MACATAWA BANK CORP
Form 10-Q
April 26, 2012

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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 March 31, 2012

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 o | Non-accelerated filer o (Do not check if 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 o No x

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 27,082,825 shares of the Company's Common Stock (no par value) were outstanding as of April 26, 2012.

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" 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 trends in credit quality metrics, future capital levels, real estate valuation, future levels of non-performing assets and costs associated with administration and disposition of non-performing loans, future levels of loan charge-offs, future levels of provisions for loan losses, the rate of asset dispositions, dividends, future growth and funding sources, future liquidity levels, future profitability levels, future trust service income levels, future FDIC assessment levels, future net interest margin levels, building our investment portfolio, the effects on earnings of changes in interest rates, future economic conditions, future effects of new or changed accounting standards 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 goodwill, mortgage servicing rights and 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, obtain continuing regulatory approval to make interest payments on our subordinated notes, 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, 2011. 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.

INDEX

Index

Part I Financial Information
Item 1.

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of March 31, 2012 (unaudited) and December 31, 2011

| (dollars in thousands, except per share data) | March 31, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 22,278 | $ 30,971 |
| Federal funds sold and other short -term investments | 184,362 | 212,071 |
| Cash and cash equivalents | 206,640 | 243,042 |
| | | |
| Securities available for sale, at fair value | 88,745 | 54,746 |
| Securities held to maturity (fair value 2012 and 2011 - $300) | 300 | 300 |
| Federal Home Loan Bank (FHLB) stock | 11,236 | 11,236 |
| Loans held for sale, at fair value | 8,562 | 1,026 |
| Total loans | 1,059,935 | 1,070,975 |
| Allowance for loan losses | (29,451) | (31,641) |
| Net loans | 1,030,484 | 1,039,334 |
| | | |
| Premises and equipment – net | 54,819 | 55,358 |
| Accrued interest receivable | 3,802 | 3,595 |
| Bank-owned life insurance | 26,180 | 25,957 |
| Other real estate owned | 66,236 | 66,438 |
| Other assets | 5,990 | 6,635 |
| Total assets | $ 1,502,994 | $ 1,507,667 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Noninterest-bearing | $ 300,617 | $ 324,253 |
| Interest-bearing | 913,854 | 891,036 |
| Total deposits | 1,214,471 | 1,215,289 |
| Other borrowed funds | 137,489 | 148,603 |
| Long-term debt | 41,238 | 41,238 |
| Subordinated debt | 1,650 | 1,650 |
| Accrued expenses and other liabilities | 9,259 | 6,461 |
| Total liabilities | 1,404,107 | 1,413,241 |
| | | |
| 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 | 30,604 | 30,604 |
| Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,600 shares issued and outstanding | 2,560 | 2,560 |
| | 187,709 | 187,709 |

| | | |
|---|---|---|
| Common stock, no par value, 200,000,000 shares authorized; 27,082,825 and 27,082,823 shares issued and outstanding at March 31, 2012 and December 31, 2011 | | |
| Retained deficit | (122,340) | (126,825) |
| Accumulated other comprehensive income | 354 | 378 |
| Total shareholders' equity | 98,887 | 94,426 |
| Total liabilities and shareholders' equity | $ 1,502,994 | $ 1,507,667 |

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three Month Periods Ended March 31, 2012 and 2011
(unaudited)

| (dollars in thousands, except per share data) | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Interest income | | |
| Loans, including fees | $ 13,526 | $ 15,582 |
| Securities | | |
| Taxable | 318 | 27 |
| Tax-exempt | 42 | --- |
| FHLB Stock | 85 | 76 |
| Federal funds sold and other short-term investments | 128 | 168 |
| Total interest income | 14,099 | 15,853 |
| | | |
| Interest expense | | |
| Deposits | 1,650 | 2,912 |
| Debt and other borrowed funds | 1,168 | 1,343 |
| Total interest expense | 2,818 | 4,255 |
| | | |
| Net interest income | 11,281 | 11,598 |
| Provision for loan losses | (3,600) | (1,450) |
| Net interest income after provision for loan losses | 14,881 | 13,048 |
| | | |
| Noninterest income | | |
| Service charges and fees | 795 | 949 |
| Net gains on mortgage loans | 471 | 435 |
| Trust fees | 609 | 651 |
| ATM and debit card fees | 981 | 918 |
| Other | 855 | 726 |
| Total noninterest income | 3,711 | 3,679 |
| | | |
| Noninterest expense | | |
| Salaries and benefits | 5,720 | 5,347 |
| Occupancy of premises | 971 | 1,011 |
| Furniture and equipment | 828 | 817 |
| Legal and professional | 212 | 270 |
| Marketing and promotion | 210 | 224 |
| Data processing | 351 | 304 |
| FDIC assessment | 710 | 978 |
| ATM and debit card processing | 288 | 271 |
| Bond and D&O Insurance | 268 | 379 |
| Losses on repossessed and foreclosed properties | 1,596 | 2,493 |
| Administration and disposition of problem assets | 1,462 | 1,941 |

| | | | | |
|---|---|---|---|---|
| Other | | 1,491 | | 1,401 |
| Total noninterest expenses | | 14,107 | | 15,436 |
| | | | | |
| Income before income tax | | 4,485 | | 1,291 |
| Income tax expense (benefit) | | --- | | --- |
| | | | | |
| Net income | | 4,485 | | 1,291 |
| Dividends declared on preferred shares | | --- | | --- |
| Net income available to common shares | $ | 4,485 | $ | 1,291 |
| | | | | |
| Basic earnings per common share | $ | 0.17 | $ | 0.07 |
| Diluted earnings per common share | $ | 0.17 | $ | 0.07 |
| Cash dividends per common share | $ | --- | $ | --- |

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three Month Periods Ended March 31, 2012 and 2011
(unaudited)

| (dollars in thousands) | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Net income | $ 4,485 | $ 1,291 |
| | | |
| Other comprehensive income (loss), net of tax: | | |
| Net unrealized gains (losses) on securities available for sale arising during period | (24) | 3 |
| | | |
| Less: reclassification adjustment for gain recognized in earnings, net of tax | --- | --- |
| Other comprehensive income (loss), net of tax | (24) | 3 |
| | | |
| | | |
| Comprehensive income | $ 4,461 | $ 1,294 |

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three Month Periods Ended March 31, 2012 and 2011
(unaudited)

| (dollars in thousands, except per share data) | Preferred Stock Series A | Preferred Stock Series B | Common Stock | Retained (Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance, January 1, 2011 | $ 30,604 | $ 2,560 | $ 167,321 | $ (132,654) | $ 11 | $ 67,842 |
| Net income for three months ended March 31, 2011 | | | | 1,291 | | 1,291 |
| Net change in unrealized gain (loss) on securities available for sale, net of tax | | | | | 3 | 3 |
| Stock compensation expense | | | 17 | | | 17 |
| Balance, March 31, 2011 | $ 30,604 | $ 2,560 | $ 167,338 | $ (131,363) | $ 14 | $ 69,153 |
| | | | | | | |
| Balance, January 1, 2012 | $ 30,604 | $ 2,560 | $ 187,709 | $ (126,825) | $ 378 | $ 94,426 |
| Net income for three months ended March 31, 2012 | | | | 4,485 | | 4,485 |
| Net change in unrealized gain (loss) on securities available for sale, net of tax | | | | | (24) | (24) |
| Balance, March 31, 2012 | $ 30,604 | $ 2,560 | $ 187,709 | $ (122,340) | $ 354 | $ 98,887 |

See accompanying notes to consolidated financial statements.

- 7 -

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Month Periods Ended March 31, 2012 and 2011
(unaudited)

| (dollars in thousands) | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Cash flows from operating activities | | |
| Net income | $ 4,485 | $ 1,291 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 704 | 781 |
| Stock compensation expense | --- | 17 |
| Provision for loan losses | (3,600) | (1,450) |
| Origination of loans for sale | (26,524) | (16,671) |
| Proceeds from sales of loans originated for sale | 19,459 | 18,701 |
| Net gains on mortgage loans | (471) | (435) |
| Write-down of other real estate | 1,690 | 2,699 |
| Net gain on sales of other real estate | (94) | (212) |
| Decrease (increase) in accrued interest receivable and other assets | 450 | (2,157) |
| Earnings in bank-owned life insurance | (223) | (215) |
| Increase in accrued expenses and other liabilities | 2,798 | 684 |
| Net cash from operating activities | (1,326) | 3,033 |
| | | |
| Cash flows from investing activities | | |
| Loan originations and payments, net | 6,639 | 45,092 |
| Purchases of securities available for sale | (44,921) | (10,549) |
| Proceeds from: | | |
| Maturities and calls of securities available for sale | 10,470 | 6,988 |
| Principal paydowns on securities | 334 | 85 |
| Sales of other real estate | 4,417 | 4,984 |
| Additions to premises and equipment | (83) | (112) |
| Net cash from investing activities | (23,144) | 46,488 |
| | | |
| Cash flows from financing activities | | |
| Net decrease in in-market deposits | (818) | (6,360) |
| Decrease in brokered deposits | --- | (5,595) |
| Repayments of other borrowed funds | (11,114) | (11,066) |
| Net cash from financing activities | (11,932) | (23,021) |
| | | |
| Net change in cash and cash equivalents | (36,402) | 26,500 |
| Cash and cash equivalents at beginning of period | 243,042 | 236,127 |
| Cash and cash equivalents at end of period | $ 206,640 | $ 262,627 |
| Supplemental cash flow information | | |
| Interest paid | $ 2,462 | $ 3,950 |
| Supplemental noncash disclosures: | | |
| Transfers from loans to other real estate | 5,811 | 14,479 |

See accompanying notes to consolidated financial statements.

Index

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 month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011.

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:

Termination of Consent Order with Macatawa Bank and its Regulators

On February 22, 2010, the Bank entered into a Consent Order with the Federal Deposit Insurance Corporation (“FDIC”) and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Bank agreed to the terms of the negotiated Consent Order without admitting or denying any charges of unsafe or unsound banking practices. The Consent Order imposed no fines or penalties on the Bank. As a result of the improvement in our financial condition and results of operations, our implementation of additional corporate governance practices and disciplined business and banking principles, and our compliance with the Consent Order, upon completion of the Bank’s 2011 joint examination by the FDIC and OFIR, the FDIC and OFIR terminated the Consent Order effective March 2, 2012.

In connection with the termination of the Consent Order, the Bank reached an understanding with the regulators in the form of a memorandum of understanding ("MOU"), which maintains many of the controls and procedures put in place by the Bank in response to the Consent Order, including: maintenance of a Tier 1 Leverage Capital Ratio of at least 8%, formulating and submitting a written plan of action on each asset classified as Substandard in the Report of Examination ("ROE"), charge-off of all assets classified as "Loss" in the ROE, submission of a written Profit Plan, Board review of the adequacy of the allowance for loan losses each quarter and the receipt of prior written consent of the FDIC and OFIR before the Bank declares or pays any dividends.  The Bank was in compliance with each of these requirements as of March 31, 2012.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Written Agreement with Macatawa and its Regulator

The Company has formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB"). The Written Agreement became effective on July 29, 2010, when it was executed and published by the FRB, and was assigned an effective date of July 23, 2010. Among other things, the Written Agreement provides that: (i) the Company must take appropriate steps to fully utilize its financial and managerial resources to serve as a source of strength to Macatawa Bank; (ii) the Company may not declare or pay any dividends without prior FRB approval; (iii) the Company may not take dividends or any other payment representing a reduction in capital from Macatawa Bank without prior FRB approval; (iv) the Company may not make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior FRB approval; (v) the Company may not incur, increase or guarantee any debt without prior FRB approval; (vi) the Company may not purchase or redeem any shares of its stock without prior FRB approval; (vii) the Company must submit a written capital plan to the FRB within 60 days of the Written Agreement; and (viii) the Company may not appoint any new director or senior executive officer, or change the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, without prior regulatory approval. The Company separately requested and received approval from the FRB to make the first quarter 2012 quarterly interest payments on its $1.65 million in outstanding subordinated debt. Each quarter the Company requests approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the interest amounts due.

We believe that as of March 31, 2012, the Company was in compliance in all material respects with all the provisions of the Written Agreement.

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 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 March 31, 2012, 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 and consumer loan portfolios. 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.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 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.

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.

The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carryback losses to available tax years. In assessing the need for a valuation allowance, we consider all relevant positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and available tax planning strategies.

As of January 1, 2010, we no longer have the ability to carryback losses to prior years. The realization of our deferred tax assets is largely dependent on generating income in future years. At March 31, 2012, the need to maintain a full valuation allowance was based primarily on our net operating losses for recent years and the continuing weak economic conditions that could impact our ability to generate future earnings. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required.

Adoption of New Accounting Standards: The FASB has issued ASU 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. The ASU is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. In a typical repo transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Codification Topic 860, Transfers and Servicing, prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repo agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. The amendments to the Codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Adoption of this ASU did not have any effect as the Company does not currently hold any such repurchase agreements.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The FASB has issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term “fair value.” The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the Codification in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. Disclosure of the fair value levels of our financial assets and financial liabilities was added to Note 5 upon adoption of this standard in the first quarter of 2012.

The FASB has issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends accounting standards to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We early adopted this standard with our 2011 annual financial statements by adding a statement of comprehensive income.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 |
|---|---|---|---|---|
| March 31, 2012 | | | | |
| Available for Sale: | | | | |
| U.S. Treasury and federal agency securities | $ 36,295 | $ 212 | $ (133) | $ 36,374 |
| U.S. Agency MBS and CMOs | 18,969 | 124 | (32) | 19,061 |
| Tax-exempt state and municipal bonds | 8,367 | 101 | (101) | 8,367 |
| Taxable state and municipal bonds | 18,834 | 367 | (28) | 19,173 |
| Corporate bonds and other debt securities | 4,233 | 22 | (28) | 4,227 |
| Other equity securities | 1,500 | 43 | --- | 1,543 |
| | $ 88,198 | $ 869 | $ (322) | $ 88,745 |
| Held to Maturity | | | | |
| State and municipal bonds | $ 300 | $ --- | $ --- | $ 300 |
| | | | | |
| December 31, 2011 | | | | |
| Available for Sale: | | | | |
| U.S. Treasury and federal agency securities | $ 27,408 | $ 205 | $ --- | $ 27,613 |
| U. S. Agency MBS and CMOs | 3,853 | 33 | --- | 3,886 |
| Tax-exempt state and municipal bonds | 4,292 | 116 | --- | 4,408 |
| Taxable state and municipal bonds | 16,531 | 239 | (54) | 16,716 |
| Corporate bonds | 1,081 | 1 | (1) | 1,081 |
| Other equity securities | 1,000 | 42 | --- | 1,042 |
| | $ 54,165 | $ 636 | $ (55) | $ 54,746 |
| Held to Maturity: | | | | |
| State and municipal bonds | $ 300 | $ --- | $ --- | $ 300 |

There were no sales of securities in the three month periods ended March 31, 2012 and 2011.

Contractual maturities of debt securities at March 31, 2012 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 | $--- | $--- | $--- | $--- |
| Due from one to five years | --- | --- | 33,569 | 33,914 |
| Due from five to ten years | --- | --- | 29,468 | 29,566 |
| Due after ten years | 300 | 300 | 23,661 | 23,722 |

| | | | | |
|---|---|---|---|---|
| | $300 | $300 | $86,698 | $87,202 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES (Continued)

Securities with unrealized losses at March 31, 2012 and December 31, 2011, 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 | |
|---|---|---|---|---|---|---|
| March 31, 2012 | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury and federal agency securities | $ 8,868 | $ (133) | $ --- | $ --- | $ 8,868 | $ (133) |
| U.S. Agency MBS and CMOs | 3,693 | (32) | | | 3,693 | (32) |
| Tax-exempt state and municipal bonds | 3,882 | (101) | --- | --- | 3,882 | (101) |
| Taxable state and municipal bonds | 3,106 | (28) | --- | --- | 3,106 | (28) |
| Corporate bonds and other debt securities | 2,605 | (28) | --- | - | 2,605 | (28) |
| Other equity securities | --- | --- | --- | --- | --- | --- |
| Total temporarily impaired | $ 22,154 | $ (322) | $ --- | $ --- | $ 22,154 | $ (322) |

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| December 31, 2011 | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury and federal agency securities | $ --- | $ --- | $ --- | $ --- | $ --- | $ --- |
| U.S. Agency MBS and CMOs | --- | --- | --- | --- | --- | --- |
| Tax-exempt state and municipal bonds | --- | --- | --- | --- | --- | --- |
| Taxable state and municipal bonds | 6,196 | (54) | --- | --- | 6,196 | (54) |
| Corporate bonds | 539 | (1) | | | 539 | (1) |
| Other equity securities | --- | --- | --- | --- | --- | --- |
| Total temporarily impaired | $ 6,735 | $ (55) | $ --- | $ --- | $ 6,735 | $ (55) |

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 month periods ended March 31, 2012 and 2011.

At both March 31, 2012 and December 31, 2011, securities with a carrying value of approximately $2.0 million were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Commercial and industrial | $ 228,771 | $ 227,051 |
| | | |
| Commercial real estate: | | |
| Residential developed | 31,553 | 33,829 |
| Unsecured to residential developers | 5,995 | 5,937 |
| Vacant and unimproved | 58,448 | 66,046 |
| Commercial development | 5,239 | 4,586 |
| Residential improved | 81,570 | 82,337 |
| Commercial improved | 291,014 | 304,070 |
| Manufacturing and industrial | 70,556 | 71,462 |
| Total commercial real estate | 544,375 | 568,267 |
| | | |
| Consumer | | |
| Residential mortgage | 169,491 | 156,891 |
| Unsecured | 1,808 | 1,952 |
| Home equity | 100,492 | 101,074 |
| Other secured | 14,998 | 15,740 |
| Total consumer | 286,789 | 275,657 |
| | | |
| Total loans | 1,059,935 | 1,070,975 |
| Allowance for loan losses | (29,451) | (31,641) |
| | | |
| | $ 1,030,484 | $ 1,039,334 |

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

| Three months ended March 31, 2012: | Commercial and Industrial | Commercial Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|
| Beginning balance | $ 6,313 | $ 20,475 | $ 4,821 | $ 32 | $ 31,641 |
| Charge-offs | (968) | (1,707) | (822) | --- | (3,497) |
| Recoveries | 171 | 4,683 | 53 | --- | 4,907 |
| Provision for loan losses | 1,991 | (5,886) | 314 | (19) | (3,600) |
| Ending Balance | $ 7,507 | $ 17,565 | $ 4,366 | $ 13 | $ 29,451 |

| Three months ended March 31, 2011: | Commercial and | Commercial Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|

| | Industrial | | | | |
|---|---|---|---|---|---|
| Beginning balance | $ 7,012 | $ 34,973 | $ 5,415 | $ 26 | $ 47,426 |
| Charge-offs | (804) | (2,397) | (931) | --- | (4,132) |
| Recoveries | 193 | 250 | 56 | --- | 499 |
| Provision for loan losses | 790 | (2,119) | (117) | (4) | (1,450) |
| Ending Balance | $ 7,191 | $ 30,707 | $ 4,423 | $ 22 | $ 42,343 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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):

March 31, 2012:

| | Commercial and Industrial | Commercial Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Ending allowance attributable to loans: | | | | | |
| Individually reviewed for impairment | $ 4,705 | $ 3,778 | $ 1,938 | $ --- | $ 10,421 |
| Collectively evaluated for impairment | 2,802 | 13,787 | 2,428 | 13 | 19,030 |
| Total ending allowance balance | $ 7,507 | $ 17,565 | $ 4,366 | $ 13 | $ 29,451 |
| | | | | | |
| Loans: | | | | | |
| Individually reviewed for impairment | $ 17,002 | $ 53,544 | $ 16,040 | $ --- | $ 86,586 |
| Collectively evaluated for impairment | 211,769 | 490,831 | 270,749 | --- | 973,349 |
| Total ending loans balance | $ 228,771 | $ 544,375 | $ 286,789 | $ --- | $ 1,059,935 |

December 31, 2011:

| | Commercial and Industrial | Commercial Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Ending allowance attributable to loans: | | | | | |
| Individually reviewed for impairment | $ 3,478 | $ 4,367 | $ 1,752 | $ --- | $ 9,597 |
| Collectively evaluated for impairment | 2,835 | 16,108 | 3,069 | 32 | 22,044 |
| Total ending allowance balance | $ 6,313 | $ 20,475 | $ 4,821 | $ 32 | $ 31,641 |
| | | | | | |
| Loans: | | | | | |
| Individually reviewed for impairment | $ 17,331 | $ 52,195 | $ 15,085 | $ --- | $ 84,611 |
| Collectively evaluated for impairment | 209,720 | 516,072 | 260,572 | --- | 986,364 |
| Total ending loans balance | $ 227,051 | $ 568,267 | $ 275,657 | $ --- | $ 1,070,975 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

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

| | Unpaid Principal Balance | Recorded Investment | Allowance Allocated |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial and industrial | $ 7,934 | $ 5,176 | $ --- |
| | | | |
| Commercial real estate: | | | |
| Residential developed | 6,206 | 5,310 | --- |
| Unsecured to residential developers | --- | --- | --- |
| Vacant and unimproved | 2,257 | 1,559 | --- |
| Commercial development | 218 | 218 | --- |
| Residential improved | 6,095 | 5,277 | --- |
| Commercial improved | 9,033 | 7,900 | --- |
| Manufacturing and industrial | 4,409 | 4,409 | --- |
| | 28,218 | 24,673 | |
| Consumer: | | | |
| Residential mortgage | --- | --- | --- |
| Unsecured | --- | --- | --- |
| Home equity | 200 | 200 | --- |
| Other secured | --- | --- | --- |
| | 200 | 200 | --- |
| | $ 36,352 | $ 30,049 | $ --- |
| | | | |
| With an allowance recorded: | | | |
| Commercial and industrial | $ 11,826 | $ 11,826 | $ 4,705 |
| | | | |
| Commercial real estate: | | | |
| Residential developed | 3,291 | 3,291 | 1,381 |
| Unsecured to residential developers | --- | --- | --- |
| Vacant and unimproved | 1,923 | 1,923 | 399 |
| Commercial development | --- | --- | --- |
| Residential improved | 9,170 | 9,170 | 808 |
| Commercial improved | 9,917 | 9,917 | 1,020 |
| Manufacturing and industrial | 4,571 | 4,571 | 170 |
| | 28,872 | 28,872 | 3,778 |
| Consumer: | | | |
| Residential mortgage | 15,174 | 15,054 | 1,894 |
| Unsecured | --- | --- | --- |
| Home equity | 785 | 785 | 44 |

| | | | |
|---|---|---|---|
| Other secured | --- | --- | --- |
| | 15,959 | 15,839 | 1,938 |
| | $ 56,657 | $ 56,537 | $ 10,421 |
| | | | |
| Total | $ 93,009 | $ 86,586 | $ 10,421 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2011 (dollars in thousands):

| | Unpaid Principal Balance | Recorded Investment | Allowance Allocated |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial and industrial | $ 3,485 | $ 3,485 | $ --- |
| Commercial real estate: | | | |
| Residential developed | 6,432 | 2,021 | --- |
| Unsecured to residential developers | --- | --- | --- |
| Vacant and unimproved | 5,226 | 4,265 | --- |
| Commercial development | --- | --- | --- |
| Residential improved | 1,943 | 1,858 | --- |
| Commercial improved | 5,428 | 5,162 | --- |
| Manufacturing and industrial | 3,997 | 3,997 | --- |
| | 23,026 | 17,303 | |
| Consumer: | | | |
| Residential mortgage | --- | --- | --- |
| Unsecured | --- | --- | --- |
| Home equity | 200 | 200 | --- |
| Other secured | --- | --- | --- |
| | 200 | 200 | --- |
| | $ 26,711 | $ 20,988 | $ --- |
| | | | |
| With an allowance recorded: | | | |
| Commercial and industrial | $ 17,052 | $ 13,846 | $ 3,478 |
| Commercial real estate: | | | |
| Residential developed | 4,941 | 4,941 | 1,960 |
| Unsecured to residential developers | --- | --- | --- |
| Vacant and unimproved | 3,378 | 2,462 | 154 |
| Commercial development | 220 | 220 | 17 |
| Residential improved | 12,312 | 11,809 | 1,176 |
| Commercial improved | 10,590 | 10,555 | 844 |
| Manufacturing and industrial | 4,905 | 4,905 | 216 |
| | 36,346 | 34,892 | 4,367 |
| Consumer: | | | |
| Residential mortgage | 14,235 | 14,114 | 1,713 |
| Unsecured | --- | --- | --- |
| Home equity | 771 | 771 | 39 |
| Other secured | --- | --- | --- |
| | 15,006 | 14,885 | 1,752 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | $ | 68,404 | $ | 63,623 | $ | 9,597 |
| | | | | | | |
| Total | $ | 95,115 | $ | 84,611 | $ | 9,597 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents information regarding average balances of impaired loans and interest recognized on impaired loans for the three month periods ended March 31, 2012 and 2011 (dollars in thousands):

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Average of impaired loans during the period: | | |
| Commercial and industrial | $ 18,960 | $ 4,725 |
| | | |
| Commercial real estate: | | |
| Residential developed | 9,468 | 16,141 |
| Unsecured to residential developers | --- | 915 |
| Vacant and unimproved | 3,483 | 4,948 |
| Commercial development | 219 | 825 |
| Residential improved | 14,545 | 8,695 |
| Commercial improved | 16,100 | 21,909 |
| Manufacturing and industrial | 9,468 | 8,349 |
| | | |
| Consumer | 15,924 | 12,755 |
| | | |
| Interest income recognized during impairment: | | |
| Commercial and industrial | 340 | (14) |
| Commercial real estate | 654 | 523 |
| Consumer | 140 | 110 |
| | | |
| Cash-basis interest income recognized | | |
| Commercial and industrial | 319 | 52 |
| Commercial real estate | 619 | 509 |
| Consumer | 138 | 110 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of March 31, 2012:

| | Nonaccrual | Over 90 days Accruing |
|---|---|---|
| Commercial and industrial | $ 9,187 | $ --- |
| Commercial real estate: | | |
| Residential developed | 5,882 | --- |
| Unsecured to residential developers | --- | --- |
| Vacant and unimproved | 155 | --- |
| Commercial development | 426 | --- |
| Residential improved | 2,492 | --- |
| Commercial improved | 3,115 | 26 |
| Manufacturing and industrial | 261 | --- |
| | 12,331 | 26 |
| Consumer: | | |
| Residential mortgage | 1,504 | --- |
| Unsecured | 22 | --- |
| Home equity | 424 | --- |
| Other secured | --- | --- |
| | 1,950 | --- |
| | | |
| Total | $ 23,468 | $ 26 |

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2011:

| | Nonaccrual | Over 90 days Accruing |
|---|---|---|
| Commercial and industrial | $ 9,270 | $ 290 |
| Commercial real estate: | | |
| Residential developed | 3,577 | 126 |
| Unsecured to residential developers | --- | --- |
| Vacant and unimproved | 3,715 | --- |
| Commercial development | 49 | --- |

| | | | | |
|---|---|---|---|---|
| Residential improved | | 5,144 | | 286 |
| Commercial improved | | 2,654 | | 1,255 |
| Manufacturing and industrial | | 134 | | --- |
| | | 15,273 | | 1,667 |
| Consumer: | | | | |
| Residential mortgage | | 1,777 | | 111 |
| Unsecured | | 22 | | --- |
| Home equity | | 534 | | --- |
| Other secured | | --- | | 2 |
| | | 2,333 | | 113 |
| | | | | |
| Total | $ | 26,876 | $ | 2,070 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of March 31, 2012 by class of loans (dollars in thousands):

| | 30-90 Days | Greater Than 90 Days | Total Past Due | Loans Not Past Due | Total |
|---|---|---|---|---|---|
| Commercial and industrial | $ 770 | $ 490 | $ 1,260 | $ 227,511 | $ 228,771 |
| | | | | | |
| Commercial real estate: | | | | | |
| Residential developed | 435 | --- | 435 | 31,118 | 31,553 |
| Unsecured to residential developers | 340 | --- | 340 | 5,655 | 5,995 |
| Vacant and unimproved | 27 | 81 | 108 | 58,340 | 58,448 |
| Commercial development | --- | 425 | 425 | 4,814 | 5,239 |
| Residential improved | 682 | 1,229 | 1,911 | 79,659 | 81,570 |
| Commercial improved | 1,108 | 1,181 | 2,289 | 288,725 | 291,014 |
| Manufacturing and industrial | --- | 32 | 32 | 70,524 | 70,556 |
| | 2,592 | 2,948 | 5,540 | 538,835 | 544,375 |
| Consumer: | | | | | |
| Residential mortgage | 74 | 1,206 | 1,280 | 168,211 | 169,491 |
| Unsecured | 6 | --- | 6 | 1,802 | 1,808 |
| Home equity | 411 | 389 | 800 | 99,692 | 100,492 |
| Other secured | 4 | --- | 4 | 14,994 | 14,998 |
| | 495 | 1,595 | 2,090 | 284,699 | 286,789 |
| Total | $ 3,857 | $ 5,033 | $ 8,890 | $ 1,051,045 | $ 1,059,935 |

The following table presents the aging of the recorded investment in past due loans as of December 31, 2011 by class of loans (dollars in thousands):

| | 30-90 Days | Greater Than 90 Days | Total Past Due | Loans Not Past Due | Total |
|---|---|---|---|---|---|
| Commercial and industrial | $ 218 | $ 1,230 | $ 1,448 | $ 225,603 | $ 227,051 |
| | | | | | |
| Commercial real estate: | | | | | |
| Residential developed | 472 | 613 | 1,085 | 32,744 | 33,829 |
| Unsecured to residential developers | --- | --- | --- | 5,937 | 5,937 |
| Vacant and unimproved | 442 | 388 | 830 | 65,216 | 66,046 |
| Commercial development | --- | 49 | 49 | 4,537 | 4,586 |
| Residential improved | 549 | 1,343 | 1,892 | 80,445 | 82,337 |
| Commercial improved | 1,355 | 3,266 | 4,621 | 299,449 | 304,070 |

| | | | | | |
|---|---|---|---|---|---|
| Manufacturing and industrial | --- | 134 | 134 | 71,328 | 71,462 |
| | 2,818 | 5,793 | 8,611 | 559,656 | 568,267 |
| Consumer: | | | | | |
| Residential mortgage | 313 | 1,517 | 1,830 | 155,061 | 156,891 |
| Unsecured | 35 | --- | 35 | 1,917 | 1,952 |
| Home equity | 663 | 498 | 1,161 | 99,913 | 101,074 |
| Other secured | 51 | 2 | 53 | 15,687 | 15,740 |
| | 1,062 | 2,017 | 3,079 | 272,578 | 275,657 |
| Total | $ 4,098 | $ 9,040 | $ 13,138 | $ 1,057,837 | $ 1,070,975 |

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The Company had allocated $9,072,000 and $6,905,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings (“TDRs”) as of March 31, 2012 and December 31, 2011, respectively. These loans involved the restructuring of terms to allow customers to mitigate the risk of foreclosure by meeting a lower loan payment requirement based upon their current cash flow. These may also include loans that renewed at existing contractual rates, but below market rates for comparable credit. The Company has been active at utilizing these programs and working with its customers to reduce the risk of foreclosure. For commercial loans, these modifications typically include an interest only period and, in some cases, a lowering of the interest rate on the loan. In some cases, the modification will include separating the note into two notes with the first note structured to be supported by current cash flows and collateral, and the second note made for the remaining unsecured debt. The second note is charged off immediately and collected only after the first note is paid in full. This modification type is commonly referred to as an A-B note structure. For consumer mortgage loans, the restructuring typically includes a lowering of the interest rate to provide payment and cash flow relief. For each restructuring, a comprehensive credit underwriting analysis of the borrower’s financial condition and prospects of repayment under the revised terms is performed to assess whether the structure can be successful and that cash flows will be sufficient to support the restructured debt. An analysis is also performed to determine whether the restructured loan should be on accrual status. Generally if the loan is on accrual at the time of restructure, it will remain on accrual after the restructuring. In some cases, a nonaccrual loan may be placed on accrual at restructuring if the loan’s actual payment history demonstrates it would have cash flowed under the restructured terms. After six consecutive payments under the restructured terms, a nonaccrual restructured loan is reviewed for possible upgrade to accruing status.

Typically, once a loan is identified as a TDR, it will retain that designation until it is paid off, since the restructured loans generally are not at market rates at the time of restructuring. An exception to this would be a loan that is modified under an A-B note structure. If the remaining “A” note is at a market rate at the time of restructuring (taking into account the borrower’s credit risk and prevailing market conditions), the loan can be removed from TDR designation in a subsequent calendar year after six months of performance in accordance with the new terms. The market rate relative to the borrower’s credit risk is determined through analysis of market pricing information gathered from peers and use of a loan pricing model. The general objective of the model is to achieve a consistent return on equity from one credit to the next, taking into consideration their differences in credit risk. In the model, credits with higher risk receive a higher potential loss allocation, and therefore require a higher interest rate to achieve the target return on equity. In general, when a loan is removed from TDR status it would no longer be considered impaired. As a result, allowance allocations for loans removed from TDR status would be based on the historical based allocation for the applicable loan grade and loan class. During the three months ended March 31, 2012 and throughout 2011, no loans were removed from TDR status. Given the nature of the TDRs outstanding at March 31, 2012, it is unlikely that any such loans will be removed from TDR status in 2012.

As with other impaired loans, an allowance for loan loss is estimated for each TDR based on the most likely source of repayment for each loan. For impaired commercial real estate loans that are collateral dependent, the allowance is computed based on the fair value of the underlying collateral. For impaired commercial loans where repayment is expected from cash flows from business operations, the allowance is computed based on a discounted cash flow computation. Certain groups of TDRs, such as residential mortgages, have common characteristics and for them the allowance is computed based on a discounted cash flow computation on the change in weighted rate for the pool. The allowance allocations for commercial TDRs where we have reduced the contractual interest rate are computed by measuring cash flows using the new payment terms discounted at the original contractual rate.

The following table presents information regarding troubled debt restructurings as of March 31, 2012 and December 31, 2011 (dollars in thousands):

| | March 31, 2012 | December 31, 2011 |
| --- | --- | --- |