MACATAWA BANK CORP
Form 10-Q
July 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

o 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: 000-25927

MACATAWA BANK CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-3391345
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10753 Macatawa Drive, Holland, Michigan 49424
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (616) 820-1444

Indicate by checkmark 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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. (Check one):

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

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 27,261,325 shares of the Company's Common Stock (no par value) were outstanding as of July 25, 2013.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Macatawa Bank Corporation. Forward-looking statements are identifiable by words or phrases such as "outlook", "plan" or "strategy"; that an event or trend "may", "should", "will", "is likely", or is "probable" to occur or "continue", has "begun" or "is scheduled" or "on track" or that the Company or its management "anticipates", "believes", "estimates", "plans", "forecasts", "intends", "predicts", "projects", or "expects" a particular result, or is "committed", "confident", "optimistic" or has an "opinion" that an event will occur, or other words or phrases such as "ongoing", "future", "signs", "efforts", "tend", "exploring", "appearing", "until", "near term", "going forward", "starting", “initiative,” “trend” and variations of such words and similar expressions. Such statements are based upon current beliefs and expectations and involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These statements include, among others, statements related to stabilization of our loan portfolio, trends in credit quality metrics, future capital levels and capital needs, including the impact of Basel III, real estate valuation, future levels of repossessed and foreclosed properties and nonperforming assets, future levels of losses and costs associated with the administration and disposition of repossessed and foreclosed properties and nonperforming assets, future levels of loan charge-offs, future levels of other real estate owned, future levels of provisions for loan losses, the rate of asset dispositions, future dividends, future growth and funding sources, future cost of funds, future liquidity levels, future profitability levels, future FDIC assessment levels, future net interest margin levels, building and improving our investment portfolio, diversifying our credit risk, the effects on earnings of changes in interest rates, future economic conditions, future effects of new or changed accounting standards, future loss recoveries, future balances of short-term investments, future loan demand and loan growth, future levels of mortgage banking revenue and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, maintain our current levels of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, originate high quality loans, maintain or improve mortgage banking income, realize the benefit of our deferred tax assets, resume payment of dividends and improve profitability is not entirely within our control and is not assured. The future effect of changes in the real estate, financial and credit markets and the national and regional economy on the banking industry, generally, and Macatawa Bank Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Macatawa Bank Corporation does not undertake to update forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2012. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

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Part I Financial Information
Item 1.
MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of June 30, 2013 (unaudited) and December 31, 2012

(dollars in thousands, except per share data)	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$27,605	$33,556
Federal funds sold and other short-term investments	129,849	192,802
Cash and cash equivalents	157,454	226,358
Interest-bearing time deposits in other financial institutions	25,000	---
Securities available for sale, at fair value	129,659	123,497
Securities held to maturity (fair value 2013 - $5,494 and 2012 - $4,301)	5,380	4,300
Federal Home Loan Bank (FHLB) stock	11,236	11,236
Loans held for sale, at fair value	4,553	8,130
Total loans	1,012,887	1,052,348
Allowance for loan losses	(22,248)	(23,739)
Net loans	990,639	1,028,609
Premises and equipment – net	53,302	53,576
Accrued interest receivable	3,405	3,411
Bank-owned life insurance	27,162	26,804
Other real estate owned	45,845	51,582
Net deferred tax asset	17,788	18,780
Other assets	5,405	4,435
Total assets	$1,476,828	$1,560,718
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$318,981	$339,520
Interest-bearing	880,597	946,741
Total deposits	1,199,578	1,286,261
Other borrowed funds	90,658	91,822
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	10,452	9,240
Total liabilities	1,343,576	1,430,211
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 31,290 shares issued and outstanding at June 30, 2013 and December 31, 2012	30,604	30,604
	2,260	2,560

Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,300 shares issued and outstanding at June 30, 2013 and 2,600 shares issued and outstanding at December 31, 2012		
Common stock, no par value, 200,000,000 shares authorized; 27,261,325 shares issued and outstanding at June 30, 2013 and 27,203,825 shares issued and outstanding at December 31, 2012	188,080	187,718
Retained deficit	(86,258)	(91,335)
Accumulated other comprehensive income (loss)	(1,434)	960
Total shareholders' equity	133,252	130,507
Total liabilities and shareholders' equity	$1,476,828	$1,560,718

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three and Six Month Periods Ended June 30, 2013 and 2012
(unaudited)

(dollars in thousands, except per share data)	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Interest income				
Loans, including fees	$11,493	$13,237	$23,161	$26,763
Securities				
Taxable	448	384	877	701
Tax-exempt	155	65	296	108
FHLB Stock	97	84	196	169
Federal funds sold and other short-term investments	114	130	210	257
Total interest income	12,307	13,900	24,740	27,998
Interest expense				
Deposits	982	1,525	2,067	3,175
Debt and other borrowed funds	862	1,053	1,726	2,221
Total interest expense	1,844	2,578	3,793	5,396
Net interest income	10,463	11,322	20,947	22,602
Provision for loan losses	(1,000)	(1,750)	(1,750)	(5,350)
Net interest income after provision for loan losses	11,463	13,072	22,697	27,952
Noninterest income				
Service charges and fees	976	776	1,888	1,571
Net gains on mortgage loans	708	780	1,533	1,251
Trust fees	625	598	1,213	1,207
Gain on sale of securities	61	59	80	59
ATM and debit card fees	1,132	1,064	2,109	2,045
Other	709	723	1,351	1,578
Total noninterest income	4,211	4,000	8,174	7,711
Noninterest expense				
Salaries and benefits	5,732	5,723	11,525	11,443
Occupancy of premises	905	941	1,851	1,912
Furniture and equipment	845	858	1,595	1,685
Legal and professional	183	180	373	392
Marketing and promotion	246	210	492	420
Data processing	352	368	704	719
FDIC assessment	345	479	817	1,188
ATM and debit card processing	361	308	652	596
Bond and D&O Insurance	183	215	368	483
Losses on repossessed and foreclosed properties	294	1,934	353	3,531

Administration and disposition of problem assets	1,005	1,256	1,907	2,718
Other	1,424	1,414	2,819	2,905
Total noninterest expenses	11,875	13,886	23,456	27,992
Income before income tax	3,799	3,186	7,415	7,671
Income tax expense	1,196	---	2,338	---
Net income	2,603	3,186	5,077	7,671
Dividends declared on preferred shares	---	---	---	---
Net income available to common shares	$2,603	$3,186	$5,077	$7,671
Basic earnings per common share	$0.10	$0.12	$0.19	$0.28
Diluted earnings per common share	$0.10	$0.12	$0.19	$0.28
Cash dividends per common share	$---	$---	$---	$---

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three and Six Month Periods Ended June 30, 2013 and 2012
(unaudited)

(dollars in thousands)	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Three Months Ended June 30, 2012
Net income	$ 2,603	$ 3,186	$ 5,077	$ 7,671
Other comprehensive income (loss):				
Unrealized gains (losses):				
Net change in unrealized gains (losses) on securities available for sale	(3,460)	560	(3,603)	523
Tax effect	1,211	(196)	1,261	(183)
Net change in unrealized gains (losses) on securities available for sale, net of tax	(2,249)	364	(2,342)	340
Less: reclassification adjustments:				
Reclassification for gains included in net income	61	59	80	59
Tax effect	(21)	(21)	(28)	(21)
Reclassification for gains included in net income, net of tax	40	38	52	38
Other comprehensive income (loss), net of tax	(2,289)	326	(2,394)	302
Comprehensive income	$ 314	$ 3,512	$ 2,683	$ 7,973

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Six Month Periods Ended June 30, 2013 and 2012

(unaudited)

(dollars in thousands, except per share data)	Preferred Stock Series A	Stock Series B	Common Stock	Retained (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2012	$30,604	$2,560	$187,709	$(126,825)	$ 378	$ 94,426
Net income for six months ended June 30, 2012				7,671		7,671
Net change in unrealized gain (loss) on securities available for sale, net of tax					302	302
Balance, June 30, 2012	$30,604	$2,560	$187,709	$(119,154)	$ 680	$ 102,399
Balance, January 1, 2013	$30,604	$2,560	$187,718	$(91,335)	$ 960	$ 130,507
Net income for six months ended June 30, 2013				5,077		5,077
Conversion of 300 shares of Preferred Stock Series B to 50,000 shares of Common Stock		(300)	300			---
Net change in unrealized gain (loss) on securities available for sale, net of tax					(2,394)	(2,394)
Stock compensation expense			62			62
Balance, June 30, 2013	$30,604	$2,260	$188,080	$(86,258)	$ (1,434)	$ 133,252

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2013 and 2012
(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Cash flows from operating activities		
Net income	$5,077	$7,671
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,452	1,416
Stock compensation expense	62	---
Provision for loan losses	(1,750)	(5,350)
Origination of loans for sale	(63,160)	(59,412)
Proceeds from sales of loans originated for sale	68,270	55,059
Net gains on mortgage loans	(1,533)	(1,251)
Gain on sales of securities	(80)	(59)
Write-down of other real estate	967	3,550
Net gain on sales of other real estate	(614)	(20)
Decrease (increase) in net deferred tax asset	2,283	---
Decrease (increase) in accrued interest receivable and other assets	(964)	1,579
Earnings in bank-owned life insurance	(358)	(447)
Increase in accrued expenses and other liabilities	2,838	911
Net cash from operating activities	12,490	3,647
Cash flows from investing activities		
Loan originations and payments, net	36,966	27,174
Change in interest-bearing deposits in other financial institutions	(25,000)	---
Purchases of securities available for sale	(27,049)	(67,461)
Purchases of securities held to maturity	(1,100)	---
Proceeds from:		
Maturities and calls of securities available for sale	8,319	25,613
Sales of securities available for sale	3,778	4,050
Principal paydowns on securities	3,290	1,035
Sales of other real estate	8,138	8,587
Additions to premises and equipment	(889)	(407)
Net cash from investing activities	6,453	(1,409)
Cash flows from financing activities		
Net decrease in in-market deposits	(86,683)	20,228
Repayments of other borrowed funds	(1,164)	(21,114)
Net cash from financing activities	(87,847)	(886)
Net change in cash and cash equivalents	(68,904)	1,352
Cash and cash equivalents at beginning of period	226,358	243,042
Cash and cash equivalents at end of period	$157,454	$244,394
Supplemental cash flow information		

Interest paid	$3,061	$4,727
Income taxes paid	55	100
Supplemental noncash disclosures:		
Transfers from loans to other real estate	2,754	7,725
Security settlement	(1,626)	4,670

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Macatawa Bank Corporation ("the Company", "our", "we") and its wholly-owned subsidiary, Macatawa Bank ("the Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 26 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan.

The Company owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are not consolidated with the Company under accounting principles generally accepted in the United States of America.

Basis of Presentation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) believed necessary for a fair presentation have been included.

Operating results for the three and six month periods ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, valuation of deferred tax assets, loss contingencies, fair value of other real estate owned and fair values of financial instruments are particularly subject to change.

Regulatory Developments:

Release of Memorandum of Understanding with Macatawa Bank and its Regulators

On April 12, 2013, the Federal Deposit Insurance Corporation (“FDIC”) and the Michigan Department of Insurance and Financial Services (“DIFS”), the primary banking regulators of the Bank, notified the Bank that the Bank’s Memorandum of Understanding (“MOU”) with the FDIC and DIFS had served its purpose and was released. As a result, the Bank is no longer subject to any regulatory order, memorandum of understanding or other similar regulatory directive or proceeding and has returned to a normal regulatory operating environment.

The MOU documented an understanding the Bank reached with regulators in connection with termination of the Bank’s former Consent Order on March 2, 2012. The requirements of the MOU which are described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 are no longer applicable to the Bank. In particular, the enhanced regulatory capital requirements of the MOU no longer apply to the Bank and the Bank is no longer required to obtain the prior written consent of the FDIC and DIFS before the Bank declares or pays dividends.

We believe the FDIC and DIFS released the MOU as a result of: (i) the Bank's substantial compliance with the MOU, (ii) our implementation of enhanced corporate governance practices and disciplined business and banking principles, (iii) substantial improvements in the Bank's asset quality, (iv) improved liquidity, (v) continued improvement in the Bank's financial condition and earnings performance, and (vi) Bank regulatory capital levels well in excess of the levels required to be classified as "well capitalized" for regulatory purposes and to comply with our MOU due to our successful capital raise and the Bank's retained earnings.

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Board Resolution

In connection with the termination of the Company's Written Agreement by the Federal Reserve Bank of Chicago ("FRB") on October 26, 2012, the Board of Directors of the Company adopted a resolution requiring the Company to obtain written approval from the FRB before declaring or paying any dividends, increasing holding company debt, or redeeming any capital stock.

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

Allowance for Loan Losses: The allowance for loan losses (allowance) is a valuation allowance for probable incurred credit losses inherent in our loan portfolio, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management believes the allowance for loan losses balance to be adequate based on known and inherent risks in the portfolio, past loan loss experience, information about specific borrower situations and estimated collateral values, economic conditions and other relevant factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Management continues its collection efforts on previously charged-off balances and applies recoveries as additions to the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class and the loan risk grade assignment for commercial loans. At June 30, 2013, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage loans and consumer loans. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative factors, including economic trends, credit quality trends, valuation trends, concentration risk, quality of loan review, changes in personnel, external factors and other considerations.

A loan is impaired when, based on current information and events, it is believed to be probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified and a concession has been made, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Commercial and commercial real estate loans with relationship balances exceeding $500,000 and an internal risk grading of 6 or worse are evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated and the loan is reported at the present value of estimated future cash flows using the loan's existing interest rate or at the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment and they are not separately identified for impairment disclosures.

Troubled debt restructurings are also considered impaired with impairment generally measured at the present value of estimated future cash flows using the loan's effective rate at inception or using the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure, primarily other real estate owned, are initially recorded at fair value less estimated costs to sell when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed unless they add value to the property.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We recognize a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. We recognize interest and penalties related to income tax matters in income tax expense.

Adoption of New Accounting Standards: The Financial Accounting Standards Board ("FASB") has issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU is intended to improve the reporting of reclassifications out of accumulated other comprehensive income. The ASU requires an entity to report, either on the face of the statement where net income is presented or in the notes to the financial statements, the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in their entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments in this ASU apply to all entities that issue financial statements that are presented in conformity with U.S. GAAP and that report items of other comprehensive income. For public entities, the amendments in this ASU are effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted this ASU on January 1, 2013 by including the required disclosures in Note 2 to the consolidated financial statements.

NOTE 2 – SECURITIES

The amortized cost and fair value of securities at period-end were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2013				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 50,552	$ 95	$ (1,259)	$ 49,388
U.S. Agency MBS and CMOs	20,130	14	(243)	19,901
Tax-exempt state and municipal bonds	23,830	52	(1,040)	22,842
Taxable state and municipal bonds	27,984	422	(209)	28,197
Corporate bonds and other debt securities	7,871	51	(86)	7,836
Other equity securities	1,500	---	(5)	1,495
	$ 131,867	$ 634	$ (2,842)	$ 129,659
Held to Maturity				
State and municipal bonds	$ 5,380	$ 114	$ ---	$ 5,494
December 31, 2012				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 42,245	$ 340	$ (21)	$ 42,564
U. S. Agency MBS and CMOs	23,495	272	(6)	23,761
Tax-exempt state and municipal bonds	20,598	244	(49)	20,793

Taxable state and municipal bonds	26,726	619	(49)	27,296
Corporate bonds	7,456	77	(7)	7,526
Other equity securities	1,500	57	---	1,557
	$ 122,020	$ 1,609	$ (132)	$ 123,497
Held to Maturity:				
State and municipal bonds	$ 4,300	$ 1	$ ---	$ 4,301

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES (Continued)

Proceeds from the sale of securities available for sale were $3.2 million in the three month period ended June 30, 2013 and $3.8 million in the six month period ended June 30, 2013 resulting in net gains on sale of $61,000 and $80,000, respectively, as reported in the consolidated statements of income. This resulted in reclassifications of $61,000 ($40,000 net of tax) and $80,000 ($52,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the consolidated statements of income in the three and six month periods ended June 30, 2013. Proceeds from the sale of securities available for sale were $4.1 million for the three and six month periods ended June 30, 2012, resulting in net gain on sale of $59,000, as reported in the consolidated statements of income. This resulted in reclassification of $59,000 ($38,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the consolidated statements of income in the three and six month periods ended June 30, 2012.

Contractual maturities of debt securities at June 30, 2013 were as follows (dollars in thousands):

	Held–to-Maturity Securities		Available-for-Sale Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$4,080	$4,194	$3,796	$3,834
Due from one to five years	430	430	50,651	50,671
Due from five to ten years	590	590	43,298	42,037
Due after ten years	280	280	32,622	31,622
	$5,380	$5,494	$130,367	$128,164

Securities with unrealized losses at June 30, 2013 and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
June 30, 2013	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$40,108	$ (1,259)	$---	$ ---	$40,108	$ (1,259)
U.S. Agency MBS and CMOs	18,893	(243)	---	---	18,893	(243)
Tax-exempt state and municipal bonds	19,024	(1,040)	---	---	19,024	(1,040)
Taxable state and municipal bonds	10,011	(199)	326	(10)	10,337	(209)
Corporate bonds and other debt securities	3,639	(86)	---	---	3,639	(86)
Other equity securities	1,500	(5)	---	---	1,500	(5)
Total temporarily impaired	$93,175	$ (2,832)	$326	$ (10)	$93,501	$ (2,842)

	Less than 12 Months		12 Months or More		Total	
December 31, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$10,977	$ (21)	$---	$ ---	$10,977	$ (21)

U.S. Agency MBS and CMOs	3,373	(6)	---	---	3,373	(6)
Tax-exempt state and municipal bonds	4,613	(49)	---	---	4,613	(49)
Taxable state and municipal bonds	4,661	(49)	---	---	4,661	(49)
Corporate bonds	3,945	(7)			3,945	(7)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$27,569	$ (132)	$---	$ ---	$27,569	$ (132)

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NOTE 2 – SECURITIES (Continued)

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during the three and six month periods ended June 30, 2013 and 2012.

Securities with a carrying value of approximately $7.0 million and $7.4 million were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law at June 30, 2013 and December 31, 2012, respectively.

NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	June 30, 2013	December 31, 2012
Commercial and industrial	$242,759	$259,700
Commercial real estate:		
Residential developed	22,788	26,090
Unsecured to residential developers	7,048	5,547
Vacant and unimproved	49,992	56,525
Commercial development	1,469	1,799
Residential improved	70,223	75,813
Commercial improved	250,544	255,738
Manufacturing and industrial	77,591	81,447
Total commercial real estate	479,655	502,959
Consumer		
Residential mortgage	181,292	182,625
Unsecured	1,601	1,683
Home equity	96,463	92,764
Other secured	11,117	12,617
Total consumer	290,473	289,689
Total loans	1,012,887	1,052,348
Allowance for loan losses	(22,248)	(23,739)
	$990,639	$1,028,609

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NOTE 3 – LOANS (Continued)

Activity in the allowance for loan losses by portfolio segment was as follows (dollars in thousands):

Three months ended June 30, 2013:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 5,980	$ 13,358	$ 4,102	$ 47	$23,487
Charge-offs	(87)	(222)	(389)	---	(698)
Recoveries	71	310	78	---	459
Provision for loan losses	(362)	(1,122)	464	20	(1,000)
Ending Balance	$ 5,602	$ 12,324	$ 4,255	$ 67	$22,248

Three months ended June 30, 2012:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,507	$ 17,565	$ 4,366	$ 13	$29,451
Charge-offs	(21)	(799)	(79)	---	(899)
Recoveries	110	201	67	---	378
Provision for loan losses	(958)	(1,728)	900	36	(1,750)
Ending Balance	$ 6,638	$ 15,239	$ 5,254	$ 49	$27,180

Six months ended June 30, 2013:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,459	$ 13,457	$ 3,787	$ 36	$23,739
Charge-offs	(249)	(459)	(633)	---	(1,341)
Recoveries	427	994	179	---	1,600
Provision for loan losses	(1,035)	(1,668)	922	31	(1,750)
Ending Balance	$ 5,602	$ 12,324	$ 4,255	$ 67	$22,248

Six months ended June 30, 2012:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,313	$ 20,475	$ 4,821	$ 32	$31,641
Charge-offs	(989)	(2,506)	(901)	---	(4,396)
Recoveries	280	4,885	120	---	5,285
Provision for loan losses	1,034	(7,615)	1,214	17	(5,350)
Ending Balance	$ 6,638	$ 15,239	$ 5,254	$ 49	$27,180

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NOTE 3 – LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method (dollars in thousands):

June 30, 2013:

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 1,963	$ 1,890	$ 1,065	$ ---	$ 4,918
Collectively evaluated for impairment	3,639	10,434	3,190	67	17,330
Total ending allowance balance	$ 5,602	$ 12,324	$ 4,255	$ 67	$ 22,248
Loans:					
Individually reviewed for impairment	$ 13,086	$ 48,395	$ 15,145	$ ---	$ 76,626
Collectively evaluated for impairment	229,673	431,260	275,328	---	936,261
Total ending loans balance	$ 242,759	$ 479,655	$ 290,473	$ ---	$ 1,012,887

December 31, 2012:

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 2,920	$ 2,418	$ 716	$ ---	$ 6,054
Collectively evaluated for impairment	3,539	11,039	3,071	36	17,685
Total ending allowance balance	$ 6,459	$ 13,457	$ 3,787	$ 36	$ 23,739
Loans:					
Individually reviewed for impairment	$ 14,390	$ 54,831	$ 14,086	$ ---	$ 83,307
Collectively evaluated for impairment	245,310	448,128	275,603	---	969,041
Total ending loans balance	$ 259,700	$ 502,959	$ 289,689	$ ---	$ 1,052,348

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NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2013 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ 4,397	$ 4,394	$ ---
Commercial real estate:			
Residential developed	5,551	4,618	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	880	880	---
Commercial development	---	---	---
Residential improved	1,073	1,073	---
Commercial improved	3,180	3,165	---
Manufacturing and industrial	810	810	---
	11,494	10,546	---
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	$ 15,891	$ 14,940	$ ---
With an allowance recorded:			
Commercial and industrial	$ 8,738	$ 8,693	$ 1,963
Commercial real estate:			
Residential developed	1,783	1,783	174
Unsecured to residential developers	---	---	---
Vacant and unimproved	1,995	1,995	101
Commercial development	14	14	1
Residential improved	10,247	10,247	411
Commercial improved	19,327	19,327	1,092
Manufacturing and industrial	4,482	4,482	111
	37,848	37,848	1,890
Consumer:			
Residential mortgage	9,433	9,433	663
Unsecured	---	---	---
Home equity	5,712	5,712	402
Other secured	---	---	---
	15,145	15,145	1,065

	$61,731	$ 61,686	$ 4,918
Total	$77,622	$ 76,626	$ 4,918

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NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2012 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ 2,515	$ 2,512	$ ---
Commercial real estate:			
Residential developed	7,136	6,283	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	2,321	2,136	---
Commercial development	213	213	---
Residential improved	3,293	3,019	---
Commercial improved	7,268	6,127	---
Manufacturing and industrial	3,686	3,686	---
	23,917	21,464	
Consumer:			
Residential mortgage	4,614	3,062	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	4,614	3,062	---
	$ 31,046	$ 27,038	$ ---
With an allowance recorded:			
Commercial and industrial	$ 11,878	$ 11,878	$ 2,920