First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
August 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2013

OR

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

For the transition period from ______________________ to ______________________

Commission File Number 000-31957

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	**32-0135202**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 S. Second Avenue, Alpena, Michigan 49707

(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: **(989) 356-9041**

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date.

Common Stock, Par Value $0.01	Outstanding at August 14, 2013
(Title of Class)	2,884,049 shares

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

FORM 10-Q

Quarter Ended June 30, 2013

INDEX

When used in this Form 10-Q or future filings by First Federal of Northern Michigan Bancorp, Inc. (the "Company") with the Securities and Exchange Commission ("SEC"), in the Company's press releases or other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheet

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	$6,295,069	$ 2,732,109
Overnight deposits with FHLB	29,659	19,701
Total cash and cash equivalents	6,324,728	2,751,810
Securities AFS	48,392,643	50,763,551
Securities HTM	2,305,000	2,345,000
Loans held for sale	423,490	78,712
Loans receivable, net of allowance for loan losses of $1,691,068 and $1,749,915 as of June 30, 2013 and December 31, 2012, respectively	139,260,220	138,911,989
Foreclosed real estate and other repossessed assets	2,097,643	2,387,307
Federal Home Loan Bank stock, at cost	3,266,100	3,266,100
Premises and equipment	5,212,555	5,394,412
Accrued interest receivable	899,163	970,450
Intangible assets	99,024	158,316
Prepaid FDIC premiums	-	582,945
Deferred tax asset	618,169	330,831
Originated mortgage servicing rights (net of valuation reserve)	949,790	1,016,070
Bank owned life insurance	4,541,215	4,474,563
Other assets	397,841	402,090
Total assets	$214,787,581	$ 213,834,146
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$161,347,153	$ 158,350,134
Advances from borrowers for taxes and insurance	413,182	132,823
Federal Home Loan Bank Advances	24,112,064	26,357,962
REPO Sweep Accounts	3,573,669	3,183,351
Accrued expenses and other liabilities	1,400,375	1,375,092
Total liabilities	190,846,443	189,399,362
Stockholders' equity:		
Common stock ($0.01 par value 20,000,000 shares authorized 3,191,799 shares issued and outstanding) at June 30, 2013 and December 31, 2012	31,918	31,918
Additional paid-in capital	23,853,891	23,853,891
Retained earnings	2,830,299	2,766,170
Treasury stock at cost (307,750 shares) at June 30, 2013 and December 31, 2012	(2,963,918)	(2,963,918)

Accumulated other comprehensive income	188,948	746,723
Total stockholders' equity	23,941,138	24,434,784
Total liabilities and stockholders' equity	$214,787,581	$ 213,834,146

See accompanying notes to consolidated financial statements.

3

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	$1,826,649	$2,011,490	$3,643,262	$4,051,698
Interest and dividends on investments				
Taxable	123,991	137,028	239,320	287,208
Tax-exempt	37,348	38,730	75,043	77,803
Interest on mortgage-backed securities	106,795	164,556	222,166	343,844
Total interest income	2,094,783	2,351,804	4,179,791	4,760,553
Interest expense:				
Interest on deposits	208,638	263,634	430,540	544,177
Interest on borrowings	76,022	163,655	175,463	347,289
Total interest expense	284,660	427,289	606,003	891,466
Net interest income	1,810,123	1,924,515	3,573,788	3,869,087
Provision for loan losses	195,753	578,315	339,827	954,583
Net interest income after provision for loan losses	1,614,370	1,346,200	3,233,961	2,914,504
Non-interest income:				
Service charges and other fees	222,279	187,539	414,719	357,493
Mortgage banking activities	161,691	214,086	332,123	434,645
Net gain (loss) on sale of premises and equipment, real estate owned and other repossessed assets	(5,729)	(68,015)	750	(70,104)
Other	86,371	57,043	157,363	115,442
Total non-interest income	464,612	390,653	904,955	837,476
Non-interest expense:				
Compensation and employee benefits	1,134,644	1,176,584	2,293,901	2,448,542
FDIC Insurance Premiums	48,978	46,645	94,677	94,125
Advertising	28,797	49,370	67,716	82,485
Occupancy	218,209	237,332	451,655	479,248
Amortization of intangible assets	29,646	44,134	59,292	117,247
Service bureau charges	77,089	76,867	154,583	155,654
Professional services	186,970	113,109	259,834	207,844
Other	358,164	398,758	693,129	858,306
Total non-interest expense	2,082,497	2,142,799	4,074,787	4,443,451
Income (loss) before income tax benefit	(3,515)	(405,946)	64,129	(691,471)
Income tax benefit	-	(135,997)	-	(1,022,197)
Net (loss) income	$(3,515)	$(269,949)	$64,129	$330,726

Other comprehensive income (loss):				
Net (loss) income	$(3,515)	$(269,949)	$64,129	$330,726
Change in unrealized gain on available-for-sale securities, net of tax	(457,978)	211,032	(557,775)	166,685
Comprehensive income (loss)	$(461,493)	$(58,917)	$(493,646)	$497,411
Per share data:				
Net (loss) income per share				
Basic	$(0.00)	$(0.09)	$0.02	$0.15
Diluted	$(0.00)	$(0.09)	$0.02	$0.15
Weighted average number of shares outstanding				
Basic	2,884,049	2,884,049	2,884,049	2,884,049
Including dilutive stock options	2,884,049	2,884,049	2,884,049	2,884,049

See accompanying notes to consolidated financial statements.

First Federal of Northern Michigan Bancorp Inc. and Subsidiaries

Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2012	$31,918	$(2,963,918)	$23,853,891	$2,766,170	$746,723	$24,434,784
Net income	-	-	-	64,129	-	64,129
Change in unrealized gain on available-for-sale securities (net of tax of $287,339)	-	-	-	-	(557,775)	(557,775)
Balance at June 30, 2013	$31,918	$(2,963,918)	$23,853,891	$2,830,299	$188,948	$23,941,138

See accompanying notes to the consolidated financial statements.

5

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Cash Flows

	For Six Months Ended June 30, 2013 (Unaudited)	2012
Cash Flows from Operating Activities:		
Net income	$64,129	$330,726
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	200,654	276,051
Provision for loan loss	339,827	954,583
Amortization and accretion on securities	303,600	233,277
Stock-based compensation	-	1,699
Gain on sale of loans held for sale	(138,002)	(174,890)
Originations of loans held for sale	(7,931,234)	(12,761,655)
Proceeds from sale of loans held for sale	7,724,458	12,659,736
(Gain) loss on sale of fixed assets	(8,084)	723
Loss on sale of real estate owned and other repossessed assets	7,334	69,382
Net change in:		
Accrued interest receivable	71,287	46,921
Other assets	70,530	(15,300)
Prepaid FDIC insurance premiums	582,945	87,594
Bank owned life insurance	(66,652)	(23,722)
Deferred income tax (benefit) expense	-	(939,328)
Accrued expenses and other liabilities	25,283	(207,281)
Net cash provided by operating activities	1,246,075	538,516
Cash Flows from Investing Activities:		
Net increase in loans (loans originated, net of principal payments)	(961,058)	(3,405,122)
Proceeds from maturity and sale of available-for-sale securities	10,715,273	9,024,991
Proceeds from sale of property and equipment	55,164	400
Proceeds from sale of real estate owned and other repossed assets	555,330	1,712,662
Purchase of securities	(9,453,079)	(8,191,262)
Purchase of premises and equipment	(6,585)	(84,869)
Net cash provided by (used for) investing activities	905,045	(943,200)
Cash Flows from Financing Activities:		
Net increase in deposits	2,997,019	3,784,755
Net increase (decrease) in Repo Sweep accounts	390,318	(1,702,424)
Net increase in advances from borrowers	280,359	295,113
Advances from Federal Home Loan Bank and notes payable	27,625,000	26,350,000
Repayments of Federal Home Loan Bank advances and notes payable	(29,870,898)	(28,400,000)
Net cash provided by financing activities	1,421,798	327,444
Net increase (decrease) in cash and cash equivalents	3,572,918	(77,240)
Cash and cash equivalents at beginning of period	2,751,810	2,749,498

Cash and cash equivalents at end of period	$6,324,728	$2,672,258
Supplemental disclosure of cash flow information:		
Cash paid during the period for Interest	$622,719	$919,561
Transfers of loans to foreclosed real estate and repossessed assets	$273,000	$884,803

See accompanying notes to the consolidated financial statements.

6

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1—BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited condensed consolidated interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim financial statements should be read in conjunction with the financial statements of First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries and the notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2012.

All adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of financial position, results of operations and cash flows, have been made. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

Note 2— PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of First Federal of Northern Michigan Bancorp, Inc., First Federal of Northern Michigan, and the Bank’s wholly owned subsidiaries, Financial Services & Mortgage Corporation (“FSMC”) and FFNM Agency, Inc. FSMC invests in real estate, which includes leasing, selling, developing, and maintaining real estate properties. The main activity of FFNM Agency is to collect the stream of income associated with the sale of the Blue Cross/Blue Shield override to the Grotenhuis Group (as discussed further below). All significant intercompany balances and transactions have been eliminated in the consolidation.

Note 3—SECURITIES

Investment securities have been classified according to management's intent. The carrying value and estimated fair value of securities are as follows:

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	$5,144	$ 38	$ (58)	$5,124
Municipal obligations	11,901	283	(115)	12,069
Corporate bonds & other obligations	1,110	12	-	1,122
Mortgage-backed securities	29,949	365	(239)	30,075
Equity securities	2	1	-	3
Total	$48,106	$ 699	$ (412)	$48,393
Securities Held to Maturity				
Municipal obligations	$2,305	$ 190	$ -	$2,495

7

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	$9,181	$ 66	$ -	9,247
Municipal obligations	10,413	368	(23)	10,758
Corporate bonds & other obligations	1,135	15	-	1,150
Mortgage-backed securities	28,901	736	(29)	29,608
Equity securities	3	-	(2)	1
Total	$49,633	$ 1,185	$ (54)	$50,764
Securities Held to Maturity				
Municipal obligations	$2,345	$ 225	$ -	$2,570

The amortized cost and estimated market value of securities at June 30, 2013, by contract maturity, 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. Securities with no specified maturity date are separately stated.

	June 30, 2013	
	Amortized Cost	Market Value
	(in thousands)	
Available For Sale:		
Due in one year or less	$2,096	$2,110
Due after one year through five years	9,063	9,230
Due in five year through ten years	6,736	6,655
Due after ten years	260	320
Subtotal	18,155	18,315
Equity securities	2	3
Mortgage-backed securities	29,949	30,075
Total	$48,106	$48,393
Held To Maturity:		
Due in one year or less	$90	$91
Due after one year through five years	1,615	1,714
Due in five year through ten years	300	340
Due after ten years	300	350

Total	$2,305	$2,495

At June 30, 2013 and December 31, 2012, securities with a carrying value and fair value of $36,268,000 and $44,135,000, respectively, were pledged to secure certain deposit accounts, FHLB advances and our line of credit at the Federal Reserve.

For the six months ended June 30, 2013 and 2012 there were no sales of securities from the investment portfolio.

The following is a summary of securities that had unrealized losses at June 30, 2013 and December 31, 2012. The information is presented for securities that have been in an unrealized loss position for less than 12 months and for more than 12 months. At June 30, 2013 there were 27 securities with unrealized losses totaling $412,000 and at December 31, 2012, the Company held 9 securities with unrealized losses totaling $54,000.

	June 30, 2013			
	Fair Value	Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
	(in thousands)			
Available For Sale:				
U.S. Government and agency obligations	$941	$ (58)	$ -	$ -
Corporate bonds & other obligations	-	-	-	-
Municipal obligations	6,382	(101)	502	(14)
Mortgage-backed securities	11,199	(231)	986	(8)
Equity securities	-	-	-	-
Total	$18,522	$ (390)	$ 1,488	$ (22)
Held to Maturity:				
Municipal obligations	$-	$ -	$ -	$ -

	December 31, 2012			
	Fair Value	Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
	(in thousands)			
Available For Sale:				
U.S. Government and agency obligations	$-	$ -	$ -	$ -
Municipal obligations	1,537	(23)	-	-
Mortgage-backed securities	2,725	(13)	1,687	(16)
Equity securities	-	-	1	(2)
Total	$4,262	$ (36)	$ 1,688	$ (18)
Held to Maturity:				
Municipal obligations	$-	$ -	$ -	$ -

The unrealized losses on the securities held in the portfolio are not considered other than temporary and have not been recognized into income. This decision is based on the Company's ability and intent to hold any potentially impaired security until maturity. The performance of the security is based on the contractual terms of the agreement, the extent of the impairment and the financial condition and credit quality of the issuer. The decline in market value is considered temporary and a result of changes in interest rates and other market variables.

Note 4—LOANS

The following table sets forth the composition of our loan portfolio by loan type at the dates indicated.

	At June 30, 2013	At December 31, 2012
	(in thousands)	
Real estate loans:		
Residential mortgage	$65,225	$ 66,539
Commercial loans:		
Secured by real estate	53,457	54,673
Other	12,052	8,102
Total commercial loans	65,509	62,775
Consumer loans:		
Secured by real estate	9,371	10,409
Other	1,152	1,259
Total consumer loans	10,523	11,668
Total gross loans	$141,257	$ 140,982
Less:		
Net deferred loan fees	(306)	(320)
Allowance for loan losses	(1,691)	(1,750)
Total loans, net	$139,260	$ 138,912

The following table illustrates the contractual aging of the recorded investment in past due loans by class of loans as of June 30, 2013 and December 31, 2012:

As of June 30, 2013

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
	(dollars in thousands)						
Commercial Real Estate:							
Commercial Real Estate - construction	$-	$ -	$ 173	$ 173	$-	$ 173	$ -
Commercial Real Estate - other	84	1,296	2,506	3,886	49,398	53,284	-
Commercial - non real estate	24	-	-	24	12,028	12,052	-

Consumer:							
Consumer - Real Estate	345	5	4	354	9,017	9,371	-
Consumer - Other	4	-	-	4	1,148	1,152	4
Residential:							
Residential	1,492	717	1,193	3,402	61,823	65,225	-
Total	$ 1,949	$ 2,018	$ 3,876	$ 7,843	$ 133,414	$ 141,257	$ 4

As of December 31, 2012

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
	(dollars in thousands)						
Commercial Real Estate:							
Commercial Real Estate - construction	$ -	$ -	$ 173	$ 173	$ 2,073	$ 2,246	$ -
Commercial Real Estate - other	3,210	540	282	4,032	48,395	52,427	-
Commercial - non real estate	113	-	-	113	7,989	8,102	-
Consumer:							
Consumer - Real Estate	59	-	13	72	10,337	10,409	-
Consumer - Other	11	5	6	22	1,237	1,259	6
Residential:							
Residential	2,047	796	1,198	4,041	62,498	66,539	61
Total	$ 5,440	$ 1,341	$ 1,672	$ 8,453	$ 132,529	$ 140,982	$ 67

The Bank uses an eight tier risk rating system to grade its commercial loans. The grade of a loan may change during the life of the loans. The risk ratings are described as follows:

Risk Grade 1 (Excellent) - Prime loans based on liquid collateral, with adequate margin or supported by strong financial statements. Probability of serious financial deterioration is unlikely. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans. This classification also includes all loans secured by certificates of deposit or cash equivalents.

Risk Grade 2 (Good) - Desirable loans of somewhat less stature than Grade 1, but with strong financial statements. Probability of serious financial deterioration is unlikely. These loans possess a sound repayment source (and/or a secondary source). These loans represent less than the normal degree of risk associated with the type of financing contemplated.

Risk Grade 3 (Satisfactory) - Satisfactory loans of average risk – may have some minor deficiency or vulnerability to changing economic conditions, but still fully collectible. There may be some minor weakness but with offsetting features or other support readily available. These loans present a normal degree of risk associated with the type of financing. Actual and projected indicators and market conditions provide satisfactory assurance that the credit shall perform in accordance with agreed terms.

Risk Grade 4 (Acceptable) - Loans considered satisfactory, but which are of slightly “below average” credit risk due to financial weaknesses or uncertainty. The loans warrant a somewhat higher than average level of monitoring to insure that weaknesses do not advance. The level of risk is considered acceptable and within normal underwriting guidelines, so long as the loan is given the proper level of management supervision.

Risk Grade 4.5 (Monitored) - Loans are considered “below average” and monitored more closely due to some credit deficiency that poses additional risk but is not considered adverse to the point of being a “classified” credit. Possible reasons for additional monitoring may include characteristics such as temporary negative debt service coverage due to weak economic conditions, borrower may have experienced recent losses from operations, declining equity and/or increasing leverage, or marginal liquidity that may affect long-term sustainability. Loans of this grade have a higher degree of risk and warrant close monitoring to insure against further deterioration. In any tables presented subsequently, Risk Grade 4.5 credits are included with Risk Grade 4 credits.

Risk Grade 5 (Other Assets Especially Mentioned) (OAEM) - Loans which possess some credit deficiency or potential weakness, which deserve close attention, but which do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk in the future.

Risk Grade 6 (Substandard) - Loans are “substandard” whose full, final collectability does not appear to be a matter of serious doubt, but which nevertheless portray some form of well defined weakness that requires close supervision by Bank management. The noted weaknesses involve more than normal banking risk. One or more of the following characteristics may be exhibited in loans classified Substandard: (1) Loans possess a defined credit weakness and the likelihood that the loan shall be paid from the primary source of repayment is uncertain; (2) Loans are not adequately protected by the current net worth and/or paying capacity of the obligor; (3) primary source of repayment is gone, and the Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility that the Bank shall sustain some loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain a high probability of repayment; (6) the borrower is not generating enough cash flow to repay loan principal, however, continues to make interest payments; (7) the Bank is forced into a subordinated or unsecured position due to flaws in documentation; (8) loans have been restructured so that payment schedules, terms, and collateral represent 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 a significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

Grade 7 (Doubtful) - Loans have all the weaknesses of those classified Substandard. Additionally, however, these weaknesses make collection or liquidation in full, based on existing conditions, improbable. Loans in this category are typically not performing in conformance with established terms and conditions. Full repayment is considered "Doubtful", but extent of loss is not currently determinable.

Risk Grade 8 (Loss) - Loans are considered uncollectible and of such little value, that continuing to carry them as an asset on the Bank's financial statements is not feasible.

The following table presents the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of June 30, 2013 and December 31, 2012:

As of June 30, 2013

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
	(dollars in thousands)		
1-2	$ -	$ -	$ -
3	-	14,255	6,157
4	-	28,317	5,573
5	-	4,207	131
6	173	6,505	191
7	-	-	-
8	-	-	-
Total	$ 173	$ 53,284	$ 12,052

As of December 31, 2012

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
	(dollars in thousands)		
1-2	$ -	$ -	$ -
3	615	13,895	2,376
4	1,458	27,488	5,489
5	-	2,712	37
6	173	8,332	200
7	-	-	-
8	-	-	-
Total	$ 2,246	$ 52,427	$ 8,102

For residential real estate and other consumer credit the Company also evaluates credit quality based on the aging status of the loan and by payment activity. Loans 60 or more days past due are monitored by the collection committee.

The following tables present the risk category of loans by class based on the most recent analysis performed as of June 30, 2013 and December 31, 2012:

As of June 30, 2013
(dollars in thousands)

	Residential
Loan Grade:	
Pass	$ 63,628
Special Mention	-
Substandard	1,597
Total	$ 65,225

	Consumer - Real Estate	Consumer - Other
	(dollars in thousands)	
Performing	$ 9,360	$ 1,152
Nonperforming	11	-
Total	$ 9,371	$ 1,152

12

As of December 31, 2012

	Residential
	(dollars in thousands)
Loan Grade:	
Pass	$ 64,668
Special Mention	-
Substandard	1,871
Total	$ 66,539

	Consumer - Real Estate	Consumer - Other
	(dollars in thousands)	
Performing	$ 10,381	$ 1,253
Nonperforming	28	6
Total	$ 10,409	$ 1,259

The following table presents the recorded investment in non-accrual loans by class as of June 30, 2013 and December 31, 2012:

	As of June 30, 2013	December 31, 2012
	(in thousands)	
Commercial Real Estate:		
Commercial Real Estate - construction	$173	$ 173
Commercial Real Estate - other	2,627	2,851
Commercial	-	-
Consumer:		
Consumer - real estate	8	28
Consumer - other	-	1
Residential:		
Residential	1,597	1,810
Total	$4,405	$ 4,863

The key features of the Company’s loan modifications are determined on a loan-by-loan basis. Generally, our restructurings have related to interest rate reductions and loan term extensions. In the past the Company has granted reductions in interest rates, payment extensions and short-term payment forbearances as a means to maximize collectability of troubled credits. The Company has not forgiven principal to date, although this would be considered if necessary to ensure the long-term collectability of the loan. The Company’s loan modifications are typically short-term in nature, although the Company would consider a long-term modification to ensure the long-term collectability of the credit. In general, a borrower must make at least six consecutive timely payments before the Company would consider a return of a restructured loan to accruing status in accordance with Federal Deposit Insurance Corporation guidelines regarding restoration of credits to accrual status.

The Bank has classified approximately $6,590,000 of its impaired loans as troubled debt restructurings as of June 30, 2013. There were no commitments to extend credit to borrowers with loans classified as troubled debt restructurings as of June 30, 2013 and December 31, 2012.

	Troubled Debt Restructurings			Troubled Debt Restructurings that Subsequently Defaulted	
	For the three months ended June 30, 2013			For the three months ended June 30, 2013	
	Number of Loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of Loans	Recorded Investment
		(dollars in thousands)			(dollars in thousands)
Troubled Debt Restructurings					
Commercial Real Estate - Construction	-	$ -	$ -	-	$ -
Commercial Real Estate - Other	1	2,030	2,030	-	-
Commercial - non real estate	-	-	-	-	-
Residential	-	-	-	-	-
Total	1	$ 2,030	$ 2,030	-	$ -

	Troubled Debt Restructurings			Troubled Debt Restructurings that Subsequently Defaulted	
	For the three months ended June 30, 2012			For the three months ended June 30, 2012	
	Number of Loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of Loans	Recorded Investment
		(dollars in thousands)			(dollars in thousands)
Troubled Debt Restructurings					
Commercial Real Estate - Construction	-	$ -	$ -	-	$ -
Commercial Real Estate - Other	-	-	-	1	63
Commercial - non real estate	1	35	34	-	-
Residential	-	-	-	-	-
Total	1	$ 35	$ 34	1	$ 63

	Troubled Debt Restructurings			Troubled Debt Restructurings that Subsequently Defaulted	
	For the six months ended June 30, 2013			For the six months ended June 30, 2013	
	Number of Loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of Loans	Recorded Investment
		(dollars in thousands)			(dollars in thousands)
Commerical Real Estate - Construction	-	$ -	$ -	-	$ -
Commercial Real Estate - Other	2	2,442	2,437	-	-

Consumer - Real Estate	-		-		-	-		-
Residential	2		331		270	1		190
Total	4	$	2,773	$	2,707	1	$	190

	Troubled Debt Restructurings					Troubled Debt Restructurings that Subsequently Defaulted		
	For the six months ended June 30, 2012					For the six months ended June 30, 2012		
	Number of Loans	Pre-modification outstanding recorded investment		Post-modification outstanding recorded investment		Number of Loans	Recorded Investment	
		(dollars in thousands)					(dollars in thousands)	
Troubled Debt Restructurings								
Commercial Real Estate - Construction	-	$	-	$	-	-	$	-
Commercial Real Estate - Other	-		-		-	1		63
Commercial - non real estate	3		1,663		1,655	-		-
Residential	-		-		-	-		-
Total	3	$	1,663	$	1,655	1	$	63

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated evaluations are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquency, secured consumer loans are charged down to the value of collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial credits are charged down at 90 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-offs may be realized as further unsecured positions are recognized.

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2013 and December 31, 2012:

Impaired Loans As of June 30, 2013				For the Three Months Ended June 30, 2013		For the Six Months Ended June 30, 2013	
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(dollars in thousands)					(dollars in thousands)	
With no specific allowance recorded:							
Commercial	$-	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	1,589	173	-	173	-	173	-
Commercial Real Estate - Other	3,249	3,149	-	3,172	33	3,195	60
Consumer - Real Estate	9	8	-	9	-	10	-
Consumer - Other	-	-	-	-	-	-	-
Residential	2,118	1,676	-	1,793	1	1,797	2
With a specific allowance recorded:							
Commercial	-	-	-	-	-	-	-
Commercial Real Estate - Construction	-	-	-	-	-	-	-
Commercial Real Estate - Other	3,596	3,596	322	3,602	20	3,607	39
Consumer - Real Estate	-	-	-	-	-	-	-
Consumer - Other	-	-	-	-	-	-	-
Residential	-	-	-	-	-	-	-
Totals:							
Commercial	$-	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	$1,589	$ 173	$ -	$ 173	$ -	$ 173	$ -
Commercial Real Estate - Other	$6,845	$ 6,745	$ 322	$ 6,774	$ 53	$ 6,802	$ 99
Consumer - Real Estate	$9	$ 8	$ -	$ 9	$ -	$ 10	$ -
Consumer - Other	$-	$ -	$ -	$ -	$ -	$ -	$ -
Residential	$2,118	$ 1,676	$ -	$ 1,793	$ 1	$ 1,797	$ 2

Impaired Loans As of December 31, 2012			For the Three Months Ended June 30, 2012		For the Six Months Ended June 30, 2012	
	Recorded	Related	Average Recorded	Interest Income	Average Recorded	Interest Income

	Unpaid Principal Balance	Investment	Allowance	Investment	Recognized	Investment	Recognized
	(dollars in thousands)						
With no specific allowance recorded:							
Commercial	$-	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	1,589	173	-	173	-	173	-
Commercial Real Estate - Other	4,869	4,535	-	758	11	751	26
Consumer - Real Estate	33	28	-	134	-	135	-
Consumer - Other	1	1	-	15	-	15	-
Residential	1,365	1,194	-	1,848	-	1,861	-
With a specific allowance recorded:							
Commercial	-	-	-	-	-	-	-
Commercial Real Estate - Construction	-	-	-	-	-	-	-
Commercial Real Estate - Other	2,138	2,127	101	2,065	20	2,072	48
Consumer - Real Estate	-	-	-	-	-	-	-
Consumer - Other	-	-	-	-	-	-	-
Residential	616	616	141	-	-	-	-
Totals:							
Commercial	$-	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	$1,589	$ 173	$ -	$ 173	$ -	$ 173	$ -
Commercial Real Estate - Other	$7,007	$ 6,662	$ 101	$ 2,823	$ 31	$ 2,823	$ 74
Consumer - Real Estate	$33	$ 28	$ -	$ 134	$ -	$ 135	$ -
Consumer - Other	$1	$ 1	$ -	$ 15	$ -	$ 15	$ -
Residential	$1,981	$ 1,810	$ 141	$ 1,848	$ -	$ 1,861	$ -

The ALLL has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense.

Activity in the allowance for loan and lease losses was as follows for the three and six months ended June 30, 2013 and June 30, 2012, respectively:

Allowance for Credit Losses and Recorded Investment in Financing Receivables
For the Three Months Ended June 30, 2013

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
	(dollars in thousands)							
Allowance for credit losses:								
Beginning Balance	$89	$ 509	$ 87	$ 87	$ 26	$ 877	$ -	$1,675
Charge-offs	-	-	-	-	(6)	(205)	-	(211)
Recoveries	-	1	-	18	-	12	-	31
Provision	(89)	163	(8)	(30)	5	155	-	196
Ending Balance	$-	$ 673	$ 79	$ 75	$ 25	$ 839	$ -	$1,691

For the Six Months Ended June 30, 2013

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
	(dollars in thousands)							
Allowance for credit losses:								
Beginning Balance	$64	$ 579	$ 69	$ 99	$ 33	$ 906	$ -	$1,750
Charge-offs	-	(85)	-	(7)	(12)	(367)	-	(471)
Recoveries	-	11	-	33	5	24	-	73
Provision	(64)	168	10	(50)	(1)	276	-	339
Ending Balance	$-	$ 673	$ 79	$ 75	$ 25	$ 839	$ -	$1,691

Loan Balances Individually Evaluated for Impairment
As of June 30, 2013

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
	(dollars in thousands)							
Ending balance: individually evaluated for impairment	$-	$ 322	$ -	$ -	$ -	$ -	$ -	$322
Ending balance: loans collectively evaluated for impairment	$-	$ 351	$ 79	$ 75	$ 25	$ 839	$ -	$1,369
Loans:								
Ending Balance	$173	$ 53,284	$ 12,052	$ 9,371	$ 1,152	$ 65,225	$ -	$141,257
Ending balance: individually								

evaluated for impairment	$173	$ 6,745	$ 8	$ -	$ -	$ 1,676	$ -	$8,602
Ending balance: loans collectively evaluated for impairment	$-	$ 46,539	$ 12,044	$ 9,371	$ 1,152	$ 63,549	$ -	$132,655

16

For the Three Months Ended June 30, 2012

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
Allowance for credit losses:								
Beginning Balance	$ -	$ 515	$ 41	$ 126	$ 42	$ 939	$ -	$1,663
Charge-offs	-	(72)	-	(19)	(1)	(391)	-	$(483)
Recoveries	-	3	-	3	4	5	-	$15
Provision	-	324	(1)	30	(30)	255	-	$578
Ending Balance	$ 0	$ 770	$ 40	$ 140	$ 15	$ 808	$ 0	$1,773

For the Six Months Ended June 30, 2012

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
	(dollars in thousands)							
Allowance for credit losses:								
Beginning Balance	$10	$ 393	$ 53	$ 146	$ 46	$ 870	$ -	$1,518
Charge-offs	-	(127)	-	(37)	(9)	(557)	-	$(730)
Recoveries	-	8	-	8	4	10	-	$30
Provision	(10)	496	(13)	23	(26)	485	-	$955
Ending Balance	$0	$ 770	$ 40	$ 140	$ 15	$ 808	$ 0	$1,773

Loan Balances Individually Evaluated for Impairment
As of June 30, 2012

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
	(dollars in thousands)							
Ending balance: individually evaluated for impairment	$ -	$ 229	$ -	$ -	$ -	$ -	$ -	$229
Ending balance: loans collectively evaluated for impairment	$ -	$ 541	$ 40	$ 140	$ 15	$ 808	$ -	$1,544
Loans: Ending Balance	$173	$ 54,933	$ 8,618	$ 12,169	$ 1,272	$ 67,362	$ -	$144,527
Ending balance: individually evaluated for impairment	$173	$ 2,814	$ -	$ 130	$ 12	$ 1,706	$ -	$4,835
	$ -	$ 52,119	$ 8,618	$ 12,039	$ 1,260	$ 65,656	$ -	$139,692

Ending balance: loans collectively evaluated for impairment

Note 5—DIVIDENDS

We are dependent primarily upon the Bank for our earnings and funds to pay dividends on our common stock. The payment of dividends also is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the Bank's earnings, capital requirements, financial condition and other factors considered by our Board of Directors.

Note 6—STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted FASB ASC 718-10 “Shareholder Based Payments”, which requires that the grant-date fair value of awarded stock options be expensed over the requisite service period. The Company’s 1996 Stock Option Plan (the “1996 Plan”), which was approved by shareholders, permits the grant of share options to its employees for up to 127,491 shares of common stock (adjusted for the exchange ratio applied in the Company’s 2005 stock offering and related second-step conversion). The Company’s 2006 Stock-Based Incentive Plan (the “2006 Plan”), which was approved by the shareholders on May 17, 2006, permits the award of up to 242,740 shares of common stock of which the maximum number to be granted as Stock Options is 173,386 and the maximum that can be granted as Restricted Stock Awards is 69,354. Option awards are granted with an exercise price equal to the market price of the Company’s stock at the date of grant; those option awards generally vest based on five years of continual service and have ten year contractual terms. Certain options provide for accelerated vesting if there is a change in control (as defined in the Plans).

During the three and six months ended June 30, 2013 no shares were awarded under either the 1996 Plan or the 2006 Plan. Shares issued under the plans and exercised pursuant to the exercise of the stock options awarded under the plans may be either authorized but unissued shares or reacquired shares held by the Company as treasury stock.

Stock Options - A summary of option activity under the Plans during the six months ended June 30, 2013 is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2013	167,620	$ 9.53	3.4	$ -
Granted	-	N/A		
Exercised	-	N/A		
Forfeited or expired	(4,900)	$ 9.54		
Oustanding at June30, 2013	162,720	$ 9.53	2.9	$ -
Options Exercisable at June 30, 2013	162,720	$ 9.53	2.9	$ -

The aggregate intrinsic value of outstanding options shown in the table above represents the total pretax intrinsic value (i.e. the difference between the Company's closing stock price of $4.38 on June 30, 2013 and the exercise price times the number of shares) that would have been received by the option holder had all option holders exercised their options on June 30, 2013. This amount changes based on the fair market value of the stock.

As of June 30, 2013 the Company had no unrecognized compensation cost related to nonvested options under the Plan. There were no shares which vested during the quarter ended June 30, 2013. In addition, there were no non-vested options as of June 30, 2013.

Restricted Stock Awards – As of June 30, 2013 all restricted stock awards have vested; therefore the Company had no unrecognized compensation costs under the Plan. There were 5,304 shares available for future stock award grants as of June 30, 2013.

Note 7 – COMMITMENTS TO EXTEND CREDIT

The Company is a party to credit-related 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, stand-by letters of credit, and commercial lines of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheet. The Company's exposure to credit loss is represented by the contracted amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At June 30, 2013, the Company had outstanding commitments to originate loans of $21.8 million. These commitments included the following:

	As of June 30, 2013
Commitments to grant loans	$ 9,795
Unfunded commitments under lines of credit	11,926
Commercial and standby letters of credit	59

Note 8-FAIR VALUE MEASUREMENTS

The fair value of financial assets and liabilities recorded at fair value is categorized in three levels. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. These levels are as follows:

Level 1 — Valuations based on quoted prices in active markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 — Valuations of assets and liabilities traded in less active dealer or broker markets. Valuations include quoted prices for similar assets and liabilities traded in the same market; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3 — Assets and liabilities with valuations that include methodologies and assumptions that may not be readily observable, including option pricing models, discounted cash flow models, yield curves and similar techniques. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities, but in all cases are corroborated by external data, which may include third-party pricing services.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012, and the valuation techniques used by the Company to determine those fair values.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at June 30, 2013

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2013
Assets				
Investment securities- available-for-sale:				
US Government and agency obligations	$ -	$ 5,124	$ -	$ 5,124
Municipal Obligations	-	12,069	-	12,069
Corporate bonds & other obligations		1,122		1,122
Mortgage-backed securities	-	30,075	-	30,075
Equity securities	-	3	-	3
Total investment securities - available-for-sale	$ -	$ 48,393	$ -	$ 48,393

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2012

	Quoted Prices in	Significant Other Observable	Significant Unobservable Inputs	Fair Value as of December 31, 2012

	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	(Level 3)	
	(dollars in thousands)			
Assets				
Investment securities - available-for-sale:				
US Government and agency obligations	$ -	$ 9,247	$ -	$ 9,247
Municipal obligations	-	10,758	-	10,758
Corporate securities	-	1,150		1,150
Mortgage-backed securities	-	29,608	-	29,608
Equity securities	-	1	-	1
Total investment securities - available-for-sale	$ -	$ 50,764	$ -	$ 50,764

Fair value measurements of U.S. Government agencies and mortgage backed securities use pricing models that vary and may consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures.

19

There were no transfers between Levels 1 and 2 of the fair value hierarchy from December 31, 2012 to June 30, 2013. For the available for sale securities, the Company obtains fair value measurements from an independent third-party service.

The Company has assets that, under certain conditions, are subject to measurement at fair value on a nonrecurring basis. At June 30, 2013 and December 31, 2012, such assets consist primarily of impaired loans and other real estate owned. The Corporation has estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets Measured at Fair Value on a Nonrecurring Basis at June 30, 2013

	Balance at June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(dollars in thousands)			
Impaired loans accounted for under FASB ASC 310-10	$6,918	$ -	$ -	$ 6,918
Other real estate owned -residential mortgages	$584	$ -	$ -	$ 584
Other Real estate owned - commercial	$490	$ -	$ -	$ 490
Other repossessed assets	$1,024			$ 1,024
Total assets at fair value on a non-recurring basis				$ 9,016

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2012

	Balance at December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(dollars in thousands)			
Impaired loans accounted for under FASB ASC 310-10	$6,835	$ -	$ -	$ 6,835
Other real estate owned -residential mortgages	$947	$ -	$ -	$ 947
Other real estate owned - commercial	$319	$ -	$ -	$ 319
Other repossessed assets	$1,121	$ -	$ -	$ 1,121

Total assets at fair value on a non-recurring basis	$ 9,222

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

Cash and Cash Equivalents - The carrying amounts of cash and short-term instruments approximate fair values.

Investment Securities - Fair value for the Bank's investment securities was determined using the market value in active markets, where available. When not available, fair values are estimated using the fair value hierarchy. In the fair value hierarchy, Level 2 fair values are determined using observable inputs other than Level 1 market prices, such as quoted prices for similar assets. Level 3 values are determined using unobservable inputs, such as discounted cash flow projections.

Loans Receivable - For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one- to four-family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial, and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Loans Held For Sale - Fair values of mortgage loans held for sale are based on commitments on hand from investors or prevailing market prices.

Federal Home Loan Bank Stock - The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Deposit Liabilities - The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank Advances - The estimated fair value of the fixed and variable rate Federal Home Loan Bank advances are estimated by discounting the related cash flows using the rates currently available for similarly structured borrowings with similar maturities.

REPO Sweep Accounts - The fair values disclosed for REPO Sweeps are equal to the amount payable on demand at the reporting date (i.e., their carrying amounts).

Accrued Interest - The carrying amounts of accrued interest approximate fair value.

The estimated fair values and related carrying or notional amounts of the Company's financial instruments are as follows:

June 30, 2013	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Financial assets:					
Cash and cash equivalents	$6,325	$6,325	$-	$-	$6,325
Securities available for sale	48,393	-	48,393	-	48,393
Securities held to maturity	2,305	-	2,495	-	2,495
Loans held for sale	423	-	-	486	486
Loans receivable - net	139,260	-	-	140,234	140,234
Federal Home Loan Bank stock	3,266	-	3,266	-	3,266
Accrued interest receivable	899	-	899	-	899
Financial liabilities:					
Customer deposits	161,347	-	163,225	-	163,225
Federal Home Loan Bank advances	24,112	-	23,689	-	23,689
REPO sweep accounts	3,574	-	3,574	-	3,574
Accrued interest payable	84	-	84	-	84

December 31, 2012	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
	(dollars in thousands)				
Financial assets:					
Cash and cash equivalents	$2,752	$2,752	$-	$-	$2,752
Securities available for sale	50,764	-	50,764	-	50,764
Securities held to maturity	2,345	-	2,570	-	2,570
Loans held for sale	79			84	84
Loans receivable - net	138,912	-	-	140,877	140,877
Federal Home Loan Bank stock	3,266	-	3,266	-	3,266
Accrued interest receivable	970	-	970	-	970
Financial liabilities:					
Customer deposits	158,350	-	159,335	-	159,335
Federal Home Loan Bank advances	26,358	-	26,493	-	26,493
REPO sweep accounts	3,183	-	3,183	-	3,183
Accrued interest payable	100	-	100	-	100

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

AND SUBSIDIARIES

PART - FINANCIAL INFORMATION

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion compares the consolidated financial condition of the Company at June 30, 2013 and December 31, 2012, and the results of operations for the three- and six-month periods ended June 30, 2013 and 2012. This discussion should be read in conjunction with the interim financial statements and footnotes included herein.

OVERVIEW

The Company operates as a community-oriented financial institution that accepts deposits from the general public in the communities surrounding its 8 full-service banking centers. The deposited funds, together with funds generated from operations and borrowings, are used by the Company to originate loans. The Company's principal lending activity is the origination of mortgage loans for the purchase or refinancing of one-to-four family residential properties. The Company also originates commercial and multi-family real estate loans, construction loans, commercial loans, automobile loans, home equity loans and lines of credit, and a variety of other consumer loans.

For the quarter ended June 30, 2013, the Company reported a net loss of $4,000, or less than $0.01 per basic and diluted share, compared to a net loss of $270,000, or $0.09 per basic and diluted share, for the year prior, an increase of $266,000. Net income was $64,000, or $0.02 per basic and diluted share, for the six months ended June 30, 2013 as compared to $331,000, or $0.11 per share, for the same period ended June 30, 2012.

Total assets increased by $953,000, or 0.5%, from $213.8 million as of December 31, 2012 to $214.8 million as of June 30, 2013. Cash and cash equivalents increased by $3.6 million and investment securities available for sale decreased by $2.4 million while net loans receivable increased $348,000 during this time period. In addition, during the three months ended June 30, 2013 the Company received $509,000 as a return of our unused FDIC insurance premiums as a result of the expiration of the prepaid assessment period which began in 2009. Total deposits increased $3.0 million from December 31, 2012 to June 30, 2013, Federal Home Loan Bank advances decreased by $2.2

million, while REPO sweep accounts increased by $390,000, and equity decreased by $494,000.

CRITICAL ACCOUNTING POLICIES

As of June 30, 2013, there have been no changes in the critical accounting policies as disclosed in the Company's Form 10-K for the year ended December 31, 2012. The Company's critical accounting policies are described in the Management's Discussion and Analysis and financial sections of its 2012 Annual Report. Management believes its critical accounting policies relate to the Company's allowance for loan losses, real estate owned, mortgage servicing rights, valuation of deferred tax assets and impairment of intangible assets.

COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2013 AND DECEMBER 31, 2012

ASSETS: Total assets increased $953,000, or 0.5%, to $214.8 million at June 30, 2013 from $213.8 million at December 31, 2012. Investment securities available for sale decreased $2.4 million, or 4.7%, as a result of a decline in market value in our portfolio of $845,000 from December 31, 2012 to June 30, 2013. Net loans receivable increased $348,000, or 0.3%, to $139.3 million at June 30, 2013 from $138.9 million at December 31, 2012. The increase in net loans was attributable primarily to increased commercial loan production for the six-month period ended June 30, 2013.

LIABILITIES: Deposits increased by $3.0 million to $161.3 million at June 30, 2013 from $158.4 million at December 31, 2012. However, the composition of our deposits changed during the six-month period. We experienced increases of $2.5 million in statement savings accounts, $1.6 million in money market accounts and $1.5 million in NOW demand deposit accounts during the six-month period. Partially offsetting these increases were decreases of $683,000 in non-interest bearing demand deposit accounts, $511,000 in our traditional certificates of deposit and $1.6 million in our liquid certificates of deposit (from which customers can take a penalty–free withdrawal with seven days advance written notice) as, in general, we were not the market leader in rates on these product during this time period. Total FHLB advances decreased $2.2 million to $24.1 million at June 30, 2013 from $26.4 million at December 31, 2012.

EQUITY: Stockholders' equity decreased by $494,000 to $23.9 million at June 30, 2013 from $24.4 million at December 31, 2012. The decrease was due primarily to a decrease of $558,000, net of tax in the unrealized gain on available-for-sale securities, partially offset by net income for the six-month period of $64,000.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2013 Compared to Three Months Ended June 30, 2012

General: Net income increased by $266,000 to a loss of $4,000 for the three months ended June 30, 2013 from a loss of $270,000 for the same period ended June 30, 2012.

Interest Income: Interest income decreased to $2.1 million for the three months ended June 30, 2013 from $2.4 million for the year earlier period, due mainly to a decrease of 39 basis points in the average yield on interest-earning assets period over period. The yield on our mortgage loans declined to 5.26% for the three months ended June 30, 2013 from 5.54% for same period in 2012. In addition, the yield on non-mortgage loans decreased to 5.23% for the three months ended June 30, 2013 when compared to 5.65% for the three-month period ended June 30, 2012. These declines are a result of continued low interest rates on loan products period over period.

Interest Expense: Interest expense decreased to $285,000 for the three months ended June 30, 2013 from $427,000 for the three months ended June 30, 2012. The decrease in interest expense for the three month period was due primarily to a decrease in our cost of funds related to certificates of deposit and FHLB advances. The average cost of our certificates of deposit decreased from 1.27% for the three months ended June 30, 2012 to 1.02% for the three months ended June 30, 2013 as higher costing deposits matured and either left the Bank as we were not a market leader in rates or were re-priced at a lower rate. In addition, the cost of our FHLB advances decreased 67 basis points from 1.90% for the three months ended June 30, 2012 to 1.23% for the three months ended June 30, 2013 due to decreases in market interest rates.

The following table sets forth information regarding the changes in interest income and interest expense of the Bank during the periods indicated.

Quarter ended June
30, 2013
Compared to

	Quarter ended June 30, 2012 Increase (Decrease) Due to:		
	Volume	Rate	Total
	(in thousands)		
Interest-earning assets:			
Loans receivable	$(64)	$(121)	$(185)
Investment securities	(13)	(72)	$(85)
Other investments	11	2	$13
Total interest-earning assets	(66)	(191)	(257)
Interest-bearing liabilities:			
Money Market/NOW accounts	2	(1)	1
Certificates of Deposit	(14)	(42)	(56)
Deposits	(12)	(43)	(55)
Borrowed funds	(119)	31	(88)
Total interest-bearing liabilities	(131)	(12)	(143)
Change in net interest income	$65	$(179)	$(114)

Net Interest Income: Net interest income decreased to $1.8 million for the three-month period ended June 30, 2013 from $1.9 million for the same period in 2012. For the three months ended June 30, 2013, average interest-earning assets decreased $5.8 million, or 2.9% when compared to the same period in 2012. Average interest-bearing liabilities decreased $7.7 million, or 4.4%, to $167.0 million for the quarter ended June 30, 2013 from $174.7 million for the quarter ended June 30, 2012. The yield on average interest-earning assets decreased to 4.28% for the three-month period ended June 30, 2013 from 4.68% for the same period ended in 2012 and the cost of average interest-bearing liabilities decreased to 0.69% from 0.98% for the three-month periods ended June 30, 2013 and 2012, respectively. The net interest margin decreased to 3.70% for the three-month period ended June 30, 2013 from 3.82% for same period in 2012.

Provision for Loan Losses: The allowance for loan losses is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibiity of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The provision for loan losses for the three-month period ended June 30, 2013 was $196,000 as compared to $578,000 for the prior year period. Prior to 2012, our provision for loan losses was based on an eight-quarter rolling average of actual net charge-offs adjusted for environmental factors for each segment of loans in our portfolio. Management has decided that eight quarters is no longer reflective of the inherent loss in the loan portfolios. In 2012, we began moving towards a twelve-quarter rolling average of actual net charge-offs by adding an additional quarter of net charge-offs each quarter in 2012. By the end of 2012 we were using a twelve-quarter rolling average. During the quarter ended June 30, 2013, we charged off $193,000 in mortgage loans as compared to $386,000 during the quarter ended June 30, 2012 due in large part to continued declines in residential real estate values in our markets. The direct effect of the decrease in charge-offs quarter over quarter combined with the impact the increased charge-offs had on the general reserve factor applied to the entire pool of mortgage loans for the quarter ended June 30, 2012, was a main cause of the decrease in provision period over period. The provision was based on management's review of the components of the overall loan portfolio, the status of non-performing loans and various subjective factors.

Non Interest Income: Non interest income increased $74,000 to $465,000 for the three months ended June 30, 2013 from $391,000 for the three months ended June 30, 2012. In 2013 we experienced a decrease in mortgage banking activities, resulting in a $52,000 decrease in income period over period. The decrease in mortgage banking activities income was offset by a decrease in losses on sale of real estate owned and other repossessed assets of $62,000, an increase of $35,000 in service charge income and $29,000 increase in other income, related to bank owned life insurance income for the three months ended June 30, 2013 as compared to the prior-year.

Non Interest Expense: Non interest expense decreased $60,000 to $2.1 million for the three months ended June 30, 2013 when compared the three months ended June 30, 2012. Salaries and benefits decreased $42,000 as we reduced staffing, suspended our accrual of the elective contribution to the Company's 401(k) plan and reduced health insurance premiums as a result of self insuring deductibles for employee insurance coverage period over period. In addition, our advertising expenses decreased $21,000, occupancy declined $19,000, amortization of intangible assets decreased by $14,000 period over period as core deposits intangible for certain branches were fully amortized during the three month period ended June 30, 2012, and we experienced a decrease of $41,000 in other expenses related to trouble credits and real estate owned expenses period over period. Partially offsetting these positive factors period over period, professional service expense increased $74,000 as we begin to recognize expenses related to a future upgrade of our core banking software during the three months ended June 30, 2013.

Income Taxes: The Company recorded no federal income tax benefit for the three months ended June 30, 2013 and June 30, 2012.

Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012

General: Net income decreased by $267,000 to $64,000 for the six months ended June 30, 2013 from $331,000 for the same period ended June 30, 2012.

Interest Income: Interest income decreased by $581,000 to $4.2 million for the six-month period ended June 30, 2013 from $4.8 million for the same period in 2012. This decrease was primarily attributed to a decline in the average balance of interest earning assets of $5.2 million to $196.1 million for the six-month period ended June 30, 2013 from $201.3 million for the six-month period ended June 30, 2012. In addition, we experienced a decrease in the yield on our interest earning assets of 46 basis points period over period due mainly to lower market interest rates period over period.

Interest Expense: Interest expense for the six months ended June 30, 2013 decreased to $606,000 from $891,000 for the six months ended June 30, 2012. The decrease in interest expense for the 2013 period was due primarily to a decrease in the cost of our certificates of deposit and FHLB advances. The cost of our certificates of deposit decreased 24 basis points from 1.30% for the six months ended June 30, 2012 to 1.06% for the six months ended June 30, 2013, as higher costing deposits matured and either left the Bank or were re-priced at lower rates. In addition, the cost of our FHLB advances decreased 62 basis points from 1.98% for the six months ended June 30, 2012 to 1.36% for the six months ended June 30, 2013 due primarily to lower market interest rates period over period.

The following table sets forth information regarding the changes in interest income and interest expense of the Bank during the periods indicated.

	Six Months ended June 30, 2013 Compared to Six Months ended June 30, 2012 Increase (Decrease) Due to:		
	Volume	Rate	Total
	(in thousands)		
Interest-earning assets:			
Loans receivable	$ (77)	$ (331)	$ (408)
Investment securities	(39)	(144)	(183)
Other investments	9	1	10
Total interest-earning assets	(107)	(474)	(581)
Interest-bearing liabilities:			
Savings Deposits	1	-	1
Money Market/NOW accounts	3	(1)	2

Certificates of Deposit	(30)	(87)	(117)
Deposits	(26)	(88)	(114)
Borrowed funds	(218)	46	(172)
Total interest-bearing liabilities	(244)	(42)	(286)
Change in net interest income	$ 137	$ (432)	$ (295)

Net Interest Income: Net interest income decreased by $295,000 for the six-month period ended June 30, 2013 compared to the same period in 2012. For the six months ended June 30, 2013, average interest-earning assets decreased $5.2 million, or 2.6%, when compared to the same period in 2012. Average interest-bearing liabilities decreased $8.4 million, or 4.8%, to $167.6 million for the six-month period ended June 30, 2013 from $176.1 million for the six-month period ended June 30, 2012. The yield on average interest-earning assets decreased to 4.28% for the six month period ended June 30, 2013 from 4.74% for the same period in 2012 while the cost of average interest-bearing liabilities decreased to 0.73% from 1.02% for the six-month periods ended June 30, 2013 and 2012, respectively. The net interest margin decreased to 3.66% for the six-month period ended June 30, 2013 from 3.86% for same period in 2012.

Delinquent Loans and Nonperforming Assets. Nonperforming assets decreased by $811,000 from December 31, 2012 to June 30, 2013 due in large part to returning $257,000 of mortgage and consumer loans to accruing status and sales of $407,000 in real estate owned properties during the six-month period ended June 30, 2013.

The ratio of nonperforming loans to total loans was 3.13% and 3.50% at June 30, 2013 and December 31, 2012, respectively. As a percent of total assets, nonperforming assets decreased to 2.97% at June 30, 2013 from 3.42% at December 31, 2012. The Company experienced a decline in the classified asset ratio from 54.19% as of December 31, 2012 to 37.23% as of June 30, 2013; the decline is attributed to securing a guarantee from the Small Business Administration (SBA) for a classified credit, which resulted in an improved collateral position for the Company and a decrease in the classified balance of the credit. In addition, the Company experience upgrades to other substandard credit relationships based on improved financial performance of the borrowers.

	June 30, 2013	December 31, 2012
	(in thousands)	
Total non-accrual loans	$4,405	$ 4,863
Accrual loans delinquent 90 days or more:		
One- to four-family residential	-	61
Other real estate loans	-	-
Construction	-	-
Purchased Out-of-State	-	-
Commerical	-	-
Consumer & other	4	6
Total accrual loans delinquent 90 days or more	$4	$ 67
Total nonperforming loans (1)	4,409	4,930
Total real estate owned-residential mortgages (2)	584	957
Total real estate owned-Commercial (2)	489	309
Total real estate owned-Consumer & other repossessed assets (2)	1,024	1,121
Total nonperforming assets	$6,506	$ 7,317
Total nonperforming loans to loans receivable	3.13%	3.50%
Total nonperforming assets to total assets	3.03%	3.42%

(1) All of the Bank's loans delinquent more than 90 days are classified as nonperforming.

(2) Represents the net book value of property acquired by the Bank through foreclosure or deed in lieu of foreclosure. Upon acquisition, this property is recorded at the lower of its fair market value or the principal balance of the related loan.

Provision for Loan Losses: For the six-month period ended June 30, 2013, the provision for loan losses was $340,000 as compared to $955,000 for the same period ended June 30, 2012. As discussed above in the discussion for the three-month period ended June 30, 2012, our provision for loan losses is based on a twelve-quarter rolling average of actual net charge-offs adjusted for various environmental factors for each pool of loans in our portfolio. During the six-month period ended June 30, 2013, we added specific reserves of approximately $280,000 on a commercial credit which was reclassified as Troubled Debt Restructuring, maintained the increased general reserve factor applied to the entire portfolio of residential mortgages as a result of increased charge-off history in 2012, and decreased our general reserve pool for special mention and substandard commercial credits by approximately $109,000 based on declining classified loan balances during the six-month period ended June 30, 2013. The provision was based on management's review of the components of the overall loan portfolio, the status of non-performing loans and various subjective factors.

The following table sets forth the details of our loan portfolio at the dates indicated:

	Portfolio Balance	Delinquent Loans Over 90 Days	Non-Accrual Loans
	(in thousands)		
At June 30, 2013			
Real estate loans:			
Construction	$1,993	$ -	$ 173
One - to four – family	63,232	-	1,597
Commercial Mortgages	53,457	-	2,627
Home equity lines of credit/ Junior liens	9,371	-	8
Commercial loans	12,052	-	-
Consumer loans	1,152	4	-
Total gross loans	$141,257	$ 4	$ 4,405
Less:			
Net deferred loan fees	(306)	-	(5)
Allowance for loan losses	(1,691)	-	-
Total loans, net	$139,260	$ 4	$ 4,400
At December 31, 2012			
Real estate loans:			
Construction	$3,208	$ -	$ 173
One - to four - family	65,578	61	1,810
Commercial Mortgages	52,427	-	2,851
Home equity lines of credit/Junior liens	10,409	-	28
Commercial loans	8,102	-	-
Consumer loans	1,258	6	1
Total gross loans	$140,982	$ 67	$ 4,863
Less:			
Net deferred loan fees	(320)	-	(5)
Allowance for loan losses	(1,750)	-	(346)
Total loans, net	$138,912	$ 67	$ 4,512

Non Interest Income: Non interest income increased from $837,000 for the six months ended June 30, 2012 to $905,000 for the six months ended June 30, 2013, mainly due to a decrease on loss on sale of real estate owned and other repossessed assets of $71,000, an increases of $57,000 in service charge income and $42,000 in other income related to bank owned life insurance income for the six months ended June 30, 2013. These positives are partially offset by a decrease in mortgage banking activities income of $103,000 period over period.

Non Interest Expense. Non interest expense decreased from $4.4 million for the six months ended June 30, 2012 to $4.1 million for the six months ended June 30, 2013. The decrease was primarily due to decreases of $155,000 in salaries and benefit expenses, as we reduced staffing, suspended our accrual of the elective contribution to the Company's 401(k) plan and reduced health insurance premiums as a result of self insuring deductibles for employee insurance coverage. In addition, the Company reduced other expenses by $165,000 through decreases in expenses related to trouble credits and real estate owned expenses period over period. These decreases were partially offset by an increase in professional service expenses of $52,000, as we begin to recognize expenses associated with a future upgrade of our core banking software during the six months ended June 30, 2013.

Income Taxes: A valuation allowance is provided against deferred tax assets (DTA) when it is more likely than not that some or all of the deferred tax asset will not be realized. At June 30, 2013 the Company did not record any income tax benefit compared to an income tax benefit of $1,022,000 for the six months ended June 30, 2012. The variance of $1,022,000 relates to a partial recovery of $866,000, during the first quarter of 2012, of a valuation allowance for our DTA that was established in 2009. The valuation allowance was recorded in 2009 against the DTA because management determined that it was more likely than not that some or all of the DTA would not be realized. At March 31, 2012, management reevaluated the Company's valuation allowance related to its DTA. The analysis of the DTA was made to determine the utilization of those tax benefits based upon projected future taxable income. Based upon management's determination and in accordance with the generally accepted accounting principles, management concluded that the utilization of this asset was "more likely than not." Accordingly, as of March 31, 2012, $866,000 of the valuation allowance was credited to income tax expense. Among the criteria that management considered in evaluating the DTA were: improved core profitability of the Bank in 2010 and 2011; substantial improvement in 2010 and 2011 of non-performing asset levels, which were driving losses in prior years; and positive forecast for taxable income looking forward over the next three years. However, during the fourth quarter of 2012 the $866,000 was reversed as a result of management's reevaluation of the DTA and determination that it was more likely than not that some or all of the DTA would not be realized during the period. Management's decision to reverse the DTA recovery in the fourth quarter of 2012 was influenced by several factors including a higher than anticipated provision expense recorded throughout the year, lower than expected commercial loan demand and lastly placing two large commercial loans into non-accrual status during the fourth quarter. A valuation allowance of $3.2 million remains on our current DTA as of June 30, 2013.

The Company will continue to evaluate the future benefits from these carryforwards and at such time as it becomes "more likely than not" that they would be utilized prior to expiration, the Company will recognize the additional benefits as an adjustment to the valuation allowance. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will fully expire in the year 2032.

LIQUIDITY

The Company's current liquidity position is more than adequate to fund expected asset growth. The Company's primary sources of funds are deposits, FHLB advances, proceeds from principal and interest payments, prepayments on loans and mortgage-backed and investment securities and sale of long-term fixed-rate mortgages into the secondary market. While maturities and scheduled amortization of loans and mortgage-backed securities are a predictable source of funds, deposit flows, mortgage prepayments and sale of mortgage loans into the secondary market are greatly influenced by general interest rates, economic conditions and competition.

Liquidity represents the amount of an institution's assets that can be quickly and easily converted into cash without significant loss. The most liquid assets are cash, short-term U.S. Government securities, U.S. Government agency securities and certificates of deposit. The Company is required to maintain sufficient levels of liquidity as defined by OCC regulations. This requirement may be varied at the direction of the OCC. Regulations currently in effect require that the Bank must maintain sufficient liquidity to ensure its safe and sound operation. The Company's objective for liquidity is to be above 20%. Liquidity as of June 30, 2013 was $58.4 million, or 46.5% compared to $52.5 million, or 42.5% at December 31, 2012. The levels of these assets are dependent on the Company's operating, financing, lending and investing activities during any given period. The liquidity calculated by the Company includes additional borrowing capacity available with the FHLB. This borrowing capacity is based on pledged collateral.

The Company intends to retain for its portfolio certain originated residential mortgage loans (primarily adjustable rate and shorter term fixed rate mortgage loans) and generally to sell the remainder. The Bank will from time to time participate in or originate commercial real estate loans, including real estate development loans. During the six month period ended June 30, 2013, the Company originated $13.6 million in residential mortgage loans, of which $5.6 million were retained in portfolio while the remainder were sold in the secondary market or are being held for sale. This compares to $20.8 million in originations during the first six months of 2012 of which $8.1 million were retained in portfolio. The Company also originated $13.8 million of commercial loans and $788,000 of consumer loans in the first six months of 2013 compared to $11.6 million of commercial loans and $1.2 million of consumer loans for the same period in 2012. Of total loans receivable, excluding loans held for sale, mortgage loans comprised 46.1% and 46.6%, commercial loans 46.4% and 44.1% and consumer loans 7.5% and 9.3% at June 30, 2013 and June 30, 2012, respectively.

Deposits are a primary source of funds for use in lending and for other general business purposes. At June 30, 2013 deposits funded 75.1% of the Company's total assets compared to 69.9% at December 31, 2012. Certificates of deposit scheduled to mature in less than one year at June 30, 2013 totaled $37.9 million. Management believes that a significant portion of such deposits will remain with the Bank. The Bank monitors the deposit rates offered by competition in the area and sets rates that take into account the prevailing market conditions along with the Bank's liquidity position. Moreover, management believes that growth in assets is not expected to require significant in-flows of liquidity. As such, the Bank does not expect to be a market leader in rates paid for liabilities, although we may from time to time offer higher rates than our competitors, as liquidity needs dictate.

Borrowings may be used to compensate for seasonal or other reductions in normal sources of funds or for deposit outflows at more than projected levels. Borrowings may also be used on a longer-term basis to support increased lending or investment activities. At June 30, 2013 the Company had $24.1 million in FHLB advances and had sufficient available collateral to obtain an additional $31.2 million. FHLB borrowings as a percentage of total assets were 11.2% at June 30, 2013 as compared to 12.3% at December 31, 2012.

CAPITAL RESOURCES

Stockholders' equity at June 30, 2013 was $23.9 million, or 11.1% of total assets, compared to $24.4 million, or 11.4% of total assets, at December 31, 2012 (See "Consolidated Statement of Changes in Stockholders' Equity"). The Bank is subject to certain capital-to-assets levels in accordance with federal regulations. The Bank was considered "well capitalized" under all capital requirements set forth by the OCC as of June 30, 2013. The following table summarizes the Bank's actual capital with the regulatory capital requirements and with requirements to be "Well Capitalized" under prompt corrective action provisions, as of June 30, 2013:

	Actual		Regulatory Minimum		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	Dollars in Thousands					
Tier 1 (Core) capital (to adjusted assets)	$22,344	10.44%	$8,565	4.00%	$10,706	5.00 %
Total risk-based capital (to risk- weighted assets)	$23,035	17.53%	$10,966	8.00%	$13,708	10.00%
Tier 1 risk-based capital (to risk weighted assets)	$22,344	16.30%	$5,483	4.00%	$8,225	6.00 %
Tangible Capital (to tangible assets)	$22,344	10.44%	$3,212	1.50%	$4,283	2.00 %

ITEM 3 - QUALITATIVE AND QUANTITIATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable to smaller reporting companies.

ITEM 4 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Company’s Chief Executive Officer and VP – Director of Financial Reporting & Accounting, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d–15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and VP - Director of Financial Reporting & Accounting concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 (1) is recorded, processed, summarized and reported, within the time periods specified by the SEC’s rules and forms, and (2) is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

There has been no change in the Company’s internal control over the financial reporting during the Company’s second quarter of fiscal year 2013 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

FORM 10-Q

Quarter Ended June 30, 2013

PART II – OTHER INFORMATION

Item 1 - Legal Proceedings:

At June 30, 2013 there were no material legal proceedings to which the Company is a party or of which any of its property is subject. From time to time the Company is a party to various legal proceedings incident to its business.

Item 1A - Risk Factors:
Not applicable to smaller reporting companies

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds:
(a) Not applicable
(b) Not applicable
(c) Not applicable

Item 3 - Defaults upon Senior Securities:
Not applicable.

Item 4 - Mine Safety Disclosures
Not applicable.

Item 5 - Other Information:
Not applicable

Item 6 - Exhibits:

Exhibit 31.1 Certification by Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification by VP - Director of Financial Reporting & Accounting pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Statement of Chief Executive Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Statement of VP - Director of Financial Reporting & Accounting furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS XBRL Taxonomy Instance Document
101.SCH XBRL Taxonomy Extension Schema Linkbase
101.CAL XBRL Taxonomy Extension Calculation Linkbase
101.DEF XBRL Taxonomy Extension Definition Linkbase
101.LAB XBRL Taxonomy Extension Label Linkbase
101.PRE XBRL Taxonomy Extension Presentation Linkbase

32

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

FORM 10-Q

Quarter Ended June 30, 2013

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

By: /s/Michael W. Mahler
Michael W. Mahler
Chief Executive Officer

Date: August 14, 2013

By: /s/Eileen M. Budnick
Eileen M. Budnick
VP-Director of Financial Reporting and Accounting
(Principal Financial and Accounting Officer)

Date: August 14, 2013