

CHEMICAL FINANCIAL CORP
Form 10-Q
November 04, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2011

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: 000-08185

CHEMICAL FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Michigan (State or Other Jurisdiction of Incorporation or Organization)	38-2022454 (I.R.S. Employer Identification No.)
235 E. Main Street Midland, Michigan (Address of Principal Executive Offices)	48640 (Zip Code)
(989) 839-5350 (Registrant's Telephone Number, Including Area Code)	

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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 the registrant's Common Stock, \$1 par value, as of October 28, 2011, was 27,456,907 shares.

Table of Contents

INDEX

Chemical Financial Corporation

Form 10-Q

Index to Form 10-Q

	Page
<u>Forward-Looking Statements</u>	3
<u>Part I. Financial Information</u>	4
<u>Item 1. Financial Statements (unaudited, except Consolidated Statement of Financial Position as of December 31, 2010)</u>	4
<u>Consolidated Statements of Financial Position as of September 30, 2011, December 31, 2010 and September 30, 2010</u>	4
<u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2011 and September 30, 2010</u>	5
<u>Consolidated Statements of Changes in Shareholders' Equity for the Nine Months Ended September 30, 2011 and September 30, 2010</u>	6
<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and September 30, 2010</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	40
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	63
<u>Item 4. Controls and Procedures</u>	63
<u>Part II. Other Information</u>	64
<u>Item 1A. Risk Factors</u>	64
<u>Item 6. Exhibits</u>	65
<u>Signatures</u>	66
<u>Exhibit Index</u>	67

Table of Contents

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 Chemical Financial Corporation (Chemical). Words such as anticipates, believes, estimates, expects, forecasts, intends, is likely, judgment, plans, predicts, projects, should, trend, will, and similar expressions are intended to identify such forward-looking statements. 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 real estate valuation, future levels of nonperforming assets, the rate of asset dispositions, future capital levels, future dividends, future growth and funding sources, future liquidity levels, future profitability levels, future deposit insurance premiums, the effects on earnings of future changes in interest rates, the future level of other revenue sources, future economic trends, future initiatives to expand Chemical's market share, future opportunities for acquisitions and future consolidation in the Michigan banking industry. All statements referencing future time periods are forward-looking. Management's determination of the provision and allowance for loan losses; the carrying value of acquired loans, goodwill and mortgage servicing rights; 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); and management's assumptions concerning pension and other postretirement benefit plans involve judgments that are inherently forward-looking. There can be no assurance that future loan losses will be limited to the amounts estimated. All of the information concerning interest rate sensitivity is forward-looking. The future effect of changes in the financial and credit markets and the national and regional economies on the banking industry, generally, and on Chemical, 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. Chemical undertakes no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise.

Risk factors include, but are not limited to, the risk factors described in Item 1A of Chemical's 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.

Table of Contents**Part I. Financial Information****Item 1. Financial Statements****Chemical Financial Corporation****Consolidated Statements of Financial Position**

	September 30, 2011 (Unaudited)	December 31, 2010	September 30, 2010 (Unaudited)
	(In thousands, except share data)		
Assets			
Cash and cash equivalents:			
Cash and cash due from banks	\$ 126,712	\$ 91,403	\$ 118,441
Interest-bearing deposits with unaffiliated banks and others	484,572	444,762	600,909
Total cash and cash equivalents	611,284	536,165	719,350
Investment securities:			
Trading securities at fair value			1,471
Available-for-sale at fair value	610,493	578,610	608,823
Held-to-maturity (fair value \$185,024 at September 30, 2011, \$159,188 at December 31, 2010 and \$152,212 at September 30, 2010)	186,432	165,400	155,475
Total investment securities	796,925	744,010	765,769
Other securities	25,572	27,133	26,189
Loans held for sale	15,212	20,479	19,547
Loans	3,760,426	3,681,662	3,640,871
Allowance for loan losses	(88,713)	(89,530)	(89,521)
Net loans	3,671,713	3,592,132	3,551,350
Premises and equipment (net of accumulated depreciation of \$86,563 at September 30, 2011, \$80,792 at December 31, 2010 and \$78,767 at September 30, 2010)	64,998	65,961	66,212
Goodwill	113,414	113,414	110,266
Other intangible assets	11,849	13,521	14,532
Interest receivable and other assets	128,637	133,394	127,093
Total Assets	\$ 5,439,604	\$ 5,246,209	\$ 5,400,308
Liabilities and Shareholders Equity			
Deposits:			
Noninterest-bearing	\$ 891,363	\$ 753,553	\$ 696,710
Interest-bearing	3,589,223	3,578,212	3,770,692
Total deposits	4,480,586	4,331,765	4,467,402
Interest payable and other liabilities	33,700	37,533	31,744
Short-term borrowings	302,298	242,703	254,799
Federal Home Loan Bank (FHLB) advances	45,991	74,130	85,390
Total liabilities	4,862,575	4,686,131	4,839,335
Shareholders equity:			
Preferred stock, no par value:			

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Authorized 200,000 shares, none issued

Common stock, \$1 par value per share:

Authorized 45,000,000 shares at September 30, 2011 and 30,000,000 at both

December 31, 2010 and September 30, 2010; issued and outstanding 27,456,907 shares

at September 30, 2011, 27,440,006 shares at December 31, 2010 and 27,440,006 shares

at September 30, 2010

	27,457	27,440	27,440
Additional paid-in capital	430,462	429,511	429,459
Retained earnings	132,611	117,238	115,187
Accumulated other comprehensive loss	(13,501)	(14,111)	(11,113)

Total shareholders equity	577,029	560,078	560,973
---------------------------	----------------	---------	---------

Total Liabilities and Shareholders Equity	\$ 5,439,604	\$ 5,246,209	\$ 5,400,308
--	---------------------	--------------	--------------

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents**Chemical Financial Corporation****Consolidated Statements of Income (Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Interest Income				
Interest and fees on loans	\$ 49,770	\$ 51,485	\$ 148,382	\$ 141,481
Interest on investment securities:				
Taxable	2,335	2,718	6,884	8,806
Tax-exempt	1,513	1,391	4,385	3,594
Dividends on other securities	114	81	605	458
Interest on deposits with unaffiliated banks and others	266	323	856	743
Total interest income	53,998	55,998	161,112	155,082
Interest Expense				
Interest on deposits	7,199	9,314	22,628	27,216
Interest on short-term borrowings	117	168	418	489
Interest on FHLB advances	413	623	1,298	2,205
Total interest expense	7,729	10,105	24,344	29,910
Net Interest Income	46,269	45,893	136,768	125,172
Provision for loan losses	6,400	8,600	20,900	35,300
Net interest income after provision for loan losses	39,869	37,293	115,868	89,872
Noninterest Income				
Service charges on deposit accounts	4,780	4,680	13,504	14,162
Wealth management revenue	2,638	2,521	8,430	7,416
Other charges and fees for customer services	2,581	2,555	7,967	6,896
Mortgage banking revenue	1,173	1,204	2,736	2,837
Investment securities gains		82		82
Other	53	77	262	166
Total noninterest income	11,225	11,119	32,899	31,559
Operating Expenses				
Salaries, wages and employee benefits	19,229	18,015	55,622	49,650
Occupancy	3,093	2,903	9,530	8,474
Equipment and software	3,162	3,698	8,994	10,110
Other	9,910	11,600	30,050	31,821
Total operating expenses	35,394	36,216	104,196	100,055
Income before income taxes	15,700	12,196	44,571	21,376
Federal income tax expense	4,075	3,325	12,725	5,825
Net Income	\$ 11,625	\$ 8,871	\$ 31,846	\$ 15,551

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Net Income Per Common Share:

Basic	\$ 0.42	\$ 0.32	\$ 1.16	\$ 0.60
Diluted	0.42	0.32	1.16	0.60
Cash Dividends Declared Per Common Share	0.20	0.20	0.60	0.60

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents**Chemical Financial Corporation****Consolidated Statements of Changes in Shareholders' Equity (Unaudited)**

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	(In thousands, except per share data)				
Balances at January 1, 2010	\$ 23,891	\$ 347,676	\$ 115,391	\$ (12,647)	\$ 474,311
Comprehensive income:					
Net income			15,551		
Other:					
Net unrealized gains on investment securities available-for-sale, net of tax expense of \$782				1,452	
Adjustment for pension and other postretirement benefits, net of tax expense of \$44				82	
Comprehensive income					17,085
Shares issued stock options	1	41			42
Shares and stock options issued in the acquisition of O.A.K. Financial Corporation	3,530	80,167			83,697
Cash dividends declared of \$0.60 per share			(15,755)		(15,755)
Shares issued directors stock plans	12	238			250
Share-based compensation	6	1,337			1,343
Balances at September 30, 2010	\$ 27,440	\$ 429,459	\$ 115,187	\$ (11,113)	\$ 560,973
Balances at January 1, 2011	\$ 27,440	\$ 429,511	\$ 117,238	\$ (14,111)	\$ 560,078
Comprehensive income:					
Net income			31,846		
Other:					
Net unrealized gains on investment securities available-for-sale, net of tax expense of \$139				259	
Adjustment for pension and other postretirement benefits, net of tax expense of \$189				351	
Comprehensive income					32,456
Cash dividends declared of \$0.60 per share			(16,473)		(16,473)
Shares issued directors stock plans	12	254			266
Share-based compensation	5	697			702
Balances at September 30, 2011	\$ 27,457	\$ 430,462	\$ 132,611	\$ (13,501)	\$ 577,029

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents**Chemical Financial Corporation****Consolidated Statements of Cash Flows (Unaudited)**

	Nine Months Ended September 30, 2011 2010 (In thousands)	
Cash Flows From Operating Activities:		
Net income	\$ 31,846	\$ 15,551
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	20,900	35,300
Gains on sales of loans	(3,373)	(3,867)
Proceeds from sales of loans	150,299	187,646
Loans originated for sale	(141,659)	(193,639)
Proceeds from sale of trading securities		1,083
Investment securities gains		(82)
Net gains on sales of other real estate and repossessed assets	(974)	(1,214)
Net losses on disposal of premises and equipment and branch bank property	225	865
Depreciation of premises and equipment	6,026	5,795
Amortization of intangible assets	2,700	2,376
Net amortization of premiums and discounts on investment securities	2,809	2,022
Share-based compensation expense	702	1,343
Net decrease in interest receivable and other assets	6,002	1,029
Net decrease in interest payable and other liabilities	(3,371)	(3,341)
Net cash provided by operating activities	72,132	50,867
Cash Flows From Investing Activities:		
Investment securities available-for-sale:		
Proceeds from maturities, calls and principal reductions	269,373	247,265
Purchases	(303,760)	(196,203)
Investment securities held-to-maturity:		
Proceeds from maturities, calls and principal reductions	43,854	35,014
Purchases	(64,793)	(59,255)
Other securities:		
Proceeds from redemption	1,561	1,259
Net increase in loans	(114,810)	(59,078)
Proceeds from sales of other real estate and repossessed assets	12,801	13,242
Purchases of premises and equipment and branch bank property, net	(5,288)	(5,978)
Cash acquired, net of cash paid, in business combination		17,177
Net cash used in investing activities	(161,062)	(6,557)
Cash Flows From Financing Activities:		
Net increase in noninterest-bearing and interest-bearing demand deposits and savings accounts	204,092	382,936
Net decrease in time deposits	(55,271)	(26,900)
Net increase in securities sold under agreements to repurchase	59,595	14,231
Repayment of FHLB advances	(28,139)	(40,473)
Cash dividends paid	(16,473)	(15,755)
Proceeds from directors stock plans and exercise of stock options	245	292
Net cash provided by financing activities	164,049	314,331

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Net increase in cash and cash equivalents	75,119	358,641
Cash and cash equivalents at beginning of period	536,165	360,709
Cash and Cash Equivalents at End of Period	\$ 611,284	\$ 719,350

Supplemental Disclosure of Cash Flow Information:

Interest paid	\$ 24,804	\$ 30,634
Federal income taxes paid	2,952	8,650
Loans transferred to other real estate and repossessed assets	14,329	15,252
Business combination:		
Fair value of tangible assets acquired (noncash)		752,554
Goodwill and identifiable intangible assets acquired		50,672
Liabilities assumed		736,706
Common stock issued		83,697
See accompanying notes to consolidated financial statements (unaudited).		

Table of Contents

Chemical Financial Corporation

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2011

Note 1: Significant Accounting Policies

Nature of Operations

Chemical Financial Corporation (Chemical or the Corporation) operates in a single operating segment – commercial banking. The Corporation is a financial holding company, headquartered in Midland, Michigan, that operates through one commercial bank, Chemical Bank. Chemical Bank operates within the State of Michigan as a state-chartered commercial bank. Chemical Bank operates through an internal organizational structure of four regional banking units and offers a full range of traditional banking and fiduciary products and services to the residents and business customers in the bank’s geographical market areas. The products and services offered by the regional banking units, through branch banking offices, are generally consistent throughout the Corporation, as is the pricing of those products and services. The marketing of products and services throughout the Corporation’s regional banking units is generally uniform, as many of the markets served by the regional banking units overlap. The distribution of products and services is uniform throughout the Corporation’s regional banking units and is achieved primarily through retail branch banking offices, automated teller machines and electronically accessed banking products.

Basis of Presentation

The accompanying unaudited consolidated financial statements of the Corporation and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Corporation’s consolidated financial statements and footnotes thereto included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments believed necessary to present fairly the financial condition and results of operations of the Corporation for the periods presented. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Use of Estimates

Management makes estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying footnotes. Estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses, expected cash flows from acquired loans, fair value amounts related to business combinations, pension expense, income taxes, goodwill impairment and those assets that require fair value measurement. Actual results could differ from these estimates.

Business Combinations

On April 30, 2010, the Corporation acquired 100% of O.A.K. Financial Corporation (OAK) for total consideration of \$83.7 million. Pursuant to the guidance of Accounting Standards Codification (ASC) Topic 805, Business Combinations (ASC 805) effective for all acquisitions with closing dates after January 1, 2009, the Corporation recognized the assets acquired and the liabilities assumed in the OAK acquisition at their fair values as of the acquisition date with the related acquisition and restructuring costs expensed in the period incurred. The Corporation recorded \$43.5 million of goodwill in conjunction with the acquisition, which represented the purchase price over the fair values of the identifiable net assets acquired. Additionally, the Corporation recorded \$9.8 million of other intangible assets as a result of the OAK acquisition attributable to core deposits, mortgage servicing rights and non-compete agreements acquired.

See Note 2 for further information regarding the OAK acquisition.

Table of Contents

Originated Loans

Originated loans include all of the Corporation's portfolio loans, excluding loans acquired in the OAK acquisition.

Originated loans are stated at their principal amount outstanding, net of unearned income, charge-offs and unamortized deferred fees and costs. Interest income on loans is reported based on the level-yield method and includes amortization of deferred loan fees and costs over the loan term. Net loan commitment fees for commitment periods greater than one year are deferred and amortized into fee income on a straight-line basis over the commitment period.

Loan interest income is recognized on the accrual basis. The past due status of a loan is based on the loan's contractual terms. A loan is placed in the nonaccrual category when principal or interest is past due 90 days or more (except for real estate residential loans that are transferred at 120 days past due), unless the loan is both well-secured and in the process of collection, or earlier when, in the opinion of management, there is sufficient reason to doubt the collectibility of principal or interest. Interest previously accrued, but not collected, is reversed and charged against interest income at the time the loan is placed in nonaccrual status. The subsequent recognition of interest income on a nonaccrual loan is then recognized only to the extent cash is received and where future collection of principal is probable. Loans are returned to accrual status when principal and interest payments are brought current, payments have been received consistently for a period of time (generally six months) and collectibility is no longer in doubt.

Loans Acquired in a Business Combination

Loans acquired in a business combination (acquired loans) consist of loans acquired in the acquisition of OAK. Acquired loans were recorded at fair value, without a carryover of OAK's associated allowance for loan losses related to these loans, through a fair value discount that was, in part, attributable to deterioration in credit quality. The fair value discount was recorded as a reduction of the acquired loans' outstanding principal balances in the consolidated statement of financial position at the acquisition date.

Those loans that qualify under ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (ASC 310-30), are recorded at fair value at acquisition. The calculation of the fair value of the acquired loans entailed estimating the amount and timing of both principal and interest cash flows expected to be collected on such loans and then discounting those cash flows at market interest rates. The excess of a loan's expected cash flows at the acquisition date over its estimated fair value is referred to as the accretable yield, which is recognized into interest income over the remaining life of the loan on a level-yield basis. The difference between a loan's contractually required principal and interest payments at the acquisition date and the cash flows expected to be collected at the acquisition date is referred to as the nonaccretable difference, which includes an estimate of future credit losses expected to be incurred over the life of the loan and interest payments that are not expected to be collected. The estimate of expected credit losses was determined based on due diligence performed by executive and senior officers of the Corporation, with assistance from third-party consultants. Decreases to the expected cash flows in subsequent periods will require the Corporation to record a provision for loan losses. Improvements in expected cash flows in subsequent periods will result in reversing a portion of the nonaccretable difference, which is then classified as part of the accretable yield and subsequently recognized into interest income over the remaining life of the loan.

The Corporation must make numerous assumptions, interpretations and judgments using internal and third-party credit quality information to determine whether it is probable that the Corporation will be able to collect all contractually required payments. This is a point in time assessment and inherently subjective due to the nature of the available information and judgment involved. Evidence of credit quality deterioration as of the purchase date may include credit metrics such as past due and nonaccrual status, deterioration in borrower credit scores and negative changes to loan-to-value percentages.

Acquired loans with an outstanding principal balance of \$105 million at the acquisition date were determined to be loans with deteriorated credit quality and, therefore, met the scope criteria set forth in ASC 310-30. Further, the Corporation understands, as outlined in the American Institute of Certified Public Accountants' open letter to the Office of the Chief Accountant of the Securities and Exchange Commission (SEC) dated December 18, 2009 and pending further standard setting, that for acquired loans that do not meet the scope criteria of ASC 310-30, a company may elect to account for such acquired loans pursuant to the provisions of either ASC 310-20, Nonrefundable Fees and Other Costs, or ASC 310-30. The Corporation elected to apply ASC 310-30 by analogy to acquired loans that were determined not to have deteriorated credit quality with an outstanding principal balance of \$578 million at the acquisition date and thus follows the accounting and disclosure guidance of ASC 310-30 for these loans. Accordingly, the Corporation applied ASC 310-30 to the entire loan portfolio acquired in the acquisition of OAK with an outstanding principal balance of \$683 million at the acquisition date. None of the acquired loans were classified as debt securities.

Table of Contents

ASC 310-30 allows investors to aggregate loans acquired into loan pools that have common risk characteristics and thereby use a composite interest rate and expectation of cash flows expected to be collected for the loan pools. Under the provisions of ASC 310-30, the Corporation aggregated acquired loans into 14 pools based upon common risk characteristics, including types of loans, commercial type loans with similar risk grades and whether loans were performing or nonperforming. A pool is considered a single unit of accounting for the purposes of applying the guidance as described above. A loan will be removed from a pool of acquired loans only if the loan is sold, foreclosed, paid off or written off, and will be removed from the pool at the carrying value. If an individual loan is removed from a pool of loans, the difference between its relative carrying amount and the cash, fair value of the collateral, or other assets received would not affect the effective yield used to recognize the accretable difference on the remaining pool. The Corporation estimated the cash flows expected to be collected over the life of the pools of loans at acquisition and estimates expected cash flows quarterly thereafter, based on a set of assumptions including expectations as to default rates, prepayment rates and loss severities. In the event that the updated expected cash flows increase in a pool from those originally projected at acquisition date, the Corporation will adjust the accretable yield amount with a resulting change in the amount recognized in interest income in subsequent periods. In the event that the updated expected cash flows in a pool decrease from those originally projected at the acquisition date, the Corporation will consider that loan pool impaired, which results in the Corporation recording a charge to the provision for loan losses.

Loans Modified Under Troubled Debt Restructurings

Loans modified under troubled debt restructurings (TDRs) involve granting a concession to a borrower who is experiencing financial difficulty. Concessions generally include modifications to original loan terms, including changes to a loan's payment schedule or interest rate, which generally would not otherwise be considered. The Corporation's loans reported as TDRs continue to accrue interest at the loan's effective interest rate as the Corporation expects to collect the full amount of principal and interest accrued at the loan's original contractual rate at the time of modification. TDRs are reported as nonperforming TDRs until a six-month payment history of principal and interest payments, in accordance with the loan modification, is sustained, at which time the Corporation moves them to a performing TDR status. All TDRs are accounted for as impaired loans and are considered accordingly as part of the analysis of the allowance for loan losses.

The Corporation's commercial and real estate commercial TDRs generally consist of allowing borrowers to defer scheduled principal payments and make interest only payments for a specified period of time at the stated interest rate of the original loan agreement or lower payments due to a modification of the loan's contractual term. The Corporation does not expect to incur a loss on these loans based on its assessment of the borrowers' expected cash flows, and accordingly, no additional provision for loan losses has been recognized related to these loans. Since no loss is incurred on these loans, they accrue interest at the loan's contractual interest rate. These loans are individually evaluated for impairment and transferred to nonaccrual status if it is probable that any remaining principal and interest payments due on the loan will not be collected in accordance with the modified terms of the loan.

The Corporation's real estate residential TDRs generally consist of reducing a borrower's monthly payments by decreasing the interest rate charged on the loan for a specified period of time (generally 24 months). The Corporation recognizes additional provision for loan losses related to impairment on these loans based on the present value of expected future cash flows discounted at the loan's original effective interest rate. These loans accrue interest at the loan's effective interest rate, which consists of contractual interest in addition to an adjustment for the accretion of computed impairment. These loans are moved to nonaccrual status if they become 90 days past due as to principal or interest, or sooner if conditions warrant.

Impaired Loans

A loan is defined to be impaired when it is probable that payment of principal and interest will not be made in accordance with the original contractual terms of the loan agreement. Impaired loans include all classes of nonaccrual loans, all TDRs (nonperforming and performing) and acquired loans that were not performing in accordance with original contractual terms. Impaired loans are carried at the lower of the present value of expected cash flows discounted at the loan's effective interest rate or the estimated fair value of the collateral if the loan is collateral dependent.

Nonperforming Loans

Nonperforming loans are comprised of originated loans for which the accrual of interest has been discontinued (nonaccrual loans), accruing loans contractually past due 90 days or more as to interest or principal payments and nonperforming TDRs.

Table of Contents

Allowance for Loan Losses

The allowance for loan losses (allowance) is presented as a reserve against loans. The allowance represents management's assessment of probable loan losses inherent in the Corporation's loan portfolio.

Management's evaluation of the adequacy of the allowance is based on a continuing review of the loan portfolio, actual loan loss experience, the underlying value of the collateral, risk characteristics of the loan portfolio, the level and composition of nonperforming loans, the financial condition of the borrowers, the balance of the loan portfolio, loan growth, economic conditions, employment levels in the Corporation's local markets, and special factors affecting specific business sectors. The Corporation maintains formal policies and procedures to monitor and control credit risk. Management evaluates the allowance on a quarterly basis in an effort to ensure the level is adequate to absorb probable losses inherent in the loan portfolio.

The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be incurred in the remainder of the originated loan portfolio, but that have not been specifically identified. The Corporation utilizes its own loss experience to estimate inherent losses on loans. Internal risk ratings are assigned to each commercial, real estate commercial, real estate construction and land development loan at the time of approval and are subject to subsequent periodic reviews by senior management. The Corporation performs a detailed credit quality review quarterly on all loans greater than \$0.25 million that have deteriorated below certain levels of credit risk, and may allocate a specific portion of the allowance to such loans based upon this review. A portion of the allowance is allocated to the remaining loans by applying projected loss ratios, based on numerous factors. Projected loss ratios incorporate factors such as recent charge-off experience, trends with respect to adversely risk-rated commercial, real estate commercial, real estate construction and land development loans, trends with respect to past due and nonaccrual loans, changes in economic conditions and trends, changes in the value of underlying collateral and other credit risk factors. This evaluation involves a high degree of uncertainty.

In determining the allowance and the related provision for loan losses, the Corporation considers four principal elements: (i) valuation allowances based upon probable losses identified during the review of impaired commercial, real estate commercial, real estate construction and land development loans, (ii) allocations established for adversely-rated commercial, real estate commercial, real estate construction and land development loans and nonaccrual real estate residential, consumer installment and home equity loans, (iii) allocations, by loan classes, on all other loans based principally on multi-year historical loan loss experience and loan loss trends and (iv) an unallocated allowance based on the imprecision in the overall allowance methodology.

The first element reflects the Corporation's estimate of probable losses based upon the systematic review of individually impaired commercial, real estate commercial, real estate construction and land development loans in the originated loan portfolio. These estimates are based upon a number of objective factors, such as payment history, financial condition of the borrower and discounted collateral exposure. The Corporation measures the investment in an impaired loan based on one of three methods: the loan's observable market price; the fair value of the collateral; or, the present value of expected future cash flows discounted at the loan's effective interest rate. At September 30, 2011, loans in the commercial loan portfolio that were in nonaccrual status were valued based on the fair value of the collateral securing the loan, while TDRs in the commercial loan portfolio were valued based on the present value of expected future cash flows discounted at the loan's effective interest rate. It is the Corporation's general policy to, at least annually, obtain new appraisals on impaired loans that are primarily secured by real estate. When the Corporation determines that the fair value of the collateral is less than the carrying value of an impaired loan on nonaccrual status and a portion is deemed not collectible, the portion of the impairment that is deemed not collectible is charged off (confirmed loss) and deducted from the allowance. The remaining carrying value of the impaired loan is classified as a nonperforming loan. When the Corporation determines that the fair value of the collateral is less than the carrying value of an impaired loan but believes it is probable it will recover this impairment, the Corporation establishes a valuation allowance for such impairment.

The second element reflects the application of the Corporation's loan grade risk rating system. This risk rating system is similar to those employed by state and federal banking regulators. Loans in the commercial loan portfolio that are risk rated below a certain predetermined risk grade and nonaccrual real estate residential and nonaccrual consumer installment and home equity loans are assigned a loss allocation factor that is based upon a historical analysis of actual loan losses incurred and a valuation of the type of collateral securing the loans.

The third element is determined by assigning allocations based principally upon a multi-year average of loss experience for each class of loan. Average losses may be adjusted based on current loan loss experience and delinquency trends. This component considers the lagging impact of historical charge-off ratios in periods where future loan charge-offs are expected to increase or decrease, trends in

Table of Contents

delinquencies and nonaccrual loans, the changing portfolio mix in terms of collateral, average loan balance, loan growth and the degree of seasoning in the various loan portfolios. Loan loss analyses are performed quarterly. During the quarter ended September 30, 2011, the Corporation revised its historical loan loss experience from three years to five years to better capture and reflect the loss experience inherent in the various classes of the loan portfolio. In addition, the Corporation judgmentally applied a percentage weighting to each of the years in the five-year period with higher weighting placed on the most recent years. The change did not have a significant impact on the overall allowance for loan losses.

The fourth element is based on factors that cannot be associated with a specific credit or loan class and reflects an attempt to ensure that the overall allowance appropriately reflects a margin for the imprecision necessarily inherent in the estimates of loan losses. Management maintains an unallocated allowance to recognize the uncertainty and imprecision underlying the process of estimating inherent loan losses in the loan portfolio. Determination of the probable losses inherent in the portfolio, which are not necessarily captured by the allocation methodology discussed above, involves the exercise of judgment. The unallocated allowance associated with the imprecision in the risk rating system is based on a historical evaluation of the accuracy of the risk ratings associated with loans. This unallocated portion of the allowance is judgmentally determined and generally serves to compensate for the uncertainty in estimating inherent losses, particularly in times of changing economic conditions, and also considers the possibility of improper risk ratings. The unallocated portion of the allowance also takes into consideration economic conditions within the State of Michigan and nationwide, including unemployment levels, industry-wide loan delinquency rates, and declining commercial and residential real estate values and historically high inventory levels of residential lots, condominiums and single family houses held for sale.

Although the Corporation allocates portions of the allowance to specific loans and loan types, the entire allowance is available for any loan losses that occur. Loans that are deemed not collectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance. Collection efforts may continue and recoveries may occur after a loan is charged off against the allowance.

Acquired loans are aggregated into pools based upon common risk characteristics. An allowance may be recorded related to acquired loans, if an acquired loan pool experiences a decrease in expected cash flows as compared to those projected at the acquisition date. On a quarterly basis, the expected future cash flow of each pool is estimated based on various factors including changes in property values of collateral dependent loans, default rates, loss severities and prepayment speeds. Decreases in estimates of expected cash flows within a pool generally result in a charge to the provision for loan losses and a corresponding increase in the allowance allocated to acquired loans for the particular pool. Increases in estimates of expected cash flows within a pool generally result first in a reduction in the allowance allocated to acquired loans for the particular pool, and second in an adjustment to the accretable yield for the pool, which will increase amounts recognized in interest income in subsequent periods.

Various regulatory agencies, as an integral part of their examination process, periodically review the allowance. Such agencies may require additions to the allowance based on their judgment reflecting information available to them at the time of their examinations.

Fair Value Measurements

Fair value for assets and liabilities measured at fair value on a recurring or nonrecurring basis refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity's own data.

The Corporation may choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, allowing the Corporation to record identical financial assets and liabilities at fair value or by another measurement basis permitted under GAAP, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. At September 30, 2011, December 31, 2010 and September 30, 2010, the Corporation had not elected the fair value option for any financial assets or liabilities.

Share-Based Compensation

The Corporation has granted stock options, stock awards and restricted stock performance units to certain executive and senior management employees. The Corporation accounts for share-based compensation expense using the modified-prospective transition method. Under that method, compensation expense is recognized for share-based awards granted after December 31, 2005, based on the estimated grant date fair

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

value as computed using the Black-Scholes option pricing model and the probability of issuance for performance-based awards. The fair value of stock options is recognized as compensation expense on a straight-line basis over the requisite service period. The fair value of restricted stock performance units is recognized as compensation expense over the requisite performance period.

Table of Contents

Cash flows realized from the tax benefits of exercised stock option awards that result from actual tax deductions that are in excess of the recorded tax benefits related to the compensation expense recognized for those options (excess tax benefits) are classified as financing activities on the consolidated statements of cash flows.

Income and Other Taxes

The Corporation is subject to the income and other tax laws of the United States and the State of Michigan. These laws are complex and are subject to different interpretations by the taxpayer and the various taxing authorities. In determining the provision for income and other taxes, management must make judgments and estimates about the application of these inherently complex laws, related regulations and case law. In the process of preparing the Corporation's tax returns, management attempts to make reasonable interpretations of enacted tax laws. These interpretations are subject to challenge by the tax authorities upon audit or to reinterpretation based on management's ongoing assessment of facts and evolving case law.

The Corporation and its subsidiaries file a consolidated federal income tax return. The provision for federal income taxes is based on income and expenses, as reported in the consolidated financial statements, rather than amounts reported on the Corporation's federal income tax return. The difference between the federal statutory income tax rate and the Corporation's effective federal income tax rate is primarily a function of the proportion of the Corporation's interest income exempt from federal taxation, nondeductible interest expense and other nondeductible expenses relative to pretax income and tax credits. When income and expenses are recognized in different periods for tax purposes than for book purposes, deferred tax assets and liabilities are recognized for the future tax consequences attributable to the temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date of the change.

On a quarterly basis, management assesses the reasonableness of its effective federal tax rate based upon its current best estimate of taxable income and the applicable taxes expected for the full year. Deferred tax assets and liabilities are reassessed on an annual basis, or sooner, if business events or circumstances warrant. Management also assesses the need for a valuation allowance for deferred tax assets on a quarterly basis using information about the Corporation's current and historical financial position and results of operations.

Income tax positions are evaluated to determine whether it is more-likely-than-not that a tax position will be sustained upon examination based on the technical merits of the tax position. If a tax position is more-likely-than-not to be sustained, a tax benefit is recognized for the amount that is greater than 50% likely to be realized. Reserves for contingent tax liabilities attributable to unrecognized tax benefits associated with uncertain tax positions are reviewed quarterly for adequacy based upon developments in tax law and the status of audits or examinations. The Corporation had no reserve for contingent income tax liabilities recorded at September 30, 2011, December 31, 2010 or September 30, 2010.

The tax periods open to examination by the Internal Revenue Service include the calendar years ended December 31, 2010, 2009 and 2008. The calendar years ended December 31, 2010, 2009 and 2008 are open to examination for the Corporation's Michigan Business Tax and the calendar years ended December 31, 2007 and 2006 are open to examination for the Michigan Single Business Tax of the Corporation and certain subsidiaries of the Corporation.

Shareholders' Equity

Common Stock Repurchase Programs

From time to time, the board of directors approves common stock repurchase programs allowing management to repurchase shares of the Corporation's common stock in the open market. The repurchased shares are available for later reissuance in connection with potential future stock dividends, the Corporation's dividend reinvestment plan, employee benefit plans and other general corporate purposes. Under these programs, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, including the projected parent company cash flow requirements and the Corporation's market price per share.

In January 2008, the board of directors of the Corporation authorized management to repurchase up to 500,000 shares of the Corporation's common stock under a stock repurchase program. Since the January 2008 authorization, no shares have been

Table of Contents

repurchased. At September 30, 2011, there were 500,000 remaining shares available for repurchase under the Corporation's stock repurchase programs.

Preferred Stock

On April 20, 2009, the shareholders of the Corporation authorized the board of directors of the Corporation to issue up to 200,000 shares of preferred stock in connection with either an acquisition by the Corporation of an entity that has shares of preferred stock issued and outstanding pursuant to any program established by the United States government or participation by the Corporation in any program established by the United States government. At September 30, 2011, no shares of preferred stock were issued and outstanding.

Common Stock

On April 18, 2011, the shareholders of the Corporation approved an amendment to the restated articles of incorporation to increase the number of authorized shares of common stock from 30,000,000 to 45,000,000.

Legal Matters

The Corporation and Chemical Bank are subject to certain legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition or results of operations of the Corporation.

Adopted Accounting Pronouncements

Determination of Troubled Debt Restructurings and Related Disclosures: In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring (ASU 2011-02). ASU 2011-02 provides additional clarifying guidance for creditors in determining whether modifications to a loan constitute a concession granted by the creditor; evaluating whether a restructuring results in a delay in payment that is insignificant; and determining whether a debtor is experiencing financial difficulties. ASU 2011-02 also establishes the effective date for certain disclosures about loans modified under troubled debt restructurings that had been delayed by the FASB's issuance of ASU No. 2011-01, Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20. For public entities, ASU 2011-02 (including related disclosures) is effective for the first interim or annual period beginning on or after June 15, 2011, with early adoption permitted. The adoption of ASU 2011-02 as of July 1, 2011 did not have a material impact on the Corporation's consolidated financial condition or results of operations.

As a result of adopting the amendments of ASU 2011-02, the Corporation reassessed all loan restructurings that occurred on or after January 1, 2011 for identification as a TDR. No new TDRs resulted from this assessment. See Note 4, Loans, to the consolidated financial statements for disclosures related to TDRs.

Testing Goodwill for Impairment: In September 2011, the FASB issued ASU No. 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing for Goodwill Impairment (ASU 2011-08). Prior to ASU 2011-08, a two-step test was required to assess goodwill for impairment. In Step 1, the fair value of a reporting unit was computed and compared to the carrying value, and if the fair value was lower, then Step 2 was used to measure the amount of goodwill impairment, if any. ASU 2011-08 permits an entity to make a qualitative assessment as to whether it is more-likely-than-not that a reporting unit's fair value is less than its carrying value before applying the two-step goodwill impairment test. If an entity concludes that it is not more-likely-than-not that the fair value of a reporting unit is less than its carrying value, it would not be required to perform the two-step impairment test for the reporting unit. ASU 2011-08 applies to both an entity's annual and, if necessary, interim goodwill impairment test. ASU 2011-08 is effective for fiscal years beginning after December 15, 2011, with early adoption permitted. The Corporation elected to adopt ASU 2011-08 as of September 30, 2011 and applied the qualitative assessment approach to its annual goodwill impairment test as of that same date. The adoption of ASU 2011-08 did not have a material impact on the Corporation's consolidated financial condition or results of operations. See Note 5, Intangible Assets, to the consolidated financial statements for further discussion of the Corporation's annual goodwill impairment test.

Table of Contents***Pending Accounting Pronouncements***

Transfers and Servicing of Financial Assets: In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements (ASU 2011-03). ASU 2011-03 modifies current guidance by eliminating (i) from the assessment of effective control over transferred financial assets in connection with a repurchase agreement the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of the transferee's default, and (ii) the condition requiring the transferor to have obtained sufficient collateral to demonstrate that ability. ASU 2011-03 is effective for interim and annual periods beginning on or after December 15, 2011, with early adoption prohibited. The adoption of ASU 2011-03 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

Fair Value Measurement and Disclosure Requirements: In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). The amended guidance of ASU 2011-04 (i) clarifies how a principal market is determined, (ii) establishes the valuation premise for the highest and best use of nonfinancial assets, (iii) addresses the fair value measurement of instruments with offsetting market or counterparty credit risks, (iv) extends the prohibition on blockage factors to all three levels of the fair value hierarchy, and (v) requires additional disclosures including transfers between Level 1 and Level 2 of the fair value hierarchy, quantitative and qualitative information and a description of an entity's valuation process for Level 3 fair value measurements, and fair value hierarchy disclosures for financial instruments not measured at fair value. ASU 2011-04 is effective for interim and annual periods beginning on or after December 15, 2011, with early adoption prohibited. The adoption of ASU 2011-04 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

Presentation of Comprehensive Income: In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 amends current guidance by (i) eliminating the option to present components of other comprehensive income (OCI) as part of the statement of changes in shareholders' equity, (ii) requiring the presentation of each component of net income and each component of OCI either in a single continuous statement or in two separate but consecutive statements, and (iii) requiring the presentation of reclassification adjustments on the face of the statement. The amendments of ASU 2011-05 do not change the option to present components of OCI either before or after related income tax effects, the items that must be reported in OCI, when an item of OCI should be reclassified to net income, or the computation of earnings per share (which continues to be based on net income). ASU 2011-05 is effective for interim and annual periods beginning on or after December 15, 2011 for public companies, with early adoption permitted and retrospective application required. The adoption of ASU 2011-05 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

Note 2: Acquisition

On April 30, 2010, the Corporation acquired 100% of OAK for total consideration of \$83.7 million. The total consideration consisted of the issuance of 3,529,772 shares of Chemical common stock with a total value of \$83.7 million based upon a price per share of the Corporation's common stock of \$23.70 at the acquisition date, the exchange of 26,425 vested stock options for the outstanding vested stock options of OAK with a value of the exchange at the acquisition date of approximately \$41,000 and approximately \$8,000 of cash in lieu of fractional shares. The issuance of 3,529,772 shares of Chemical common stock was based on an exchange rate of 1.306 times the 2,703,009 outstanding shares of OAK at the acquisition date. There were no contingencies resulting from the acquisition.

OAK, a bank holding company, owned Byron Bank, which provided traditional commercial banking services and products through 14 banking offices serving communities in Ottawa, Allegan and Kent counties in west Michigan. Byron Bank was consolidated with and into Chemical Bank on July 23, 2010. At the acquisition date, OAK had total assets of \$820 million, including total loans of \$627 million, and total deposits of \$693 million, including brokered deposits of \$193 million.

Upon acquisition, the OAK loan portfolio had contractually required principal and interest payments receivable of \$683 million and \$97 million, respectively, expected principal and interest cash flows of \$636 million and \$88 million, respectively, and a fair value of \$627 million. The difference between the contractually required payments receivable and the expected cash flows represents the nonaccretable difference, which totaled \$56 million at the acquisition date, with \$47 million attributable to expected credit losses. The difference between the expected cash flows and fair value represents the accretable yield, which totaled \$97 million at the acquisition date. The outstanding contractual principal balance and the carrying amount of the acquired loan portfolio were \$534 million and \$495 million, respectively, at September 30, 2011, compared to \$597 million and \$552 million, respectively, at December 31, 2010 and \$646 million and \$595 million, respectively, at September 30, 2010.

Table of Contents

Activity for the accretable yield, which includes contractually due interest, of acquired loans follows (in thousands):

Balance at January 1, 2011	\$ 72,863
Additions	
Reductions	
Accretion recognized in interest income	(24,549)
Reclassification from (to) nonaccretable difference	300
Balance at September 30, 2011	\$ 48,614

Note 3: Investment Securities

The following is a summary of the amortized cost and fair value of investment securities available-for-sale and investment securities held-to-maturity at September 30, 2011, December 31, 2010 and September 30, 2010:

	Investment Securities Available-for-Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
September 30, 2011				
Government sponsored agencies	\$ 74,381	\$ 241	\$ 61	\$ 74,561
State and political subdivisions	43,647	1,817		45,464
Residential mortgage-backed securities	125,400	3,910	446	128,864
Collateralized mortgage obligations	295,347	1,029	444	295,932
Corporate bonds	64,828	35	679	64,184
Preferred stock	1,389	99		1,488
Total	\$ 604,992	\$ 7,131	\$ 1,630	\$ 610,493
December 31, 2010				
Government sponsored agencies	\$ 117,167	\$ 394	\$ 40	\$ 117,521
State and political subdivisions	45,951	326	231	46,046
Residential mortgage-backed securities	132,683	4,439	187	136,935
Collateralized mortgage obligations	233,202	911	192	233,921
Corporate bonds	43,115	99	467	42,747
Preferred stock	1,389	51		1,440
Total	\$ 573,507	\$ 6,220	\$ 1,117	\$ 578,610
September 30, 2010				
Government sponsored agencies	\$ 139,298	\$ 640	\$ 17	\$ 139,921
State and political subdivisions	47,231	1,491	1	48,721
Residential mortgage-backed securities	152,446	4,476	149	156,773
Collateralized mortgage obligations	239,777	736	224	240,289
Corporate bonds	23,132	148	161	23,119
Total	\$ 601,884	\$ 7,491	\$ 552	\$ 608,823

Investment Securities Held-to-Maturity

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
September 30, 2011				
State and political subdivisions	\$ 175,932	\$ 5,635	\$ 1,008	\$ 180,559
Trust preferred securities	10,500		6,035	4,465
Total	\$ 186,432	\$ 5,635	\$ 7,043	\$ 185,024
December 31, 2010				
State and political subdivisions	\$ 154,900	\$ 2,106	\$ 1,758	\$ 155,248
Trust preferred securities	10,500		6,560	3,940
Total	\$ 165,400	\$ 2,106	\$ 8,318	\$ 159,188
September 30, 2010				
State and political subdivisions	\$ 144,975	\$ 3,824	\$ 527	\$ 148,272
Trust preferred securities	10,500		6,560	3,940
Total	\$ 155,475	\$ 3,824	\$ 7,087	\$ 152,212

Table of Contents

The majority of the Corporation's residential mortgage-backed securities and collateralized mortgage obligations are backed by a U.S. government agency (Government National Mortgage Association) or a government sponsored enterprise (Federal Home Loan Mortgage Corporation or Federal National Mortgage Association).

At September 30, 2011, the Corporation held \$10.5 million of trust preferred investment securities that were recorded as held-to-maturity, with \$10.0 million of these securities representing a 100% interest in a trust preferred investment security of a non-public bank holding company in Michigan that has been assessed by the Corporation as financially strong. The remaining \$0.5 million represents a 10% interest in another trust preferred investment security of a non-public bank holding company located in Michigan that reported net income for the nine months ended September 30, 2011 compared to a net loss in 2010, while remaining well-capitalized under regulatory guidelines during that time.

At September 30, 2011, it was the Corporation's opinion that the market for trust preferred investment securities was not active, and thus, in accordance with GAAP, when there is a significant decrease in the volume and activity for an asset or liability in relation to normal market activity, adjustments to transaction or quoted prices may be necessary or a change in valuation technique or multiple valuation techniques may be appropriate. The fair values of the trust preferred investment securities were based upon a calculation of discounted cash flows. The cash flows were discounted based upon both observable inputs and appropriate risk adjustments that market participants would make for nonperformance, illiquidity and issuer specifics. An independent third party provided the Corporation with observable inputs based on the existing market and insight into appropriate rate of return adjustments that market participants would require for the additional risk associated with a single issue investment security of this nature. Using a model that incorporated the average current yield of publicly traded performing trust preferred securities of large financial institutions with no known material financial difficulties at September 30, 2011, and adjusted for both illiquidity and the specific characteristics of the issuer, such as size, leverage position and location, the Corporation calculated an implied yield of 43% on its \$10.0 million trust preferred investment security and 33% for its \$0.5 million trust preferred investment security. Based upon these implied yields, the fair values of the trust preferred investment securities were calculated by the Corporation at \$4.3 million and \$0.2 million, respectively, resulting in a combined unrealized loss of \$6.0 million. At September 30, 2011, the Corporation concluded that the \$6.0 million of combined unrealized loss on the trust preferred investment securities was temporary in nature.

The following is a summary of the amortized cost and fair value of investment securities at September 30, 2011, by maturity, for both available-for-sale and held-to-maturity investment securities. The maturities of residential mortgage-backed securities and collateralized mortgage obligations are based on scheduled principal payments. The maturities of all other debt securities are based on final contractual maturity.

	September 30, 2011	
	Amortized Cost	Fair Value
	(In thousands)	
Investment Securities Available-for-Sale:		
Due in one year or less	\$ 135,281	\$ 135,643
Due after one year through five years	328,234	330,180
Due after five years through ten years	71,279	72,943
Due after ten years	68,809	70,239
Preferred stock	1,389	1,488
Total	\$ 604,992	\$ 610,493
Investment Securities Held-to-Maturity:		
Due in one year or less	\$ 26,135	\$ 26,191
Due after one year through five years	78,625	79,367
Due after five years through ten years	51,323	53,588
Due after ten years	30,349	25,878
Total	\$ 186,432	\$ 185,024

Table of Contents

The following schedule summarizes information for both available-for-sale and held-to-maturity investment securities with gross unrealized losses at September 30, 2011, December 31, 2010 and September 30, 2010, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(In thousands)						
September 30, 2011						
Government sponsored agencies	\$ 28,763	\$ 59	\$ 2,753	\$ 2	\$ 31,516	\$ 61
State and political subdivisions	38,661	874	7,544	134	46,205	1,008
Residential mortgage-backed securities	29,560	343	19,206	103	48,766	446
Collateralized mortgage obligations	108,302	367	16,164	77	124,466	444
Corporate bonds	37,658	648	2,467	31	40,125	679
Trust preferred securities			4,465	6,035	4,465	6,035
Total	\$ 242,944	\$ 2,291	\$ 52,599	\$ 6,382	\$ 295,543	\$ 8,673
December 31, 2010						
Government sponsored agencies	\$ 20,117	\$ 40	\$	\$	\$ 20,117	\$ 40
State and political subdivisions	71,900	1,863	3,800	126	75,700	1,989
Residential mortgage-backed securities	26,117	187			26,117	187
Collateralized mortgage obligations	57,556	170	9,616	22	67,172	192
Corporate bonds	24,683	317	2,341	150	27,024	467
Trust preferred securities			3,940	6,560	3,940	6,560
Total	\$ 200,373	\$ 2,577	\$ 19,697	\$ 6,858	\$ 220,070	\$ 9,435
September 30, 2010						
Government sponsored agencies	\$ 10,863	\$ 17	\$	\$	\$ 10,863	\$ 17
State and political subdivisions	22,912	418	5,717	110	28,629	528
Residential mortgage-backed securities	30,763	149			30,763	149
Collateralized mortgage obligations	95,231	224			95,231	224
Corporate bonds			2,329	161	2,329	161
Trust preferred securities			3,940	6,560	3,940	6,560
Total	\$ 159,769	\$ 808	\$ 11,986	\$ 6,831	\$ 171,755	\$ 7,639

An assessment is performed quarterly by the Corporation to determine whether unrealized losses in its investment securities portfolio are temporary or other-than-temporary by carefully considering all available information. The Corporation reviews factors such as financial statements, credit ratings, news releases and other pertinent information of the underlying issuer or company to make its determination. Management did not believe any individual unrealized loss on any investment security, as of September 30, 2011, represented an other-than-temporary impairment (OTTI). Management believed that the unrealized losses on investment securities at September 30, 2011 were temporary in nature and due primarily to changes in interest rates, increased credit spreads and reduced market liquidity and not as a result of credit-related issues. Unrealized losses of \$6.0 million in the trust preferred securities portfolio, related to trust preferred securities of two well-capitalized bank holding companies in Michigan, were attributable to illiquidity in certain financial markets. The Corporation performed an analysis of the creditworthiness of these issuers and concluded that, at September 30, 2011, the Corporation expected to recover the entire amortized cost basis of these investment securities.

At September 30, 2011, the Corporation did not have the intent to sell any of its impaired investment securities and believed that it was more-likely-than-not that the Corporation will not have to sell any such investment securities before a full recovery of amortized cost. Accordingly, at September 30, 2011, the Corporation believed the impairments in its investment securities portfolio were temporary in nature. Additionally, no impairment loss was realized in the Corporation's consolidated statement of income for the nine months ended September 30,

2011. However, there is no assurance that OTTI may not occur in the future.

Table of Contents**Note 4: Loans**

Loan portfolio segments are defined as the level at which an entity develops and documents a systematic methodology to determine its allowance. The Corporation has two loan portfolio segments (commercial loans and consumer loans) which it uses in determining the allowance. Both quantitative and qualitative factors are used by management at the loan portfolio segment level in determining the adequacy of the allowance for the Corporation. Classes of loans are a disaggregation of an entity's loan portfolio segments. Classes of loans are defined as a group of loans which share similar initial measurement attributes, risk characteristics, and methods for monitoring and assessing credit risk. The Corporation has seven classes of loans, which are set forth below.

Commercial Loans to varying types of businesses, including municipalities, school districts and nonprofit organizations, for the purpose of supporting working capital, operational needs and term financing of equipment. Repayment of such loans is generally provided through operating cash flows of the business. Commercial loans are predominately secured by equipment, inventory, accounts receivable, personal guarantees of the owner and other sources of repayment, although the Corporation may also secure commercial loans with real estate.

Real estate commercial Loans secured by real estate occupied by the borrower for ongoing operations, non-owner occupied real estate leased to one or more tenants and vacant land that has been acquired for investment or future land development.

Real estate construction Secured loans for the construction of business properties. Real estate construction loans often convert to a real estate commercial loan at the completion of the construction period.

Land development Secured development loans are made to borrowers for the purpose of infrastructure improvements to vacant land to create finished marketable residential and commercial lots/land. Most land development loans are originated with the intention that the loans will be paid through the sale of developed lots/land by the developers within twelve months of the completion date. Land development loans at September 30, 2011 were primarily comprised of loans to develop residential properties.

Real estate residential Loans secured by one- to four-family residential properties generally with fixed interest rates of fifteen years or less. The loan-to-value ratio at the time of origination is generally 80% or less. Real estate residential loans with a loan-to-value ratio of more than 80% generally require private mortgage insurance.

Consumer installment Loans to consumers primarily for the purpose of home improvements and acquiring automobiles, recreational vehicles and boats. These loans consist of relatively small amounts that are spread across many individual borrowers.

Home equity Loans whereby consumers utilize equity in their personal residence, generally through a second mortgage, as collateral to secure the loan.

Commercial, real estate commercial, real estate construction and land development loans are referred to as the Corporation's commercial loan portfolio, while real estate residential, consumer installment and home equity loans are referred to as the Corporation's consumer loan portfolio.

A summary of loans follows:

	September 30, 2011	December 31, 2010 (In thousands)	September 30, 2010
Commercial loan portfolio:			
Commercial	\$ 858,969	\$ 818,997	\$ 794,739
Real estate commercial	1,056,092	1,076,971	1,077,760
Real estate construction	72,851	89,234	112,093
Land development	46,978	53,386	55,645
Subtotal	2,034,890	2,038,588	2,040,237
Consumer loan portfolio:			
Real estate residential	840,044	798,046	747,135

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Consumer installment	526,573	503,132	510,991
Home equity	358,919	341,896	342,508
Subtotal	1,725,536	1,643,074	1,600,634
Total loans	\$ 3,760,426	\$ 3,681,662	\$ 3,640,871

Table of Contents

Credit Quality Monitoring

The Corporation maintains loan policies and credit underwriting standards as part of the process of managing credit risk. These standards include making loans generally only within the Corporation's market areas. The Corporation's lending markets generally consist of communities across the middle to southern and western sections of the lower peninsula of Michigan. The Corporation's lending market areas do not include the southeastern portion of Michigan. The Corporation has no foreign loans.

The Corporation has a loan approval process involving underwriting and individual and group loan approval authorities to consider credit quality and loss exposure at loan origination. The loans in the Corporation's commercial loan portfolio are risk rated at origination based on the grading system set forth below. The approval authority of relationship managers is established based on experience levels, with credit decisions greater than \$1.0 million requiring group loan authority approval, except for four executive and senior officers who have varying limits exceeding \$1.0 million and up to \$2.5 million. With respect to the group loan authorities, the Corporation has a loan committee, consisting of certain executive and senior officers, that meets weekly to consider loans in the amount of \$1.0 million to \$2.5 million. A directors' loan committee, consisting of ten members of the board of directors, including the chief executive officer, and the senior credit officer, meets regularly to consider loans in the amount of \$2.5 million to \$10 million. Loans over \$10 million require the approval of the board of directors.

The majority of the Corporation's consumer loan portfolio is comprised of secured loans that are relatively small and are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer loan portfolio is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Corporation's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

Loans in the commercial loan portfolio tend to be larger and more complex than those in the consumer loan portfolio, and therefore, are subject to more intensive monitoring. All loans in the commercial loan portfolio have an assigned relationship manager, and most borrowers provide periodic financial and operating information that allows the relationship managers to stay abreast of credit quality during the life of the loans. The risk ratings of loans in the commercial loan portfolio are reassessed at least annually, with loans below an acceptable risk rating reassessed more frequently and reviewed by various loan committees within the Corporation at least quarterly.

The Corporation maintains a centralized independent loan review function that monitors the approval process and on-going asset quality of the loan portfolio, including the accuracy of loan grades. The Corporation also maintains an independent appraisal review function that participates in the review of all appraisals obtained by the Corporation.

Credit Quality Indicators

The Corporation uses a nine grade risk rating system to monitor the ongoing credit quality of its commercial loan portfolio. These loan grades rank the credit quality of a borrower by measuring liquidity, debt capacity, coverage and payment behavior as shown in the borrower's financial statements. The loan grades also measure the quality of the borrower's management and the repayment support offered by any guarantors. A summary of the Corporation's loan grades (or, characteristics of the loans within each grade) follows:

Risk Grades 1-5 (Acceptable Credit Quality) All loans in risk grades 1-5 are considered to be acceptable credit risks by the Corporation and are grouped for purposes of allowance for loan loss considerations and financial reporting. The five grades essentially represent a ranking of loans that are all viewed to be of acceptable credit quality, taking into consideration the various factors mentioned above, but with varying degrees of financial strength, debt coverage, management and factors that could impact credit quality. Business credits within risk grades 1-5 range from Risk Grade 1: Prime Quality (factors include: excellent business credit; excellent debt capacity and coverage; outstanding management; strong guarantors; superior liquidity and net worth; favorable loan-to-value ratios; debt secured by cash or equivalents, or backed by the full faith and credit of the U.S. Government) to Risk Grade 5: Acceptable Quality With Care (factors include: acceptable business credit, but with added risk due to specific industry or internal situations).

Table of Contents

Risk Grade 6 (Watch) A business credit that is not acceptable within the Corporation's loan origination criteria; cash flow may not be adequate or is continually inconsistent to service current debt; financial condition has deteriorated as company trends/management have become inconsistent; the company is slow in furnishing quality financial information; working capital needs of the company are reliant on short-term borrowings; personal guarantees are weak and/or with little or no liquidity; the net worth of the company has deteriorated after recent or continued losses; the loan requires constant monitoring and attention from the Corporation; payment delinquencies becoming more serious; if left uncorrected, these potential weaknesses may, at some future date, result in deterioration of repayment prospects.

Risk Grade 7 (Substandard - Accrual) A business credit that is inadequately protected by the current financial net worth and paying capacity of the obligor or of the collateral pledged, if any; management has deteriorated or has become non-existent; quality financial information is unobtainable; a high level of maintenance is required by the Corporation; cash flow can no longer support debt requirements; loan payments are continually and/or severely delinquent; negative net worth; personal guaranty has become insignificant; a credit that has a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. The Corporation still expects a full recovery of all contractual principal and interest payments; however, a possibility exists that the Corporation will sustain some loss if deficiencies are not corrected.

Risk Grade 8 (Substandard - Nonaccrual) A business credit accounted for on a nonaccrual basis that has all the weaknesses inherent in a loan classified as risk grade 7 with the added characteristic that the weaknesses are so pronounced that, on the basis of current financial information, conditions, and values, collection in full is highly questionable; a partial loss is possible and interest is no longer being accrued. This loan meets the definition of an impaired loan. The risk of loss requires analysis to determine whether a valuation allowance needs to be established.

Risk Grade 9 (Substandard - Doubtful) A business credit that has all the weaknesses inherent in a loan classified as risk grade 8 and interest is no longer being accrued, but additional deficiencies make it highly probable that liquidation will not satisfy the majority of the obligation; the primary source of repayment is nonexistent and there is doubt as to the value of the secondary source of repayment; the possibility of loss is likely, but current pending factors could strengthen the credit. This loan meets the definition of an impaired loan. A loan charge-off is recorded when management deems an amount uncollectible; however, the Corporation will establish a valuation allowance for probable losses, if required.

The Corporation considers all loans graded 1-5 as acceptable credit risks and structures and manages such relationships accordingly. Periodic financial and operating data combined with regular loan officer interactions are deemed adequate to monitor borrower performance. Loans with risk grades of 6 and 7 are considered watch credits and the frequency of loan officer contact and receipt of financial data is increased to stay abreast of borrower performance. Loans with risk grades of 8 and 9 are considered problematic and require special care. Further, loans with risk grades of 6-9 are managed and monitored regularly through a number of processes, procedures and committees, including oversight by a loan administration committee comprised of executive and senior management of the Corporation, which includes highly structured reporting of financial and operating data, intensive loan officer intervention and strategies to exit, as well as potential management by the Corporation's special assets group.

Table of Contents

The following schedule presents the recorded investment of loans in the commercial loan portfolio by risk rating categories at September 30, 2011 and December 31, 2010:

	Commercial Loan Portfolio Credit Exposure				Total
	Commercial	Real Estate Commercial	Real Estate Construction (In thousands)	Land Development	
September 30, 2011:					
Originated Portfolio:					
Risk Grades 1-5	\$ 661,237	\$ 673,659	\$ 53,044	\$ 15,762	\$ 1,403,702
Risk Grade 6	28,669	28,094	288	7,027	64,078
Risk Grade 7	26,096	50,709	52	851	77,708
Risk Grade 8	9,888	44,712		6,220	60,820
Risk Grade 9	916	4,142		1,657	6,715
Subtotal	726,806	801,316	53,384	31,517	1,613,023
Acquired Portfolio:					
Risk Grades 1-5	111,354	231,467	19,324	8,979	371,124
Risk Grade 6	6,814	10,504		1,446	18,764
Risk Grade 7	4,762	10,180		688	15,630
Risk Grade 8	9,198	2,625	143	4,348	16,314
Risk Grade 9	35				35
Subtotal	132,163	254,776	19,467	15,461	421,867
Total	\$ 858,969	\$ 1,056,092	\$ 72,851	\$ 46,978	\$ 2,034,890
December 31, 2010:					
Originated Portfolio:					
Risk Grades 1-5	\$ 619,150	\$ 656,471	\$ 67,907	\$ 15,797	\$ 1,359,325
Risk Grade 6	22,173	39,653	737	8,935	71,498
Risk Grade 7	16,480	35,471	551	983	53,485
Risk Grade 8	16,061	57,287		6,537	79,885
Risk Grade 9	607	3,271		2,430	6,308
Subtotal	674,471	792,153	69,195	34,682	1,570,501
Acquired Portfolio:					
Risk Grades 1-5	119,943	249,495	19,796	12,667	401,901
Risk Grade 6	10,236	18,202			28,438
Risk Grade 7	6,050	14,896		457	21,403
Risk Grade 8	8,282	2,225	243	5,580	16,330
Risk Grade 9	15				15
Subtotal	144,526	284,818	20,039	18,704	468,087
Total	\$ 818,997	\$ 1,076,971	\$ 89,234	\$ 53,386	\$ 2,038,588

Table of Contents

The Corporation evaluates the credit quality of loans in the consumer loan portfolio based primarily on the aging status of the loan and payment activity. The following schedule presents the recorded investment of loans in the consumer loan portfolio based on the credit risk profile of loans in a performing status and loans in a nonperforming status at September 30, 2011 and December 31, 2010:

	Consumer Loan Portfolio Credit Exposure			
	Credit Risk Profile Based on			
	Aging Status and Payment Activity			
	Real			
	Estate Residential	Consumer Installment	Home Equity	Total Consumer
	(In thousands)			
September 30, 2011:				
Originated Loans:				
Performing	\$ 789,338	\$ 519,409	\$ 307,578	\$ 1,616,325
Nonperforming	28,329	2,931	4,446	35,706
Subtotal	817,667	522,340	312,024	1,652,031
Acquired Loans:				
Performing	21,517	4,233	46,344	72,094
Nonperforming	860		551	1,411
Subtotal	22,377	4,233	46,895	73,505
Total	\$ 840,044	\$ 526,573	\$ 358,919	\$ 1,725,536
December 31, 2010:				
Originated Loans:				
Performing	\$ 733,461	\$ 495,203	\$ 286,854	\$ 1,515,518
Nonperforming	37,638	1,846	3,895	43,379
Subtotal	771,099	497,049	290,749	1,558,897
Acquired Loans:				
Performing	25,406	6,083	50,873	82,362
Nonperforming	1,541		274	1,815
Subtotal	26,947	6,083	51,147	84,177
Total	\$ 798,046	\$ 503,132	\$ 341,896	\$ 1,643,074

Nonperforming Loans

A summary of nonperforming loans follows:

	September 30, 2011	December 31, 2010	September 30, 2010
	(In thousands)		
Nonaccrual loans:			
Commercial	\$ 10,804	\$ 16,668	\$ 19,440

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Real estate commercial	48,854	60,558	59,353
Real estate construction and land development	7,877	8,967	16,085
Real estate residential	17,544	12,083	13,485
Consumer installment and home equity	6,033	4,686	4,469
Total nonaccrual loans	91,112	102,962	112,832
Accruing loans contractually past due 90 days or more as to interest or principal payments:			
Commercial	282	530	909
Real estate commercial	415	1,350	2,265
Real estate construction and land development		1,220	
Real estate residential	974	3,253	2,316
Consumer installment and home equity	1,344	1,055	1,036
Total accruing loans contractually past due 90 days or more as to interest or principal payments	3,015	7,408	6,526
TDRs:			
Commercial and real estate commercial	16,457	15,057	9,834
Real estate residential	9,811	22,302	18,712
Total nonperforming TDRs	26,268	37,359	28,546
Total nonperforming loans	\$ 120,395	\$ 147,729	\$ 147,904

Table of Contents

Impaired Loans

The following schedule presents impaired loans by classes of loans at September 30, 2011:

	Recorded Investment	Unpaid Principal Balance (In thousands)	Related Valuation Allowance
Impaired loans with a valuation allowance:			
Commercial	\$ 5,342	\$ 6,965	\$ 1,562
Real estate commercial	20,084	21,245	6,759
Land development	1,748	1,757	387
Real estate residential	21,416	21,416	618
Subtotal	48,590	51,383	9,326
Impaired loans with no related valuation allowance:			
Commercial	24,454	32,108	
Real estate commercial	44,844	58,929	
Real estate construction	143	1,115	
Land development	11,047	17,069	
Real estate residential	17,544	17,544	
Consumer installment	2,931	2,931	
Home equity	3,102	3,102	
Subtotal	104,065	132,798	
Total impaired loans:			
Commercial	29,796	39,073	1,562
Real estate commercial	64,928	80,174	6,759
Real estate construction	143	1,115	
Land development	12,795	18,826	387
Real estate residential	38,960	38,960	618
Consumer installment	2,931	2,931	
Home equity	3,102	3,102	
Total	\$ 152,655	\$ 184,181	\$ 9,326

The following schedule presents information related to impaired loans for the three and nine months ended September 30, 2011:

	Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Average Recorded Investment	Interest Income Recognized While on Impaired Status	Average Recorded Investment	Interest Income Recognized While on Impaired Status
	(In thousands)			
Commercial	\$ 28,593	\$ 260	\$ 30,384	\$ 730
Real estate commercial	70,634	281	71,854	616
Real estate construction	145	2	192	10
Land development	13,414	86	13,940	270

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Real estate residential	39,848	223	38,467	708
Consumer installment	2,916		2,844	
Home equity	3,456		3,213	
Total	\$ 159,006	\$ 852	\$ 160,894	\$ 2,334

Table of Contents

The following schedule presents impaired loans by classes of loans at December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance
	(In thousands)		
Impaired loans with a valuation allowance:			
Commercial	\$ 8,289	\$ 8,675	\$ 2,947
Real estate commercial	34,681	35,744	11,356
Land development	1,881	1,984	663
Real estate residential	22,302	22,302	806
Subtotal	67,153	68,705	15,772
Impaired loans with no related valuation allowance:			
Commercial	28,597	39,927	
Real estate commercial	38,689	51,722	
Land development	10,498	15,039	
Real estate residential	12,083	12,083	
Consumer installment	1,751	1,751	
Home equity	2,935	2,935	
Subtotal	94,553	123,457	
Total impaired loans:			
Commercial	36,886	48,602	2,947
Real estate commercial	73,370	87,466	11,356
Land development	12,379	17,023	663
Real estate residential	34,385	34,385	806
Consumer installment	1,751	1,751	
Home equity	2,935	2,935	
Total	\$ 161,706	\$ 192,162	\$ 15,772

The difference between an impaired loan's recorded investment and the unpaid principal balance represents either (i) for originated loans, a partial charge-off resulting from a confirmed loss due to the value of the collateral securing the loan being below the loan balance and management's assessment that full collection of the loan balance is not likely or (ii) for acquired loans that meet the definition of an impaired loan, fair value adjustments recognized at the acquisition date attributable to expected credit losses and the discounting of expected cash flows at market interest rates. The difference between the recorded investment and the unpaid principal balance of \$31.5 million and \$30.5 million at September 30, 2011 and December 31, 2010, respectively, includes confirmed losses (partial charge-offs) of \$22.1 million and \$19.8 million, respectively, and fair value discount adjustments of \$9.4 million and \$10.7 million, respectively.

The following schedule presents a summary of impaired loans between those with and without a valuation allowance at September 30, 2010:

	Recorded Investment	Related Valuation Allowance
	(In thousands)	
Impaired loans with a valuation allowance:		
Commercial, real estate commercial, real estate construction and land development	\$ 58,269	\$ 17,815

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Real estate residential	18,712	824
Subtotal	76,981	18,639
Impaired loans with no valuation allowance:		
Commercial, real estate commercial, real estate construction and land development	56,062	
Real estate residential	13,485	
Consumer installment and home equity	4,469	
Subtotal	74,016	
Total	\$ 150,997	\$ 18,639

Table of Contents

Impaired loans include \$19.7 million, \$21.4 million and \$12.5 million at September 30, 2011, December 31, 2010 and September 30, 2010, respectively, of acquired loans that were not performing in accordance with original contractual terms. These loans are not reported as nonperforming loans, as a market yield adjustment was recognized on these loans at acquisition that is being amortized into interest income. Impaired loans also include \$15.5 million at September 30, 2011 of performing TDRs.

The following schedule presents the aging status of the recorded investment in loans by classes of loans at September 30, 2011 and December 31, 2010:

	31-60 Days Past Due	61-89 Days Past Due	Accruing Loans Past Due 90 Days or More	Nonaccrual Loans (In thousands)	Total Past Due	Current	Total Loans
September 30, 2011							
Originated Portfolio:							
Commercial	\$ 7,471	\$ 3,364	\$ 282	\$ 10,804	\$ 21,921	\$ 704,885	\$ 726,806
Real estate commercial	10,104	4,832	415	48,854	64,205	737,111	801,316
Real estate construction	214	288			502	52,882	53,384
Land development		349		7,877	8,226	23,291	31,517
Real estate residential	5,793	247	974	17,544	24,558	793,109	817,667
Consumer installment	4,578	775		2,931	8,284	514,056	522,340
Home equity	1,823	1,312	1,344	3,102	7,581	304,443	312,024
Total	\$ 29,983	\$ 11,167	\$ 3,015	\$ 91,112	\$ 135,277	\$ 3,129,777	\$ 3,265,054
Acquired Portfolio:							
Commercial	\$ 540	\$	\$ 10,515	\$	\$ 11,055	\$ 121,108	\$ 132,163
Real estate commercial			2,864		2,864	251,912	254,776
Real estate construction			143		143	19,324	19,467
Land development			4,799		4,799	10,662	15,461
Real estate residential		766	860		1,626	20,751	22,377
Consumer installment	47	83			130	4,103	4,233
Home equity	236	256	551		1,043	45,852	46,895
Total	\$ 823	\$ 1,105	\$ 19,732	\$	\$ 21,660	\$ 473,712	\$ 495,372
December 31, 2010							
Originated Portfolio:							
Commercial	\$ 6,788	\$ 3,645	\$ 530	\$ 16,668	\$ 27,631	\$ 646,840	\$ 674,471
Real estate commercial	9,960	4,139	1,350	60,558	76,007	716,146	792,153
Real estate construction	689				689	68,506	69,195
Land development		119	1,220	8,967	10,306	24,376	34,682
Real estate residential	1,126	6,610	3,253	12,083	23,072	748,027	771,099
Consumer installment	6,179	1,741	95	1,751	9,766	487,283	497,049
Home equity	3,046	825	960	2,935	7,766	282,983	290,749
Total	\$ 27,788	\$ 17,079	\$ 7,408	\$ 102,962	\$ 155,237	\$ 2,974,161	\$ 3,129,398
Acquired Portfolio:							
Commercial	\$ 131	\$ 64	\$ 10,445	\$	\$ 10,640	\$ 133,886	\$ 144,526
Real estate commercial	993		3,302		4,295	280,523	284,818
Real estate construction	736		243		979	19,060	20,039

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Land development	2,697		5,580		8,277	10,427	18,704
Real estate residential	685		1,541		2,226	24,721	26,947
Consumer installment	19	43			62	6,021	6,083
Home equity	85	34	274		393	50,754	51,147
Total	\$ 5,346	\$ 141	\$ 21,385	\$	\$ 26,872	\$ 525,392	\$ 552,264

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Balance at beginning of period	\$ 89,733	\$ 89,502	\$ 89,530	\$ 80,841
Provision for loan losses	6,400	8,600	20,900	35,300
Net loan charge-offs:				
Loan charge-offs	(8,839)	(9,245)	(25,787)	(29,440)
Loan recoveries	1,419	664	4,070	2,820
Net loan charge-offs	(7,420)	(8,581)	(21,717)	(26,620)
Balance at end of period	\$ 88,713	\$ 89,521	\$ 88,713	\$ 89,521

Table of Contents

The following schedule presents, by loan portfolio segment, the changes in the allowance for the three and nine months ended September 30, 2011 and details regarding the balance in the allowance and the recorded investment in loans at September 30, 2011 by impairment evaluation method.

	Commercial Loan Portfolio	Consumer Loan Portfolio	Unallocated	Total
	(In thousands)			
Changes in allowance for loan losses for the three months ended September 30, 2011:				
Beginning balance	\$ 58,572	\$ 29,283	\$ 1,878	\$ 89,733
Provision for loan losses	2,258	2,296	1,846	6,400
Charge-offs	(5,439)	(3,400)		(8,839)
Recoveries	899	520		1,419
Ending balance	\$ 56,290	\$ 28,699	\$ 3,724	\$ 88,713
Changes in allowance for loan losses for the nine months ended September 30, 2011:				
Beginning balance	\$ 59,443	\$ 27,338	\$ 2,749	\$ 89,530
Provision for loan losses	11,348	8,577	975	20,900
Charge-offs	(16,629)	(9,158)		(25,787)
Recoveries	2,128	1,942		4,070
Ending balance	\$ 56,290	\$ 28,699	\$ 3,724	\$ 88,713
Allowance for loan losses balance at September 30, 2011 attributable to:				
Loans individually evaluated for impairment	\$ 8,708	\$ 618	\$	\$ 9,326
Loans collectively evaluated for impairment	46,282	28,081	3,724	78,087
Loans acquired with deteriorated credit quality	1,300			1,300
Total	\$ 56,290	\$ 28,699	\$ 3,724	\$ 88,713
Recorded investment (loan balance) at September 30, 2011:				
Loans individually evaluated for impairment	\$ 87,930	\$ 21,416	\$	\$ 109,346
Loans collectively evaluated for impairment	1,525,093	1,630,615		3,155,708
Loans acquired with deteriorated credit quality	421,867	73,505		495,372
Total	\$ 2,034,890	\$ 1,725,536	\$	\$ 3,760,426

The following presents, by loan portfolio segment, details regarding the balance in the allowance and the recorded investment in loans at December 31, 2010 by impairment evaluation method.

	Commercial Loan Portfolio	Consumer Loan Portfolio	Unallocated	Total
	(In thousands)			
Allowance for loan losses balance at December 31, 2010 attributable to:				
Loans individually evaluated for impairment	\$ 14,966	\$ 806	\$	\$ 15,772
Loans collectively evaluated for impairment	44,477	26,532	2,749	73,758
Loans acquired with deteriorated credit quality				

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Total	\$ 59,443	\$ 27,338	\$ 2,749	\$ 89,530
-------	-----------	-----------	----------	-----------

Recorded investment (loan balance) at December 31, 2010:

Loans individually evaluated for impairment	\$ 101,250	\$ 22,302	\$	\$ 123,552
Loans collectively evaluated for impairment	1,469,251	1,536,595		3,005,846
Loans acquired with deteriorated credit quality	468,087	84,177		552,264

Total	\$ 2,038,588	\$ 1,643,074	\$	\$ 3,681,662
-------	--------------	--------------	----	--------------

At September 30, 2011, the \$1.3 million allowance attributable to acquired loans was primarily attributable to one of the acquired loan pools experiencing a decline in expected cash flows as of that date. There were no material changes in expected cash flows for the remaining acquired loan pools at September 30, 2011. An allowance related to acquired loans was not required at December 31, 2010 and September 30, 2010 due to no material changes in expected cash flows since the date of acquisition as of these dates.

Table of Contents**Note 5: Intangible Assets**

The Corporation has recorded four types of intangible assets: goodwill, core deposit intangible assets, mortgage servicing rights (MSRs) and non-compete agreements. Goodwill, core deposit intangible assets and non-compete agreements arose as the result of business combinations or other acquisitions. MSRs arose as a result of selling residential real estate mortgage loans in the secondary market while retaining the right to service these loans and receive servicing income over the life of the loan, as well as a result of the OAK acquisition. Amortization is recorded on the core deposit intangible assets, MSRs and non-compete agreements. Goodwill is not amortized but is evaluated at least annually for impairment. The Corporation's annual goodwill impairment test was performed as of September 30, 2011, and based on a qualitative assessment, the Corporation determined that it was not more-likely-than-not that the fair value of the Corporation's sole reporting unit, Chemical Bank, was less than its carrying value, and that accordingly, no impairment existed for the Corporation's goodwill at that date.

The following table shows the net carrying value of the Corporation's intangible assets:

	September 30, 2011	December 31, 2010 (In thousands)	September 30, 2010
Goodwill	\$ 113,414	\$ 113,414	\$ 110,266
Other intangible assets:			
Core deposit intangible assets	8,261	9,406	10,352
Mortgage servicing rights	3,561	3,782	3,718
Non-compete agreements	27	333	462
Total other intangible assets	\$ 11,849	\$ 13,521	\$ 14,532

In conjunction with the OAK acquisition, the Corporation recorded \$43.5 million of goodwill, \$8.4 million in core deposit intangible assets, \$0.7 million of mortgage servicing rights and \$0.7 million of non-compete agreements as of the acquisition date.

The following table sets forth the carrying amount, accumulated amortization and amortization expense of core deposit intangible assets that are amortizable and arose from business combinations or other acquisitions:

	September 30, 2011	December 31, 2010 (In thousands)	September 30, 2010
Gross original amount	\$ 26,468	\$ 26,468	\$ 26,978
Accumulated amortization	18,207	17,062	16,626
Carrying amount	\$ 8,261	\$ 9,406	\$ 10,352
Amortization expense for the three months ended September 30	\$ 382		\$ 439
Amortization expense for the nine months ended September 30	\$ 1,145		\$ 924

At September 30, 2011, the remaining amortization expense on core deposit intangible assets that existed as of that date was estimated as follows (in thousands):

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

2011	\$ 382
2012	1,469
2013	1,309
2014	1,146
2015	1,066
2016 and thereafter	2,889
Total	\$ 8,261

The following shows the net carrying value and fair value of MSR's and the total loans that the Corporation is servicing for others:

	September 30, 2011	December 31, 2010 (In thousands)	September 30, 2010
Net carrying value of MSR's	\$ 3,561	\$ 3,782	\$ 3,718
Fair value of MSR's	\$ 4,437	\$ 5,674	\$ 4,324
Loans serviced for others that have servicing rights capitalized	\$ 900,197	\$ 891,937	\$ 882,200

Table of Contents

The following table shows the activity for capitalized MSRs:

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2010	
	2011	2010	2011	2010
	(In thousands)			
Balance at beginning of period	\$ 3,577	\$ 3,641	\$ 3,782	\$ 3,077
Acquired in OAK acquisition				691
Additions	317	560	1,028	1,186
Amortization	(333)	(483)	(1,249)	(1,236)
Balance at end of period	\$ 3,561	\$ 3,718	\$ 3,561	\$ 3,718

There was no impairment valuation allowance recorded on MSRs as of September 30, 2011, December 31, 2010 or September 30, 2010.

Amortization expense on non-compete agreements totaled \$0.1 million during the three months ended September 30, 2011 and 2010 and \$0.3 million and \$0.2 million during the nine months ended September 30, 2011 and 2010, respectively. Remaining amortization expense on non-compete agreements that existed at September 30, 2011 was less than \$0.1 million.

Note 6: Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of related tax benefit/expense were as follows:

	September 30, 2011	December 31, 2010	September 30, 2010
	(In thousands)		
Net unrealized gains on investment securities available-for-sale, net of related tax expense of \$1,925 at September 30, 2011, \$1,786 at December 31, 2010 and \$2,428 at September 30, 2010	\$ 3,576	\$ 3,317	\$ 4,510
Pension and other postretirement benefits adjustment, net of related tax benefit of \$9,195 at September 30, 2011, \$9,384 at December 31, 2010 and \$8,412 at September 30, 2010	(17,077)	(17,428)	(15,623)
Accumulated other comprehensive loss	\$ (13,501)	\$ (14,111)	\$ (11,113)

Note 7: Regulatory Capital

The Corporation and Chemical Bank are subject to various regulatory capital requirements administered by federal banking agencies. Under these capital requirements, Chemical Bank must meet specific capital guidelines that involve quantitative measures of assets and certain off-balance sheet items as calculated under regulatory accounting practices. In addition, capital amounts and classifications are subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated financial statements.

Quantitative measures established by regulation to ensure capital adequacy require minimum ratios of Tier 1 capital to average assets (Leverage Ratio) and Tier 1 and Total capital to risk-weighted assets. These capital guidelines assign risk weights to on- and off-balance sheet items in arriving at total risk-weighted assets. Minimum capital levels are based upon the perceived risk of various asset categories and certain off-balance sheet instruments.

At September 30, 2011, December 31, 2010 and September 30, 2010, Chemical Bank's capital ratios exceeded the quantitative capital ratios required for an institution to be considered well-capitalized. Significant factors that may affect capital adequacy include, but are not limited to, a disproportionate growth in assets versus capital and a change in mix or credit quality of assets.

Table of Contents

The summary below compares the Corporation's and Chemical Bank's actual capital amounts and ratios with the quantitative measures established by regulation to ensure capital adequacy:

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
September 30, 2011						
Total Capital to Risk-Weighted Assets:						
Corporation	\$ 493,976	13.1%	\$ 302,360	8.0%	N/A	N/A
Chemical Bank	486,207	12.9	302,149	8.0	\$ 377,686	10.0%
Tier 1 Capital to Risk-Weighted Assets:						
Corporation	446,217	11.8	151,180	4.0	N/A	N/A
Chemical Bank	438,480	11.6	151,074	4.0	226,612	6.0
Leverage Ratio:						
Corporation	446,217	8.6	206,656	4.0	N/A	N/A
Chemical Bank	438,480	8.5	206,613	4.0	258,266	5.0
December 31, 2010						
Total Capital to Risk-Weighted Assets:						
Corporation	\$ 473,471	12.9%	\$ 293,856	8.0%	N/A	N/A
Chemical Bank	465,709	12.7	293,573	8.0	\$ 366,966	10.0%
Tier 1 Capital to Risk-Weighted Assets:						
Corporation	427,014	11.6	146,928	4.0	N/A	N/A
Chemical Bank	419,296	11.4	146,786	4.0	220,179	6.0
Leverage Ratio:						
Corporation	427,014	8.4	204,426	4.0	N/A	N/A
Chemical Bank	419,296	8.2	204,291	4.0	255,363	5.0
September 30, 2010						
Total Capital to Risk-Weighted Assets:						
Corporation	\$ 500,253	13.7%	\$ 292,057	8.0%	N/A	N/A
Chemical Bank	488,346	13.4	291,454	8.0	\$ 364,318	10.0%
Tier 1 Capital to Risk-Weighted Assets:						
Corporation	454,074	12.4	146,028	4.0	N/A	N/A
Chemical Bank	442,260	12.1	145,727	4.0	218,591	6.0
Leverage Ratio:						
Corporation	454,074	8.8	205,361	4.0	N/A	N/A
Chemical Bank	442,260	8.6	205,080	4.0	256,350	5.0

Note 8: Fair Value Measurements

Fair value, as defined by GAAP, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for market activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Investment securities available-for-sale are recorded at fair value on a recurring basis. Additionally, the Corporation may be required to record other assets at fair value on a nonrecurring basis, such as impaired loans, goodwill, other intangible assets and other real estate and repossessed assets. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of

individual assets.

The Corporation determines the fair value of its financial instruments based on a three-level hierarchy established by GAAP. The classification and disclosure of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained

Table of Contents

from independent sources, while unobservable inputs reflect management's estimates about market data. The three levels of inputs that may be used to measure fair value within the GAAP hierarchy are as follows:

- Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 valuations for the Corporation include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Valuations are obtained from a third party pricing service for these investment securities.
- Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 valuations for the Corporation include government sponsored agency securities, including securities issued by the Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Federal Farm Credit Bank, Student Loan Marketing Corporation and the Small Business Administration, securities issued by certain state and political subdivisions, residential mortgage-backed securities, collateralized mortgage obligations, corporate bonds and preferred stock. Valuations are obtained from a third-party pricing service for these investment securities.
- Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models, yield curves and similar techniques. The determination of fair value requires management judgment or estimation and generally is corroborated by external data, which includes third-party pricing services. Level 3 valuations for the Corporation include securities issued by certain state and political subdivisions, trust preferred securities, impaired loans, goodwill, core deposit intangible assets, MSRs and other real estate and repossessed assets.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Corporation's financial assets and financial liabilities carried at fair value and all financial instruments disclosed at fair value. In general, fair value is based upon quoted market prices, where available. If quoted market prices are not available, fair value is based upon third-party pricing services when available. Fair value may also be based on internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be required to record financial instruments at fair value. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values.

While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts may change significantly after the date of the statement of financial position from the amounts presented herein.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are generally measured using independent pricing models or other model-based valuation techniques that include market inputs, such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Level 1 securities include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include securities issued by government sponsored agencies, securities issued by certain state and political subdivisions, residential mortgage-backed securities, collateralized mortgage obligations, corporate bonds and preferred stock.

Table of Contents**Disclosure of Recurring Basis Fair Value Measurements**

For assets measured at fair value on a recurring basis, quantitative disclosures about the fair value measurements for each major category of assets were as follows:

Description	Fair Value Measurements Recurring Basis			Total
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(In thousands)				
September 30, 2011				
Investment securities available-for-sale:				
Government sponsored agencies	\$	\$ 74,561	\$	\$ 74,561
State and political subdivisions		45,464		45,464
Residential mortgage-backed securities		128,864		128,864
Collateralized mortgage obligations		295,932		295,932
Corporate bonds		64,184		64,184
Preferred stock		1,488		1,488
Total	\$	\$ 610,493	\$	\$ 610,493
December 31, 2010				
Investment securities available-for-sale:				
Government sponsored agencies	\$	\$ 117,521	\$	\$ 117,521
State and political subdivisions		46,046		46,046
Residential mortgage-backed securities		136,935		136,935
Collateralized mortgage obligations		233,921		233,921
Corporate bonds		42,747		42,747
Preferred stock		1,440		1,440
Total	\$	\$ 578,610	\$	\$ 578,610
September 30, 2010				
Investment securities Trading	\$	\$ 1,471	\$	\$ 1,471
Investment securities available-for-sale:				
Government sponsored agencies		139,921		139,921
State and political subdivisions		48,721		48,721
Residential mortgage-backed securities		156,773		156,773
Collateralized mortgage obligations		240,289		240,289
Corporate bonds		23,119		23,119
Subtotal		608,823		608,823
Total	\$	\$ 610,294	\$	\$ 610,294

There were no liabilities recorded at fair value on a recurring basis at September 30, 2011, December 31, 2010 and September 30, 2010.

Table of Contents**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allocation of the allowance (valuation allowance) may be established or a portion of the loan is charged off. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. The fair value of impaired loans is estimated using one of several methods, including the loan's observable market price, the fair value of the collateral or the present value of the expected future cash flows discounted at the loan's effective interest rate. Those impaired loans not requiring a valuation allowance represent loans for which the fair value of the expected repayments or collateral exceed the remaining carrying amount of such loans. At September 30, 2011, December 31, 2010 and September 30, 2010, substantially all of the impaired loans were evaluated based on the fair value of the collateral. Impaired loans, where a valuation allowance is established or a portion of the loan is charged off based on the fair value of collateral, are subject to nonrecurring fair value measurement and require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as a Level 2 valuation. When management determines the fair value of the collateral is further impaired below the appraised value or there is no observable market price or independent appraised value, the Corporation records the impaired loan as a Level 3 valuation.

Goodwill is subject to impairment testing on an annual basis. In accordance with ASU 2011-08, the Corporation performed a qualitative assessment in order to evaluate goodwill for impairment as of the annual impairment test date of September 30, 2011. The qualitative assessment requires a significant degree of judgment. In the event the qualitative assessment indicates that it is more-likely-than-not that the fair value is less than the carrying value, the amount of impairment, if any, is computed under a two-step approach and goodwill is recorded at fair value as determined by either the income or market approach method, which requires a significant degree of judgment. Goodwill that is impaired and subject to nonrecurring fair value measurements is a Level 3 valuation. At September 30, 2011, December 31, 2010 and September 30, 2010, no goodwill was impaired, and therefore, goodwill was not recorded at fair value on a nonrecurring basis.

Other intangible assets consist of core deposit intangible assets and MSRs. These items are both recorded at fair value when initially recorded. Subsequently, core deposit intangible assets are amortized primarily on an accelerated basis over periods ranging from ten to fifteen years and are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount exceeds the fair value of the asset. If core deposit intangible asset impairment is identified, the Corporation classifies impaired core deposit intangible assets subject to nonrecurring fair value measurements as Level 3 valuations. The fair value of MSRs is initially estimated using a model that calculates the net present value of estimated future cash flows using various assumptions, including prepayment speeds, the discount rate and servicing costs. If the valuation model reflects a value less than the carrying value, MSRs are adjusted to fair value, as determined by the model, through a valuation allowance. The Corporation classifies MSRs subject to nonrecurring fair value measurements as Level 3 valuations. At September 30, 2011, December 31, 2010 and September 30, 2010, there was no impairment identified for core deposit intangible assets or MSRs and, therefore, no other intangible assets were recorded at fair value on a nonrecurring basis.

The carrying amounts for other real estate (ORE) and repossessed assets (RA) are reported in the consolidated statements of financial position under interest receivable and other assets. ORE and RA include real estate and other types of assets repossessed by the Corporation. ORE and RA are recorded at the lower of cost or fair value upon the transfer of a loan to ORE or RA and, subsequently, ORE and RA continue to be measured and carried at the lower of cost or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records ORE and RA as a Level 2 valuation. When management determines the fair value of the collateral is further impaired below the appraised value or there is no observable market price or there is no available appraised value, the Corporation records the ORE and RA as a Level 3 valuation.

Table of Contents**Disclosure of Nonrecurring Basis Fair Value Measurements**

For assets measured at fair value on a nonrecurring basis, quantitative disclosures about fair value measurements for each major category of assets were as follows:

Description	Fair Value Measurements - Nonrecurring Basis			Total
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	(In thousands)			
September 30, 2011				
Impaired originated loans	\$	\$	\$ 59,896	\$ 59,896
Other real estate/repossessed assets			28,679	28,679
Total	\$	\$	\$ 88,575	\$ 88,575
December 31, 2010				
Impaired originated loans	\$	\$	\$ 64,883	\$ 64,883
Other real estate/repossessed assets			27,510	27,510
Total	\$	\$	\$ 92,393	\$ 92,393
September 30, 2010				
Impaired loans	\$	\$	\$ 74,939	\$ 74,939
Other real estate/repossessed assets			22,704	22,704
Total	\$	\$	\$ 97,643	\$ 97,643

There were no liabilities recorded at fair value on a nonrecurring basis at September 30, 2011, December 31, 2010 and September 30, 2010.

Disclosures about Fair Value of Financial Instruments

GAAP requires disclosures about the estimated fair value of the Corporation's financial instruments, including those financial assets and liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. However, the method of estimating fair value for financial instruments that are not required to be measured on a recurring or nonrecurring basis, as prescribed by ASC Topic 820, Fair Value Measurements and Disclosures (ASC 820) does not incorporate the exit-price concept of fair value. The Corporation utilized the fair value hierarchy in computing the fair values of its financial instruments. In cases where quoted market prices were not available, the Corporation employed present value methods using unobservable inputs requiring management's judgment to estimate the fair values of its financial instruments, which are considered Level 3 valuations. These Level 3 valuations are affected by the assumptions made and, accordingly, do not necessarily indicate amounts that could be realized in a current market exchange. It is also the Corporation's general practice and intent to hold the majority of its financial instruments until maturity and, therefore, the Corporation does not expect to realize the estimated amounts disclosed.

The methodologies for estimating the fair value of financial assets and financial liabilities on a recurring or nonrecurring basis are discussed above. At September 30, 2011, December 31, 2010 and September 30, 2010, the estimated fair values of cash and cash equivalents, interest receivable and interest payable approximated their carrying values at those dates. The methodologies for other financial assets and financial liabilities follow.

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Fair value measurement for investment securities held-to-maturity is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques that include market inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Fair value measurements using Level 2 valuations of investment securities held-to-maturity include certain securities issued by state and political subdivisions and residential mortgage-backed securities. Level 3 valuations include certain securities issued by state and political subdivisions and trust preferred securities.

Table of Contents

Fair value measurements of other securities, which consisted of FHLB and Federal Reserve Bank (FRB) stock, are based on their redeemable value, which is cost. The market for these stocks is restricted to the issuer of the stock and subject to impairment evaluation.

The carrying amounts reported in the consolidated statements of financial position for loans held-for-sale are at the lower of cost or market value. The fair values of loans held-for-sale are based on the market price for similar loans in the secondary market. The fair value measurements for loans held-for-sale are Level 2 valuations.

The fair value of variable interest rate loans that reprice regularly with changes in market interest rates are based on carrying values. The fair values for fixed interest rate loans are estimated using discounted cash flow analyses, using the Corporation's interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting fair value amounts are adjusted to estimate the impact of changes in the credit quality of borrowers after the loans were originated. The fair value measurements for loans are Level 3 valuations.

The fair values of deposit accounts without defined maturities, such as interest- and noninterest-bearing checking, savings and money market accounts, are equal to the amounts payable on demand. Fair value measurements for fixed-interest rate time deposits with defined maturities are based on the discounted value of contractual cash flows, using the Corporation's interest rates currently being offered for deposits of similar maturities and are Level 3 valuations. The fair values for variable-interest rate time deposits with defined maturities approximate their carrying amounts.

Short-term borrowings consist of repurchase agreements. Fair value measurements for repurchase agreements are based on the present value of future estimated cash flows using current interest rates offered to the Corporation for debt with similar terms and are Level 2 valuations.

Fair value measurements for FHLB advances are estimated based on the present value of future estimated cash flows using current interest rates offered to the Corporation for debt with similar terms and are Level 2 valuations.

The Corporation's unused commitments to extend credit, standby letters of credit and loan commitments have no carrying amount and have been estimated to have no realizable fair value. Historically, a majority of the unused commitments to extend credit have not been drawn upon and, generally, the Corporation does not receive fees in connection with these commitments other than standby letter of credit fees, which are not significant.

Fair value measurements have not been made for items that are not defined by GAAP as financial instruments, including such items as the value of the Corporation's Wealth Management department and the value of the Corporation's core deposit base. The Corporation believes it is impractical to estimate a representative fair value for these types of assets, even though management believes they add significant value to the Corporation.

A summary of carrying amounts and estimated fair values of the Corporation's financial instruments included in the consolidated statements of financial position are as follows:

	September 30, 2011		December 31, 2010		September 30, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)					
Assets:						
Cash and cash equivalents	\$ 611,284	\$ 611,284	\$ 536,165	\$ 536,165	\$ 719,350	\$ 719,350
Investment and other securities	822,497	821,089	771,143	764,931	791,958	788,695
Loans held-for-sale	15,212	15,212	20,479	20,479	19,547	19,547
Net loans	3,671,713	3,684,251	3,592,132	3,601,805	3,551,350	3,543,451
Interest receivable	15,810	15,810	15,761	15,761	16,372	16,372
Liabilities:						
Deposits without defined maturities	\$ 2,942,811	\$ 2,942,811	\$ 2,738,719	\$ 2,738,719	\$ 2,890,121	\$ 2,890,121
Time deposits	1,537,775	1,562,604	1,593,046	1,614,854	1,577,281	1,610,711
Interest payable	2,427	2,427	2,887	2,887	3,059	3,059
Short-term borrowings	302,298	302,298	242,703	242,703	254,799	254,799
FHLB advances	45,991	47,365	74,130	75,166	85,390	87,608

Table of Contents**Note 9: Earnings Per Common Share**

Basic earnings per common share for the Corporation is computed by dividing net income by the weighted average number of common shares outstanding during the period. Basic earnings per common share excludes any dilutive effect of common stock equivalents.

Diluted earnings per common share for the Corporation is computed by dividing net income by the sum of the weighted average number of common shares outstanding and the dilutive effect of common stock equivalents using the treasury stock method. Average shares of common stock for diluted net income per common share include shares to be issued upon exercise of stock options granted under the Corporation's stock option plans, restricted stock performance units that may be converted to stock, stock to be issued under the deferred stock compensation plan for non-employee directors and stock to be issued under the stock purchase plan for non-employee advisory directors. For any period in which a loss is recorded, the assumed exercise of stock options, restricted stock performance units that may be converted to stock and stock to be issued under the deferred stock compensation plan and the stock purchase plan would have an anti-dilutive impact on the loss per common share and thus are excluded in the diluted earnings per common share calculation.

The following summarizes the numerator and denominator of the basic and diluted earnings per common share computations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Numerator for both basic and diluted earnings per common share, net income	\$ 11,625	\$ 8,871	\$ 31,846	\$ 15,551
Denominator for basic earnings per common share, weighted average common shares outstanding	27,457	27,438	27,454	25,883
Weighted average common stock equivalents	47	33	40	28
Denominator for diluted earnings per common share	27,504	27,471	27,494	25,911
Basic earnings per common share	\$ 0.42	\$ 0.32	\$ 1.16	\$ 0.60
Diluted earnings per common share	0.42	0.32	1.16	0.60

The average number of exercisable employee stock option awards outstanding that were out-of-the-money, whereby the option exercise price per share exceeded the market price per share, and therefore, were not included in the computation of diluted earnings per common share totaled 670,725 and 638,717 for the three months ended September 30, 2011 and 2010, respectively, and 663,492 and 586,668 for the nine months ended September 30, 2011 and 2010, respectively.

Note 10: Share-Based Compensation Plans

During the three-month periods ended September 30, 2011 and 2010, share-based compensation expense related to stock options and restricted stock performance units totaled \$0.3 million and \$0.4 million, respectively. During the nine-month periods ended September 30, 2011 and 2010, share-based compensation expense related to stock options and restricted stock performance units totaled \$0.7 million and \$1.3 million, respectively.

During the nine-month period ended September 30, 2011, the Corporation granted options to purchase 99,172 shares of common stock and 51,598 restricted stock performance units to certain officers. At September 30, 2011, there were 394,404 shares of common stock available for future grants under share-based compensation plans.

Table of Contents**Stock Options**

The Corporation issues fixed stock options to certain officers. Stock options are issued at the current market price of the Corporation's common stock on the date of grant, generally vest ratably over a three-year period and expire ten years from the date of grant.

A summary of activity for the Corporation's stock options as of and for the nine months ended September 30, 2011 is presented below:

	Non-Vested Stock Options Outstanding			Stock Options Outstanding	
	Number of Options	Weighted- Average Exercise Price Per Share	Weighted- Average Grant Date Fair Value Per Share	Number of Options	Weighted- Average Exercise Price Per Share
Outstanding at January 1, 2011	126,670	\$ 23.29	\$ 6.99	757,665	\$ 29.42
Granted	99,172	19.95	6.12	99,172	19.95
Exercised					
Vested	(62,959)	23.27	6.76		
Forfeited/expired				(27,950)	31.58
Outstanding at September 30, 2011	162,883	\$ 21.27	\$ 6.55	828,887	\$ 28.22
Exercisable/vested at September 30, 2011				666,004	\$ 29.92

The weighted-average remaining contractual terms were 5.5 years for all outstanding stock options and 4.6 years for exercisable stock options. The outstanding and exercisable stock options at September 30, 2011 had no intrinsic value as the closing price of the Corporation's common stock on that date of \$15.31 per share was less than the exercise price of all stock options outstanding.

At September 30, 2011, unrecognized compensation cost related to stock options totaled \$0.8 million. This cost is expected to be recognized over a remaining weighted average period of 2.1 years.

Restricted Stock Performance Units

In addition to stock options, the Corporation also grants restricted stock performance units to certain officers. The restricted stock performance units vest based on the Corporation achieving certain performance target levels. Generally, the restricted stock performance units are eligible to vest from 0.5x to 1.5x the number of units originally granted depending on which, if any, of the performance target levels are met. However, if the minimum performance target level is not achieved, no shares will become vested or be issued for that respective year's restricted stock performance units. Upon achievement of the performance target level and satisfaction of a service condition, if applicable, the restricted stock performance units are converted into shares of the Corporation's common stock on a one-to-one basis. Compensation expense related to restricted stock performance units is recognized over the expected requisite performance period, or requisite service period for awards with multiple performance and service conditions.

A summary of the activity for restricted stock performance units as of and for the nine months ended September 30, 2011 is presented below:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2011	80,852	\$ 22.99

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Granted	51,598	17.87
Converted into shares of common stock	(2,427)	23.70
Forfeited/expired		
Outstanding at September 30, 2011	130,023	\$ 20.99

At September 30, 2011, unrecognized compensation cost related to restricted stock performance unit awards totaled \$0.8 million. This cost is recognized based on the expected achievement of the targeted earnings per common share level for the restricted stock performance units over approximately two years.

Table of Contents**Note 11: Pension and Other Postretirement Benefit Plans**

The components of net periodic benefit cost (income) for the Corporation's qualified and nonqualified pension plans and nonqualified postretirement benefits plan are as follows:

	Defined Benefit Pension Plans			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	(In thousands)			
Service cost	\$ 290	\$ 314	\$ 872	\$ 941
Interest cost	1,207	1,209	3,622	3,627
Expected return on plan assets	(1,582)	(1,431)	(4,746)	(4,293)
Amortization of prior service credit		(1)	(1)	(2)
Amortization of unrecognized net loss	270	123	809	370
Net periodic benefit cost	\$ 185	\$ 214	\$ 556	\$ 643

	Postretirement Benefits Plan			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	(In thousands)			
Interest cost	\$ 42	\$ 55	\$ 125	\$ 163
Amortization of prior service credit	(81)	(81)	(243)	(243)
Amortization of unrecognized net gain	(8)		(24)	
Net periodic benefit income	\$ (47)	\$ (26)	\$ (142)	\$ (80)

401(k) Savings Plan expense for the Corporation's match of participants' base compensation contributions and a 4% of eligible pay contribution to certain employees who are not grandfathered under the pension plan was \$0.7 million for both the three months ended September 30, 2011 and 2010 and \$2.1 million and \$1.8 million for the nine months ended September 30, 2011 and 2010, respectively.

Note 12: Financial Guarantees

In the normal course of business, the Corporation is a party to financial instruments containing credit risk that are not required to be reflected in the consolidated statements of financial position. For the Corporation, these financial instruments are financial and performance standby letters of credit. The Corporation has risk management policies to identify, monitor and limit exposure to credit risk. To mitigate credit risk for these financial guarantees, the Corporation generally determines the need for specific covenant, guarantee and collateral requirements on a case-by-case basis, depending on the nature of the financial instrument and the customer's creditworthiness. At September 30, 2011, December 31, 2010 and September 30, 2010, the Corporation had \$48.0 million, \$44.9 million and \$43.5 million, respectively, of outstanding financial and performance standby letters of credit which expire in five years or less. The majority of these standby letters of credit are collateralized. At September 30, 2011, December 31, 2010 and September 30, 2010, the Corporation's assessment determined there was \$0.3 million of probable losses relating to standby letters of credit, which has been recorded as an other liability in the Corporation's statement of financial position.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following is management's discussion and analysis of certain significant factors that have affected the financial condition and results of operations of Chemical Financial Corporation (Corporation) during the periods included in the consolidated financial statements included in this filing.

Critical Accounting Policies

The Corporation's consolidated financial statements are prepared in accordance with generally accepted accounting principles (GAAP) and follow general practices within the industry in which the Corporation operates. Application of these principles requires management to make estimates, assumptions and complex judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Actual results could differ significantly from those estimates. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Management has identified the determination of the allowance for loan losses, accounting for loans acquired in business combinations, pension plan accounting, income and other taxes, fair value measurements and the evaluation of goodwill impairment to be the accounting areas that require the most subjective or complex judgments, and as such, could be most subject to revision as new or additional information becomes available or circumstances change, including overall changes in the economic climate and/or market interest rates. Therefore, management considers them to be critical accounting policies and discusses them directly with the Audit Committee of the board of directors. The Corporation's significant accounting policies are more fully described in Note 1 to the audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010 and the more significant assumptions and estimates made by management are more fully described in

Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010. During the third quarter of 2011, the Corporation adopted Accounting Standards Update (ASU) No. 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing for Goodwill Impairment (ASU 2011-08). See Note 1, Significant Accounting Policies, to the consolidated financial statements (unaudited) contained in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 under the subheading Adopted Accounting Pronouncements for more information regarding the adoption of ASU 2011-08. There were no other material changes to the Corporation's significant accounting policies or the estimates made pursuant to those policies during the most recent quarter.

Acquisition of O.A.K. Financial Corporation

On April 30, 2010, the Corporation acquired 100% of O.A.K. Financial Corporation (OAK) for total consideration of \$83.7 million. OAK, a bank holding company, owned Byron Bank, which provided traditional banking services and products through 14 banking offices serving communities in Ottawa, Allegan and Kent counties in west Michigan. At April 30, 2010, OAK had total assets of \$820 million, including total loans of \$627 million, and total deposits of \$693 million, including brokered deposits of \$193 million. The Corporation operated Byron Bank as a separate subsidiary from the acquisition date until July 23, 2010, the date Byron Bank was consolidated with and into Chemical Bank.

In connection with the acquisition of OAK, the Corporation recorded \$43.5 million of goodwill. Goodwill recorded is primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and OAK. In addition, the Corporation recorded \$9.8 million of other intangible assets, including core deposit intangible assets of \$8.4 million, mortgage servicing rights of \$0.7 million and non-compete agreements of \$0.7 million, in conjunction with the acquisition.

Summary

The Corporation's net income was \$11.6 million, or \$0.42 per diluted share, in the third quarter of 2011, compared to net income of \$11.0 million, or \$0.40 per diluted share, in the second quarter of 2011 and net income of \$8.9 million, or \$0.32 per diluted share, in the third quarter of 2010. The increase in net income and earnings per share in the third quarter of 2011, compared to the second quarter of 2011, was primarily attributable to higher net interest income, a lower provision for loan losses and lower federal income tax expense, being partially offset by higher operating expenses. The increase in net income and earnings per share in the third quarter of 2011, compared to the third quarter of 2010, was primarily attributable to a lower provision for loan losses and lower operating expenses.

Table of Contents

Return on average assets, on an annualized basis, in the third quarter of 2011 was 0.87%, compared to 0.84% in the second quarter of 2011 and 0.67% in the third quarter of 2010. Return on average equity, on an annualized basis, in the third quarter of 2011 was 8.0%, compared to 7.8% in the second quarter of 2011 and 6.3% in the third quarter of 2010.

Total assets were \$5.44 billion at September 30, 2011, an increase of \$193 million, or 3.7%, from total assets of \$5.25 billion at December 31, 2010 and an increase of \$39 million, or 0.7%, from total assets of \$5.40 billion at September 30, 2010. Total loans were \$3.76 billion at September 30, 2011, an increase of \$79 million, or 2.1%, from total loans of \$3.68 billion at December 31, 2010 and an increase of \$120 million, or 3.3%, from total loans of \$3.64 billion at September 30, 2010. Total deposits were \$4.48 billion at September 30, 2011, an increase of \$149 million, or 3.4%, from total deposits of \$4.33 billion at December 31, 2010, and an increase of \$13 million, or 0.3%, from total deposits of \$4.47 billion at September 30, 2010.

At September 30, 2011, tangible shareholders' equity was 8.6% of total assets, compared to 8.6% of total assets at December 31, 2010 and 8.4% of total assets at September 30, 2010.

Financial Condition***Total Assets***

Total assets were \$5.44 billion at September 30, 2011, an increase of \$193 million, or 3.7%, from total assets of \$5.25 billion at December 31, 2010 and an increase of \$39 million, or 0.7%, from total assets of \$5.40 billion at September 30, 2010.

Interest-earning assets were \$5.08 billion at September 30, 2011, an increase of \$165 million, or 3.3%, from interest-earning assets of \$4.92 billion at December 31, 2010 and an increase of \$29 million, or 0.6%, from interest-earning assets of \$5.05 billion at September 30, 2010.

The increases in total assets and interest-earning assets during the nine months ended September 30, 2011 were primarily attributable to growth in loans and investment securities that were funded by seasonal increases in municipal customer deposits. The increases in total assets and interest-earning assets during the twelve months ended September 30, 2011 were primarily attributable to loan growth.

Investment Securities

The carrying value of investment securities totaled \$796.9 million at September 30, 2011, an increase of \$52.9 million, or 7.1%, from investment securities of \$744.0 million at December 31, 2010 and an increase of \$31.1 million, or 4.1%, from investment securities of \$765.8 million at September 30, 2010. The increase in investment securities during the nine months ended September 30, 2011 was primarily attributable to the Corporation investing a portion of its excess liquidity in collateralized mortgage obligations. At September 30, 2011, the Corporation's investment securities portfolio consisted of \$74.6 million in government sponsored agency debt obligations comprised primarily of fixed rate senior bonds issued by the twelve regional Federal Home Loan Banks that make up the Federal Home Loan Bank System (FHLBanks) and variable rate instruments backed by the Federal Farm Credit Bank, Small Business Administration and Student Loan Marketing Corporation; \$221.3 million in state and political subdivisions debt obligations comprised primarily of general debt obligations of issuers primarily located in the State of Michigan; \$128.9 million in residential mortgage-backed securities comprised primarily of fixed rate instruments backed by a U.S. government agency (Government National Mortgage Association) or government sponsored enterprises (the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association); \$295.9 million of collateralized mortgage obligations comprised primarily of variable rate instruments with average maturities of less than three years backed by the same U.S. government agency and government sponsored enterprises as the residential mortgage-backed securities; \$64.2 million in corporate bonds comprised primarily of debt obligations of large national financial organizations; \$1.5 million of preferred stock securities of two large banks; and \$10.5 million of trust preferred securities (TRUPs) comprised primarily of a 100% interest in a TRUP of a non-public bank holding company in Michigan.

The Corporation records all investment securities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 320, Investments-Debt and Equity Securities (ASC 320), under which the Corporation is required to assess equity and debt securities that have fair values below their amortized cost basis to determine whether the decline (impairment) is other-than-temporary. An assessment is performed quarterly by the Corporation to determine whether unrealized losses in its investment securities portfolio are temporary or other-than-temporary by carefully considering all available information. The Corporation reviews factors such as financial statements, credit ratings, news releases and other pertinent information of the underlying issuer or company to make its determination. In assessing whether a decline is other-than-temporary, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than amortized cost, (ii) the

Table of Contents

financial condition and near-term prospects of the issuer, (iii) the potential for impairments in an entire industry or sub-sector and (iv) the potential for impairments in certain economically depressed geographical locations.

The Corporation's investment securities portfolio with a carrying value of \$796.9 million at September 30, 2011, had gross impairment of \$8.7 million at that date. Management believed that the unrealized losses on investment securities were temporary in nature and due primarily to changes in interest rates on the investment securities and market illiquidity and not as a result of credit-related issues. Accordingly, at September 30, 2011, the Corporation believed the impairment in its investment securities portfolio was temporary in nature and, therefore, no impairment loss was realized in the Corporation's consolidated statement of income for the nine months ended September 30, 2011. However, due to market and economic conditions, other-than-temporary impairment (OTTI) may occur as a result of material declines in the fair value of investment securities in the future. A further discussion of the assessment of potential impairment and the Corporation's process that resulted in the conclusion that the impairment was temporary in nature follows.

At September 30, 2011, the Corporation's investment securities portfolio included government sponsored agencies, residential mortgage-backed securities and collateralized mortgage obligations, combined, with gross impairment of \$1.0 million, state and political subdivisions securities with gross impairment of \$1.0 million, corporate bonds with gross impairment of \$0.7 million and trust preferred securities with gross impairment of \$6.0 million. The amortized costs and fair values of investment securities are disclosed in Note 3 to the consolidated financial statements.

The government sponsored agencies, residential mortgage-backed securities and collateralized mortgage obligations, included in the available-for-sale investment securities portfolio, had a combined amortized cost of \$495.1 million, with gross impairment of \$1.0 million, at September 30, 2011. Virtually all of the impaired investment securities in these three categories are backed by the full faith and credit of the U.S. government, or a guarantee of a U.S. government agency or government sponsored enterprise. The Corporation determined that the impairment on these investment securities was attributable to the low level of market interest rates and that the impairment on these investment securities was temporary in nature at September 30, 2011.

The state and political subdivisions securities, included in the available-for-sale and the held-to-maturity investment securities portfolios, had an amortized cost totaling \$219.6 million, with gross impairment of \$1.0 million, at September 30, 2011. The majority of these investment securities are from issuers primarily located in the State of Michigan and are general obligations of the issuer, meaning that repayment of these obligations is funded by general tax collections of the issuer. The gross impairment was attributable to impaired state and political subdivisions securities with an amortized cost of \$47.2 million, with the majority of these investment securities maturing beyond 2012. It was the Corporation's assessment that the impairment on these investment securities was attributable to changes in market interest rates for these investment securities and the market's perception of the Michigan economy causing illiquidity in the market for these investment securities and that the impairment on these investment securities was temporary in nature at September 30, 2011.

The Corporation's corporate bond portfolio, included in the available-for-sale investment securities portfolio, had an amortized cost of \$64.8 million, with gross impairment of \$0.7 million, at September 30, 2011. All of the corporate bonds held at September 30, 2011 were of an investment grade, except a corporate bond of American General Finance Corporation (AGFC). At September 30, 2011, the AGFC corporate bond had an amortized cost and fair value of \$2.5 million and a maturity date of December 15, 2011. At September 30, 2011, the Corporation's assessment was that it was probable that it would collect all of the contractual amounts due on the AGFC corporate bond. The investment grade ratings obtained for the balance of the corporate bond portfolio, with a gross impairment of \$0.7 million at September 30, 2011, indicated that the obligors' capacities to meet their financial commitments was strong. It was the Corporation's assessment that the gross impairment of \$0.7 million on the corporate bond portfolio at September 30, 2011 was attributable to the current level of market interest rates and the recent negative market perception of the financial industry, and not due to credit-related issues, and that the impairment on the corporate bond portfolio was temporary in nature at September 30, 2011.

At September 30, 2011, the Corporation held two TRUPs in the held-to-maturity investment securities portfolio, with a combined amortized cost of \$10.5 million that had gross impairment of \$6.0 million. One TRUP, with an amortized cost of \$10.0 million, represented a 100% interest in a TRUP of a non-public bank holding company in Michigan that was purchased in the second quarter of 2008. At September 30, 2011, the Corporation determined that the fair value of this TRUP was \$4.3 million. The second TRUP, with an amortized cost of \$0.5 million, represented a 10% interest in the TRUP of another non-public bank holding company in Michigan. At September 30, 2011, the Corporation determined the fair value of this TRUP was \$0.2 million. The fair value measurements of the two TRUP investments were developed based upon market pricing observations of much larger banking institutions in an illiquid market adjusted by risk measurements. The fair values of the TRUPs were based on calculations of discounted cash flows, and further based upon both observable inputs and appropriate risk adjustments that market participants would

Table of Contents

make for performance, liquidity and issuer specifics. See the additional discussion of the development of the fair values of the TRUPs in Note 3 to the consolidated financial statements. Management reviewed financial information of the issuers of the TRUPs at September 30, 2011. Based on this review, the Corporation concluded that the significant decline in fair values of the TRUPs, compared to their amortized cost, was not attributable to materially adverse conditions specifically related to the issuers.

The issuer of the \$10.0 million TRUP reported net income in the first three quarters of 2011 and in each of the three years ended December 31, 2010 and was categorized as well-capitalized under applicable regulatory requirements during that time. Based on the Corporation's analysis at September 30, 2011, it was the Corporation's opinion that this issuer appeared to be a financially sound financial institution with sufficient liquidity to meet its financial obligations in 2011. Common stock cash dividends have been paid quarterly throughout 2011, 2010 and 2009 by the issuer and the Corporation understands that the issuer's management anticipates cash dividends to continue to be paid in the future. All scheduled interest payments on this TRUP have been made on a timely basis. The principal of \$10.0 million of this TRUP matures in 2038, with interest payments due quarterly.

Based on the information provided by the issuer of the \$10.0 million TRUP, it was the Corporation's opinion that, as of September 30, 2011, there had been no material adverse changes in the issuer's financial performance since the TRUP was issued and purchased by the Corporation and no indication that any material adverse trends were developing that would suggest that the issuer would be unable to make all future principal and interest payments under the TRUP. Further, based on the information provided by the issuer, the issuer appeared to be a financially viable financial institution with both the credit quality and liquidity necessary to meet its financial obligations in 2011. At September 30, 2011, the Corporation was not aware of any regulatory issues, memorandums of understanding or cease and desist orders that had been issued to the issuer or its subsidiaries. In reviewing all available information regarding the issuer, including past performance and its financial and liquidity position, it was the Corporation's opinion that the future cash flows of the issuer supported the carrying value of the TRUP at its original cost of \$10.0 million at September 30, 2011. While the total fair value of the TRUP was \$5.7 million below the Corporation's amortized cost at September 30, 2011, it was the Corporation's assessment that, based on the overall financial condition of the issuer, the impairment was temporary in nature at September 30, 2011.

The issuer of the \$0.5 million TRUP reported a small amount of net income through the first three quarters of 2011 compared to large net losses reported in 2010 and 2009. At September 30, 2011, the issuer was categorized as well-capitalized under applicable regulatory requirements. All scheduled interest payments on this TRUP have been made on a timely basis. The principal of \$0.5 million of this TRUP matures in 2033, with interest payments due quarterly. At September 30, 2011, the Corporation was not aware of any regulatory issues, memorandums of understanding or cease and desist orders that had been issued to the issuer of this TRUP or any subsidiary. In reviewing all financial information regarding the \$0.5 million TRUP, it was the Corporation's opinion that the carrying value of this TRUP at its original cost of \$0.5 million was supported by the issuer's financial position at September 30, 2011, even though the fair value of the TRUP was \$0.3 million below the Corporation's amortized cost at September 30, 2011. It was the Corporation's assessment that the impairment was temporary in nature at September 30, 2011.

At September 30, 2011, the Corporation expected to fully recover the entire amortized cost basis of each impaired investment security in its investment securities portfolio at that date. Furthermore, at September 30, 2011, the Corporation did not have the intent to sell any of its impaired investment securities and believed that it was more likely-than-not that the Corporation would not have to sell any of its impaired investment securities before a full recovery of amortized cost. However, there can be no assurance that OTTI losses will not be recognized on the TRUPs or on any other investment security in the future.

Loans

Chemical Bank is a full-service commercial bank and, therefore, the acceptance and management of credit risk is an integral part of the Corporation's business. At September 30, 2011, the Corporation's loan portfolio was \$3.76 billion and consisted of loans to commercial borrowers (commercial, real estate commercial, real estate construction and land development) totaling \$2.03 billion, or 54% of total loans, loans to borrowers for the purpose of acquiring residential real estate totaling \$840 million, or 22% of total loans, and loans to consumer borrowers (consumer installment and home equity) secured by various types of collateral totaling \$885 million, or 24% of total loans, at that date. Loans at fixed interest rates comprised approximately 73% of the Corporation's total loan portfolio at September 30, 2011, compared to 72% and 74% at December 31, 2010 and September 30, 2010, respectively.

The Corporation maintains loan policies and credit underwriting standards as part of the process of managing credit risk. These standards include making loans generally only within the Corporation's market areas. The Corporation's lending markets generally consist of communities across the middle to southern and western sections of the lower peninsula of Michigan. The Corporation's lending market areas do not include the southeastern portion of Michigan. The Corporation has no foreign loans or any loans to finance highly leveraged transactions. The Corporation's lending philosophy is implemented through strong administrative and

Table of Contents

reporting controls. The Corporation maintains a centralized independent loan review function that monitors the approval process and ongoing asset quality of the loan portfolio.

Total loans were \$3.76 billion at September 30, 2011, an increase of \$79 million, or 2.1%, from total loans of \$3.68 billion at December 31, 2010 and an increase of \$120 million, or 3.3%, from total loans of \$3.64 billion at September 30, 2010. The increase in total loans during the nine months ended September 30, 2011 was due to the Corporation originating \$33 million of conforming fifteen-year fixed-rate residential mortgage loans since year end 2010 that it held in its portfolio, as opposed to selling them in the secondary market as has been its general historic practice, and \$43 million of other fifteen-year fixed-rate residential mortgage loans due to an increase in loan demand for these products, combined with the Corporation extending its consumer loan promotion program. A summary of the Corporation's loan portfolio by category follows.

Commercial Loan Portfolio

Commercial loans consist of loans to varying types of businesses, including municipalities, school districts and nonprofit organizations, for the purpose of supporting working capital and operational needs and term financing of equipment. Repayment of such loans is generally provided through operating cash flows of the customer. Commercial loans are generally secured with inventory, accounts receivable, equipment, personal guarantees of the owner or other sources of repayment, although the Corporation may also obtain real estate as collateral.

Commercial loans were \$859.0 million at September 30, 2011, an increase of \$40.0 million, or 4.9%, from commercial loans of \$819.0 million at December 31, 2010 and an increase of \$64.3 million, or 8.1%, from commercial loans of \$794.7 million at September 30, 2010. The increase in commercial loans during the nine months ended September 30, 2011 was primarily due to increases in seasonal advances on working lines of credit. Commercial loans represented 22.8% of the Corporation's loan portfolio at September 30, 2011, compared to 22.2% and 21.8% at December 31, 2010 and September 30, 2010, respectively.

Real estate commercial loans include loans that are secured by real estate occupied by the borrower for ongoing operations, non-owner occupied real estate leased to one or more tenants and vacant land that has been acquired for investment or future land development. Real estate commercial loans were \$1.06 billion at September 30, 2011, a decrease of \$20.9 million, or 1.9%, from December 31, 2010 and a decrease of \$21.7 million, or 2.0%, from September 30, 2010. Loans secured by owner occupied properties, non-owner occupied properties and vacant land comprised 60%, 37% and 3%, respectively, of the Corporation's real estate commercial loans outstanding at September 30, 2011. Real estate commercial loans represented 28.1% of the Corporation's loan portfolio at September 30, 2011, compared to 29.3% and 29.7% at December 31, 2010 and September 30, 2010, respectively.

Real estate commercial lending is generally considered to involve a higher degree of risk than real estate residential lending and typically involves larger loan balances concentrated in a single borrower. In addition, the payment experience on loans secured by income-producing properties and vacant land loans are typically dependent on the success of the operation of the related project and are typically affected by adverse conditions in the real estate market and in the economy.

The Corporation generally attempts to mitigate the risks associated with commercial and real estate commercial lending by, among other things, lending primarily in its market areas, lending across industry lines, not developing a concentration in any one line of business and using prudent loan-to-value ratios in the underwriting process. The weakened economy in Michigan has resulted in higher loan delinquencies, customer bankruptcies and real estate foreclosures. Based on current economic conditions in Michigan, management expects real estate foreclosures to remain higher than historical averages. It is also management's belief that the loan portfolio is generally well-secured, despite declining market values for all types of real estate in the State of Michigan and nationwide.

Real estate construction and land development loans are primarily originated for land development and construction of commercial properties. Land development loans include loans made to developers for the purpose of infrastructure improvements to vacant land to create finished marketable residential and commercial lots/land. Real estate construction loans often convert to a real estate commercial loan at the completion of the construction period; however, most land development loans are originated with the intention that the loans will be repaid through the sale of finished properties by the developers within twelve months of the completion date. Real estate construction and land development loans were \$119.8 million at September 30, 2011, a decrease of \$22.8 million, or 16%, from real estate construction and land development loans of \$142.6 million at December 31, 2010 and a decrease of \$47.9 million, or 29%, from real estate construction and land development loans of \$167.7 million at September 30, 2010. The decrease in real estate construction loans during the nine months ended September 30, 2011 was primarily attributable to one project to finance the construction of a private recreational facility paying off during the third quarter of 2011. The Corporation's land development loans totaled \$47.0 million, \$53.4 million and \$55.6 million at September 30, 2011, December 31, 2010 and September 30, 2010, respectively, and consisted primarily of loans to develop land for the future construction of residential real estate properties. Real

Table of Contents

estate construction and land development loans represented 3.2% of the Corporation's loan portfolio at September 30, 2011, compared to 3.9% and 4.6% at December 31, 2010 and September 30, 2010, respectively.

Real estate construction lending involves a higher degree of risk than real estate commercial lending and real estate residential lending because of the uncertainties of construction, including the possibility of costs exceeding the initial estimates, the need to obtain a tenant or purchaser of the property if it will not be owner-occupied or the need to sell developed properties. The Corporation generally attempts to mitigate the risks associated with construction lending by, among other things, lending primarily in its market areas, using prudent underwriting guidelines and closely monitoring the construction process. The Corporation's risk in this area has increased since early 2008 due to the recessionary economic environment within the State of Michigan. The sale of lots and units in both residential and commercial development projects remains weak, as customer demand also remains low, resulting in the inventory of unsold lots and housing units remaining high across the State of Michigan. The unfavorable economic environment in Michigan has resulted in the inability of most developers to sell their finished developed lots and units within their original expected time frames. Accordingly, few of the Corporation's land development borrowers have sold developed lots or units since early 2008 due to the unfavorable economic environment.

The Corporation's commercial loan portfolio, comprised of commercial, real estate commercial, real estate construction and land development loans, is well diversified across business lines and has no concentration in any one industry. The commercial loan portfolio totaling \$2.03 billion at September 30, 2011 included 145 loan relationships of \$2.5 million or greater. These 145 borrowing relationships totaled \$759 million and represented 37% of the commercial loan portfolio at September 30, 2011 and included 11 borrowing relationships that had outstanding balances of \$10 million or higher, totaling \$148 million, or 7.3%, of the commercial loan portfolio at that date. Further, the Corporation had 10 loan relationships at September 30, 2011 with loan balances greater than \$2.5 million and less than \$10 million, totaling \$68 million, that had unfunded credit amounts that, if advanced, could result in a loan relationship of \$10 million or more.

Consumer Loan Portfolio

Real estate residential loans consist primarily of one- to four-family residential loans with fixed interest rates of fifteen years or less. The loan-to-value ratio at the time of origination is generally 80% or less. Loans with more than an 80% loan-to-value ratio generally require private mortgage insurance. The Corporation has historically sold conforming fixed interest rate real estate residential loans originated with maturities of fifteen years and over in the secondary market. However, during 2010 and the first nine months of 2011, the Corporation originated \$47 million and \$33 million, respectively, of conforming fifteen-year fixed-rate real estate residential loans and \$24 million and \$43 million, respectively, of other fifteen-year fixed-rate residential loans, that it retained in its portfolio. The Corporation's other fifteen-year fixed-rate real estate residential loans have historically been low. However, due to an increase in customer loan demand, the Corporation experienced a significant increase in these loans during the second half of 2010 and first nine months of 2011.

Real estate residential loans were \$840.0 million at September 30, 2011, an increase of \$42.0 million, or 5.3%, from real estate residential loans of \$798.0 million at December 31, 2010 and an increase of \$92.9 million, or 12%, from real estate residential loans of \$747.1 million at September 30, 2010. The increases in real estate residential loans from December 31, 2010 and September 30, 2010 were due to the Corporation originating fifteen-year term fixed interest rate real estate residential loans, as previously discussed. While real estate residential loans have historically involved the least amount of credit risk in the Corporation's loan portfolio, the risk on these loans has increased with the increase in the unemployment rate in the State of Michigan and the decrease in real estate property values in the State of Michigan. Real estate residential loans also include loans to consumers for the construction of single family residences that are secured by these properties. Real estate residential construction loans to consumers were \$16.9 million at September 30, 2011, compared to \$15.3 million at December 31, 2010 and \$20.5 million at September 30, 2010. Real estate residential loans represented 22.3% of the Corporation's loan portfolio at September 30, 2011, compared to 21.7% and 20.5% at December 31, 2010 and September 30, 2010, respectively.

The Corporation's consumer installment and home equity loans (collectively referred to as consumer loans) consist of relatively small loan amounts to consumers to finance personal items, primarily automobiles, recreational vehicles, boats and home improvements. These loans are spread across many individual borrowers, which minimizes the risk per loan transaction. Collateral values, particularly those of automobiles, recreational vehicles and boats, are negatively impacted by many factors, such as new car promotions, the physical condition of the collateral and even more significantly, overall economic conditions. Consumer loans also include home equity loans, whereby consumers utilize equity in their personal residence, generally through a second mortgage, as collateral to secure the loan.

Consumer loans were \$885.5 million at September 30, 2011, an increase of \$40.5 million, or 4.8%, from consumer loans of \$845.0 million at December 31, 2010 and an increase of \$32.0 million, or 3.7%, from consumer loans of \$853.5 million at September 30,

Table of Contents

2010. The increase in consumer loans from December 31, 2010 was due to the Corporation's extended consumer loan promotion program, which historically occurred during the spring but has extended into the fall in 2011 due to the low interest rate environment, increased competition for these loans and general lack of loan demand. Consumer loans include indirect loans for automobile, recreational vehicle and boat financing purchased from dealerships. At September 30, 2011, approximately 46% of consumer loans were secured by the borrowers' personal residences (primarily second mortgages), 23% by automobiles, 20% by recreational vehicles, 9% by marine vehicles and the remaining 2% was mostly unsecured. Consumer loans represented 23.6% of the Corporation's loan portfolio at September 30, 2011, compared to 22.9% and 23.4% at December 31, 2010 and September 30, 2010, respectively.

Consumer loans generally have shorter terms than residential mortgage loans, but generally involve more credit risk than real estate residential lending because of the type and nature of the collateral. The Corporation originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. Consumer lending collections are dependent on the borrowers' continuing financial stability and are more likely to be affected by adverse personal situations. The unemployment rate in the State of Michigan was 11.1% at September 30, 2011, unchanged from December 31, 2010, and down from 11.9% at September 30, 2010, although higher than the national average of 9.1% at September 30, 2011. The Corporation has experienced decreases in losses on consumer loans, with net loan losses totaling 66 basis points (annualized) of average consumer loans during the first nine months of 2011, compared to 116 basis points of average consumer loans in 2010. The credit risk on home equity loans has historically been low as property values of residential real estate have historically increased year over year. However, credit risk has increased since the beginning of 2008 as property values have declined throughout the State of Michigan, thus increasing the risk of insufficient collateral, and in many instances no collateral on some home equity loans, as the majority of these loans are secured by a second mortgage on the borrowers' residences.

Nonperforming Assets

Nonperforming assets include nonperforming loans, which consist of originated loans for which the accrual of interest has been discontinued (nonaccrual loans), originated loans that are past due as to principal or interest by 90 days or more and are still accruing interest and originated loans that have been modified under troubled debt restructurings (TDRs) where a concession has been granted to the borrower due to a decline in the credit quality and the borrower has not satisfied the Corporation's payment policy (as described below) to be considered performing. Nonperforming assets also include assets obtained through foreclosures and repossessions, including foreclosed and repossessed assets acquired as a result of the OAK acquisition. The Corporation transfers an originated loan that is 90 days or more past due to nonaccrual status (except for real estate residential loans that are transferred at 120 days past due), unless it believes the loan is both well-secured and in the process of collection. Accordingly, the Corporation has determined that the collection of accrued and unpaid interest on any originated loan that is 90 days or more past due (120 days or more past due on real estate residential loans) and still accruing interest is probable. TDRs continue to be reported as nonperforming loans until a six-month payment history of principal and interest payments is sustained in accordance with the loan modification, at which time the Corporation moves the loan to a performing TDR status.

Nonperforming assets were \$149.1 million at September 30, 2011, compared to \$160.5 million at June 30, 2011 and \$175.2 million at December 31, 2010, and represented 2.74%, 3.08% and 3.34%, respectively, of total assets. While the Corporation's levels of nonperforming assets have remained elevated due to the unfavorable economic climate within the State of Michigan that has existed for more than four years and which has resulted in cash flow difficulties being encountered by many business and consumer loan customers, the credit quality of the Corporation's loan portfolio has improved, with nonperforming assets as of September 30, 2011 declining \$11.4 million, or 7.1%, since June 30, 2011 and \$26.1 million, or 15%, since December 31, 2010. The Corporation's nonperforming assets are not concentrated in any one industry or any one geographical area within Michigan, other than \$8.0 million in nonperforming land development loans. At September 30, 2011, there were three commercial loan relationships exceeding \$2.5 million, totaling \$12.6 million, that were in nonperforming status. Based on declines in both residential and commercial real estate appraised values due to the weakness in the Michigan economy over the past several years, management continues to evaluate and, when appropriate, discount appraised values and obtain new appraisals to compute estimated fair market values of impaired real estate secured loans and other real estate properties. Due to the economic climate within Michigan, it is management's belief that nonperforming assets will remain at elevated levels through the remainder of 2011 and beyond.

Table of Contents

The following schedule provides a summary of nonperforming assets, including the composition of nonperforming loans by major loan category.

	September 30, 2011	June 30, 2011 (In thousands)	December 31, 2010
Nonaccrual loans:			
Commercial	\$ 10,804	\$ 14,386	\$ 16,668
Real estate commercial	48,854	57,324	60,558
Real estate construction and land development	7,877	8,933	8,967
Real estate residential	17,544	17,809	12,083
Consumer installment and home equity	6,033	6,898	4,686
Total nonaccrual loans	91,112	105,350	102,962
Accruing loans contractually past due 90 days or more as to interest or principal payments:			
Commercial	282	629	530
Real estate commercial	415	143	1,350
Real estate construction and land development			1,220
Real estate residential	974	1,729	3,253
Consumer installment and home equity	1,344	1,243	1,055
Total accruing loans contractually past due 90 days or more as to interest or principal payments	3,015	3,744	7,408
TDRs:			
Commercial and real estate commercial	16,457	15,443	15,057
Real estate residential	9,811	11,392	22,302
Total nonperforming TDRs	26,268	26,835	37,359
Total nonperforming loans	120,395	135,929	147,729
Other real estate and repossessed assets(1)	28,679	24,607	27,510
Total nonperforming assets	\$ 149,074	\$ 160,536	\$ 175,239
Nonperforming loans as a percent of total loans	3.20%	3.63%	4.01%
Nonperforming assets as a percent of total assets	2.74%	3.08%	3.34%
Performing TDRs not included in the categories above	\$ 15,543	\$ 12,889	\$

(1) Includes property acquired through foreclosure and by acceptance of a deed in lieu of foreclosure and other property held for sale, including properties acquired as a result of the OAK acquisition.

The following schedule provides the composition of nonperforming loans by major loan category.

	September 30, 2011 Amount	June 30, 2011 Amount	December 31, 2010 Amount
--	------------------------------	-------------------------	-----------------------------

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

		Percent of Total	(In thousands)		Percent of Total	Percent of Total
Commercial	\$ 16,624	14%	\$ 20,186	15%	\$ 22,511	15%
Real estate commercial	60,068	50	67,620	50	71,652	49
Real estate construction and land development	7,997	7	9,052	6	10,187	7
Subtotal	84,689	71	96,858	71	104,350	71
Real estate residential	28,329	23	30,930	23	37,638	25
Consumer installment and home equity	7,377	6	8,141	6	5,741	4
Total nonperforming loans	\$ 120,395	100%	\$ 135,929	100%	\$ 147,729	100%

Table of Contents

Total nonperforming loans were \$120.4 million at September 30, 2011, a decrease of \$15.5 million, or 11%, compared to \$135.9 million at June 30, 2011 and a decrease of \$27.3 million, or 19%, compared to \$147.7 million at December 31, 2010. The Corporation's nonperforming loans to commercial borrowers (commercial, real estate commercial and real estate construction and land development), including TDRs, were \$84.7 million at September 30, 2011, a decrease of \$12.2 million, or 13%, from \$96.9 million at June 30, 2011 and a decrease of \$19.7 million, or 19%, from \$104.4 million at December 31, 2010. Nonperforming loans to commercial borrowers comprised 71% of total nonperforming loans at September 30, 2011, June 30, 2011 and December 31, 2010. The majority of the Corporation's 2011 net loan charge-offs occurred within these three commercial loan categories, with 61% and 67% of net loan charge-offs during the three and nine months ended September 30, 2011, respectively, attributable to commercial borrowers. Nonperforming real estate residential loans, including TDRs, were \$28.3 million at September 30, 2011, a decrease of \$2.6 million, or 8.4%, from \$30.9 million at June 30, 2011 and a decrease of \$9.3 million, or 25%, from \$37.6 million at December 31, 2010. Nonperforming consumer loans were \$7.4 million at September 30, 2011, a decrease of \$0.7 million, or 9.4%, from \$8.1 million at June 30, 2011 and an increase of \$1.7 million, or 28%, from \$5.7 million at December 31, 2010.

The following schedule summarizes changes in nonaccrual loans during the three and nine months ended September 30, 2011.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(In thousands)	
Balance at beginning of period	\$ 105,350	\$ 102,962
Additions during period	12,541	52,003
Principal balances charged off	(7,413)	(22,605)
Transfers to other real estate/repossessed assets	(7,063)	(11,368)
Return to accrual status	(6,542)	(12,884)
Payments received	(5,761)	(16,996)
Balance at end of period	\$ 91,112	\$ 91,112

The following schedule presents data related to nonperforming loans to commercial borrowers by dollar amount at September 30, 2011, June 30, 2011 and December 31, 2010.

	September 30, 2011		June 30, 2011		December 31, 2010	
	Number of Borrowers	Amount	Number of Borrowers	Amount	Number of Borrowers	Amount
	(Dollars in thousands)					
\$5,000,000 or more	1	\$ 7,024	1	\$ 7,114	1	\$ 7,227
\$2,500,000 - \$4,999,999	2	5,594	3	8,834	6	17,071
\$1,000,000 - \$2,499,999	16	26,978	16	28,552	18	29,246
\$500,000 - \$999,999	17	11,686	21	14,999	22	14,483
\$250,000 - \$499,999	54	19,386	56	20,386	50	18,188
Under \$250,000	165	14,021	192	16,973	202	18,135
Total	255	\$ 84,689	289	\$ 96,858	299	\$ 104,350

Nonperforming commercial loans were \$16.6 million at September 30, 2011, a decrease of \$3.6 million, or 18%, from \$20.2 million at June 30, 2011 and a decrease of \$5.9 million, or 26%, from \$22.5 million at December 31, 2010. The nonperforming commercial loans at September 30, 2011 were not concentrated in any single industry.

Nonperforming real estate commercial loans were \$60.1 million at September 30, 2011, a decrease of \$7.5 million, or 11%, from \$67.6 million at June 30, 2011 and a decrease of \$11.6 million, or 16% from \$71.7 million at December 31, 2010. At September 30, 2011, the Corporation's nonperforming real estate commercial loans were comprised of \$29.7 million of loans secured by owner occupied real estate, \$23.0 million of

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

loans secured by non-owner occupied real estate and \$7.4 million of loans secured by vacant land, resulting in approximately 6% of owner occupied real estate commercial loans, 9% of non-owner occupied real estate commercial loans and 31% of vacant land loans in a nonperforming status at September 30, 2011. At September 30, 2011, the Corporation's nonperforming real estate commercial loans were comprised of a diverse mix of commercial lines of business and were also geographically disbursed throughout the Corporation's market areas. The largest concentration of the \$60.1 million in nonperforming real estate commercial loans at September 30, 2011 was one customer relationship totaling \$6.8 million that was secured by a combination of vacant land and non-owner occupied commercial real estate. This same customer relationship had another \$0.2 million included in nonperforming real estate construction and land development loans. At September 30, 2011, \$11.0 million of the nonperforming real estate commercial loans were in various stages of foreclosure with 47 borrowers. Challenges remain in the Michigan economy, thus creating a difficult business environment for many lines of business across the state.

Table of Contents

Nonperforming real estate construction and land development loans were \$8.0 million at September 30, 2011, a decrease of \$1.1 million, or 12%, from \$9.1 million at June 30, 2011 and a decrease of \$2.2 million, or 21%, from \$10.2 million at December 31, 2010. At September 30, 2011, all of the nonperforming real estate construction and land development loans were land development loans secured primarily by residential real estate improved lots and housing units. The \$8.0 million of nonperforming loans secured by land development projects represented 25% of total originated land development loans outstanding of \$31.5 million at September 30, 2011. The economy in Michigan has adversely impacted housing demand throughout the state and, accordingly, a significant percentage of the Corporation's residential real estate development borrowers have experienced cash flow difficulties associated with a significant decline in sales of both lots and residential real estate.

Nonperforming real estate residential loans were \$28.3 million at September 30, 2011, a decrease of \$2.6 million, or 8.4%, from \$30.9 million at June 30, 2011 and a decrease of \$9.3 million, or 25%, from \$37.6 million at December 31, 2010. The decrease at September 30, 2011 was attributable to the Corporation classifying \$11.6 million of real estate residential TDRs as performing TDRs due to the borrowers' sustained repayment history. At September 30, 2011, a total of \$7.0 million of nonperforming real estate residential loans were in various stages of foreclosure.

Nonperforming consumer loans were \$7.4 million at September 30, 2011, a decrease of \$0.7 million, or 9.4%, from \$8.1 million at June 30, 2011 and an increase of \$1.7 million, or 28%, from \$5.7 million at December 31, 2010.

The unfavorable economic climate in Michigan has resulted in an increasing number of both business and consumer customers with cash flow difficulties and thus the inability to maintain their loan balances in a performing status. The Corporation determined that it was probable that certain customers who were past due on their loans, if provided a reduction in their monthly payment for a limited time period, would be able to bring their loan relationship to a performing status and was believed by the Corporation to potentially result in a lower level of loan losses and loan collection costs than if the Corporation currently proceeded through the foreclosure process with these borrowers. These modifications meet the criteria to be considered TDRs.

The Corporation's nonperforming TDRs-commercial and real estate commercial generally consist of allowing borrowers to temporarily defer scheduled principal payments and make interest only payments for a short period of time (generally six months to one year) at the stated interest rate of the original loan agreement or lower payments due to a modification of the loan's contractual terms. The outstanding balance of these loans was \$16.5 million at September 30, 2011, compared to \$15.4 million at June 30, 2011 and \$15.1 million at December 31, 2010. The Corporation does not expect to incur a loss on these loans based on its assessment of the borrowers' expected cash flows, and accordingly, no additional provision for loan losses has been recognized related to these loans. These loans are individually evaluated for impairment and transferred to nonaccrual status if conditions change and it is probable that any remaining principal and interest payments due on the loan will not be collected in accordance with the modified contractual terms of the loan. Once these loans have made at least six consecutive months of payments under a formal modification agreement that follows the temporary deferral period, they are classified by the Corporation as performing TDRs. At September 30, 2011, the Corporation classified \$3.9 million of TDRs-commercial and real estate commercial as performing TDRs, compared to \$2.1 million at June 30, 2011, due to the borrowers' sustained repayment history.

The Corporation's nonperforming TDRs-real estate residential generally consist of reducing a borrower's monthly payments by decreasing the interest rate charged on the loan to 3% for a specified period of time (generally 24 months). These loans are moved to nonaccrual status when the loan becomes 90 days past due as to principal or interest, or sooner if conditions warrant. The outstanding balance of these loans was \$9.8 million at September 30, 2011, compared to \$11.4 million at June 30, 2011 and \$22.3 million at December 31, 2010. At September 30, 2011, the Corporation classified \$11.6 million of TDRs-real estate residential as performing TDRs, compared to \$10.8 million at June 30, 2011, due to the borrowers' sustained repayment history. The Corporation recognized \$0.2 million of additional provision for loan losses during the nine months ended September 30, 2011 related to impairment on these loans based on the present value of expected future cash flows discounted at the loan's original effective interest rate.

Other real estate and repossessed assets is a component of nonperforming assets that includes residential and commercial real estate and development properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure, and also other personal and commercial assets. Other real estate and repossessed assets were \$28.7 million at September 30, 2011, an increase of \$4.1 million, or 17%, from \$24.6 million at June 30, 2011 and an increase of \$1.2 million, or 4.2%, from \$27.5 million at December 31, 2010. The net increase during the third quarter of 2011 was primarily attributable to the addition of eight foreclosed properties totaling \$4.5 million.

Table of Contents

The following schedule provides the composition of other real estate and repossessed assets.

	September 30, 2011	June 30, 2011 (In thousands)	December 31, 2010
Other real estate:			
Vacant land	\$ 7,662	\$ 7,811	\$ 9,149
Commercial properties	11,049	8,564	8,604
Residential real estate properties	7,323	5,236	6,189
Residential development properties	2,085	2,529	3,035
Total other real estate	28,119	24,140	26,977
Repossessed assets	560	467	533
Total other real estate and repossessed assets	\$ 28,679	\$ 24,607	\$ 27,510

The following schedule summarizes other real estate and repossessed asset activity during the three and nine months ended September 30, 2011.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(In thousands)	
Balance at beginning of period	\$ 24,607	\$ 27,510
Additions	8,460	14,545
Write-downs to fair value	(625)	(1,549)
Dispositions	(3,763)	(11,827)
Balance at end of period	\$ 28,679	\$ 28,679

The historically large inventory of real estate properties for sale across the State of Michigan has resulted in an increase in the Corporation's carrying time and cost of holding other real estate. Consequently, the Corporation had \$11.2 million in real estate properties at September 30, 2011 that had been held in excess of one year as of that date, of which \$2.9 million was vacant land, \$4.0 million were commercial properties, \$2.3 million were residential real estate properties and \$2.0 million were residential development properties. Due to the redemption period on foreclosures being relatively long in Michigan (six months to one year) and the Corporation having a significant number of nonperforming loans that were in the process of foreclosure at September 30, 2011, it is anticipated that the level of other real estate will remain at elevated levels throughout 2011. Other real estate properties are carried at the lower of cost or fair value less estimated costs to sell.

At September 30, 2011, all of the other real estate properties had been written down to fair value through either a charge-off at the transfer of the loan to other real estate, a write-down recorded as an operating expense to recognize a further market value decline of the property after the initial transfer date or recording at fair value in conjunction with the OAK acquisition. Accordingly, at September 30, 2011, the carrying value of other real estate of \$28.1 million was reflective of \$37.4 million in fair value adjustments, resulting in the carrying value at September 30, 2011 representing 43% of the contractual loan balance remaining at the time the property was transferred to other real estate.

There were 178 other real estate properties sold during the first nine months of 2011 for net proceeds of \$10.3 million. On an average basis, the net proceeds from these sales represented 112% of the carrying value of the property at the time of sale, although the net proceeds represented 42% of the remaining contractual loan balance at the time the Corporation received title to the properties.

Impaired Loans

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

A loan is considered impaired when management determines it is probable that all of the principal and interest due will not be collected according to the original contractual terms of the loan agreement. In most instances, impairment is measured based on the fair market value of the underlying collateral. Impairment may also be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. A portion of the allowance for loan losses may be specifically allocated to impaired loans. The process of measuring impaired loans and the allocation of the allowance for loan losses requires judgment and estimation. The eventual outcome may differ from amounts estimated. A discussion of the allowance for loan losses is included under the subheading, Allowance for Loan Losses, below.

Table of Contents

Impaired loans totaled \$152.7 million at September 30, 2011, a decrease of \$10.9 million, compared to \$163.6 million at June 30, 2011 and a decrease of \$9.0 million, compared to \$161.7 million at December 31, 2010. A summary of impaired loans at September 30, 2011, June 30, 2011 and December 31, 2010 follows:

	September 30, 2011	June 30, 2011 (In thousands)	December 31, 2010
Nonaccrual loans:			
Commercial borrowers	\$ 67,535	\$ 80,643	\$ 86,193
Consumer borrowers	23,577	24,707	16,769
Nonperforming TDRs:			
Commercial borrowers	16,457	15,443	15,057
Real estate residential	9,811	11,392	22,302
Performing TDRs:			
Commercial borrowers	3,938	2,125	
Real estate residential	11,605	10,764	
Acquired loans not performing in accordance with original contractual terms	19,732	18,570	21,385
Total impaired loans	\$ 152,655	\$ 163,644	\$ 161,706

After analyzing the various components of the customer relationships and evaluating the underlying collateral of impaired loans, it was determined that impaired loans to commercial borrowers totaling \$27.2 million at September 30, 2011 required a specific allocation of the allowance for loan losses (valuation allowance), compared to \$39.2 million at June 30, 2011 and \$44.9 million at December 31, 2010.

The following schedule summarizes impaired loans to commercial borrowers and the related valuation allowance at September 30, 2011, June 30, 2011 and December 31, 2010 and partial loan charge-offs (confirmed losses) taken on these impaired loans:

	Amount	Valuation Allowance	Confirmed Losses	Cumulative Inherent Loss Percentage
(In thousands)				
September 30, 2011				
Impaired originated loans to commercial borrowers:				
With valuation allowance and no charge-offs	\$ 18,226	\$ 5,338	\$	29%
With valuation allowance and charge-offs	8,948	3,370	2,793	52
With charge-offs and no valuation allowance	32,722		19,334	37
Without valuation allowance or charge-offs	28,034			
Total	87,930	\$ 8,708	\$ 22,127	28%
Impaired acquired loans	19,732			
Total impaired loans to commercial borrowers	\$ 107,662			
June 30, 2011				
Impaired originated loans to commercial borrowers:				
With valuation allowance and no charge-offs	\$ 24,196	\$ 5,987	\$	25%
With valuation allowance and charge-offs	14,988	4,889	3,563	46
With charge-offs and no valuation allowance	29,582		19,021	39

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Without valuation allowance or charge-offs	29,445			
Total	98,211	\$ 10,876	\$ 22,584	28%
Impaired acquired loans	18,570			
Total impaired loans to commercial borrowers	\$ 116,781			
December 31, 2010				
Impaired originated loans to commercial borrowers:				
With valuation allowance and no charge-offs	\$ 33,056	\$ 12,015	\$	36%
With valuation allowance and charge-offs	11,795	2,951	1,551	34
With charge-offs and no valuation allowance	20,033		18,277	48
Without valuation allowance or charge-offs	36,366			
Total	101,250	\$ 14,966	\$ 19,828	29%
Impaired acquired loans	21,385			
Total impaired loans to commercial borrowers	\$ 122,635			

Table of Contents

Confirmed losses represent partial loan charge-offs on impaired loans due primarily to the receipt of a recent third-party property appraisal indicating the value of the collateral securing the loan is below the loan balance and management believes full collection of the loan balance is not likely.

The Corporation's valuation allowance for impaired commercial, real estate commercial and real estate construction and land development loans was \$8.7 million at September 30, 2011, a decrease of \$2.2 million from \$10.9 million at June 30, 2011 and a decrease of \$6.3 million from \$15.0 million at December 31, 2010. The decrease in the valuation allowance is primarily reflective of partial loan charge-offs of impaired loans during the three and nine months ended September 30, 2011 combined with improvement in the credit quality of the loan portfolio. Additionally, the Corporation had a valuation allowance attributable to TDRs-real estate residential of \$0.6 million at September 30, 2011, compared to \$0.7 million at June 30, 2011 and \$0.8 million at December 31, 2010. The Corporation's nonperforming TDRs-commercial borrowers of \$16.5 million, \$15.4 million and \$15.1 million at September 30, 2011, June 30, 2011 and December 31, 2010, respectively, did not require a valuation allowance as the Corporation expects to collect the full principal and interest owed on each loan.

Impaired loans included acquired loans totaling \$19.7 million, \$18.6 million and \$21.4 million at September 30, 2011, June 30, 2011 and December 31, 2010, respectively, that were not performing in accordance with the original contractual terms of the loans. These loans were recorded at their estimated fair value, which included estimated credit losses, at the acquisition date and are considered performing due to the application of ASC 310-30 as discussed in Note 1 to the consolidated financial statements under the subheading, Loans Acquired in a Business Combination.

Allowance for Loan Losses

The allowance for loan losses (allowance) provides for probable losses in the originated loan portfolio that have been identified with specific customer relationships and for probable losses believed to be inherent in the remainder of the originated loan portfolio but that have not been specifically identified. The allowance is comprised of specific valuation allowances (assessed for originated loans that have known credit weaknesses), pooled allowances based on assigned risk ratings and historical loan loss experience for each loan type, and an unallocated allowance for imprecision in the subjective nature of the specific and pooled allowance methodology. Management evaluates the allowance on a quarterly basis in an effort to ensure the level is adequate to absorb probable losses inherent in the loan portfolio. This evaluation process is inherently subjective as it requires estimates that may be susceptible to significant change and has the potential to affect net income materially. The Corporation's methodology for measuring the adequacy of the allowance includes several key elements, which includes a review of the loan portfolio, both individually and by category, and includes consideration of changes in the mix and volume of the loan portfolio, actual loan loss experience, review of collateral values, the financial condition of the borrowers, industry and geographical exposures within the portfolio, economic conditions and employment levels of the Corporation's local markets and other factors affecting business sectors. Management believes that the allowance is currently maintained at an appropriate level, considering the inherent risk in the loan portfolio. Future significant adjustments to the allowance may be necessary due to changes in economic conditions, delinquencies or the level of loan losses incurred.

The Corporation's allowance does not include losses inherent in the acquired loan portfolio, as an allowance was not carried over on the date of acquisition. The acquired loans were recorded at their estimated fair value at the date of acquisition, with the estimated fair value including a component for expected credit losses. A portion of the allowance, however, may be set aside in the future, related to the acquired loans, if an acquired loan pool experiences a decrease in expected cash flows as compared to those expected at the acquisition date. At September 30, 2011, an allowance of \$1.3 million related to acquired loans was required primarily due to one of the acquired loan pools experiencing a decline in expected cash flows during the third quarter of 2011. There were no material changes in expected cash flows for the remaining acquired loan pools.

The Corporation's allowance for originated loans was \$87.4 million at September 30, 2011, compared to \$89.7 million at June 30, 2011 and \$89.5 million at both December 31, 2010 and September 30, 2010. The allowance for originated loans as a percentage of originated loans was 2.68% at September 30, 2011, compared to 2.78% at June 30, 2011, 2.86% at December 31, 2010 and 2.94% at September 30, 2010. The allowance for originated loans as a percentage of nonperforming loans was 73% at September 30, 2011, compared to 66% at June 30, 2011 and 61% at both December 31, 2010 and September 30, 2010. The allowance for originated loans as a percentage of nonperforming loans, net of impaired originated loans for which the expected loss has been charged-off, was 100% at September 30, 2011, compared to 84% at June 30, 2011, 70% at December 31, 2010 and 68% at September 30, 2010.

Table of Contents

The following schedule summarizes the allowance for originated loans as a percentage of nonperforming loans.

	September 30, 2011	June 30, 2011 (In thousands)	December 31, 2010
Allowance for loan losses originated loans	\$ 87,413	\$ 89,733	\$ 89,530
Nonperforming loans	120,395	135,929	147,729
Allowance for originated loans as a percent of nonperforming loans	73%	66%	61%
Allowance for originated loans as a percent of nonperforming loans, net of impaired originated loans for which the expected loss has been charged-off	100%	84%	70%

Economic conditions in the Corporation's markets, all within Michigan, were generally less favorable than those nationwide during 2010. Economic challenges remain in Michigan and are expected to continue in 2011. Accordingly, management believes net loan losses, delinquencies and nonperforming loans will remain at elevated levels during 2011 and beyond.

Total Deposits

Total deposits were \$4.48 billion at September 30, 2011, an increase of \$149 million, or 3.4%, from total deposits of \$4.33 billion at December 31, 2010, and an increase of \$13 million, or 0.3%, from total deposits of \$4.47 billion at September 30, 2010. The increase in total deposits from year end 2010 was primarily attributable to seasonal increases in municipal customer deposits being partially offset by the Corporation paying off maturing brokered deposits acquired in the OAK acquisition. The increase in total deposits for the twelve-month period ended September 30, 2011 was primarily attributable to growth in customer deposits of \$97 million during the twelve-month period ended September 30, 2011 that was offset by the Corporation paying off maturing brokered deposits that were acquired in the OAK acquisition. At September 30, 2011, the Corporation had \$98 million in remaining brokered deposits that were acquired in the OAK acquisition. The Corporation intends to continue to use its liquidity to pay off brokered deposits as they mature, with \$7 million maturing during the remainder of 2011, \$35 million maturing in 2012 and the remainder thereafter.

The Corporation's competitive position within many of its market areas has historically limited its ability to materially increase core deposits without adversely impacting the weighted average cost of the deposit portfolio. While competition for core deposits remained strong throughout the Corporation's markets during 2010 and the first nine months of 2011, the Corporation's increased efforts to expand its deposit relationships with existing customers, the Corporation's financial strength and a general trend in customers holding more liquid assets, resulted in the Corporation experiencing a significant increase in customer deposits during 2010. Total deposits increased \$97 million, excluding brokered deposits acquired in the OAK acquisition, during the twelve months ended September 30, 2011, while during the same time frame, the Corporation experienced a decrease in the average cost of its deposits.

Borrowed Funds

Short-term borrowings, comprised of securities sold under agreements to repurchase with customers, were \$302.3 million at September 30, 2011, compared to \$242.7 million at December 31, 2010 and \$254.8 million at September 30, 2010. Securities sold under agreements to repurchase are funds deposited by customers that are secured by investment securities that are owned by Chemical Bank, although not covered by FDIC insurance. These funds have been a stable source of liquidity for Chemical Bank, much like its core deposit base. The increase of \$47.5 million in securities sold under agreements to repurchase during the twelve-month period ended September 30, 2011, was primarily due to increases attributable to municipal and business customers. The Corporation's securities sold under agreements to repurchase do not qualify as sales for accounting purposes.

Federal Home Loan Bank (FHLB) advances are comprised of borrowings from the FHLB that have original maturities of greater than one year. FHLB advances totaled \$46.0 million at September 30, 2011, compared to \$74.1 million at December 31, 2010 and \$85.4 million at September 30, 2010. The Corporation acquired \$36 million of FHLB advances in conjunction with the OAK acquisition, of which \$21 million were outstanding at September 30, 2011. FHLB advances are secured under a blanket security agreement of real estate residential first lien loans with an aggregate book value equal to at least 155% of the advances. At September 30, 2011, the carrying value of real estate residential first lien loans eligible for collateral under the blanket security agreement was \$793 million.

Table of Contents

The scheduled principal reductions on FHLB advances outstanding at September 30, 2011, including amortization of the unamortized fair value premium of \$0.7 million attributable to the OAK acquisition, were as follows (in thousands):

2011	\$ 2,934
2012	8,767
2013	28,025
2014	5,734
2015	531
Total	\$ 45,991

At September 30, 2011, the Corporation's additional borrowing availability through the FHLB, based on the amount of FHLB stock owned by the Corporation and subject to the FHLB's credit requirements and policies, was \$295 million. At September 30, 2011, the Corporation had agreements in place to obtain up to \$29 million in additional liquidity through borrowings from the Federal Reserve Bank's discount window at the Corporation's discretion.

Credit Related Commitments

The Corporation has credit related commitments that may impact its liquidity. The following schedule summarizes the Corporation's loan commitments and expected expiration dates by period at September 30, 2011. Since many of these commitments historically have expired without being drawn upon, the total amount of these commitments does not necessarily represent future cash requirements of the Corporation.

	Less than 1 year	1-3 years	3-5 years (In thousands)	More than 5 years	Total
Unused commitments to extend credit	\$ 439,325	\$ 92,361	\$ 61,346	\$ 61,144	\$ 654,176
Loan commitments	224,623				224,623
Standby letters of credit	30,508	13,460	3,798	225	47,991
Total commitments	\$ 694,456	\$ 105,821	\$ 65,144	\$ 61,369	\$ 926,790

Capital

Total shareholders' equity was \$577.0 million at September 30, 2011, compared to \$560.1 million at December 31, 2010 and \$561.0 million at September 30, 2010. Total shareholders' equity as a percentage of total assets was 10.6% as of September 30, 2011, compared to 10.7% at December 31, 2010 and 10.4% at September 30, 2010. Tangible shareholders' equity as a percentage of total assets was 8.6% at both September 30, 2011 and December 31, 2010, compared to 8.4% at September 30, 2010.

The Corporation and Chemical Bank continue to maintain strong capital positions, which significantly exceeded the minimum levels prescribed by the Federal Reserve at September 30, 2011, as shown in the following schedule:

	Leverage	Tier 1 Risk-Based Capital	Total Risk-Based Capital
Actual Ratio:			
Chemical Financial Corporation	8.6%	11.8%	13.1%
Chemical Bank	8.5	11.6	12.9

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Minimum required for capital adequacy purposes	4.0	4.0	8.0
Minimum required for well-capitalized capital adequacy purposes	5.0	6.0	10.0

On April 18, 2011, the shareholders of the Corporation approved an amendment to the restated articles of incorporation to increase the number of authorized shares of common stock from 30,000,000 to 45,000,000.

Table of Contents**Results of Operations*****Net Interest Income***

Interest income is the total amount earned on funds invested in loans, investment and other securities, federal funds sold and interest-bearing deposits with unaffiliated banks and others. Interest expense is the amount of interest paid on interest-bearing checking and savings accounts, time deposits, short-term borrowings and FHLB advances. Net interest income, on a fully taxable equivalent (FTE) basis, is the difference between interest income and interest expense adjusted for the tax benefit on tax-exempt commercial loans and investment securities. Net interest margin is calculated by dividing net interest income (FTE) by average interest-earning assets, annualized as applicable. Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Because noninterest-bearing sources of funds, or free funds (principally demand deposits and shareholders' equity), also support earning assets, the net interest margin exceeds the net interest spread.

Net interest income (FTE) was \$47.6 million in the third quarter of 2011, compared to \$46.5 million in the second quarter of 2011 and \$47.1 million in the third quarter of 2010.

The presentation of net interest income on an FTE basis is not in accordance with GAAP but is customary in the banking industry. This non-GAAP measure ensures comparability of net interest income arising from both taxable and tax-exempt loans and investment securities. The adjustments to determine net interest income (FTE) were \$1.3 million for both the third quarter of 2011 and second quarter of 2011 and \$1.2 million for the third quarter of 2010. These adjustments were computed using a 35% federal income tax rate.

Net interest income is the most important source of the Corporation's earnings and thus is critical in evaluating the results of operations. Changes in the Corporation's net interest income are influenced by a variety of factors, including changes in the level and mix of interest-earning assets and interest-bearing liabilities, the level and direction of interest rates, the difference between short-term and long-term interest rates (the steepness of the yield curve) and the general strength of the economies in the Corporation's markets. Risk management plays an important role in the Corporation's level of net interest income. The ineffective management of credit risk, and more significantly interest rate risk, can adversely impact the Corporation's net interest income. Management monitors the Corporation's consolidated statement of financial position to reduce the potential adverse impact on net interest income caused by significant changes in interest rates. The Corporation's policies in this regard are further discussed under the subheading Market Risk.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, was 3.25% at the end of 2008 and remained at this historically low rate through September 30, 2011.

Net interest income (FTE) of \$47.6 million in the third quarter of 2011 was \$1.1 million, or 2.4%, higher than net interest income (FTE) of \$46.5 million in the second quarter of 2011. The increase in net interest income of \$1.1 million in the third quarter of 2011, as compared to the second quarter of 2011, was primarily attributable to a decrease in the cost of interest-bearing liabilities due to the continued declines in market interest rates, an increase in the loan portfolio, with average loans up \$64 million in the third quarter, and one additional day during the third quarter, which were partially offset by a decline in the average yield on loans due to the lower interest rate environment. The net interest margin in the third quarter of 2011 was 3.80%, up from 3.78% in the second quarter of 2011. The average yield on interest-earning assets decreased four basis points to 4.41% in the third quarter of 2011, from 4.45% in the second quarter of 2011. The average cost of interest-bearing liabilities decreased five basis points to 0.80% in the third quarter of 2011 from 0.85% in the second quarter of 2011. The decreases in the yield on interest-earning assets and the cost of interest-bearing liabilities were primarily attributable to the continued historical low interest rate environment.

Net interest income (FTE) of \$47.6 million in the third quarter of 2011 was \$0.5 million, or 1.1%, higher than net interest income (FTE) of \$47.1 million in the third quarter of 2010. The increase was due to an increase in the average volume of interest-earning assets and a decrease in the average cost of funds that was partially offset by a decrease in the average yields of loans and investment securities. The average volume of interest-earning assets in the third quarter of 2011 increased \$60 million, or 1.2%, compared to the third quarter of 2010, with the increase primarily attributable to loan growth. Net interest margin was 3.80% in the third quarter of 2011, unchanged from the third quarter of 2010. The average yield on interest-earning assets decreased 20 basis points to 4.41% in the third quarter of 2011, from 4.61% in the third quarter of 2010. The average cost of interest-bearing liabilities decreased 22 basis points to 0.80% in the third quarter of 2011, from 1.02% in the third quarter of 2010. The decreases in the yield on interest-earning assets and the cost of interest-bearing liabilities were attributable primarily to the continued historical low interest rate environment and its subsequent lag effect.

Table of Contents

Net interest income (FTE) of \$140.6 million for the nine months ended September 30, 2011 was \$12.2 million, or 9.6%, higher than net interest income (FTE) of \$128.4 million for the nine months ended September 30, 2010. The increase was primarily due to an increase in the average volume of interest-earning assets that was primarily attributable to the OAK acquisition.

The Corporation is primarily funded by core deposits, which is a lower-cost funding base than wholesale funding and historically has had a positive impact on the Corporation's net interest income and net interest margin. However, based on the historically low level of market interest rates and the Corporation's current low levels of interest rates on its core deposit transaction accounts, further market interest rate reductions would likely not result in a significant decrease in interest expense.

The following schedules present the average daily balances of the Corporation's major categories of assets and liabilities, interest income and expense on an FTE basis, average interest rates earned and paid on the assets and liabilities, net interest income (FTE), net interest spread and net interest margin for the three and nine months ended September 30, 2011 and 2010.

Average Balances, Tax Equivalent Interest and Effective Yields and Rates* (Dollars in thousands)

	Three Months Ended September 30,					
	2011			2010		
	Average Balance	Tax Equivalent Interest	Effective Yield/ Rate	Average Balance	Tax Equivalent Interest	Effective Yield/ Rate
Assets						
Interest-Earning Assets:						
Loans**	\$ 3,776,572	\$ 50,291	5.29%	\$ 3,675,349	\$ 51,929	5.62%
Taxable investment securities	615,354	2,335	1.52	628,143	2,718	1.73
Tax-exempt investment securities	172,787	2,299	5.32	155,454	2,108	5.42
Other securities	25,572	114	1.77	26,531	81	1.21
Federal funds sold and interest-bearing deposits with unaffiliated banks and others	395,095	266	0.27	439,625	323	0.29
Total interest-earning assets	4,985,380	55,305	4.41	4,925,102	57,159	4.61
Less: Allowance for loan losses	91,987			91,209		
Other Assets:						
Cash and cash due from banks	122,727			130,447		
Premises and equipment	65,241			68,372		
Interest receivable and other assets	242,601			231,833		
Total Assets	\$ 5,323,962			\$ 5,264,545		
Liabilities and Shareholders' Equity						
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	\$ 808,236	\$ 313	0.15%	\$ 900,425	\$ 501	0.22%
Savings deposits	1,129,822	547	0.19	1,121,172	1,140	0.40
Time deposits	1,558,267	6,339	1.61	1,581,593	7,673	1.92
Short-term borrowings	289,986	117	0.16	257,342	168	0.26
FHLB advances	67,132	413	2.44	86,031	623	2.87
Total interest-bearing liabilities	3,853,443	7,729	0.80	3,946,563	10,105	1.02
Noninterest-bearing deposits	862,333			722,906		
Total deposits and borrowed funds	4,715,776			4,669,469		
Interest payable and other liabilities	34,606			37,149		

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Shareholders' equity	573,580	557,927
Total Liabilities and Shareholders' Equity	\$ 5,323,962	\$ 5,264,545
Net Interest Spread (Average yield earned minus average rate paid)	3.61%	3.59%
Net Interest Income (FTE)	\$ 47,576	\$ 47,054
Net Interest Margin (Net Interest Income (FTE) divided by total average interest-earning assets)	3.80%	3.80%

* Taxable equivalent basis using a federal income tax rate of 35%.

** Nonaccrual loans and loans held-for-sale are included in average balances reported and are included in the calculation of yields. Also, tax equivalent interest includes net loan fees.

Table of Contents**Average Balances, Tax Equivalent Interest and Effective Yields and Rates* (Dollars in thousands)**

	Average Balance	Nine Months Ended September 30,			Average Balance	2010 Tax Equivalent Interest	Effective Yield/ Rate
		2011 Tax Equivalent Interest	Effective Yield/ Rate	2010 Tax Equivalent Interest			
Assets							
Interest-Earning Assets:							
Loans**	\$ 3,725,790	\$ 149,970	5.38%	\$ 3,372,594	\$ 142,812	5.66%	
Taxable investment securities	594,125	6,884	1.54	622,319	8,806	1.89	
Tax-exempt investment securities	170,381	6,661	5.21	132,612	5,442	5.47	
Other securities	26,481	605	3.06	24,820	458	2.47	
Federal funds sold and interest-bearing deposits with unaffiliated banks and others	442,422	856	0.26	354,617	743	0.28	
Total interest-earning assets	4,959,199	164,976	4.44	4,506,962	158,261	4.69	
Less: Allowance for loan losses	91,956			87,982			
Other Assets:							
Cash and cash due from banks	114,685			111,855			
Premises and equipment	65,311			62,363			
Interest receivable and other assets	244,492			205,869			
Total Assets	\$ 5,291,731			\$ 4,799,067			
Liabilities and Shareholders Equity							
Interest-Bearing Liabilities:							
Interest-bearing demand deposits	\$ 819,606	\$ 1,093	0.18%	\$ 755,088	\$ 1,352	0.24%	
Savings deposits	1,141,843	1,895	0.22	1,063,225	3,256	0.41	
Time deposits	1,570,489	19,640	1.67	1,448,482	22,608	2.09	
Short-term borrowings	281,254	418	0.20	246,136	489	0.27	
FHLB advances	70,990	1,298	2.44	89,029	2,205	3.31	
Total interest-bearing liabilities	3,884,182	24,344	0.84	3,601,960	29,910	1.11	
Noninterest-bearing deposits	808,434			642,835			
Total deposits and borrowed funds	4,692,616			4,244,795			
Interest payable and other liabilities	32,487			33,755			
Shareholders equity	566,628			520,517			
Total Liabilities and Shareholders Equity	\$ 5,291,731			\$ 4,799,067			
Net Interest Spread (Average yield earned minus average rate paid)			3.60%			3.58%	
Net Interest Income (FTE)		\$ 140,632			\$ 128,351		
Net Interest Margin (Net Interest Income (FTE) divided by total average interest-earning assets)			3.79%			3.80%	

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

- * Taxable equivalent basis using a federal income tax rate of 35%.
- ** Nonaccrual loans and loans held-for-sale are included in average balances reported and are included in the calculation of yields. Also, tax equivalent interest includes net loan fees.

Table of Contents

The following schedules allocate the dollar change in net interest income (FTE) between the portion attributable to changes in the average volume of interest-earning assets and interest-bearing liabilities, including changes in the mix of assets and liabilities and changes in average interest rates earned and paid, for the three and nine months ended September 30, 2011 compared to 2010.

Volume and Rate Variance Analysis* (In Thousands)

	Three Months Ended September 30, 2011 Compared to 2010		
	Increase (Decrease) Due to Changes in		Combined Increase/ (Decrease)
	Average Volume**	Average Yield/Rate**	
Changes in Interest Income on Interest-Earning Assets:			
Loans	\$ 1,369	\$ (3,007)	\$ (1,638)
Taxable investment/other securities	(57)	(293)	(350)
Tax-exempt investment securities	232	(41)	191
Federal funds sold and interest-bearing deposits with unaffiliated banks and others	(31)	(26)	(57)
Total change in interest income on interest-earning assets	1,513	(3,367)	(1,854)
Changes in Interest Expense on Interest-Bearing Liabilities:			
Interest-bearing demand deposits	(59)	(129)	(188)
Savings deposits	(19)	(574)	(593)
Time deposits	(44)	(1,290)	(1,334)
Short-term borrowings	19	(70)	(51)
FHLB advances	(125)	(85)	(210)
Total change in interest expense on interest-bearing liabilities	(228)	(2,148)	(2,376)
Total Change in Net Interest Income (FTE)	\$ 1,741	\$ (1,219)	\$ 522

	Nine Months Ended September 30, 2011 Compared to 2010		
	Increase (Decrease) Due to Changes in		Combined Increase/ (Decrease)
	Average Volume**	Average Yield/Rate**	
Changes in Interest Income on Interest-Earning Assets:			
Loans	\$ 14,377	\$ (7,219)	\$ 7,158
Taxable investment/other securities	(349)	(1,426)	(1,775)
Tax-exempt investment securities	1,491	(272)	1,219
Federal funds sold and interest-bearing deposits with unaffiliated banks and others	173	(60)	113
Total change in interest income on interest-earning assets	15,692	(8,977)	6,715
Changes in Interest Expense on Interest-Bearing Liabilities:			
Interest-bearing demand deposits	71	(330)	(259)
Savings deposits	136	(1,497)	(1,361)
Time deposits	1,871	(4,839)	(2,968)
Short-term borrowings	67	(138)	(71)
FHLB advances	(396)	(511)	(907)

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Total change in interest expense on interest-bearing liabilities	1,749	(7,315)	(5,566)
Total Change in Net Interest Income (FTE)	\$ 13,943	\$ (1,662)	\$ 12,281

* Taxable equivalent basis using a federal income tax rate of 35%.

** The change in interest income and interest expense due to both volume and rate has been allocated to the volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Table of Contents**Provision for Loan Losses**

The provision for loan losses (provision) is an increase to the allowance to provide for probable losses inherent in the originated loan portfolio and for impairment of pools of acquired loans that results from the Corporation experiencing a decrease in cash flows of acquired loans compared to expected cash flows estimated at the acquisition date. The Corporation recognized a \$1.3 million provision related to the acquired portfolio during the third quarter of 2011 that was primarily attributable to one of the acquired loan pools experiencing a significant decline in expected cash flows during the quarter. There were no material changes in expected cash flows for the remaining acquired loan pools since the date of acquisition.

The provision was \$6.4 million in the third quarter of 2011, compared to \$7.0 million in the second quarter of 2011 and \$8.6 million in the third quarter of 2010. The Corporation experienced net loan charge-offs of \$7.4 million in the third quarter of 2011, compared to \$6.9 million in the second quarter of 2011 and \$8.6 million in the third quarter of 2010. Net loan charge-offs as a percentage of average loans were 0.78% (annualized) in the third quarter of 2011, compared to 0.75% in the second quarter of 2011 and 0.93% in the third quarter of 2010. Net loan charge-offs of commercial, real estate commercial and real estate construction and land development loans totaled \$4.5 million in the third quarter of 2011, compared to \$4.3 million in the second quarter of 2011 and \$5.3 million in the third quarter of 2010 and represented 61% of total net loan charge-offs during the third quarter of 2011, compared to 63% during the second quarter of 2011 and 62% during the third quarter of 2010. The commercial loan portfolio's net loan charge-offs in the first nine months of 2011 and in 2010 were not concentrated in any one industry or borrower. Net loan charge-offs of residential real estate and consumer loans totaled \$2.9 million in the third quarter of 2011, compared to \$2.6 million in the second quarter of 2011 and \$3.3 million in the third quarter of 2010.

The Corporation's provision of \$6.4 million in the third quarter of 2011 was \$1.0 million lower than net loan charge-offs for the quarter, and was \$0.6 million lower than the provision in the second quarter of 2011 of \$7.0 million. The level of the provision in the third quarter of 2011 was reflective of an improvement in credit quality of the loan portfolio that included significant decreases in nonperforming loans and no significant changes in risk grade categories of the commercial loan portfolio. It is management's belief that the overall credit quality of the Corporation's loan portfolio during the nine months ended September 30, 2011 continues to be impacted by the economic environment in the State of Michigan, with the state unemployment rate at 11.1% at September 30, 2011, compared to 10.5% at June 30, 2011 and 11.1% at December 31, 2010. The Corporation's loan portfolio has no concentration in the automotive sector and management has identified its direct exposure to this industry as not material, although the economic impact of the decline in the production of automobiles continues to have an effect on the general economy within Michigan.

Noninterest Income

Noninterest income was \$11.2 million and \$32.9 million for the three and nine months ended September 30, 2011, respectively. The following includes the major components of noninterest income during the three months ended September 30, 2011, June 30, 2011 and September 30, 2010 and the nine months ended September 30, 2011 and 2010.

	Three Months Ended			Nine Months Ended	
	September 30, 2011	June 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In thousands)				
Service charges on deposit accounts	\$ 4,780	\$ 4,628	\$ 4,680	\$ 13,504	\$ 14,162
Wealth management revenue	2,638	3,026	2,521	8,430	7,416
Electronic banking fees	1,594	1,443	1,438	4,644	3,858
Mortgage banking revenue	1,173	499	1,204	2,736	2,837
Other fees for customer services	633	897	740	2,299	2,086
Insurance commissions	354	388	377	1,024	952
Other	53	21	159	262	248
Total Noninterest Income	\$ 11,225	\$ 10,902	\$ 11,119	\$ 32,899	\$ 31,559

Noninterest income of \$11.2 million in the third quarter of 2011 increased \$0.3 million, or 3.0%, compared to \$10.9 million in the second quarter of 2011, with the increase attributable to higher mortgage banking revenue that was partially offset by a decline in wealth management revenue.

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Mortgage banking revenue of \$1.2 million in the third quarter of 2011 increased \$0.7 million, or 135%, compared to \$0.5 million in the second quarter of 2011 due primarily to an increase in both the volume of loans sold and the gains earned on those sales. The

Table of Contents

Corporation sold \$48 million of real estate residential loans in the secondary mortgage market during the third quarter of 2011, compared to \$31 million during the second quarter of 2011.

Wealth management revenue of \$2.6 million in the third quarter of 2011 decreased \$0.4 million, or 13%, compared to \$3.0 million in the second quarter of 2011, due primarily to decreases in assets under management resulting from declines in the equity markets and decreases in sales of mutual funds, annuity products and marketable securities through the Corporation's Chemical Financial Advisors program.

Noninterest income of \$11.2 million in the third quarter of 2011 increased \$0.1 million, or 1.0%, compared to \$11.1 million in the third quarter of 2010. Moderate increases in service charges on deposit accounts, wealth management revenue and electronic banking fees were offset by moderate decreases in other fees for customer services and other noninterest income.

Operating Expenses

Total operating expenses were \$35.4 million and \$104.2 million in the three and nine months ended September 30, 2011, respectively. The following includes the major categories of operating expenses during the three months ended September 30, 2011, June 30, 2011 and September 30, 2010 and the nine months ended September 30, 2011 and 2010.

	Three Months Ended			Nine Months Ended	
	September 30, 2011	June 30, 2011	September 30, 2010 (In thousands)	September 30, 2011	September 30, 2010
Salaries and wages	\$ 15,612	\$ 14,970	\$ 14,929	\$ 45,531	\$ 40,986
Employee benefits	3,617	3,098	3,086	10,091	8,664
Equipment and software	3,162	3,110	3,698	8,994	10,110
Occupancy	3,093	3,099	2,903	9,530	8,474
Other real estate and repossessed asset expenses	1,532	559	888	3,055	2,147
Outside processing / service fees	1,474	1,640	1,251	4,782	3,282
FDIC insurance premiums	1,182	1,219	1,961	4,170	5,369
Advertising and marketing	846	674	1,066	2,034	2,342
Postage and courier	732	830	780	2,384	2,329
Loan collection costs	706	871	957	2,705	3,251
Professional fees	648	1,290	1,048	3,197	4,355
Intangible asset amortization	462	479	570	1,452	1,141
Telephone	442	308	501	1,191	1,344
Supplies	416	445	477	1,267	1,261
Other	1,470	821	2,101	3,813	5,000
Total Operating Expenses	\$ 35,394	\$ 33,413	\$ 36,216	\$ 104,196	\$ 100,055

Total operating expenses of \$35.4 million in the third quarter of 2011 increased \$2.0 million, or 5.9%, compared to \$33.4 million in the second quarter of 2011, with the increase primarily attributable to higher salaries and wages, employee benefits, other real estate (ORE) and repossessed asset (RA) expenses and other expenses that were partially offset by lower professional fees.

Salaries and wages of \$15.6 million in the third quarter of 2011 increased \$0.6 million, or 4.3%, compared to \$15.0 million in the second quarter of 2011. The increase was primarily attributable to a seasonal increase in staff.

Employee benefit costs of \$3.6 million in the third quarter of 2011 increased \$0.5 million, or 17%, compared to \$3.1 million in the second quarter of 2011, with the increase primarily attributable to higher group health costs.

ORE and RA expenses of \$1.5 million in the third quarter of 2011 increased \$0.9 million, or 174%, compared to \$0.6 million in the second quarter of 2011, with the increase primarily attributable to property taxes on ORE properties that are largely incurred in the third quarter of the year.

Edgar Filing: CHEMICAL FINANCIAL CORP - Form 10-Q

Professional fees of \$0.6 million in the third quarter of 2011 decreased \$0.7 million, or 50%, compared to \$1.3 million in the second quarter of 2011. The decrease was primarily attributable to process and technology improvement initiatives incurred by the Corporation during the second quarter of 2011.

Other expenses of \$1.5 million in the third quarter of 2011 increased \$0.7 million, or 79%, compared to \$0.8 million in the second quarter of 2011, with the increase primarily attributable to the reversal of state tax expense accruals in the second quarter 2011 resulting from the elimination of a contingent liability during the quarter.

Table of Contents

Total operating expenses of \$35.4 million in the third quarter of 2011 decreased \$0.8 million, or 2.3%, compared to \$36.2 million in the third quarter of 2010. The decrease was primarily attributable to lower FDIC insurance premiums of \$0.8 million, resulting from a lower assessment rate in 2011, and no acquisition-related expenses compared to \$1.1 million incurred in the third quarter of 2010 offset partially by higher salaries and wages, employee benefits and ORE and RA expenses. Total operating expenses of \$104.2 million in the nine months ended September 30, 2011 were \$4.1 million higher than the same period of 2010 due primarily to the acquisition of OAK.

Income Tax Expense

The Corporation's effective federal income tax rate was 26.0% and 28.5% for the three and nine months ended September 30, 2011, respectively, compared to 27.3% and 27.3% for the three and nine months ended September 30, 2010, respectively. The difference between the federal statutory income tax rate and the Corporation's effective federal income tax rate is primarily a function of the proportion of the Corporation's interest income exempt from federal taxation, nondeductible interest expense, nondeductible acquisition expenses and other nondeductible expenses relative to pre-tax net income and tax credits.

The Corporation records income tax expense for interim periods based on its best estimate of the effective income tax rate expected to be applicable for the full year. However, when a reliable estimate for the full year cannot be made, the Corporation utilizes the actual effective income tax rate on a year-to-date basis. The Corporation recorded income tax expense for the three- and nine-month periods ended September 30, 2011 and 2010 using its best estimate of the effective income tax rate expected for the full year and applied that rate on a year-to-date basis.

Liquidity Risk

Liquidity risk is the possibility of the Corporation being unable to meet current and future financial obligations in a timely manner and the adverse impact on net interest income if the Corporation was unable to meet its funding requirements at a reasonable cost.

Liquidity is managed to ensure stable, reliable and cost-effective sources of funds are available to satisfy deposit withdrawals and lending and investment opportunities. The Corporation's largest sources of liquidity on a consolidated basis are the deposit base that comes from consumer, business and municipal customers within the Corporation's local markets, principal payments on loans, cash held at the FRB, unpledged investment securities available-for-sale and federal funds sold. Total deposits increased \$149 million, or 3.4%, during the nine months ended September 30, 2011, with the majority of the increase due to seasonal increases in municipal customer deposits being partially offset by the Corporation paying off maturing brokered deposits acquired in the OAK acquisition. The Corporation's loan-to-deposit ratio decreased slightly to 84% at September 30, 2011 from 85% at December 31, 2010. At September 30, 2011, the Corporation had \$479 million of cash deposits held at the FRB that were not invested in federal funds sold due to the low interest rate environment. In addition, at September 30, 2011, the Corporation had \$148 million of unpledged investment securities available-for-sale. The Corporation also has available unused wholesale sources of liquidity, including FHLB advances and borrowings from the discount window of the FRB.

Chemical Bank is a member of the FHLB and as such has access to short-term and long-term advances from the FHLB that are generally secured by real estate residential first lien loans. The Corporation considers advances from the FHLB as its primary wholesale source of liquidity. FHLB advances decreased \$28 million during the nine months ended September 30, 2011 to \$46 million at that date. The Corporation's additional borrowing availability from the FHLB, based on its FHLB capital stock and subject to certain requirements, was \$295 million at September 30, 2011. Chemical Bank can also borrow from the FRB's discount window to meet short-term liquidity requirements. These borrowings are required to be secured by investment securities and/or certain loan types, with each category of assets carrying various borrowing capacity percentages. At September 30, 2011, Chemical Bank maintained an unused borrowing capacity of \$29 million with the FRB's discount window based upon pledged collateral as of that date, although it is management's opinion that this borrowing capacity could be expanded, if deemed necessary, as Chemical Bank has a significant amount of additional assets that could be used as collateral at the FRB's discount window.

The Corporation manages its liquidity primarily through dividends from Chemical Bank. The Corporation manages its liquidity position to provide the cash necessary to pay dividends to shareholders, invest in new subsidiaries, enter new banking markets, pursue investment opportunities and satisfy other operating requirements.

Federal and state banking laws place certain restrictions on the amount of dividends that a bank may pay to its parent company. During the nine months ended September 30, 2011, Chemical Bank paid \$16.5 million in cash dividends to the Corporation, and the Corporation paid cash dividends to shareholders of \$16.5 million. At September 30, 2011, the Corporation maintained \$5 million of cash which it held in a deposit account at Chemical Bank. During 2010, Chemical Bank paid \$21.3 million in dividends to the Corporation and the Corporation paid cash dividends to shareholders of \$21.2 million. The earnings of Chemical Bank have been the

Table of Contents

principal source of funds to pay cash dividends to the Corporation's shareholders. Over the long term, cash dividends to shareholders are dependent upon earnings, as well as capital requirements, regulatory restraints and other factors affecting Chemical Bank.

Market Risk

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due primarily to changes in interest rates. Interest rate risk is the Corporation's primary market risk and results from timing differences in the repricing of interest rate sensitive assets and liabilities and changes in relationships between rate indices due to changes in interest rates. The Corporation's net interest income is largely dependent upon the effective management of interest rate risk. The Corporation's goal is to avoid a significant decrease in net interest income, and thus an adverse impact on the profitability of the Corporation, in periods of changing interest rates. Sensitivity of earnings to interest rate changes arises when yields on assets change differently from the interest costs on liabilities. Interest rate sensitivity is determined by the amount of interest-earning assets and interest-bearing liabilities repricing within a specific time period and the magnitude by which interest rates change on the various types of interest-earning assets and interest-bearing liabilities. The management of interest rate sensitivity includes monitoring the maturities and repricing opportunities of interest-earning assets and interest-bearing liabilities. The Corporation's interest rate risk is managed through policies and risk limits approved by the boards of directors of the Corporation and Chemical Bank and an Asset and Liability Committee (ALCO). The ALCO, which is comprised of executive and senior management from various areas of the Corporation and Chemical Bank, including finance, lending, investments and deposit gathering, meets regularly to execute asset and liability management strategies. The ALCO establishes guidelines and monitors the sensitivity of earnings to changes in interest rates. The goal of the ALCO process is to manage the impact on net interest income and the net present value of future cash flows of probable changes in interest rates within authorized risk limits.

The primary technique utilized by the Corporation to measure its interest rate risk is simulation analysis. Simulation analysis forecasts the effects on the balance sheet structure and net interest income under a variety of scenarios that incorporate changes in interest rates, the shape of the Treasury yield curve, interest rate relationships and the mix of assets and liabilities and loan prepayments. These forecasts are compared against net interest income projected in a stable interest rate environment. While many assets and liabilities reprice either at maturity or in accordance with their contractual terms, several balance sheet components demonstrate characteristics that require an evaluation to more accurately reflect their repricing behavior. Key assumptions in the simulation analysis include prepayments on loans, probable calls of investment securities, changes in market conditions, loan volumes and loan pricing, deposit sensitivity and customer preferences. These assumptions are inherently uncertain as they are subject to fluctuation and revision in a dynamic environment. As a result, the simulation analysis cannot precisely forecast the impact of rising and falling interest rates on net interest income. Actual results will differ from simulated results due to many other factors, including changes in balance sheet components, interest rate changes, changes in market conditions and management strategies.

The Corporation's interest rate sensitivity is estimated by first forecasting the next twelve months of net interest income under an assumed environment of constant market interest rates. The Corporation then compares the results of various simulation analyses to the constant interest rate forecast (base case). At September 30, 2011, the Corporation projected the change in net interest income during the next twelve months assuming short-term market interest rates were to uniformly and gradually increase or decrease by up to 200 basis points in a parallel fashion over the entire yield curve during the same time period. These projections were based on the Corporation's assets and liabilities remaining static over the next twelve months, while factoring in probable calls and prepayments of certain investment securities and real estate residential and consumer loans. The ALCO regularly monitors the Corporation's forecasted net interest income sensitivity to ensure that it remains within established limits.

A summary of the Corporation's interest rate sensitivity at September 30, 2011 follows:

<i>Twelve month interest rate change projection (in basis points)</i>	<i>-200</i>	<i>-100</i>	<i>0</i>	<i>+100</i>	<i>+200</i>
<i>Percent change in net interest income vs. constant rates</i>	<i>(3.6)</i>	<i>(2.0)</i>		<i>2.1</i>	<i>2.9</i>

At September 30, 2011, the Corporation's model simulations projected that 100 and 200 basis point increases in interest rates would result in positive variances in net interest income of 2.1% and 2.9%, respectively, relative to the base case over the next 12-month period, while decreases in interest rates of 100 and 200 basis points would result in negative variances in net interest income of 2.0% and 3.6%, respectively, relative to the base case over the next 12-month period. The likelihood of a decrease in interest rates beyond 100 basis points at September 30, 2011 was considered to be unlikely given prevailing interest rate levels.

The Corporation's mix of interest-earning assets and interest-bearing liabilities has historically resulted in its interest rate position being liability sensitive. To mitigate this, during 2010 and 2009, the Corporation adjusted its liability sensitive position by

Table of Contents

significantly increasing the amount of variable rate instruments in its investment securities and loan portfolios. Variable rate investment securities at September 30, 2011 of \$303 million comprised 38% of total investment securities at that date, compared to \$325 million, or 44% of total investment securities, at December 31, 2010 and \$321 million, or 43% of total investment securities, at September 30, 2010. Variable rate investment securities comprised 28% of total investment securities at December 31, 2008, which was more indicative of the Corporation's historical level of variable rate investment securities. Variable rate loans comprised 27% of the total loan portfolio at September 30, 2011, compared to 28% at December 31, 2010 and 26% at September 30, 2010.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information concerning quantitative and qualitative disclosures about market risk is contained in the discussion regarding interest rate risk and sensitivity under the captions Liquidity Risk and Market Risk herein and in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

The Corporation does not believe that there has been a material change in the nature or categories of the Corporation's primary market risk exposure, or the particular markets that present the primary risk of loss to the Corporation. As of the date of this report, the Corporation does not know of or expect there to be any material change in the general nature of its primary market risk exposure in the near term. The methods by which the Corporation manages its primary market risk exposure, as described in its Annual Report on Form 10-K for the year ended December 31, 2010, have not changed materially during the current year. As of the date of this report, the Corporation does not expect to make material changes in those methods in the near term. The Corporation may change those methods in the future to adapt to changes in circumstances or to implement new techniques.

The Corporation's market risk exposure is mainly comprised of its vulnerability to interest rate risk. Prevailing interest rates and interest rate relationships are largely determined by market factors that are beyond the Corporation's control. All information provided in response to this item consists of forward-looking statements. Reference is made to the section captioned Forward-Looking Statements in this report for a discussion of the limitations on the Corporation's responsibility for such statements. In this discussion, near term means a period of one year following the date of the most recent consolidated statement of financial position contained in this report.

Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on and as of the time of that evaluation, the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this report. There was no change in the Corporation's internal control over financial reporting that occurred during the three months ended September 30, 2011 that has materially affected, or that is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Table of Contents

Part II. Other Information

Item 1A. Risk Factors

Information concerning risk factors is contained in the discussion in Item 1A, Risk Factors, in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010. As of the date of this report, the Corporation does not believe that there has been a material change in the nature or categories of the Corporation's risk factors, as compared to the information disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

Table of Contents**Item 6. Exhibits**

Exhibits. The following exhibits are filed as part of this report on Form 10-Q:

Exhibit

Number	Document
3.1	Restated Articles of Incorporation. Previously filed as Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 5, 2011. Here incorporated by reference.
3.2	Bylaws. Previously filed as Exhibit 3.2 to the registrant's Current Report on Form 8-K dated January 20, 2009, filed with the SEC on January 23, 2009. Here incorporated by reference.
4.1	Restated Articles of Incorporation. Exhibit 3.1 is here incorporated by reference.
4.2	Bylaws. Exhibit 3.2 is here incorporated by reference.
31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. §1350.
101.1	Interactive Data File.*

* As provided in Rule 406T of Regulation S-T, this information shall not be deemed "Filed" for purposes of Section 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.

Table of Contents

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHEMICAL FINANCIAL CORPORATION

Date: November 4, 2011

By: /s/ David B. Ramaker
David B. Ramaker
Chairman of the Board, Chief Executive Officer and President
(Principal Executive Officer)

Date: November 4, 2011

By: /s/ Lori A. Gwizdala
Lori A. Gwizdala
Executive Vice President, Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

Table of Contents

Exhibit Index

Exhibits. The following exhibits are filed as part of this report on Form 10-Q:

Exhibit

Number	Document
3.1	Restated Articles of Incorporation. Previously filed as Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 5, 2011. Here incorporated by reference.
3.2	Bylaws. Previously filed as Exhibit 3.2 to the registrant's Current Report on Form 8-K dated January 20, 2009, filed with the SEC on January 23, 2009. Here incorporated by reference.
4.1	Restated Articles of Incorporation. Exhibit 3.1 is here incorporated by reference.
4.2	Bylaws. Exhibit 3.2 is here incorporated by reference.
31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. §1350.
101.1	Interactive Data File.*

* As provided in Rule 406T of Regulation S-T, this information shall not be deemed "Filed" for purposes of Section 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.