

First Federal of Northern Michigan Bancorp, Inc.
Form 10-K
March 19, 2014

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2013

OR

Transition Report Pursuant to 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 (I.R.S.
jurisdiction of Employer
incorporation Identification
or Number)
organization)

100 S. Second Avenue, Alpena, Michigan 49707
(Address of Principal Executive Offices) Zip Code

(989) 356-9041
(Registrant's
telephone
number)

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$.01 per share The Nasdaq Stock Market LLC
(Title of Class) (Name of Exchange of Which Registered)

Securities Registered Pursuant to Section 12(g) of the Act:
None

Edgar Filing: First Federal of Northern Michigan Bancorp, Inc. - Form 10-K

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES . NO .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES .
NO .

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. .

Indicate by check mark whether the registrant is a large 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 Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the last sale price on June 30, 2013 (\$4.38 per share) was \$11.1 million.

As of March 19, 2014, there were issued and outstanding 2,884,049 shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Proxy Statement for the 2014 Annual Meeting of Stockholders (Parts I and III).
2. Annual Report to Shareholders for the Year Ended December 31, 2013 (Part II).

TABLE OF CONTENTS

PART I

<u>ITEM 1</u>	<u>BUSINESS</u>	4
<u>ITEM 1A</u>	<u>RISK FACTORS</u>	33
<u>ITEM 1B</u>	<u>UNRESOLVED STAFF COMMENTS</u>	34
<u>ITEM 2</u>	<u>PROPERTIES</u>	34
<u>ITEM 3</u>	<u>LEGAL PROCEEDINGS</u>	34
<u>ITEM 4</u>	<u>MINE SAFETY DISCLOSURES</u>	34

PART II

<u>ITEM 5</u>	<u>MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	33
<u>ITEM 6</u>	<u>SELECTED FINANCIAL DATA</u>	34
<u>ITEM 7</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	34
<u>ITEM 7A</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	34
<u>ITEM 8</u>	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	34
<u>ITEM 9</u>	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	34
<u>ITEM 9A</u>	<u>CONTROLS AND PROCEDURES</u>	34
<u>ITEM 9B</u>	<u>OTHER INFORMATION</u>	35

PART III

<u>ITEM 10</u>	<u>DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE</u>	35
<u>ITEM 11</u>	<u>EXECUTIVE COMPENSATION</u>	35
<u>ITEM 12</u>	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	35
<u>ITEM 13</u>	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	35
<u>ITEM 14</u>	<u>PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	35

PART IV

	<u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	36
--	--	----

ITEM

15

SIGNATURES

37

3

PART I

ITEM 1. BUSINESS

Private Securities Litigation Reform Act Safe Harbor Statement

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect,” “will,” “may,” and words of similar meaning. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Form 10-K.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market areas, that are worse than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;
- changes in our organization, compensation and benefit plans;
- changes in our financial condition or results or operations that reduce capital available to pay dividends;
- regulatory changes or actions; and
- changes in the financial condition or future prospects of issuers of securities that we own.

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

First Federal of Northern Michigan Bancorp, Inc.

First Federal of Northern Michigan Bancorp, Inc. is a Maryland corporation that owns all of the outstanding shares of common stock of First Federal of Northern Michigan. At December 31, 2013, we had consolidated assets of \$209.7 million, deposits of \$160.0 million and stockholders' equity of \$23.5 million. As of December 31, 2013, First Federal of Northern Michigan Bancorp, Inc. had 2,884,049 shares of common stock issued and outstanding. Our executive offices are located at 100 South Second Avenue, Alpena, Michigan 49707. Our phone number at that address is (800) 498-0013.

The Company maintains a website at www.first-federal.com that includes important information on our Company, including a list of our products and services, branch locations and current financial information. In addition, we make available, without charge, through our website, a link to our filings with the SEC, including copies of annual reports on Form 10-K, quarterly reports in Form 10-Q, current reports in Form 8-K, and amendments to these filings, if any. Information on our website should not be considered a part of this Annual Report.

First Federal of Northern Michigan

First Federal of Northern Michigan is a full-service, community-oriented savings bank that provides financial services to individuals, families and businesses from eight full-service facilities located in Alpena, Cheboygan, Emmet, Iosco, Otsego, Montmorency and Oscoda Counties, Michigan. First Federal of Northern Michigan was chartered in 1957, and reorganized into the mutual holding company structure in 1994. In 2000, First Federal of Northern Michigan became the wholly owned subsidiary of Alpena Bancshares, Inc., our predecessor company, and in April 2005 we completed our "second step" mutual-to-stock conversion and formed our current ownership structure.

First Federal of Northern Michigan's business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in one- to four-family residential mortgage loans, commercial real estate loans, commercial business loans, consumer loans and in investment securities and mortgage-backed securities.

First Federal of Northern Michigan's executive offices are located at 100 South Second Avenue, Alpena, Michigan 49707. Its phone number at that address is (800) 498-0013.

Market Area and Competition

First Federal of Northern Michigan conducts operations through its main office in Alpena, Michigan, which is located in the northeastern lower peninsula of Michigan, and through its seven other branch offices in Michigan. According to the Michigan Senate, the population of Alpena County, from which the majority of our deposits are drawn, has decreased approximately 6.6% since 2000, and currently is approximately 30,000. The population of our primary market area, which includes Alpena County and seven surrounding counties, was estimated to be approximately 155,000 in 2012, a decrease of 13.9% from approximately 180,000 according to the 2012 census. Median household income for the counties which comprised our market area in 2012 ranged from approximately \$33,900 to \$50,700, which represented moderate increases from 2010 levels in most counties in our market area. Median household income for our entire market area was below the national level of \$51,371 and below the Michigan level of \$46,859 in all but 2 counties in our market area, reflecting the largely rural nature of our market area and the absence of more densely populated urban and suburban areas. Household income levels are not expected to increase substantially in our market area in the near future. The unemployment rate in our primary market, Alpena County, was 9.5% for December 2013, and ranged from 10.8% to 18.1% across the rest of our primary market area, as compared to 6.7% nationally and 8.4% for Michigan (all numbers not seasonally adjusted).

Alpena is the largest city located in the northeastern lower peninsula of Michigan. This area has long been associated with agricultural, wood and concrete industries. Tourism has also been a major industry in our primary market area. All of these industries tend to be seasonal and are strongly affected by state and national economic conditions.

Major employers in our primary market area include various public schools and governmental agencies, Alpena Regional Medical Center, Besser Company (a manufacturer of concrete products equipment), Lafarge Corporation (an international limestone mining and cement producer), Panel Processing (a peg board manufacturer), Treetops Sylvan Resort (an operator of resort properties), Garland Resort (an operator of resort properties and golf courses), Otsego Memorial Hospital, Decorative Panels International (a hardboard manufacturer), OMNI Metalcraft Corp. (a diversified manufacturer), and various other small companies.

As of December 31, 2013, First Federal of Northern Michigan was the only thrift institution headquartered in our market area. We encounter strong competition both in attracting deposits and in originating residential and commercial real estate and other loans. Our most direct competition for deposits has historically come from commercial banks, other savings institutions, and credit unions in our market area. Competition for loans comes from such financial institutions. We expect continued strong competition in the foreseeable future, including the “super-regional” banks currently in our markets, from internet banks, and from credit unions in many of our markets. We compete for savings deposits by offering depositors a high level of personal service and a wide range of competitively priced financial products. We compete for real estate loans primarily on the basis of the interest rates and fees we charge and through advertising. Strong competition for deposits and loans may limit our ability to grow and may adversely affect our profitability in the future.

Lending Activities

General. The largest part of our loan portfolio is mortgage loans secured by one- to four-family residential real estate. In recent years, we have sold most of the fixed-rate conventional one- to four-family mortgage loans that we originate that have terms of 15 years or more. We retain the servicing on a majority of the mortgage loans that we sell. To a lesser extent, we also originate commercial loans, commercial real estate loans and consumer loans. At December 31, 2013, we had total loans of \$138.1 million, of which \$63.8 million, or 46.2% were one- to four-family residential real estate mortgage loans, \$51.9 million, or 37.6% were commercial real estate loans, and \$12.5 million, or 9.0%, were commercial loans. Other loans consisted primarily of home equity loans, which totaled \$8.7 million, or 6.3% of total loans, and other consumer loans which totaled \$1.2 million, or 0.9% of total loans.

One- to Four-Family Residential Real Estate Lending. Our primary lending activity consists of originating one- to four-family owner-occupied residential mortgage loans, virtually all of which are collateralized by properties located in our market area. We also originate one- to four-family construction loans that pay interest only during the initial construction period (which generally does not exceed twelve months) and then pay interest and principal for the remainder of the loan term. To address interest rate risk we generally sell most of our one- to four-family fixed-rate mortgage loans with terms of 15 years or more and retain the loan servicing on a majority of these mortgage loans. Fixed-rate loans with terms of 15 years or less are either sold into the secondary market or, in some cases, retained in our portfolio. Adjustable rate mortgage loans are generally underwritten to secondary market mortgage standards, but are retained in our loan portfolio. One- to four-family residential mortgage loans are underwritten and originated according to policies and guidelines established by the secondary mortgage market agencies and approved by our Board of Directors. We utilize existing liquidity, deposits, loan repayments, and Federal Home Loan Bank advances to fund new loan originations.

We currently offer fixed rate one- to four-family residential mortgage loans with terms ranging from 15 to 30 years. One- to four-family residential mortgage loans often remain outstanding for significantly shorter periods than their contractual terms because borrowers may refinance or prepay loans at their option. The average length of time that our one- to four-family residential mortgage loans remain outstanding varies significantly depending upon trends in market interest rates and other factors. In recent years, the average maturity of our mortgage loans has decreased significantly because of the declining trend in market interest rates and the unprecedented volume of refinancing activity resulting from such interest rate decreases.

Originations of one- to four fixed-rate mortgage loans are regularly monitored and are affected significantly by the level of market interest rates, our interest rate gap position, and loan products offered by our competitors. Our fixed rate mortgage loans amortize on a monthly basis with principal and interest due each month.

We have in the past originated fixed-rate loans that amortize over 15 years but that have “balloon payments” that are due upon the maturity of the loan in five years. As a general rule, we no longer originate this type of mortgage loan. Upon maturity, existing balloon mortgage loans are either underwritten as fixed-rate loans and sold or rewritten as adjustable rate mortgages at current market rates. While the majority of our balloon mortgage loans amortize over 15 years, some amortize over 10 or 30 years, and a limited number amortize over five years.

Our one- to four-family residential mortgage loans customarily include due-on-sale clauses, which are provisions giving us the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells or otherwise disposes of the underlying real property serving as security for the loan. Due-on-sale clauses are an important means of adjusting the rates on our fixed-rate mortgage loan portfolio, and we have generally exercised our rights under these clauses.

Regulations limit the amount that a savings institution may lend relative to the appraised value of the real estate securing the loan, as determined by an appraisal at the time of loan origination. Such regulations permit a maximum loan-to-value ratio of 100% for residential property and 90% for all other real estate loans. Our lending policies limit the maximum loan-to-value ratio on fixed-rate loans without private mortgage insurance to 80% of the lesser of the appraised value or the purchase price of the property serving as collateral for the loan.

Generally, we make one- to four-family mortgage loans with loan-to-value ratios of up to 90%. However, for one- to four-family real estate loans with loan-to-value ratios of between 80% and 90%, we may require the borrower to purchase private mortgage insurance. In 2005 we began making 80/20 loans and interest-only loans subject to Board-approved dollar limits to limit risk exposure. In late 2007 these products were eliminated; however, at December 31, 2013 approximately \$339,000 of these products remained in our portfolio. We require fire and casualty insurance, flood insurance when applicable, as well as title insurance, on all properties securing real estate loans made by us.

Commercial Real Estate Lending. We originate commercial real estate loans. At December 31, 2013, we had a total of 148 loans secured primarily by commercial real estate properties, unimproved vacant land and, to a limited extent, multifamily properties. Our commercial real estate loans are secured by income-producing properties such as office buildings, retail buildings, restaurants and motels. A majority of our commercial real estate loans are secured by properties located in our primary market area, although at December 31, 2013 we did have \$3.8 million in commercial real estate loans located outside of Michigan. We have originated commercial construction loans that are originated as permanent loans but are interest-only during the initial construction period, which generally does not exceed nine months. At December 31, 2013, our commercial real estate loans, totaled \$51.9 million, or 37.6% of our total loans, and had an average principal balance of approximately \$350,000. The terms of each loan typically amortize over 15 years and have a three- or five-year balloon feature. An origination fee of 0.5% to 1.0% is generally charged on commercial real estate loans. We generally make commercial real estate loans up to 75% of the appraised value of the property securing the loan.

At December 31, 2013, our largest commercial real estate relationship consisted of one loan having a total principal balance of \$3.1 million, which was performing according to its repayment terms as of December 31, 2013. This loan relationship is secured by a single piece of commercial real estate and is also our largest single commercial real estate loan.

Commercial real estate loans generally carry higher interest rates and have shorter terms than those on one- to four-family residential mortgage loans. However, loans secured by commercial real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the business or the related real estate property. If the cash flow from the business operation is reduced, the borrower's ability to repay the loan may be impaired. This may be particularly true in the early years of the business operation when the risk of failure is greatest. Many of our commercial real estate loans have been made to borrowers whose business operations are untested, which increases our risk.

Consumer and Other Loans. We originate a variety of consumer and other loans, including loans secured by savings accounts, new and used automobiles, mobile homes, boats, recreational vehicles, and other personal property. As of December 31, 2013, consumer and other loans totaled \$9.9 million, or 7.2% of our total loan portfolio. At such date, \$290,000, or 0.2% of our consumer loans, were unsecured. As of December 31, 2013, home equity loans totaled \$8.7 million, or 6.3% of our total loan portfolio, and automobile loans totaled \$458,000, or 0.3% of our total loan portfolio. We originate automobile loans directly to our customers and have no outstanding agreements with automobile dealerships to generate indirect loans.

Our procedures for underwriting consumer loans include an assessment of an applicant's credit history and the ability to meet existing obligations and payments on the proposed loan. Although an applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral security, if any, to the proposed loan amount.

Consumer loans generally entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that tend to depreciate rapidly, such as automobiles, mobile homes, boats and recreational vehicles. In addition, the repayment of consumer loans depends on the borrower's continued financial stability, as repayment is more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy than a single family mortgage loan.

Commercial Loans. At December 31, 2013, we had \$12.5 million in commercial loans which amounted to 9.0% of total loans. We make commercial loans primarily in our market area to a variety of professionals, sole proprietorships and small businesses. Commercial lending products include term loans and revolving lines of credit. The maximum amount of a commercial loan is our loans-to-one-borrower limit, which was \$3.6 million at December 31, 2013. Such loans are generally used for longer-term working capital purposes such as purchasing equipment or furniture. Commercial loans are made with either adjustable or fixed rates of interest. Variable rates are generally based on the prime rate, as published in *The Wall Street Journal*, plus a margin. Fixed rate commercial loans are set at a margin above the Federal Home Loan Bank comparable advance rate.

When making commercial loans, we consider the financial statements of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business and the value of the collateral. Commercial loans are generally secured by a variety of collateral, primarily accounts receivable, inventory and equipment, and are supported by personal guarantees. Depending on the collateral used to secure the loans, commercial loans are typically made in amounts of up to 75% of the value of the collateral securing the loan.

Commercial loans generally have greater credit risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial loans generally are made on the basis of the borrower's ability to repay the loan from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. If the cash flow from the business operation is reduced, the borrower's ability to repay the loan may be impaired. This may be particularly true in the early years of the business operation when the risk of failure is greatest. Moreover, any collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We seek to minimize these risks through our underwriting standards. At December 31, 2013, our largest commercial loan was a \$2.2 million commercial term loan and was collateralized by equipment and inventory of a supermarket. At December 31, 2013, the outstanding balance was \$1.7 million and the loan was performing according to its repayment terms.

Construction Loans. We originate construction loans to local home builders in our market area, generally with whom we have an established relationship, and to individuals engaged in the construction of their residences. We also originate loans for the construction of commercial buildings and, to a lesser extent, participate in construction loan projects originated by other lenders. Our construction loans totaled \$1.8 million, or 1.3% of our total loan portfolio, at December 31, 2013.

Our construction loans to home builders are repaid on an interest-only basis for the term of the loan (which is generally six to 12 months), with interest calculated on the amount disbursed to the builders based upon a percentage of completion of construction. These loans typically have a maximum loan-to-value ratio of 80%, based on the appraised value. Interest rates are fixed during the construction phase of the loan. Loans to builders are made on either a pre-sold or speculative (unsold) basis. Most of our construction loans to individuals who intend to occupy the completed dwelling are originated via a "one-step closing" process, whereby the construction phase and end-financing are handled with one loan closing. Prior to funding a construction loan, we require an appraisal of the property from a qualified appraiser approved by us, and all appraisals are reviewed by us.

Construction lending exposes us to greater credit risk than permanent mortgage financing because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. If the estimate of construction costs is inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion is inaccurate, the value of the property may be insufficient to assure full repayment. Projects may also be jeopardized by disagreements between borrowers and builders and by the failure of builders to pay subcontractors. Loans to builders to construct homes for which no purchaser has been identified carry more risk because the repayment of the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. We have attempted to minimize these risks by, among other things, limiting our residential construction lending primarily to residential properties in our market area and generally requiring personal guarantees from the principals of corporate borrowers.

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

	At December 31,		2012		2011		2010		2009		
	2013		Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	
Real estate loans:											
Residential Mortgages:											
1-4 Family Mortgages	\$60,750	44.0	% \$63,867	45.3	% \$64,177	45.0	% \$68,298	42.7	% \$77,851	44.4	%
Purchased Mortgage	1,506	1.2	% 1,711	1.3	% 1,924	1.3	% 3,243	2.0	% 3,342	1.9	%
In-State											
1-4 Family Construction	1,583	1.1	% 962	0.7	% 498	0.3	% 156	0.1	% 427	0.2	%
Home Equity/Junior Liens	8,730	6.3	% 10,409	7.4	% 13,395	9.4	% 16,547	10.3	% 18,732	10.7	%
Nonresidential Mortgages:											
Nonresidential Purchased	41,090	29.8	% 40,992	29.1	% 44,020	30.9	% 43,580	27.3	% 43,446	24.8	%
Nonresidential In-State	6,886	5.0	% 4,553	3.2	% 2,130	1.5	% 4,232	2.6	% 3,894	2.2	%
Purchased											
Nonresidential Out-of-State	3,750	2.7	% 6,882	4.9	% 7,788	5.5	% 9,928	6.2	% 8,428	4.8	%
Nonresidential Construction	—	0.0	% 1,458	1.0	% 91	0.1	% 1,498	0.9	% 2,816	1.6	%
Purchased											
Construction In-State	—	0.0	% 615	0.4	% —	0.0	% —	0.0	% —	0.0	%
Purchased											
Construction Out-of-State	173	0.1	% 173	0.1	% 173	0.1	% 1,772	1.1	% 3,792	2.2	%
Non real estate loans:											
Commercial Loans	12,164	8.8	% 7,769	5.5	% 6,621	4.6	% 7,382	4.6	% 7,035	4.0	%
Purchased											
Commercial Loans In-State	287	0.2	% 333	0.2	% 381	0.3	% 1,466	0.9	% 2,838	1.6	%
Consumer and other loans	1,165	0.8	% 1,258	0.9	% 1,477	1.0	% 2,118	1.3	% 2,553	1.6	%

Edgar Filing: First Federal of Northern Michigan Bancorp, Inc. - Form 10-K

Total Loans	\$ 138,084	100.00%	\$ 140,982	100.00%	\$ 142,675	100.00%	\$ 160,220	100.00%	\$ 175,154	100.00%
Other items:										
Deferred loan origination costs	179		15		14		31		12	
Deferred loan origination fees	(476)		(335)		(287)		(276)		(287)	
Allowance for loan losses	(1,472)		(1,750)		(1,518)		(2,831)		(3,660)	
Total loans, net	\$ 136,315		\$ 138,912		\$ 140,884		\$ 157,144		\$ 171,219	

Loan Portfolio Maturities and Yield. The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2013. Demand loans, loans having no stated repayment or maturity, and overdraft loans are reported as being due in one year or less.

	1-4 Family Mortgage		Purchased Mortgage In-State		1-4 Family Construction		
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
(dollars in thousands)							
<u>Due During the Years Ending December 31,</u>							
2014	\$235	6.90	% \$—	0.00	% \$1,583	3.68	%
2015	101	7.98	% —	0.00	% —	0.00	%
2016	157	7.03	% —	0.00	% —	0.00	%
2017 to 2018	1,634	5.65	% —	0.00	% —	0.00	%
2019 to 2023	5,712	5.76	% —	0.00	% —	0.00	%
2024 to 2028	24,068	4.58	% 26	4.85	% —	0.00	%
2029 and beyond	28,843	5.39	% 1,480	2.63	% —	0.00	%
Total	\$60,750	5.13	% \$1,506	2.67	% \$1,583	2.54	%

	Home Equity/Junior Liens		Nonresidential		Purchased Nonresidential In-State		
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
(dollars in thousands)							
<u>Due During the Years Ending December 31,</u>							
2014	\$42	6.73	% \$5,437	5.97	% \$1,737	5.05	%
2015	107	7.18	% 3,944	6.39	% 39	7.48	%
2016	307	8.02	% 3,907	5.71	% 760	4.75	%
2017 to 2018	391	5.59	% 19,951	5.49	% 1,616	4.75	%
2019 to 2023	4,542	5.77	% 5,353	5.64	% 1,750	4.75	%
2024 to 2028	3,341	4.21	% 1,485	6.75	% 984	5.75	%
2029 and beyond	—	0.00	% 1,013	6.25	% —	0.00	%
Total	\$8,730	5.27	% \$41,090	5.74	% \$6,886	4.98	%

	Purchased Nonresidential Out-of-State		Purchased Construction Out-of-State		Commercial Loans		
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
(dollars in thousands)							
<u>Due During the Years Ending December 31,</u>							

Edgar Filing: First Federal of Northern Michigan Bancorp, Inc. - Form 10-K

2014	\$1,441	5.50	% \$173	9.25	% \$3,406	5.19	%
2015	—	0.00	% —	0.00	% 2,165	5.25	%
2016	—	0.00	% —	0.00	% 1,378	5.42	%
2017 to 2018	—	0.00	% —	0.00	% 3,255	5.00	%
2019 to 2023	—	0.00	% —	0.00	% 1,960	5.48	%
2024 to 2028	—	0.00	% —	0.00	% —	0.00	%
2029 and beyond	2,309	5.75	% —	0.00	% —	0.00	%
Total	\$3,750	0.00	% \$173	122.56	% \$12,164	0.13	%

	Purchased Commercial Loans In-State		Consumer & Other Loans		Total		
	Weighted Amount	Average Rate	Weighted Amount	Average Rate	Weighted Amount	Average Rate	
	(dollars in thousands)						
<u>Due During the Years Ending December 31.</u>							
2014	\$—	0.00	% \$16	8.88	% \$14,070	0.01	%
2015	—	0.00	% 77	8.14	% 6,433	0.10	%
2016	—	0.00	% 220	8.09	% 6,729	0.26	%
2017 to 2018	287	4.75	% 658	6.71	% 27,792	0.16	%
2019 to 2023	—	0.00	% 176	6.36	% 19,493	0.06	%
2024 to 2028	—	0.00	% 18	5.50	% 29,922	0.00	%
2029 and beyond	—	0.00	% —	0.00	% 33,645	0.00	%
Total	\$287	4.75	% \$1,165	1.17	% \$138,084	0.06	%

Fixed- and Adjustable-Rate Loans. The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at December 31, 2013 that are contractually due after December 31, 2014.

	Due After December 31, 2014		
	Fixed	Adjustable	Total
	(dollars in thousands)		
Residential Mortgages:			
1-4 Family Mortgages	\$36,547	\$23,968	\$60,515
Purchased Mortgage In-State	—	1,506	1,506
Home Equity/Junior Liens	3,065	5,623	8,688
Nonresidential Mortgages:			
Nonresidential	24,799	10,854	35,653
Purchased Nonresidential In-State	3,406	1,743	5,149
Purchased Nonresidential Out-of-State	2,309	—	2,309
Non real estate loans:			
Commercial Loans	6,773	1,985	8,758
Purchased Commercial Loans In-State	287	—	287
Consumer and other loans	945	204	1,149
Total Loans	\$78,131	\$45,883	\$124,014

Loan Originations, Purchases, Sales and Servicing. While we originate both fixed-rate and adjustable-rate loans, our ability to generate each type of loan depends upon borrower demand, market interest rates, borrower preference for fixed- versus adjustable-rate loans, and the interest rates offered on each type of loan by other lenders in our market area. These lenders include competing banks, savings banks, credit unions, internet lenders, mortgage banking companies and life insurance companies that may also actively compete for local commercial real estate loans. Loan originations are derived from a number of sources, including real estate agent referrals, existing customers, borrowers, builders, attorneys, our directors, walk-in customers and our own sales force. Upon receiving a loan application, we obtain a credit report and employment verification to verify specific information relating to the applicant's employment, income, and credit standing. In the case of a real estate loan, we obtain a determination of value of the real estate intended to collateralize the proposed loan. Our residential mortgage officers have residential mortgage lending authority up to \$150,000. While certain Senior Bank Officers have residential lending limits up to \$400,000, the Officer Loan Committee generally approves residential loans from \$150,000 to \$500,000, while requests over \$500,000 must be approved by the Board of Directors. Secured consumer lending limits by officer range from \$25,000 to \$50,000, while certain Senior Bank Officers have secured consumer lending limits up to \$150,000. For secured commercial loans, the limits range from \$100,000 to \$400,000. Senior Loan Committee generally approves secured commercial loans from \$400,000 to \$500,000, while requests over \$500,000 must be approved by the Board of Directors.

A commercial commitment letter specifies the terms and conditions of the proposed loan including the amount of the loan, interest rate, amortization term, a brief description of the required collateral, and required insurance coverage. Commitments are typically issued for 15-day periods. The borrower must provide proof of fire and casualty insurance on the property serving as collateral, which must be maintained during the full term of the loan. A title insurance policy is required on all real estate loans. At December 31, 2013, we had outstanding loan commitments of \$18.9 million, including unfunded commitments under lines of credit and commercial and standby letters of credit.

Our loan origination and sales activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand, while declining interest rates may stimulate increased loan demand. Accordingly, the volume of loan originations, the mix of fixed- and adjustable-rate loans, and the profitability of this activity can vary from period to period. One- to four-family residential mortgage loans are generally underwritten to investor

guidelines, and closed on standard investor documents. We currently sell loans to Freddie Mac and the Federal Home Loan Bank of Indianapolis (the "FHLB"). If such loans are sold, the sales are conducted using standard investor purchase contracts and master commitments as applicable. The majority of one- to four-family mortgage loans that we have sold to investors have been sold on a non-recourse basis, whereby foreclosure losses are generally the responsibility of the purchaser and not First Federal of Northern Michigan.

We are a qualified loan servicer for both Freddie Mac and the FHLB. Our policy has historically been to retain the servicing rights for all conforming loans sold, and to continue to collect payments on the loans, maintain tax escrows and applicable fire and flood insurance coverage, and supervise foreclosure proceedings if necessary. We retain a portion of the interest paid by the borrower on the loans as consideration for our servicing activities.

We require appraisals of real property securing loans. Appraisals are performed by independent appraisers, who are approved by our Board of Directors annually. We require fire and extended coverage insurance in amounts adequate to protect our principal balance. Where appropriate, flood insurance is also required. Private mortgage insurance is required for most residential mortgage loans with loan-to-value ratios greater than 80%.

Loan Origination Fees and Costs. In addition to interest earned on loans, we generally receive fees in connection with loan originations. Such loan origination fees, net of costs to originate, are deferred and amortized using an interest method over the contractual life of the loan. Fees deferred are recognized into income immediately upon prepayment or subsequent sale of the related loan. At December 31, 2013, we had \$297,000 of net deferred loan origination fees. Such fees vary with the volume and type of loans and commitments made and purchased, principal repayments, and competitive conditions in the mortgage markets, which in turn respond to the demand and availability of money. In addition to loan origination fees, we also generate other income through the sales and servicing of mortgage loans, late charges on loans, and fees and charges related to deposit accounts. We recognized fees and service charges of \$857,000 and \$760,000 for the years ended December 31, 2013 and 2012, respectively.

To the extent that originated loans are sold with servicing retained, we capitalize a mortgage servicing asset at the time of the sale in accordance with applicable accounting standards (FASB ASC 860, "Transfers and Servicing"). The capitalized amount is amortized thereafter (over the period of estimated net servicing income) as a reduction of servicing fee income. The unamortized amount is fully charged to income when loans are prepaid. Originated mortgage servicing rights with an amortized cost of \$860,000 were included on our balance sheet at December 31, 2013. During 2013, we reversed the \$20,000 valuation reserve that was established in 2012 on the value of our rights to service 20 year fixed-rate loans which we have sold to Freddie Mac.

Origination, Purchase and Sale of Loans. The table below shows our loan originations, purchases, sales, and repayments of loans for the periods indicated.

	Years Ended December 31,		
	2013	2012	2011
	(dollars in thousands)		
Loans receivable at beginning of period	\$ 140,982	\$ 142,675	\$ 160,220
Originations:			
Real estate:			
Residential 1-4 family	28,776	52,387	38,150
Commercial and Multi-family	33,260	18,182	12,941
Consumer	1,639	2,040	2,113
Total originations	63,675	72,609	53,204
Loan purchases:			
Commercial	2,844	6,538	1,000
Total loan purchases	2,844	6,538	1,000
Loan sales	(17,776)	(36,529)	(28,353)
Transfer of loans to foreclosed assets	(1,486)	(1,823)	(3,459)
Repayments	(50,155)	(42,488)	(39,937)

Total loans receivable at end of period \$138,084 \$140,982 \$142,675

Delinquent Loans, Other Real Estate Owned and Classified Assets

Collection Procedures. Our general collection procedures provide that when a commercial loan becomes 10 days past due and when a mortgage or consumer loan become 15 days past due, a computer-generated late charge notice is sent to the borrower requesting payment. If delinquency continues, a second delinquent notice is mailed when the loan continues past due for 30 days. If a loan becomes 60 days past due, the loan becomes subject to possible legal action. We will generally send a “due and payable” letter upon a loan becoming 60 days delinquent. This letter grants the borrower 30 days to bring the account paid to date prior to the start of any legal action. If not paid, foreclosure proceedings are initiated after this 30-day period. To the extent required by regulations of the Department of Housing and Urban Development (“HUD”), generally within 30 days of delinquency, a Section 160 HUD notice is given to the borrower which provides access to consumer counseling services. General collection procedures may vary with particular circumstances on a loan by loan basis. Also, collection procedures for Freddie Mac serviced loans follow the Freddie Mac guidelines which are different from our general procedures.

Loans Past Due and Non-Performing Assets. Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of additional interest is doubtful or when extraordinary efforts are required to collect the debt. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income.

Real estate acquired by us as a result of foreclosure or by deed in lieu of foreclosure is deemed real estate owned (“REO”) until such time as it is sold. In general, we consider collateral for a loan to be “in-substance” foreclosed if: (i) the borrower has little or no equity in the collateral; (ii) proceeds for repayment of the loan can be expected to come only from the operation or sale of the collateral; and (iii) the borrower has either formally or effectively abandoned control of the collateral, or retained control of the collateral but is unlikely to be able to rebuild equity in the collateral or otherwise repay the loan in the foreseeable future. Cash flow attributable to in-substance foreclosures is used to reduce the carrying value of the collateral.

When collateral, other than real estate, securing commercial and consumer loans is acquired as a result of delinquency or other reasons, it is classified as Other Repossessed Assets (“ORA”) and recorded at the lower of cost or fair market value until it is disposed of.

When collateral is acquired or otherwise deemed REO/ORA, it is recorded at the lower of the unpaid principal balance of the related loan or its estimated net realizable value. This write down is recorded against the allowance for loan losses. Periodic future valuations are performed by management, and any subsequent decline in fair value is charged to operations. At December 31, 2013, we held \$757,000 in properties that were classified REO and \$1.0 million in assets classified as ORA.

Delinquent Loans. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated.

	At December 31,				
	2013	2012	2011	2010	2009
	(dollars in thousands)				
Non-Accrual Loans:					
Residential Mortgage	\$651	\$1,810	\$2,420	\$3,114	\$2,944
Commercial Mortgage	13	821	356	1,148	2,204
Purchased Mortgage Out-of-State	1,441	2,030	—	—	—
Construction	—	—	—	—	1,433
Purchased Construction Out-of-State	173	173	173	1,772	2,113
Commercial	—	—	—	—	96
Consumer and other	7	29	152	206	157
Total non-accrual loans	\$2,285	\$4,863	\$3,101	\$6,240	\$8,947
Accrual loans delinquent 90 days or more:					
Residential Mortgage	24	61	238	282	89
Commercial Mortgage	—	—	—	82	2,696
Construction	—	—	—	—	—
Purchased Construction Out-of-State	—	—	—	—	—
Commercial	—	—	—	—	—
Consumer and other	2	6	—	2	54
Total accrual loans delinquent 90 days or more	\$26	\$67	\$238	\$366	\$2,839
Total nonperforming loans (1)	\$2,311	\$4,930	\$3,339	\$6,606	\$11,786
Real Estate Owned and Other Repossessed Assets:					
Residential Mortgage	285	957	1,086	494	584
Commercial Mortgage	472	309	1,015	2,304	2,985
Construction	—	—	—	—	—
Commercial	—	—	—	—	—
Consumer and other	1,023	1,121	1,307	20	11
Total real estate owned and other repossessed assets (2)	\$1,780	\$2,387	\$3,408		