

MACATAWA BANK CORP
Form 10-Q
October 27, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from _____ to _____

Commission file number: 000-25927

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

Michigan
(State or other jurisdiction of
incorporation or organization)

38-3391345
(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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
27,082,823 shares of the Company's Common Stock (no par value) were outstanding as of October 27, 2011.

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 "probably" 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, real estate valuation, future levels 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, 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 liquidity, respond to declines in collateral values and credit quality, increase loan volume, 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, 2010. 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 September 30, 2011 (unaudited) and December 31, 2010

(dollars in thousands)	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	\$ 22,878	\$ 21,274
Federal funds sold and other short -term investments	230,681	214,853
Cash and cash equivalents	253,559	236,127
Securities available for sale, at fair value	41,987	9,120
Securities held to maturity (fair value 2010 - \$83)	---	83
Federal Home Loan Bank stock	11,236	11,932
Loans held for sale, at fair value	5,356	2,537
Total loans	1,082,512	1,217,196
Allowance for loan losses	(34,842)	(47,426)
Net loans	1,047,670	1,169,770
Premises and equipment – net	55,597	56,988
Accrued interest receivable	3,585	3,845
Bank-owned life insurance	25,725	25,014
Other real estate owned	66,484	57,984
Other assets	4,902	4,861
Total assets	\$ 1,516,101	\$ 1,578,261
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 319,491	\$ 255,897
Interest-bearing	881,067	1,020,723
Total deposits	1,200,558	1,276,620
Other borrowed funds	173,603	185,336
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	5,723	5,575
Total liabilities	1,422,772	1,510,419
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

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Common stock, no par value, 200,000,000 shares authorized; 27,082,823 and 17,679,621 shares issued and outstanding at September 30, 2011 and December 31, 2010	187,739	167,321
Retained deficit	(127,911)	(132,654)
Accumulated other comprehensive income	337	11
Total shareholders' equity	93,329	67,842
Total liabilities and shareholders' equity	\$ 1,516,101	\$ 1,578,261

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three and Nine Month Periods Ended September 30, 2011 and 2010
(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
(dollars in thousands, except per share data)				
Interest income				
Loans, including fees	\$ 14,498	\$ 18,227	\$ 45,274	\$ 56,674
Securities	166	21	278	1,794
FHLB Stock	73	46	223	168
Federal funds sold and other short-term investments	163	150	468	283
Total interest income	14,900	18,444	46,243	58,919
Interest expense				
Deposits	2,104	4,024	7,431	14,123
Debt and other borrowed funds	1,295	1,983	3,931	6,513
Total interest expense	3,399	6,007	11,362	20,636
Net interest income	11,501	12,437	34,881	38,283
Provision for loan losses	(1,250)	550	(4,700)	22,060
Net interest income after provision for loan losses	12,751	11,887	39,581	16,223
Noninterest income				
Service charges and fees	889	1,097	2,806	3,225
Net gains on mortgage loans	697	345	1,393	925
Trust fees	644	695	1,915	2,382
Gain on sale of securities	---	---	---	2,715
ATM and debit card fees	1,013	962	2,958	2,762
Other	684	627	2,149	1,507
Total noninterest income	3,927	3,726	11,221	13,516
Noninterest expense				
Salaries and benefits	5,668	5,546	16,615	16,550
Occupancy of premises	961	1,026	2,961	3,067
Furniture and equipment	812	854	2,458	2,723
Legal and professional	187	343	779	1,503
Marketing and promotion	228	214	677	643
Data processing	314	272	952	946
FDIC assessment	842	1,232	2,660	3,682
ATM and debit card processing	337	275	918	850
Bond and D&O Insurance	379	556	1,136	1,658
Losses on repossessed and foreclosed properties	2,544	1,418	7,157	5,933

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Administration of problem assets	1,941	1,802	5,503	5,286
Other	1,413	1,372	4,243	4,284
Total noninterest expenses	15,626	14,910	46,059	47,125
Income (loss) before income tax	1,052	703	4,743	(17,386)
Income tax expense (benefit)	---	---	---	1,303
Net income (loss)	1,052	703	4,743	(18,689)
Dividends declared on preferred shares	---	---	---	---
Net income (loss) available to common shares	\$ 1,052	\$ 703	\$ 4,743	\$ (18,689)
Basic earnings (loss) per common share	\$ 0.04	\$ 0.04	\$ 0.22	\$ (1.06)
Diluted earnings (loss) per common share	\$ 0.04	\$ 0.04	\$ 0.22	\$ (1.06)
Cash dividends per common share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 Three and Nine Month Periods Ended September 30, 2011 and 2010
 (unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
(dollars in thousands)				
Net income (loss)	\$ 1,052	\$ 703	\$ 4,743	\$ (18,689)
Other comprehensive income (loss), net of tax:				
Net change in unrealized gains on securities available for sale	174	4	326	(651)
Less: reclassification adjustment for gain recognized in earnings, net of tax	---	---	---	1,765
Other comprehensive income (loss), net of tax	174	4	326	(2,416)
Comprehensive income (loss)	\$ 1,226	\$ 707	\$ 5,069	\$ (21,105)

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Nine Month Periods Ended September 30, 2011 and 2010
(unaudited)

(dollars in thousands, except per share data)	Preferred Stock		Common	Retained	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Series A	Series B	Stock	(Deficit)		
Balance, January 1, 2010	\$30,604	\$2,560	\$167,183	\$(114,800)	\$ 2,444	\$ 87,991
Net loss for nine months ended September 30, 2010				(18,689)		(18,689)
Net change in unrealized gain (loss) on securities available for sale, net of tax					(2,416)	(2,416)
Stock compensation expense			106			106
Balance, September 30, 2010	\$30,604	\$2,560	\$167,289	\$(133,489)	\$ 28	\$ 66,992
Balance, January 1, 2011	\$30,604	\$2,560	\$167,321	\$(132,654)	\$ 11	\$ 67,842
Net income for nine months ended September 30, 2011				4,743		4,743
Net change in unrealized gain (loss) on securities available for sale, net of tax					326	326
Net proceeds from sale of 8,912,372 shares of common stock on June 7, 2011 and June 29, 2011			19,358			19,358
Conversion of subordinated note to 491,830 shares of common stock on June 29, 2011			1,003			1,003
Stock compensation expense			57			57
Balance, September 30, 2011	\$30,604	\$2,560	\$187,739	\$(127,911)	\$ 337	\$ 93,329

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Nine Month Periods Ended September 30, 2011 and 2010
(unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities		
Net income (loss)	\$ 4,743	\$(18,689)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	2,308	2,201
Stock compensation expense	57	106
Provision for loan losses	(4,700)	22,060
Deferred tax asset valuation allowance	---	7,847
Origination of loans for sale	(59,273)	(56,066)
Proceeds from sales of loans originated for sale	57,847	49,884
Net gains on mortgage loans	(1,393)	(925)
Gain on sales of securities	---	(2,715)
Write-down of other real estate	8,336	5,729
Net (gain) loss on sales of other real estate	(1,191)	167
Decrease (increase) in accrued interest receivable and other assets	(151)	13,395
Earnings in bank-owned life insurance	(711)	(453)
Increase in accrued expenses and other liabilities	151	572
Net cash from operating activities	6,023	23,113
Cash flows from investing activities		
Loan originations and payments, net	94,785	173,481
Purchases of securities available for sale	(53,972)	(18,973)
Proceeds from:		
Maturities and calls of securities available for sale	21,494	21,625
Maturities and calls of securities held to maturity	---	277
Sales of securities available for sale	---	105,553
Principal paydowns on securities	107	86
Sales of other real estate	16,370	13,527
Redemption of FHLB stock	696	---
Additions to premises and equipment	(634)	(486)
Net cash from investing activities	78,846	295,090
Cash flows from financing activities		
Net increase (decrease) in in-market deposits	(31,546)	3,064
Net decrease in brokered deposits	(44,516)	(139,691)
Proceeds from other borrowed funds	10,000	90,000
Repayments of other borrowed funds	(21,733)	(151,687)
Proceeds from issuance of subordinated note	1,000	---

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Proceeds from sale of common stock, net	19,358	---
Net cash from financing activities	(67,437)	(198,314)
Net change in cash and cash equivalents	17,432	119,889
Cash and cash equivalents at beginning of period	236,127	78,749
Cash and cash equivalents at end of period	\$ 253,559	\$198,638
Supplemental cash flow information		
Interest paid	\$ 10,589	\$20,239
Supplemental noncash disclosures:		
Transfers from loans to other real estate	32,015	34,546
Transfers from fixed assets to other real estate	---	1,676

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 nine month periods ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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, 2010.

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 September 30, 2011, 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.

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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 September 30, 2011, 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: In July 2010, FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The ASU amends FASB Accounting Standards Codification™ Topic 310, Receivables, to improve the disclosures that an entity provides

about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. Disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010 and are included in Note 3. Disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010 and are also included in Note 3.

In January 2010, the FASB issued ASU 2010-06, Improving Disclosure about Fair Value Measurements. This standard requires new disclosures on the amount and reason for transfers in and out of Level 1 and Level 2 recurring fair value measurements. The standard also requires disclosure of activities (i.e., on a gross basis), including purchases, sales, issuances, and settlements, in the reconciliation of Level 3 fair value recurring measurements. The standard clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. The new disclosures regarding Level 1 and Level 2 fair value measurements and clarification of existing disclosures were effective for periods beginning after December 15, 2009. The disclosures about the reconciliation of information in Level 3 recurring fair value measurements were required for periods beginning after December 15, 2010. Adoption of this standard did not have a significant impact on our disclosures.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In April 2011, the FASB issued ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This ASU provides guidance for companies when determining whether a loan modification is a troubled debt restructuring. The ASU also provides additional disclosure requirements. It is effective for public companies for interim and annual periods beginning on or after June 15, 2011. The guidance is to be applied retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. As a result of adopting the amendments in ASU 2011-02, the Company reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) to determine whether they are now considered troubled debt restructurings (TDRs). The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company identified them as impaired under the applicable accounting guidance. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance for those loans newly identified as impaired. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in loans for which the allowance was previously measured under a general allowance methodology and are now impaired was \$15.8 million, and the allowance for loan losses associated with those loans, on the basis of a current evaluation of loss was \$1.6 million. Adoption of this guidance did not materially affect the amount of allowance allocated to these loans.

Newly Issued Not Yet Effective 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 is not expected to have any effect as the Company does not currently hold any such repurchase agreements.

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. The impact of adoption of this ASU is not expected to be material.

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 anticipate early adopting this standard with our 2011 annual financial statements by adding a statement of comprehensive income.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Regulatory Developments:

Consent Order with Macatawa Bank and its Regulators

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 (our "2010 Form 10-K"), on February 22, 2010, Macatawa Bank entered into a Consent Order (the "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 imposes no fines or penalties on the Bank. The Consent Order will remain in effect and enforceable until it is modified, terminated, suspended, or set aside by the FDIC and the OFIR.

The Consent Order covers various aspects of the Bank's financial condition and performance; loan administration; and capital planning. The requirements of the Consent Order are summarized in Part I, Item 1 of our 2010 Form 10-K under the heading "Regulatory Developments", which summary is here incorporated by reference.

The Consent Order requires the Bank to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. At June 30, 2011, these levels were exceeded through the Bank's continued efforts to improve profitability and reduce risk weighted assets and the Company's successful capital raise that closed in June 2011. At September 30, 2011, the Bank's Tier 1 Leverage Capital Ratio was 8.2% and the Total Risk Based Capital Ratio was 12.2%, which would ordinarily categorize the Bank as "well capitalized" under applicable regulatory standards absent the Consent Order. However, as long as the Bank remains under the Consent Order, the highest it can be categorized is "adequately capitalized", regardless of actual capital levels. At September 30, 2011, the Bank was categorized as "adequately capitalized".

We believe that, as of September 30, 2011, the Bank was in compliance in all material respects with all of the provisions of the Consent Order.

Written Agreement with Macatawa Bank Corporation and its Regulator

As discussed in our 2010 Form 10-K, the Company formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB") effective 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 to the FRB an acceptable written plan to maintain sufficient capital on a consolidated basis; (viii) the Company must submit to the FRB a written statement of the Company's planned sources and uses of cash for debt service, operating expenses, and other purposes for 2010 and subsequent years; and (ix) 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 requested and received approval from the FRB to make its first, second and third quarter 2011 interest payments on its \$1.65 million in outstanding subordinated debt. Each quarter, the Company intends to request approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the amounts due.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Since the effective date of the Written Agreement, we have submitted our capital plan, cash flow projections and other reports in accordance with the timelines specified in the Written Agreement or agreed upon extensions. In addition, our senior management has met with and spoken to FRB representatives several times since the Written Agreement became effective. On November 15, 2010, we submitted a plan to maintain sufficient capital and have had several conversations with the FRB regarding the plan since that time. At the FRB's request, we submitted an updated draft of the capital plan on March 31, 2011, with the final plan submitted on April 30, 2011. On February 11, 2011, we submitted to the FRB a written statement of the Company's planned sources and uses of cash for 2011. At the FRB's request, we submitted a plan for how the Company will meet its cash flow obligations for 2011 on March 31, 2011.

We believe that, as of September 30, 2011, the Company was in compliance in all material respects with all of the provisions of the Written Agreement.

Deposit Gathering Activities

Because the Bank is subject to the Consent Order and cannot be categorized as "well-capitalized," regardless of actual capital levels, it is subject to the following restrictions regarding its deposit gathering activities:

Effective January 1, 2010, the interest rate paid for deposits by institutions that are categorized as less than "well capitalized" is limited to 75 basis points above the national rate for similar products unless the institution can support to the FDIC that prevailing rates in its market area exceed the national average. During the first quarter of 2010, the Company received notification from the FDIC that the prevailing rates in our market area exceeded the national average. Accordingly, the interest rates paid for deposits by the Bank are limited to 75 basis points above the average rate for similar products within our market area. Although this may impact our ability to compete for more rate sensitive deposits, we have reduced, and expect to continue to reduce our need to utilize rate sensitive deposits.

The Bank cannot accept, renew or rollover any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC. The Bank has not accepted or renewed brokered deposits since November of 2008. At September 30, 2011, there were \$3.7 million in brokered deposits and all of these deposits will mature in the fourth quarter of 2011. The Bank expects it will be able to fund the remaining maturing brokered deposits under its current liquidity contingency program.

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MACATAWA BANK CORPORATION
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 (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
September 30, 2011				
Available for Sale:				
U.S. Treasury and federal agency securities	\$27,234	\$255	\$(5)	\$27,484
State and municipal bonds	12,689	255	(24)	12,920
Corporate bonds	545	---	(10)	535
Other equity securities	1,000	48	---	1,048
	\$41,468	\$558	\$(39)	\$41,987
December 31, 2010				
Available for Sale:				
U.S. Treasury and federal agency securities	\$8,103	\$6	\$---	\$8,109
Other equity securities	1,000	11	---	1,011
	\$9,103	\$17	\$---	\$9,120
Held to Maturity:				
State and municipal bonds	\$83	\$---	\$---	\$83
	\$83	\$---	\$---	\$83

There were no sales of securities in the three and nine month periods ended September 30, 2011 or in the three month period ended September 30, 2010. During the nine month period ended September 30, 2010, we completed the disposition of nearly all of the municipal, corporate and U.S. agency securities then in our available-for-sale investment portfolio through sales in the open market. Proceeds from these sales totaled \$105.6 million and resulted in a net gain of \$2.7 million.

Contractual maturities of debt securities at September 30, 2011 were as follows (dollars in thousands):

	Available-for-Sale Securities	
	Amortized Cost	Fair Value
Due in one year or less	\$ ---	\$ ---
Due from one to five years	14,261	14,493
Due from five to ten years	23,957	24,145
Due after ten years	2,250	2,301
	\$ 40,468	\$ 40,939

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES (Continued)

Securities with unrealized losses at September 30, 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):

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S federal agency securities	\$5,010	\$(5)	\$---	\$---	\$5,010	\$(5)
State and municipal bonds	2,817	(24)	---	---	2,817	(24)
Corporate bonds	535	(10)	---	---	535	(10)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	\$8,362	\$(39)	\$---	\$---	\$8,362	\$(39)

There were no securities with unrealized losses at December 31, 2010.

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 nine month periods ended September 30, 2011 and 2010.

At September 30, 2011 and December 31, 2010, securities with a carrying value of approximately \$2.0 million and \$2.3 million respectively, were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law.

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	September 30, 2011	December 31, 2010
Commercial and industrial	\$221,619	\$264,679
Commercial real estate:		
Residential developed	40,073	46,835
Unsecured to residential developers	2,588	7,631
Vacant and unimproved	70,075	71,528
Commercial development	5,326	8,952
Residential improved	84,331	96,784
Commercial improved	318,333	355,899
Manufacturing and industrial	77,226	81,560
Total commercial real estate	597,952	669,189
Consumer		
Residential mortgage	134,320	135,227
Unsecured	1,918	2,867
Home equity	110,263	125,866
Other secured	16,440	19,368
Total consumer	262,941	283,328
Total loans	1,082,512	1,217,196
Allowance for loan losses	(34,842)	(47,426)
	\$1,047,670	\$1,169,770

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

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Three months ended September 30, 2011:					
Beginning balance	\$5,491	\$26,815	\$5,115	\$56	\$37,477
Charge-offs	(997)	(2,190)	(506)	---	(3,693)
Recoveries	87	2,113	108	---	2,308
Provision for loan losses	463	(980)	(708)	(25)	(1,250)
Ending Balance	\$5,044	\$25,758	\$4,009	\$31	\$34,842

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Three months ended September 30, 2010:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	\$6,121	\$47,103	\$3,030	\$32	\$56,286
Charge-offs	(1,578)	(2,729)	(806)	---	(5,113)
Recoveries	146	225	98	---	469
Provision for loan losses	2,164	(4,816)	3,208	(6)	550
Ending Balance	\$6,853	\$39,783	\$5,530	\$26	\$52,192

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 3 – LOANS (Continued)

Nine months ended September 30, 2011:	Commercial and		Commercial Real Estate	Consumer	Unallocated	Total
	Industrial					
Beginning balance	\$ 7,012		\$ 34,973	\$ 5,415	\$ 26	\$ 47,426
Charge-offs	(2,583)	(7,716)		(1,956)	---	(12,255)
Recoveries	1,364		2,750	257	---	4,371
Provision for loan losses	(749)	(4,249)		293	5	(4,700)
Ending Balance	\$ 5,044		\$ 25,758	\$ 4,009	\$ 31	\$ 34,842

Nine months ended September 30, 2010:	Commercial and		Commercial Real Estate	Consumer	Unallocated	Total
	Industrial					
Beginning balance	\$ 6,086		\$ 45,759	\$ 2,767	\$ 11	\$ 54,623
Charge-offs	(6,213)	(17,770)		(2,217)	---	(26,200)
Recoveries	554		961	194	---	1,709
Provision for loan losses	6,426		10,833	4,786	15	22,060
Ending Balance	\$ 6,853		\$ 39,783	\$ 5,530	\$ 26	\$ 52,192

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):

September 30, 2011:

Allowance for loan losses:	Commercial and		Commercial Real Estate	Consumer	Unallocated	Total
	Industrial					
Ending allowance attributable to loans:						
Individually reviewed for impairment	\$ 1,768		\$ 6,593	\$ 736	\$ ---	\$ 9,097
Collectively evaluated for impairment	3,276		19,165	3,273	31	25,745
Total ending allowance balance	\$ 5,044		\$ 25,758	\$ 4,009	\$ 31	\$ 34,842
Loans:						
Individually reviewed for impairment	\$ 14,318		\$ 55,978	\$ 14,664	\$ ---	\$ 84,960
Collectively evaluated for impairment	207,301		541,974	248,277	---	997,552
Total ending loans balance	\$ 221,619		\$ 597,952	\$ 262,941	\$ ---	\$ 1,082,512

December 31, 2010:

	Commercial and		Commercial Real Estate	Consumer	Unallocated	Total
	Industrial					

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Allowance for loan losses:

Ending allowance attributable to loans:

Individually reviewed for impairment	\$ 1,576	\$ 5,334	\$ 458	\$ ---	\$ 7,368
Collectively evaluated for impairment	5,436	29,639	4,957	26	40,058
Total ending allowance balance	\$ 7,012	\$ 34,973	\$ 5,415	\$ 26	\$ 47,426

Loans:

Individually reviewed for impairment	\$ 7,757	\$ 70,677	\$ 13,752	\$ ---	\$ 92,186
Collectively evaluated for impairment	256,922	598,512	269,576	---	1,125,010
Total ending loans balance	\$ 264,679	\$ 669,189	\$ 283,328	\$ ---	\$ 1,217,196

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 3 – LOANS (Continued)

Total impaired loans of \$85.0 million at September 30, 2011 included the additional \$15.8 million in troubled debt restructurings (“TDRs”) identified upon adoption of the new accounting standard ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. Since adoption of the new standard was appropriately applied only to restructurings occurring on or after January 1, 2011, the December 31, 2010 impaired loan total does not include TDRs identified under the new standard. Impaired loans were as follows (dollars in thousands):

	September 30, 2011	December 31, 2010
Impaired commercial loans with no allocated allowance for loan losses	\$21,338	\$48,519
Impaired loans with allocated allowance for loan losses:		
Impaired commercial loans	48,958	29,915
Consumer mortgage loans modified under a troubled debt restructuring	14,664	13,752
	63,622	43,667
Total impaired loans	\$84,960	\$92,186
Amount of the allowance for loan losses allocated	\$9,097	\$7,368

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Average of impaired loans during the period:		
Commercial and industrial	\$ 6,011	\$ 9,357
Commercial real estate:		
Residential developed	13,443	25,841
Unsecured to residential developers	727	2,015
Vacant and unimproved	5,700	4,445
Commercial development	463	2,530
Residential improved	9,576	14,203
Commercial improved	19,679	29,576
Manufacturing and industrial	7,464	7,159
Consumer	12,452	10,239

Interest income recognized during impairment:

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Commercial and industrial	157	201
Commercial real estate	1,505	635
Consumer	308	316
Cash-basis interest income recognized		
Commercial and industrial	220	549
Commercial real estate	1,467	926
Consumer	315	350

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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 September 30, 2011 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	\$2,588	\$2,588	\$---
Commercial real estate:			
Residential developed	11,378	5,198	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	5,908	4,609	---
Commercial development	---	---	---
Residential improved	1,568	1,568	---
Commercial improved	7,772	6,536	---
Manufacturing and industrial	839	839	---
	27,465	18,750	
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	\$30,053	\$21,338	\$---
With an allowance recorded:			
Commercial and industrial	\$11,731	\$11,731	\$1,768
Commercial real estate:			
Residential developed	6,364	6,364	2,435
Unsecured to residential developers	---	---	---
Vacant and unimproved	2,604	2,604	553
Commercial development	221	221	17
Residential improved	9,278	9,260	1,651
Commercial improved	12,205	12,205	1,652
Manufacturing and industrial	6,573	6,573	285
	37,245	37,227	6,593
Consumer:			
Residential mortgage	14,664	14,664	736
Unsecured	---	---	---
Home equity	---	---	---

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Other secured	---	---	---
	14,664	14,664	736
	\$63,640	\$63,622	\$9,097
Total	\$93,693	\$84,960	\$9,097

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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, 2010 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	\$5,394	\$4,286	\$---
Commercial real estate:			
Residential developed	28,289	8,205	---
Unsecured to residential developers	315	315	---
Vacant and unimproved	6,219	5,693	---
Commercial development	3,176	1,055	---
Residential improved	4,396	4,378	---
Commercial improved	24,566	22,749	---
Manufacturing and industrial	2,239	1,838	---
	69,200	44,233	
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	\$74,594	\$48,519	\$---
With an allowance recorded:			
Commercial and industrial	\$3,517	\$3,470	\$1,576
Commercial real estate:			
Residential developed	6,373	6,373	2,402
Unsecured to residential developers	2,364	609	84
Vacant and unimproved	266	266	44
Commercial development	199	199	15
Residential improved	4,806	4,662	1,381
Commercial improved	6,710	6,172	1,096
Manufacturing and industrial	8,163	8,164	312
	28,881	26,445	5,334
Consumer:			
Residential mortgage	13,752	13,752	458
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	13,752	13,752	458

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	\$46,150	\$43,667	\$7,368
Total	\$120,744	\$92,186	\$7,368

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 (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 September 30, 2011:

	Nonaccrual	Over 90 days Accruing
Commercial and industrial	\$8,708	\$---
Commercial real estate:		
Residential developed	6,375	---
Unsecured to residential developers	---	---
Vacant and unimproved	5,133	170
Commercial development	426	60
Residential improved	4,902	---
Commercial improved	6,137	937
Manufacturing and industrial	134	---
	23,107	1,167
Consumer:		
Residential mortgage	1,042	331
Unsecured	23	---
Home equity	395	250
Other secured	---	3
	1,460	584
Total	\$33,275	\$1,751

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, 2010:

	Nonaccrual	Over 90 days Accruing
Commercial and industrial	\$11,583	\$---
Commercial real estate:		
Residential developed	10,848	---
Unsecured to residential developers	925	390
Vacant and unimproved	7,517	---
Commercial development	1,652	---

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Residential improved	9,858	---
Commercial improved	27,816	---
Manufacturing and industrial	1,570	197
	60,186	587
Consumer:		
Residential mortgage	1,830	---
Unsecured	25	---
Home equity	1,127	13
Other secured	10	---
	2,992	13
Total	\$74,761	\$600

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(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of September 30, 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	\$682	\$739	\$1,421	\$220,198	\$221,619
Commercial real estate:					
Residential developed	---	1,917	1,917	38,156	40,073
Unsecured to residential developers	---	---	---	2,588	2,588
Vacant and unimproved	788	3,524	4,312	65,763	70,075
Commercial development	---	426	426	4,900	5,326
Residential improved	811	865	1,676	82,655	84,331
Commercial improved	3,287	4,374	7,661	310,672	318,333
Manufacturing and industrial	---	134	134	77,092	77,226
	4,886	11,240	16,126	581,826	597,952
Consumer:					
Residential mortgage	316	996	1,312	133,008	134,320
Unsecured	54	---	54	1,864	1,918
Home equity	1,059	608	1,667	108,596	110,263
Other secured	116	3	119	16,321	16,440
	1,545	1,607	3,152	259,789	262,941
Total	\$7,113	\$13,586	\$20,699	\$1,061,813	\$1,082,512

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 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	\$825	\$5,389	\$6,214	\$258,465	\$264,679
Commercial real estate:					
Residential developed	438	4,568	5,006	41,829	46,835
Unsecured to residential developers	---	999	999	6,632	7,631
Vacant and unimproved	670	4,367	5,037	66,491	71,528
Commercial development	---	1,144	1,144	7,808	8,952
Residential improved	1,929	6,353	8,282	88,502	96,784
Commercial improved	901	21,440	22,341	333,558	355,899

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Manufacturing and industrial	1,084	613	1,697	79,863	81,560
	5,022	39,484	44,506	624,683	669,189
Consumer:					
Residential mortgage	1,293	1,489	2,782	132,445	135,227
Unsecured	45	---	45	2,822	2,867
Home equity	1,207	927	2,134	123,732	125,866
Other secured	57	10	67	19,301	19,368
	2,602	2,426	5,028	278,300	283,328
Total	\$8,449	\$47,299	\$55,748	\$1,161,448	\$1,217,196

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS (Continued)

The Company had allocated \$5,753,000 and \$1,361,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings (“TDRs”) as of September 30, 2011 and December 31, 2010, 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. 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.

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.

Total TDRs of \$62.0 million at September 30, 2011 included the additional \$15.8 million in TDRs identified upon adoption of the new accounting standard ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. Since adoption of the new standard was appropriately applied only to restructurings occurring on or after January 1, 2011, the December 31, 2010 TDR total does not include TDRs identified under the new standard.

The following table presents information regarding troubled debt restructurings as of September 30, 2011 and December 31, 2010 (dollars in thousands):

	September 30, 2011		December 31, 2010	
	Number of Loans	Outstanding Recorded Balance	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	37	\$ 8,173	6	\$ 743
Commercial real estate	93	39,177	24	11,548
Consumer	83	14,664	80	13,765
	213	\$ 62,014	110	\$ 26,056

The following table presents information regarding troubled debt restructurings executed during the three and nine month periods ended September 30, 2011 (dollars in thousands):

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	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Loans	Outstanding Recorded Balance	Principal Writedown upon Modification	Number of Loans	Outstanding Recorded Balance	Principal Writedown upon Modification
Commercial and industrial	12	\$3,876	\$ 51	32	\$6,124	\$ 51
Commercial real estate	23	8,065	144	37	23,459	697
Consumer	1	213	---	12	1,883	---

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MACATAWA BANK CORPORATION
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 (Unaudited)

NOTE 3 – LOANS (Continued)

The table below presents by class, information regarding troubled debt restructured loans which had payment defaults during the three and nine month periods ended September 30, 2011 (dollars in thousands). Included are loans that became delinquent more than 90 days past due or transferred to nonaccrual within 12 months of restructuring.

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Number of Loans	Outstanding Recorded Balance	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	1	\$ 66	4	\$ 830
Commercial real estate	9	1,925	9	1,925
Consumer	2	402	2	402

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

Credit Quality Indicators: The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes commercial loans individually and classifies these relationships by credit risk grading. The Company uses an eight point grading system, with grades 5 through 8 being considered classified, or watch, credits. All commercial loans are assigned a grade at origination, at each renewal or any amendment. When a credit is first downgraded to a watch credit (either through renewal, amendment, lender identification or the loan review process), an Administrative Loan Review (“ALR”) is generated by credit and the lender. All watch credits have an ALR completed monthly which analyzes the collateral position and cash flow of the borrower and its guarantors. The lender is required to complete both a short term and long term plan to rehabilitate or exit the credit and to provide monthly comments on the progress to these plans. Management meets quarterly with lenders to discuss each of these credits in detail and to help attempt to formulate solutions where progress has stalled. When necessary, the loan officer proposes changes to the assigned loan grade as part of the ALR. Additionally, Loan Review reviews all loan grades upon origination, renewal or amendment and again as loans are selected through the loan review process. The credit will stay on the ALR until either its grade has improved to a 4 or better or the credit relationship is at a zero balance. The Company uses the following definitions for the risk grades:

1. Excellent - Borrowings supported by extremely strong financial condition or secured by the Bank’s own deposits. Minimal risk to the Bank and the probability of serious rapid financial deterioration is extremely small.
2. Above Average - Borrowings supported by sound financial statements that indicate the ability to repay or borrowings secured (and margined properly) with marketable securities. Nominal risk to the Bank and probability of serious financial deterioration is highly unlikely. The overall quality of these credits is very high.
3. Good Quality - Average borrowings supported by satisfactory asset quality and liquidity, good debt capacity coverage, and good management in all critical positions. Loans are secured by acceptable collateral with adequate margins. There is a slight risk of deterioration if adverse market conditions prevail.
4. Acceptable Risk - This is an acceptable risk to the Bank, which may be slightly below average quality. The borrower has limited financial strength with considerable leverage. There is some probability of deterioration if adverse market conditions prevail. These credits should be monitored closely by the Relationship Manager.
5. Marginally Acceptable - Loans are of marginal quality with above normal risk to the Bank. The borrower shows acceptable asset quality but very little liquidity with high leverage. There is inconsistent earning performance without the ability to sustain adverse market conditions. The primary source of repayment is questionable, but the secondary source of repayment still remains an option. Very close attention by the Relationship Manager and management is needed.
6. Substandard - Loans are inadequately protected by the net worth and paying capacity of the borrower or the collateral pledged. The primary and secondary sources of repayment are questionable. Heavy debt condition may be evident and volume and earnings deterioration may be underway. It is possible that the Bank will sustain some loss if the deficiencies are not immediately addressed and corrected.

7. Doubtful - Borrowings supported by weak or no financial statements. The ability to repay the entire loan is questionable. Loans in this category are normally characterized with less than adequate collateral, insolvent, or extremely weak financial condition. A loan classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses makes collection or liquidation in full highly questionable. The possibility of loss is extremely high, however, activity may be underway to minimize the loss or maximize the recovery.

8. Loss - Loan are considered uncollectible and of little or no value as a bank asset.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

NOTE 3 – LOANS (Continued)

As of September 30, 2011, the risk grade category of commercial loans by class of loans was as follows (dollars in thousands):

	1	2	3	4	5	6	7	8
Commercial and industrial	\$ 600	\$ 1,335	\$ 44,442	\$ 136,976	\$ 21,721	\$ 7,851	\$ 8,694	\$ ---
Commercial real estate:								
Residential developed	---	---	283	10,429	15,549	7,437	6,375	---
Unsecured to residential developers	---	---	1,386	674	188	340	---	---
Vacant and unimproved	---	---	13,895	31,243	15,398	4,406	5,133	---
Commercial development	---	---	55	2,625	1,111	1,110	426	---
Residential improved	---	---	2,818	47,274	17,871	11,466	4,902	---
Commercial improved	---	---	65,385	184,163	38,461	24,186	6,137	---
Manufacturing and industrial	---	221	13,637	42,170	11,572	9,493	133	---
	\$ 600	\$ 1,556	\$ 141,901	\$ 455,554	\$ 121,871	\$ 66,289	\$ 31,800	\$ ---

As of December 31, 2010, the risk grade category of commercial loans by class of loans was as follows (dollars in thousands):

	1	2	3	4	5	6	7	8
Commercial and industrial	\$ 442	\$ 1,583	\$ 51,558	\$ 148,880	\$ 41,467	\$ 9,165	\$ 11,584	\$ ---
Commercial real estate:								
Residential developed	---	---	240	6,682	14,705	14,360	10,848	---
Unsecured to residential developers	---	---	4,784	907	500	515	925	---
Vacant and unimproved	---	794	5,450	38,808	14,978	3,982	7,516	---
Commercial development	---	---	---	4,240	2,765	295	1,652	---
Residential improved	---	---	3,321	49,905	18,715	14,985	9,858	---
Commercial improved	---	---	71,622	191,772	41,490	23,199	27,816	---
Manufacturing and industrial	---	246	14,299	37,487	22,261	5,697	1,570	---

\$ 442	\$ 2,623	\$ 151,274	\$ 478,681	\$ 156,881	\$ 72,198	\$ 71,769	\$ ---
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Commercial loans rated a 6 or worse per the Company's internal risk rating system are considered substandard, doubtful or loss. Commercial loans classified as substandard or worse were as follows at period-end (dollars in thousands):

	September 30, 2011	December 31, 2010
Not classified as impaired	\$39,815	\$65,533
Classified as impaired	58,274	78,434
Total commercial loans classified substandard or worse	\$98,089	\$143,967

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

At September 30, 2011, approximately \$31.8 million of the \$98.1 million of commercial loans classified as substandard or worse were on nonaccrual status, while the remaining \$66.3 million of these loans were on accrual status.

At December 31, 2010, approximately \$71.8 million of the \$144.0 million of commercial loans classified as substandard or worse were on nonaccrual status, while the remaining \$72.2 million of these loans were on accrual status.

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For consumer loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in consumer loans based on payment activity (dollars in thousands):

	Residential Mortgage	Consumer Unsecured	Home Equity	Consumer Other
September 30, 2011				
Performing	\$133,324	\$1,918	\$109,655	\$16,437
Nonperforming	996	---	608	3
Total	\$134,320	\$1,918	\$110,263	\$16,440
December 31, 2010				
Performing	\$133,738	\$2,867	\$124,939	\$19,358
Nonperforming	1,489	---	927	10
Total	\$135,227	\$2,867	\$125,866	\$19,368

NOTE 4 – OTHER REAL ESTATE OWNED

Period-end other real estate owned was as follows (dollars in thousands):

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010	Nine Months Ended September 30, 2010
Beginning balance	\$68,388	\$41,987	\$41,987
Additions, transfers from loans and fixed assets	32,015	45,248	36,221
Proceeds from sales of other real estate owned	(16,370)	(16,003)	(13,527)
Valuation allowance reversal upon sale	(2,031)	(2,677)	(2,163)

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Gain (loss) on sale of other real estate owned	1,191	(167)	(167)
	83,193	68,388	62,351
Less: valuation allowance	(16,709)	(10,404)	(8,369)