| Unused portion of credit card lines of credit | 3,427 | 3,255 |
| Unused portion of home equity lines of credit | 18,523 | 16,769 |
| Standby letters of credit and financial guarantees written | 3,674 | 3,667 |
| All other off-balance sheet commitments | 30,000 | - |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Most commercial lines of credit are secured by real estate mortgages or other collateral, and generally have fixed expiration dates or other termination clauses. Since the lines of credit may expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. Credit card lines of credit have various established expiration dates, but are fundable on demand. Home equity lines of credit are secured by real estate mortgages, a majority of which have ten year expiration dates, but are fundable on demand. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on Management's credit evaluation of the counterparty.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and other business transactions.

Other off-balance sheet commitments as of September 30, 2014 consist of a commitment to purchase loan participations. This commitment is scheduled to be funded in 2014.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Introduction

MBT Financial Corp. (the "Company") is a bank holding company with one subsidiary, Monroe Bank & Trust ("the Bank"). The Bank is a commercial bank with a wholly owned subsidiary, MB&T Financial Services. MB&T Financial Services is an insurance agency which sells insurance policies to the Bank. The Bank operates 17 branch offices in Monroe County, Michigan and 7 branch offices in Wayne County, Michigan, and a loan and wealth management office in Lenawee County, Michigan. The Bank's primary source of income is interest income on its loans and investments and its primary expense is interest expense on its deposits and borrowings. The discussion and analysis should be read in conjunction with the accompanying consolidated statements and footnotes.

Executive Overview

The Bank is operated as a community bank, primarily providing loan, deposit, and wealth management products and services to the people, businesses, and communities in its market area. In addition to our commitment to our mission of serving the needs of our local communities, we are focused on improving asset quality, increasing net interest income, and improving non-interest income and expenses.

The net profit of $1,712,000 for the quarter ended September 30, 2014 was a decrease of $19,575,000 or 92.0% compared to the third quarter of 2013. The decrease was the result of a tax benefit of $18.8 million recorded in the third quarter of 2013 to reverse the valuation allowance on the Company's deferred tax asset. The pre-tax income of $2,315,000 in the third quarter of 2014 represents a decrease of $177,000, or 7.1% compared to the pre-tax income in the third quarter of 2013. The pre-tax income decrease was mainly attributable to the loss on the sale of pooled trust preferred investment securities in the third quarter of 2014. The securities loss exceeded the improvement in the net interest margin and the significant improvement in the provision for loan losses. This quarter marked the thirteenth consecutive quarterly profit following significant losses caused by the severe economic downturn that impacted the regional and national economies beginning in 2006.

The national economic recovery is gaining momentum, and the recovery in southeast Michigan is steadily improving. Local unemployment rates improved significantly since 2011, and while they are now comparable to the state and national averages, they remain above the historical norms. Commercial and residential development property values are improving, but remain below pre-recession levels. Our total classified assets, which include internal watch list loans, other real estate owned, and sub investment grade securities, improved steadily during 2013 and the first half of 2014, and showed significant improvement in the third quarter of 2014. Classified assets went down $26.3 million, or 32.4% during the third quarter of 2014, and decreased $43.7 million or 44.4% compared to a year ago. Net charge offs increased from $0.6 million in the third quarter of 2013 to $1.2 million in the third quarter of 2014, but this was mainly due to charge offs totaling $1.7 million on a portfolio of classified assets that were sold during the quarter. These charge offs were previously identified and our allowance included a specific allocation for nearly the entire amount, so the sale did not significantly impact the provision. Also during the third quarter of 2014, we recovered

$0.7 million that had been charged off in a previous year. As a result, we were able to maintain an adequate Allowance for Loan and Lease Losses (ALLL) while reducing the ALLL from $15.0 million to $13.1 million during the quarter. We recorded a credit to the provision expense of $700,000, a reduction of $900,000, or 450% compared to the third quarter of 2013. The loan portfolio held for investment decreased during the quarter due to the sale of classified loans, and the ALLL as a percent of loans decreased from 2.50% to 2.24%. We will continue to assess the adequacy of our ALLL each quarter, and adjust it as necessary by debiting or crediting the provision expense.

Net Interest Income increased $313,000, or 3.7% compared to the third quarter of 2013 even though the net interest margin was unchanged at 3.17% because the average earning assets increased $40.6 million. The increase in the average earning assets was mainly funded by growth in deposits. The margin was unchanged as the cost of funds and the yield on earning assets both decreased due to the continued historically low level of interest rates. The provision for loan losses decreased $900,000 compared to the third quarter of 2013 as the improving quality of the loan portfolio enabled us to reduce our ALLL by recording a negative provision expense. Non-interest income for the quarter decreased $1,359,000, primarily due to a large loss on securities transactions and a decrease in the service charges and other fees on deposit accounts. Non-interest expenses increased only $31,000, as increases in salaries and employee benefits expenses and professional fees were nearly offset by a large reduction in the FDIC insurance assessment.

Critical Accounting Policies

The Company's Allowance for Loan Losses, Fair Value of Investment Securities, and Other Real Estate Owned are "critical accounting estimates" because they are estimates that are based on assumptions that are highly uncertain, and if different assumptions were used or if any of the assumptions used were to change, there could be a material impact on the presentation of the Company's financial condition. These assumptions include, but are not limited to, collateral values, the effect of economic conditions on the financial condition of the borrowers, the Company, and the issuers of investment securities, market interest rates, and projected earnings for the Company.

To determine the Allowance for Loan Losses, the Company estimates losses on all loans that are not classified as nonaccrual or renegotiated by applying historical loss rates, adjusted for current conditions, to those loans. In addition, all nonaccrual loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are individually tested for impairment. Any amount of monetary impairment is included in the Allowance for Loan Losses.

To determine the fair value of investment securities, the Company utilizes quoted prices in active markets for identical assets, quoted prices for similar assets in active markets, or discounted cash flow calculations for investments where there is little, if any, market activity for the asset.

To determine the fair value of Other Real Estate Owned, the Company utilizes independent appraisals to estimate the fair value of the property.

Financial Condition

The pace of the economic recovery increased over the last year, with local unemployment and property values steadily improving. Management focused our efforts on improving asset quality, increasing net interest income, and improving non-interest income and expenses.

With respect to asset quality, our nonperforming assets (“NPAs”) decreased 27.6% during the quarter, from $60.0 million to $43.5 million, and total classified assets decreased 32.4% from $81.0 million to $54.7 million. Loan delinquencies decreased from 2.1% to 1.9% during the quarter, which is significantly better than the 3.3% total reported one year ago. Over the last twelve months, NPAs decreased $28.6 million, or 39.7%, with nonperforming loans decreasing 35.4% from $57.9 million to $37.5 million, and Other Real Estate Owned (“OREO”) decreasing 44.3% from $10.8 million to $6.0 million. Total classified assets, which include internally classified watch list loans, other real estate, and pooled trust preferred collateralized debt obligation securities, decreased $43.7 million, or 44.4%. The reduction in classified assets was accomplished by the sales of $9.8 million in classified loans and $9.4 million in pooled trust preferred CDO securities in the third quarter of 2014, and $24.5 million in upgrades, payments, and charge offs of classified loans over the last four quarters. The Company’s Allowance for Loan and Lease Losses (“ALLL”) decreased $3.6 million over the last four quarters due to a decrease in the size of the portfolio and an improvement in the quality of the assets in the loan portfolio. The ALLL is now 2.24% of loans, down from 2.74% at September 30, 2013. The ALLL is 35.06% of nonperforming loans (“NPLs”), compared to 28.84% at year end and 28.94% at September 30, 2013. In light of current economic conditions, we believe that this level of ALLL adequately estimates the potential losses in the loan portfolio.

Since December 31, 2013, total loans held for investment decreased 2.0% as new loan activity was not sufficient to cover payments received and the reduction from the sale of classified loans in the third quarter of 2014. Our new loan pipeline remains modest, and we expect loan originations and new loan participations in the fourth quarter of 2014 to result in growth in loans for the full year.

Since December 31, 2013, deposits increased $19.8 million, or 1.8% due to normal seasonal fluctuations in local deposit activity. Since year end we reduced our non-deposit funding by paying off $12.0 million of Federal Home Loan Bank borrowings. The decrease in non-deposit funding was exceeded by the increase of $19.8 million in deposits and the increase of $20.0 million in capital. As a result, our total assets increased $29.1 million, or 2.4%. The Company expects deposit funding to remain stable for the rest of 2014. The increase in total capital during the first nine months of 2014 was due to the profit of $5.2 million, issuance of common stock of $8.3 million, and an increase of $6.6 million in the accumulated other comprehensive income (AOCI). AOCI increased due to an increase in the value of our securities available for sale and due to the sale of the pooled trust preferred CDOs, which had a net unrealized loss of $2.5 million that was included in AOCI at December 31, 2013. The increase in capital caused the capital to assets ratio to increase from 9.05% at December 31, 2013 to 10.44% at September 30, 2014.

On October 29, 2014, the Bank conducted an auction of commercial properties that are held in Other Real Estate. Following the auction, the Bank offered to sell some of the properties that did not sell at the auction at prices below the carrying values. As a result, the September 30, 2014 financial statements include the effect of writing down the values of these properties by $500,000. This decreased the value of the Other Real Estate and increased the amount of losses on sales of Other Real Estate in the financial statements as of September 30, 2014 by $500,000.

Results of Operations – Third Quarter 2014 vs. Third Quarter 2013

Net Interest Income - A comparison of the income statements for the three months ended September 30, 2014 and 2013 shows an increase of $313,000, or 3.7%, in Net Interest Income. Interest income on loans decreased $350,000 or 4.6% as the average loans outstanding decreased $13.5 million and the average yield on loans decreased from 4.94% to 4.82%. The interest income on investments, fed funds sold, and interest bearing balances due from banks increased $383,000 as the average amount of investments, fed funds sold, and interest bearing balances due from banks increased $54.1 million and the yield increased from 1.81% to 1.91%. The yield on investments increased because the Company invested more of its cash into investment securities. The interest expense on deposits decreased $266,000 or 25.8% even though the average deposits increased $18.1 million because the average cost of deposits decreased from 0.39% to 0.28%.

Provision for Loan Losses - The Provision for Loan Losses decreased from $200,000 in the third quarter of 2013 to a credit of $700,000 in the third quarter of 2014. Net charge offs were $1,171,000 during the third quarter of 2014, compared to $629,000 in the third quarter of 2013, however, $1.5 million was specifically allocated in the ALLL for loans that were included in the classified assets sold. Each quarter, the Company conducts a review and analysis of its ALLL to determine its adequacy. This analysis involves specific allocations for impaired credits and a general allocation for losses expected based on historical experience adjusted for current conditions. Due to a decrease in the size of the portfolio, an improvement in portfolio risk indicators, and a decrease in the historical loss percentages, the amount of provision required to maintain an adequate ALLL in the third quarter of 2014 decreased 450.0% compared to the amount required in the third quarter of 2013. The ALLL is 2.24% of loans as of September 30, 2014, and, in light of current economic conditions, we believe that at this level the ALLL adequately estimates the potential losses in our loan portfolio.

Other Income – Non interest income decreased $1,359,000, or 39.0% compared to the third quarter of 2013 mainly due to a loss on securities transactions in 2014. The large loss on securities transactions was the result of the sale of the pooled trust preferred CDO securities, which was done in order to reduce classified assets. Excluding securities activity, non-interest income decreased $197,000, or 5.9% compared to the third quarter of 2013. Wealth management income increased $116,000 or 10.8% due to an increase in the market value of assets managed. Service charges and other fees decreased $74,000, or 6.6% due to a decrease in the amount of checking account overdraft activity. Origination fees on mortgage loans sold decreased $53,000, or 39.8% as higher market interest rates decreased mortgage refinance activity.

Other Expenses – Total non-interest expenses increased $31,000, or 0.3% compared to the third quarter of 2013. Salaries and Employee Benefits increased $321,000, or 6.0%, due to an increase of $149,000 in the officers' incentive plan accrual, and an increase of $155,000 in salaries and wages. The incentive plan accrual increased because the awards under the plan are based on certain earnings performance measures, which are currently higher than last year. Salaries increased due to a small increase in the number of employees and annual merit increases. Occupancy expense decreased $111,000 due to lower depreciation, repairs, and maintenance expenses. Also, rent expense is lower in 2014 due to the relocation of our mortgage operations from leased space to a property that we purchased and renovated in downtown Monroe. Professional fees increased $154,000, mainly due to expenses related to the sale of classified loans in the third quarter of 2014. FDIC insurance assessments decreased $420,000 primarily due to a decrease in the assessment rate following the termination of the Bank's Consent Order. The lower assessment rate became effective in the second quarter of 2014, requiring an adjustment to the expense accrual in the third quarter. We expect the FDIC insurance expense to be approximately $400,000 per quarter beginning in the fourth quarter of 2014.

As a result of the above activity, the Profit Before Income Taxes in the third quarter of 2014 was $2,315,000, a decrease of $177,000 compared to the pre-tax profit of $2,492,000 in the third quarter of 2013. The Company recorded a federal income tax expense of $603,000 in the third quarter of 2014, reflecting an effective tax rate of 26.0%. In the third quarter of 2013, the Company eliminated the valuation allowance against its deferred tax asset by recording a federal income tax benefit of $18.8 million. If the Company did not have the valuation allowance reversal and the benefit of its NOL carry forward, the tax expense for the third quarter of 2013 would have been $634,000, for an effective tax rate of 25.4%. The Net profit for the third quarter of 2014 was $1,712,000, a decrease of 92.0% compared to the net profit of $21,287,000 in the third quarter of 2013.

Results of Operations – Nine Months Ended September 30, 2014 vs. Nine Months Ended September 30, 2013

Net Interest Income - A comparison of the income statements for the nine months ended September 30, 2014 and 2013 shows an increase of $1,227,000, or 5.0%, in Net Interest Income. Interest income on loans decreased $1.8 million or 7.6% as the average loans outstanding decreased $19.5 million and the average yield on loans decreased from 5.01% to 4.78%. The interest income on investments, fed funds sold, and interest bearing balances due from banks increased $1,058,000 as the average amount of investments, fed funds sold, and interest bearing balances due from banks increased $0.6 million and the yield increased from 1.68% to 1.96%. The yield on investments increased because the Company was maintaining a very high liquidity position in 2013 by keeping a large amount of funds in low yielding short term investments and deposits in the Federal Reserve Bank. This large cash position was being maintained through most of the first six months of 2013 in anticipation of paying off maturing debt near the end of the second quarter of 2013. A continued low overall level of interest rates and the maturity of some high cost borrowings helped reduce the funding costs. The interest expense on deposits decreased $938,000 or 27.9% even though the average deposits increased $13.8 million because the average cost of deposits decreased from 0.43% to 0.30%. The cost of borrowed funds decreased $982,000 as the average amount of borrowed funds decreased $53.0 million.

Provision for Loan Losses - The Provision for Loan Losses decreased from $2.1 million in the first nine months of 2013 to a credit of $500,000 in the first nine months of 2014. Net charge offs were $2.6 million during the first nine months of 2014 and 2013. Each quarter, the Company conducts a review and analysis of its ALLL to determine its adequacy. This analysis involves specific allocations for impaired credits and a general allocation for losses expected based on historical experience adjusted for current conditions. Due to a decrease in the size of the portfolio, an improvement in portfolio risk indicators, and a decrease in the historical loss percentages, the amount of provision required to maintain an adequate ALLL in the first nine months of 2014 decreased 123.8% compared to the amount required in the first nine months of 2013. The ALLL is 2.24% of loans as of September 30, 2014, and, in light of current economic conditions, we believe that at this level the ALLL adequately estimates the potential losses in our loan portfolio.

Other Income – Non interest income decreased $1,381,000, or 12.8% compared to the first nine months of 2013. Wealth management income increased $240,000 or 7.4% due to an increase in the market value of assets managed. Service charges and other fees decreased $274,000, or 8.5% due to a decrease in the amount of checking account overdraft activity. Securities gains decreased $1,050,000 or 343.1% primarily due to the sale of pooled trust preferred CDOs in 2014. Losses on other real estate owned decreased $375,000 or 28.0% as real estate values in southeast Michigan continued to improve. Origination fees on mortgage loans sold decreased $376,000, or 62.0% as a sharp increase in market interest rates near the end of the second quarter of 2013 significantly decreased mortgage refinance activity.

Other Expenses – Total non-interest expenses increased $628,000, or 2.2% compared to the first nine months of 2013. Salaries and Employee Benefits increased $1,316,000, or 8.3%, as salaries increased due to an increase in the number of employees, annual merit increases, and an increase in the accrual for the officer incentive program. Occupancy expense decreased $106,000 due to lower depreciation and maintenance expenses. Marketing expense increased $92,000 due to higher advertising and sales promotion expenses in an effort to grow our lending and wealth management business. FDIC insurance assessments decreased $543,000 due to a decrease in the assessment rate due

to the termination of our Consent Order and a decrease in the assessment base that resulted from reducing our use of borrowed funds.

As a result of the above activity, the Profit Before Income Taxes in the first nine months of 2014 was $6,920,000, an increase of $1,818,000 compared to the pre-tax profit of $5,102,000 in the first nine months of 2013. The Company recorded a federal income tax expense of $1,754,000 in the first nine months of 2014, reflecting an effective tax rate of 25.3%. In the third quarter of 2013, the Company eliminated the valuation allowance against its deferred tax asset, and accordingly, recorded a federal income tax benefit of $18.8 million. If we did not have the valuation allowance reversal and the benefit of the NOL carry forward, we would have incurred a federal income tax expense for the nine months ended September 30, 2013 of $1,086,000, for an effective tax rate of 21.3%. The Net profit for the first nine months of 2014 was $5,166,000, a decrease of 78.4% compared to the net profit of $23,897,000 in the first nine months of 2013.

Cash Flows

Cash flows provided by operating activities decreased $2.5 million compared to the first nine months of 2013 as the decrease in net income was due to improvements in noncash items, primarily the $20.5 million increase in the deferred income tax. In the first nine months of 2013, investing activities used $0.9 million in cash as net investment securities increases and investment in bank premises exceeded reductions in loans and other real estate owned. In the first nine months of 2014, cash used to purchase investment securities exceeded cash provided by sales and maturities of investment securities by $60.5 million while decreases in loans and sales of other real estate owned and other assets provided $12.2 million of cash, and total cash used for investing activities was $50.0 million. This use of cash for investing activities contributed to the improvement in interest income for the company. The amount of cash used for financing activities in the first nine months of 2013 was $88.0 million as the repayment of maturing Federal Home Loan Bank borrowings was slightly offset by an increase in deposits and issuance of common stock. The cash provided by financing was $15.9 million in the first nine months of 2014, as the repayment of $12.0 million of Federal Home Loan Bank debt was exceeded by the increase of $19.8 million in deposits and the issuance of $8.1 million in common stock. In the first nine months of 2014, the use of beginning cash and cash provided by operations for investment in securities and to reduce borrowings contributed to the improvement in net interest income by decreasing the amount of cash and cash equivalents by $24.9 million. In the first nine months of 2013, the beginning cash and cash provided by operations were used to reduce financing. This resulted in a reduction in interest expense by decreasing the amount of interest bearing borrowed funds.

Liquidity and Capital

The Company believes it has sufficient liquidity to fund its lending activity and allow for fluctuations in deposit levels. Internal sources of liquidity include the maturities of loans and securities in the ordinary course of business as well as our available for sale securities portfolio. External sources of liquidity include a line of credit with the Federal Home Loan Bank of Indianapolis, the Federal funds line that has been established with our correspondent bank, and Repurchase Agreements with money center banks that allow us to pledge securities as collateral for borrowings. As of September 30, 2014, the Bank was not utilizing any of its authorized limit of $255 million with the Federal Home Loan Bank of Indianapolis, or its $20 million overdraft line of credit with the Federal Home Loan Bank of Indianapolis, or of its $25 million of federal funds line with a correspondent bank. The Company periodically draws on its overdraft and fed funds lines to ensure that funding will be available if needed.

The Company's Funds Management Policy includes guidelines for desired amounts of liquidity and capital. The Funds Management Policy also includes contingency plans for liquidity and capital that specify actions to take if liquidity and capital ratios fall below the levels contained in the policy. Throughout the first nine months of 2014 the Company was in compliance with its Funds Management Policy regarding liquidity and capital.

Total stockholders’ equity of the Company was $130.7 million at September 30, 2014 and $110.6 million at December 31, 2013. Common stock increased $8.3 million due to the issuance of stock in a private placement and a rights offering, retained earnings increased $5.2 million due to the year to date profit, and the Accumulated Other Comprehensive Loss (AOCL) decreased $6.6 million due to a reduction in the unrealized losses on securities that are classified as Available For Sale. Total equity increased $20.0 million and total assets increased $29.1 million, so the ratio of equity to assets increased from 9.05% at December 31, 2013 to 10.44% at September 30, 2014.

Federal bank regulatory agencies have set capital adequacy standards for Total Risk Based Capital, Tier 1 Risk Based Capital, and Leverage Capital. These standards require banks to maintain Leverage and Tier 1 ratios of at least 4% and a Total Capital ratio of at least 8% to be adequately capitalized. The regulatory agencies consider a bank to be well capitalized if its Total Risk Based Capital is at least 10% of Risk Weighted Assets, Tier 1 Capital is at least 6% of Risk Weighted Assets, and the Leverage Capital Ratio is at least 5%.

The following table summarizes the capital ratios of the Company and the Bank:

| | Actual | | Minimum to Qualify as Well Capitalized | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| As of September 30, 2014: | | | | |
| Total Capital to Risk-Weighted Assets | | | | |
| Consolidated | $125,863 | 16.92% | $ 74,389 | 10 % |
| Monroe Bank & Trust | 124,281 | 16.71% | 74,372 | 10 % |
| Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 116,478 | 15.66% | 44,633 | 6 % |
| Monroe Bank & Trust | 114,898 | 15.45% | 44,623 | 6 % |
| Tier 1 Capital to Average Assets | | | | |
| Consolidated | 116,478 | 9.50 % | 61,276 | 5 % |
| Monroe Bank & Trust | 114,898 | 9.38 % | 61,264 | 5 % |

| | Actual | | Minimum to Qualify as Well Capitalized | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| As of December 31, 2013: | | | | |
| Total Capital to Risk-Weighted Assets | | | | |
| Consolidated | $110,414 | 14.55% | $ 75,899 | 10 % |
| Monroe Bank & Trust | 108,818 | 14.36% | 75,760 | 10 % |
| Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 100,839 | 13.29% | 45,540 | 6 % |
| Monroe Bank & Trust | 99,242 | 13.10% | 45,456 | 6 % |
| Tier 1 Capital to Average Assets | | | | |
| Consolidated | 100,839 | 8.61 % | 58,593 | 5 % |

| | | | | |
|---|---|---|---|---|
| Monroe Bank & Trust | 99,242 | 8.48 % | 58,522 | 5 % |

On July 12, 2010, the Bank entered into a Consent Order with its state and federal regulators. While the Bank was under the Consent Order, it was classified as "adequately capitalized" even though its ratios met the "well capitalized" guidelines. The Consent Order required the Bank to raise its Tier 1 Leverage ratio to 9% and its Total Risk Based Capital Ratio to 12%. As of June 30, 2014, the Bank was in compliance with the capital ratio requirements of the Consent Order. The Consent Order was terminated by the regulators effective June 30, 2014 and the Bank is now considered "well capitalized".

Although the Consent Order has been terminated, the Bank continues to be subject to certain informal regulatory requirements and restrictions, including, among other things, requirements to maintain a Tier 1 leverage ratio of at least 9%, continue to reduce classified and delinquent assets, continually monitor its progress, and submit quarterly progress reports to the regulators. The Bank must also request prior approval from its state and federal regulators before paying dividends.

Market risk for the Bank, as is typical for most banks, consists mainly of interest rate risk and market price risk. The Bank's earnings and the economic value of its equity are exposed to interest rate risk and market price risk, and monitoring this risk is the responsibility of the Asset/Liability Management Committee (ALCO) of the Bank. The Bank's market risk is monitored monthly and it has not changed significantly since year-end 2013.

Internal Revenue Service Audit

Since the fourth quarter of 2010, the Internal Revenue Service (IRS) has been conducting an audit of our tax returns for the 2004, 2005, 2007, 2008, 2009, and 2010 tax years. The IRS is nearing completion of the audit and has proposed adjustments to our taxable income, mainly challenging our treatment of interest on non accrual loans, OREO valuations, OREO carrying costs, and loan charge-offs. Although our loan charge-offs were in compliance with state and federal bank regulatory agency guidelines, the IRS examining agent conducting the audit has called into question the deductibility of certain charge-offs for income tax purposes based on the facts and circumstances of a loan at the time of the charge-off and certain differences between tax and financial accounting for charge-offs. We believe that the charge-off deductions were proper when taken, and our belief is supported by confirmation of our charge off methodology by our federal and state banking regulators.

According to ASC 740, Accounting for Uncertainty in Income Taxes, an entity is required to evaluate the validity of uncertain tax positions and determine if the relevant taxing authority would conclude that it is more likely than not (greater than fifty percent) that the position taken will be sustained, based upon technical merits, upon examination. We have reviewed our tax positions and have concluded that it is appropriate to record a liability for potential reimbursement to the IRS.

Since the audit began in 2010, the Company has incurred over $200,000 of professional fees expenses with its accountants and lawyers for assistance in resolution. In order to resolve the audit without incurring significant additional expenses, the Company offered a settlement proposal to the IRS in the third quarter of 2012. The Company's proposal resulted in a current tax liability of $2.0 million. The Company has concluded that its offer to settle of $2.0 million is the best estimate of potential liability at this time. The Company expects the audit to be resolved without incurring significant additional tax or professional fees expenses.

Although the timing of the resolution and/or closure of the audit remains highly uncertain, the Company believes it is reasonably possible that the IRS will conclude this audit within the current year. Adjustments could be necessary in

future periods to the estimated potential federal income tax payable noted above based on issues raised by the IRS. Management will re-evaluate the estimate quarterly based on current, relevant facts.

Forward-Looking Statements

Certain statements contained herein are not based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements, due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, changes in the financial and securities markets, including changes with respect to the market value of our financial assets, the availability of and costs associated with sources of liquidity, and the ability of the Company to resolve or dispose of problem loans.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Bank faces market risk to the extent that the fair values of its financial instruments are affected by changes in interest rates. The Bank does not face market risk due to changes in foreign currency exchange rates, commodity prices, or equity prices. The asset and liability management process of the Bank seeks to monitor and manage the amount of interest rate risk. This is accomplished by analyzing the differences in repricing opportunities for assets and liabilities, by simulating operating results under varying interest rate scenarios, and by estimating the change in the net present value of the Bank’s assets and liabilities due to interest rate changes.

Each month, the Asset and Liability Committee (ALCO), which includes the senior management of the Bank, estimates the effect of interest rate changes on the projected net interest income of the Bank. The sensitivity of the Bank’s net interest income to changes in interest rates is measured by using a computer based simulation model to estimate the impact on earnings of both gradual and sudden increases or decreases of 100, 200, 300, and 400 basis points in the interest rates. The net interest income projections are compared to a base case projection, which assumes no changes in interest rates.

The Bank’s ALCO has established limits in the acceptable amount of interest rate risk, as measured by the change in the Bank’s projected net interest income, in its policy. Throughout the first nine months of 2014, the Bank’s interest rate

risk has remained within its policy limits.

The ALCO also monitors interest rate risk by estimating the effect of changes in interest rates on the economic value of the Bank's equity each month. The economic value of the Bank's equity is first determined by subtracting the fair value of the Bank's liabilities from the fair value of the Bank's assets. The Bank estimates the interest rate risk by calculating the effect of market interest rate changes on that economic value of its equity. For this analysis, the Bank assumes immediate parallel shifts of plus or minus 100, 200, and 300 basis points in interest rates. The discount rates used to determine the present values of the loans and deposits, as well as the prepayment rates for the loans, are based on Management's expectations of the effect of the rate changes on the market for loans and deposits. In addition, each quarter, the Bank conducts additional analyses that utilize other rate scenarios, such as larger shifts in rates and changes in the shape of the yield curve, to assess the Bank's exposure to interest rate risk in stress scenarios.

The Bank's interest rate risk, as measured by the net interest income and economic value of equity simulations, has not changed significantly from December 31, 2013.

**Item 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2014, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2014, in alerting them in a timely manner to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

There was no change in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended September 30, 2014, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II Other Information**

**Item 1. Legal Proceedings**

MBT Financial Corp. and its subsidiaries are not a party to, nor is any of their property the subject of any material legal proceedings other than ordinary routine litigation incidental to their respective businesses, nor are any such proceedings known to be contemplated by governmental authorities.

**Item 1A. Risk Factors**

Not applicable for smaller reporting companies.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

No matters to be reported.

**Item 6. Exhibits**

3.1 Articles of Incorporation of MBT Financial Corp. Previously filed as Exhibit 3.1 to MBT Financial Corp.'s Form 10-Q for its quarter ended June 30, 2011.

3.2 Amended and Restated Bylaws of MBT Financial Corp. Previously filed as Exhibit 3.2 to MBT Financial Corp.'s Form 10-Q for its quarter ended March 31, 2008.

31.1 Certification by Chief Executive Officer required by Securities and Exchange Commission Rule 13a-14.

| | |
|---|---|
| 31.2 | Certification by Chief Financial Officer required by Securities and Exchange Commission Rule 13a-14. |
| 32.1 | Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

**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.

| | |
|---|---|
| | MBT Financial Corp.<br>(Registrant) |
| November 14, 2014<br>Date | By /s/ H. Douglas Chaffin<br>H. Douglas Chaffin<br>President &<br>Chief Executive Officer |

| November 14, 2014 | By/s/ John L. Skibski |
| --- | --- |
| Date | John L. Skibski |
| | Executive Vice President |
| | and |
| | Chief Financial Officer |

**Exhibit Index**

| Exhibit Number | Description of Exhibits |
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