MACATAWA BANK CORP
Form 10-K
February 21, 2013

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

FORM 10-K

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

For the fiscal year ended December 31, 2012

OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______ to ________

Commission file number 000-25927

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

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

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

Registrant's telephone number, including area code: (616) 820-1444
Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock	The Nasdaq Stock Market

Securities registered pursuant to Section 12(g) of the Exchange Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained in this form and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, as of June 30, 2012, was $85,507,285 based on the closing sale price of $3.41 as reported on the Nasdaq Stock Market. There were 27,203,825 outstanding shares of the Company's common stock as of February 21, 2013.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 7, 2013 are incorporated by reference into Part III of this report.

MACATAWA BANK CORPORATION
FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

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

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of this report. 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

ITEM 1: Business.

As used in this report, the terms "we," "us," "our" and "Company" mean Macatawa Bank Corporation and its subsidiaries, unless the context indicates another meaning. The term "Bank" means Macatawa Bank.

Overview

Macatawa Bank Corporation is a Michigan corporation and a registered bank holding company. The Company was incorporated in 1997. Our business is concentrated in a single industry segment - commercial banking. Through our wholly-owned subsidiary, Macatawa Bank, we offer a full range of commercial and personal banking services, including checking, savings and certificates of deposit accounts, cash management, safe deposit boxes, trust services and commercial, mortgage and consumer loans through our twenty-six branch offices and a lending and operation service facility in Ottawa County, Kent County and northern Allegan County, Michigan. Other services we offer include ATMs, internet banking, telephone banking and debit cards. The Bank provides various brokerage services, including discount brokerage through Infinex, personal financial planning and consultation regarding mutual funds.

At December 31, 2012, we had total assets of $1.56 billion, total loans of $1.05 billion, total deposits of $1.29 billion and shareholders' equity of $130.5 million. We recognized net income of $35.5 million in 2012, a substantial improvement over the prior two years, and we experienced our eleventh consecutive quarter of net income to end 2012. Positively impacting our net income for 2012 was a $18.9 million reversal of our deferred tax asset valuation allowance as we determined it to be more likely than not that we will be able to utilize our deferred tax asset against future taxable income. During 2012, 2011 and 2010, our interest income accounted for approximately 79%, 80% and 81%, respectively, of our operating revenues and our non-interest income accounted for approximately 21%, 20% and 19%, respectively, of our operating revenues. For additional information about our financial condition and results of operations, see our consolidated financial statements and related notes included in this report.

In response to our losses during 2008, 2009 and the first quarter of 2010, our Board of Directors implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles. The focus of our management team turned from growth in our business to executing these disciplined business and banking procedures and policies designed to limit future losses, preserve capital and improve operational efficiencies. In addition, the Board of Directors added experienced members to provide further oversight and guidance. These and other efforts were reflected in our results of operations for the past two years with lower levels of charge-offs and provisions for loan losses, reductions in operating expenses and reductions in balance sheet totals resulting in improvement in our regulatory capital and liquidity ratios. We successfully completed our shareholder rights offering and public offering of common stock in June 2011 resulting in net proceeds of $20.3 million and contributed $10.0 million of the proceeds from the stock offering to the Bank, retaining the remaining $10.3 million at the holding company. As of December 31, 2012, the Company's and the Bank's risk-based regulatory capital ratios were the highest they have ever been. The Bank was categorized as "well capitalized" at December 31, 2012.

On February 22, 2010, Macatawa Bank entered into a Consent Order with the Federal Deposit Insurance Corporation ("FDIC") and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Company also entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB") with an effective date of July 23, 2010. Upon completion of the Bank's 2011 joint examination, the FDIC and OFIR terminated the Bank's Consent Order effective March 2, 2012. In connection with the termination of the Consent Order, the Bank reached an understanding with the regulators in the form of a Memorandum of Understanding ("MOU").

On October 26, 2012, the FRB terminated the Written Agreement. In connection with the termination of the Written Agreement, the Board of Directors adopted a resolution requiring the Company to obtain written approval from the FRB before declaring or paying any dividends, increasing holding company debt (including the issuance of trust preferred securities), or redeeming any capital stock.

For more information about the Consent Order, Written Agreement and MOU, see “Regulatory Developments” and our consolidated financial statements and related notes included in this report.

Table of Contents

Also within the past three years, much progress has been made at reducing our nonperforming assets. The following table reflects period end balances of these nonperforming assets as well as total loan delinquencies.

(dollars in thousands)	December 31, 2012	December 31, 2011	December 31, 2010
Nonperforming loans	$ 16,003	$ 28,946	$ 75,361
Other repossessed assets	6	---	50
Other real estate owned	51,582	66,438	57,984
Total nonperforming assets	$ 67,591	$ 95,384	$ 133,395
Total loan delinquencies 30 days or greater past due	$ 7,887	$ 13,138	$ 55,748

Earnings in recent years have been severely impacted by high costs associated with administration and disposition of nonperforming assets. These costs, including losses on repossessed and foreclosed properties, were $10.0 million and $15.6 million for the years ended December 31, 2012 and 2011, respectively. During 2012, we added $9.2 million in other real estate and sold $18.7 million, allowing for a meaningful reduction in our year-end balance. We expect a significant reduction in the amount of new additions to other real estate in 2013 and continued sales volume, which should allow for reductions in carrying costs in 2013.

Our earnings in 2012 and 2011 were favorably impacted by a negative provision for loan losses of $7.1 million and $4.7 million, respectively. As discussed in detail later in Item 7 of this report under the heading "Allowance for Loan Losses", this was primarily a result of a large recovery taken in the first quarter of 2012 and also impacted by the decline in our historical charge-off levels from prior years. We do not expect a similar level of negative provision for loan losses in 2013.

The following table reflects the provision for loan losses for the past three years along with certain metrics that impact the determination of the level of the provision for loan losses.

(dollars in thousands)	For The Year Ended December 31		
	2012	2011	2010
Provision for loan losses	$(7,100)	$(4,700)	$22,460
Net charge-offs	802	11,085	29,657
Net charge-offs to average loans	0.08 %	0.99 %	2.18 %
Nonperforming loans to total loans	1.52 %	2.70 %	6.19 %
Loans transferred to ORE to average loans	0.88 %	3.42 %	3.32 %
Performing troubled debt restructurings (“TDRs”) to average loans	6.24 %	5.15 %	1.91 %

The State of Michigan entered into a recession earlier than the rest of the country and experienced heavy job loss as a result of the concentration the state has related to the automotive industry. Our market areas of Grand Rapids and Holland fared better than the state as a whole, but nevertheless the impact of our local economy on our results has been profound. The recession and job loss impacted housing values, commercial real estate values and consumer activity. Improvement has been evident during 2011 and 2012. The state’s unemployment rate at the end of 2012 was 8.9%, no longer the highest in the country and down dramatically from 15.2% in June 2009. The Holland area unemployment was 5.5%, and the Grand Rapids area unemployment was 5.6% at the end of 2012. Residential housing values and commercial real estate property values decreased significantly over the past few years, but have shown recent signs of stabilization, with some of our newer appraisals tending to reflect values at or above prior year values.

It also appears that the housing market in our primary market area is beginning to show signs of stabilization. In the Grand Rapids market during 2012, there were 28% more single family home starts than in 2011. Similarly, in the Holland-Grand Haven/Lakeshore region, there were 42% more single family home starts in 2012 than in 2011. Also, these markets are now seeing activity in duplex, condominium and apartment starts after years of virtually no activity.

Over the past two years, we have reduced our balance of loans outstanding, diversified our commercial loan portfolio, reduced concentrations to residential real estate developers and increased our consumer loan portfolio and residential mortgage activity as a percentage of overall production. This has included adding experienced residential mortgage lenders and pulling back on commercial loan production in some cases. Our loans to residential developers have decreased from $66.3 million at December 31, 2011 to $48.9 million at December 31, 2012. In addition, overall commercial real estate loans have decreased from $795.3 million at December 31, 2011 to $762.7 million at December 31, 2012. Consumer loans have increased in 2012, totaling $289.7 million at December 31, 2012, compared to $275.7 million at December 31, 2011. With our improved financial condition and successful capital raise in 2011, our focus has shifted from shrinkage in our loan portfolio to stabilizing our loan balances and growing certain portfolios in 2013.

Table of Contents

We have no material foreign loans, assets or activities. No material part of our business is dependent on a single customer or very few customers. Our loan portfolio is not concentrated in any one industry.

Our headquarters and administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424, and our telephone number is (616) 820-1444. Our internet website address is www.macatawabank.com. We make available free of charge through this website our annual report on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after filing or furnishing such reports with the Securities and Exchange Commission. The information on our website address is not incorporated by reference into this report, and the information on the website is not part of this report.

Regulatory Developments

Termination of Consent Order with Macatawa Bank and its Regulators

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

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

Termination of Written Agreement with Macatawa Bank Corporation and its Regulator

The Company formally entered into a Written Agreement with the FRB. The Written Agreement became effective on July 29, 2010. Effective October 26, 2012, the FRB terminated the Written Agreement due to the improvement in the Company. In connection with the termination of the Written Agreement, the Board of Directors adopted a resolution requiring the Company to obtain written approval from the FRB before declaring or paying any dividends, increasing holding company debt (including the issuance of trust preferred securities), or redeeming any capital stock.

Table of Contents

Products and Services

Loan Portfolio

We have historically offered a broad range of loan products to business customers, including commercial and industrial and commercial real estate loans, and to retail customers, including residential mortgage and consumer loans. Given current soft economic conditions, new commercial loan origination activity has been significantly lower than it was when economic conditions were stronger. However, select, well-managed loan renewal activity is taking place. Following is a discussion of our various types of lending activities.

Commercial and Industrial Loans

Our commercial and industrial lending portfolio contains loans with a variety of purposes and security, including loans to finance operations and equipment. Generally, our commercial and industrial lending has been limited to borrowers headquartered, or doing business, in our primary market area. These credit relationships typically require the satisfaction of appropriate loan covenants and debt formulas, and generally require that the Bank be the primary depository bank of the business. These loan covenants and debt formulas are monitored through periodic, required reporting of accounts receivable aging schedules and financial statements, and in the case of larger business operations, reviews or audits by independent professional firms.

Commercial and industrial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself and economic conditions. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

Commercial Real Estate Loans

Our commercial real estate loans consist primarily of construction and development loans and multi-family and other non-residential real estate loans.

Construction and Development Loans. These consist of construction loans to commercial customers for the construction of their business facilities. They also include construction loans to builders and developers for the construction of one- to four-family residences and the development of one- to four-family lots, residential subdivisions, condominium developments and other commercial developments.

This portfolio was particularly adversely affected by job losses, declines in real estate value, declines in home sale volumes, and declines in new home building. Declining real estate values resulted in sharp increases in losses, particularly in the land development and construction loan portfolios to residential developers. We curtailed this type of lending beginning in 2008. During the past several years, we made a significant effort to reduce exposure to residential land development and other construction and development loans.

Multi-Family and Other Non-Residential Real Estate Loans. These are permanent loans secured by multi-family and other non-residential real estate and include loans secured by apartment buildings, condominiums, small office buildings, small business facilities, medical facilities and other non-residential building properties, substantially all of which are located within our primary market area.

Multi-family and other non-residential real estate loans generally present a higher level of risk than loans secured by owner occupied one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of these loans is typically dependent upon the successful operation of the related real estate project. For example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations, cash flow from the project will be reduced. If cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

Retail Loans

Our retail loans are loans to consumers and consist primarily of residential mortgage loans and consumer loans.

Table of Contents

Residential Mortgage Loans. We originate construction loans to individuals for the construction of their residences and owner-occupied residential mortgage loans, which are generally long-term with either fixed or adjustable interest rates. Our general policy is to sell the majority of our fixed rate residential mortgage loans in the secondary market due primarily to the interest rate risk associated with these loans.

During 2010, we sold the majority of our loan originations in the secondary market to support our goal of shrinking the loan portfolio and preserving capital. We retained loans representing only approximately 10% of the dollar volume originated. Relationships were established with new investors in 2010 and 2011, allowing us to continue our historical practice of originating and selling most of our fixed rate mortgage loan volume. During 2011 and 2012, in an effort to further diversify our loan concentrations, we increased our targeted retention of residential mortgage loans, resulting in a $25.7 million increase in balances held in portfolio at December 31, 2012 compared to December 31, 2011. For 2012, we retained loans representing 34.6% of the total dollar volume originated.

Our borrowers generally qualify and are underwritten using industry standards for quality residential mortgage loans. We do not originate loans that are considered "sub-prime". Residential mortgage loan originations derive from a number of sources, including advertising, direct solicitation, real estate broker referrals, existing borrowers and depositors, builders and walk-in customers. Loan applications are accepted at most of our offices. The substantial majority of these loans are secured by one-to-four family properties in our market area.

Consumer Loans. We originate a variety of different types of consumer loans, including automobile loans, home equity lines of credit and installment loans, home improvement loans, deposit account loans and other loans for household and personal purposes. We also originate home equity lines of credit utilizing the same underwriting standards as for home equity installment loans. Home equity lines of credit are revolving line of credit loans. The majority of our existing home equity line of credit portfolio has variable rates with floors and ceilings, interest only payments and a maximum maturity of ten years.

The underwriting standards that we employ for consumer loans include a determination of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Table of Contents

Loan Portfolio Composition

The following table reflects the composition of our loan portfolio and the corresponding percentage of our total loans represented by each class of loans as of the dates indicated.

(Dollars in thousands)	December 31								
	2012		2011		2010		2009		200
	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount
Real estate - construction (1)	$89,631	8 %	$90,191	8 %	$133,228	11 %	$162,615	11 %	$237,108
Real estate - mortgage	408,338	40 %	478,076	45 %	535,961	44 %	640,437	42 %	690,525
Commercial and industrial	264,690	25 %	227,051	21 %	264,679	22 %	369,523	24 %	451,826
Total Commercial	762,659	73 %	795,318	74 %	933,868	77 %	1,172,575	77 %	1,379,45
Residential mortgage	182,625	17 %	156,891	15 %	135,227	11 %	163,074	11 %	203,954
Consumer	107,064	10 %	118,766	11 %	148,101	12 %	175,167	12 %	190,650
Total loans	$1,052,348	100%	$1,070,975	100%	$1,217,196	100%	$1,510,816	100%	$1,774,06
Less:									
Allowance for loan losses	(23,739)		(31,641)		(47,426)		(54,623)		(38,262
Total loans receivable, net	$1,028,609		$1,039,334		$1,169,770		$1,456,193		$1,735,80

(1) Consists of construction and development loans.

At December 31, 2012, there was no concentration of loans exceeding 10% of total loans which were not otherwise disclosed as a category of loans in the table above.

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table shows the amount of total loans outstanding at December 31, 2012 which, based on remaining scheduled repayments of principal, are due in the periods indicated.

(Dollars in thousands)	Maturing			
	Within One Year	After One, But Within Five Years	After Five Years	Total
Real estate - construction (1)	$53,188	$17,001	$7,128	$77,317
Real estate – mortgage	132,847	232,672	55,133	420,652
Commercial and industrial	134,529	116,037	14,124	264,690
Total Commercial	320,564	365,710	76,385	762,659
Residential mortgage	7,857	385	174,383	182,625
Consumer	12,042	39,313	55,709	107,064
Total Loans	$340,463	$405,408	$306,477	$1,052,348

	Maturing or Repricing			
Loans above:				
With predetermined interest rates	$110,304	$233,976	$128,945	$473,225
With floating or adjustable rates	515,853	21,315	26,570	563,738
Total (excluding nonaccrual loans)	$626,157	$255,291	$155,515	$1,036,963
Nonaccrual loans				15,385
Total Loans				$1,052,348

(1) Consists of construction and development loans.

Table of Contents

Nonperforming Assets

The following table shows the composition and amount of our nonperforming assets.

	December 31				
(Dollars in thousands)	2012	2011	2010	2009	2008
Nonaccrual loans	$15,385	$26,876	$74,761	$95,725	$89,049
Loans 90 days or more delinquent and still accruing	618	2,070	600	8,160	3,200
Total nonperforming loans (NPLs)	16,003	28,946	75,361	103,885	92,249
Foreclosed assets	51,582	66,438	57,984	37,184	19,516
Repossessed assets	6	---	50	124	306
Total nonperforming assets (NPAs)	67,591	95,384	133,395	141,193	112,071
Accruing troubled debt restructurings (TDRs) (1)	65,024	55,679	25,395	18,000	---
Total NPAs and accruing TDRs	$132,615	$151,063	$158,790	$159,193	$112,071
NPLs to total loans	1.52 %	2.70 %	6.19 %	6.88 %	5.20 %
NPAs to total assets	4.33 %	6.33 %	8.45 %	7.71 %	5.21 %

(1) Comprised of approximately $51.8 million and $40.9 million of commercial loans and $13.2 million and $14.8 million of residential mortgage loans at December 31, 2012 and 2011, respectively, whose terms have been restructured. Interest is being accrued on these loans under their restructured terms as they are less than 90 days past due.

Interest income totaling $4.0 million was recorded in 2012 on loans that were on a non-accrual status or classified as restructured as of December 31, 2012. Additional interest income of $959,000 would have been recorded during 2012 on these loans had they been current in accordance with their original terms. More information about the elevated levels of nonperforming loan balances in 2012 and 2011 and our policy for placing loans on non-accrual status may be found in Item 7 of this report under the heading "Loan Portfolio and Asset Quality" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition."

Loans at December 31, 2012 that were classified as substandard or worse per our internal risk rating system not included in the nonperforming assets table above that would cause management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms are discussed in Item 7 of this report under the heading "Loan Portfolio and Asset Quality" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition." At December 31, 2012, there were no other interest-bearing assets that would be required to be disclosed under Industry Guide 3, Item III, C. 1. or 2. if such assets were loans.

Table of Contents

Loan Loss Experience

The following is a summary of our loan balances at the end of each period and the daily average balances of these loans. It also includes changes in the allowance for loan losses arising from loans charged-off and recoveries on loans previously charged-off, and additions to the allowance which we have expensed.

	December 31				
(Dollars in thousands)	2012	2011	2010	2009	2008
Loans:					
Average daily balance of loans for the year	$1,041,833	$1,120,857	$1,360,548	$1,637,143	$1,762,102
Amount of loans outstanding at end of period	1,052,348	1,070,975	1,217,196	1,510,816	1,774,063
Allowance for loan losses:					
Balance at beginning of year	$31,641	$47,426	$54,623	$38,262	$33,422
Addition/(Reduction) to allowance charged to operations	(7,100)	(4,700)	22,460	74,340	37,435
Loans charged-off:					
Real estate – construction (1)	(1,455)	(3,014)	(9,768)	(29,237)	(15,754)
Real estate – mortgage	(1,751)	(7,967)	(11,499)	(17,952)	(11,005)
Commercial and industrial	(1,245)	(2,935)	(7,400)	(10,632)	(5,651)
Total Commercial	(4,451)	(13,916)	(28,667)	(57,821)	(32,410)
Residential mortgage	(2,257)	(1,559)	(1,364)	(613)	(223)
Consumer	(788)	(976)	(1,806)	(1,508)	(684)
Total charge-offs	(7,496)	(16,451)	(31,837)	(59,942)	(33,317)
Recoveries:					
Real estate - construction (1)	5,521	2,541	613	142	310
Real estate - mortgage	319	802	663	157	8
Commercial and industrial	547	1,727	694	1,608	348
Total Commercial	6,387	5,070	1,970	1,907	666
Residential mortgage	142	39	115	13	28
Consumer	165	257	95	43	28
Total recoveries	6,694	5,366	2,180	1,963	722
Net charge-offs	(802)	(11,085)	(29,657)	(57,979)	(32,595)
Balance at end of year	$23,739	$31,641	$47,426	$54,623	$38,262
Ratios:					
Net charge-offs to average loans outstanding	.08%	.99%	2.18%	3.54%	1.85%
Allowance for loan losses to loans outstanding at year end	2.26%	2.95%	3.90%	3.62%	2.16%
Allowance for loan losses to nonperforming loans at year end	148.34%	109.31%	62.93%	52.58%	41.48%

(1) Consists of construction and development loans.

Additional information about our allowance for loan losses, including the factors which influenced management’s judgment in determining the amount of the additions to the allowance charged to operating expense, may be found in Item 7 of this report under the heading "Allowance for Loan Losses" in "Management's Discussion and Analysis of Results of Operations and Financial Condition."

Table of Contents

Allocation of the Allowance for Loan Losses

The following table shows the allocation of the allowance for loan loss at the dates indicated to the extent specific allocations have been determined relative to particular loans.

(Dollars in thousands)	December 31									
	2012		2011		2010		2009		2008	
	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans
Commercial and commercial real estate	$19,952	73 %	$26,820	74 %	$42,011	77 %	$51,856	77 %	$35,427	78 %
Residential mortgage	2,544	17 %	3,093	15 %	2,155	11 %	1,263	11 %	982	11 %
Consumer	1,243	10 %	1,728	11 %	3,260	12 %	1,504	12 %	1,853	11 %
Total	$23,739	100 %	$31,641	100 %	$47,426	100 %	$54,623	100 %	$38,262	100 %

Deposit Portfolio

We offer a broad range of deposit services, including checking accounts, savings accounts and time deposits of various types. Transaction accounts and savings and time certificates are tailored to the principal market area at rates competitive with those offered in the area. All deposit accounts are insured by the FDIC up to the maximum amount permitted by law.

We solicit deposit services from individuals, businesses, associations, churches, nonprofit organizations, financial institutions and government authorities. Deposits are gathered primarily from the communities we serve through our network of 26 branches. We offer business and consumer checking accounts, regular and money market savings accounts, and certificates of deposit with many term options. We operate in a competitive environment, competing with other local banks similar in size and with significantly larger regional banks. We monitor rates at other financial institutions in the area to ascertain that our rates are competitive with the market. We also attempt to offer a wide variety of products to meet the needs of our customers. We set our deposit pricing to be competitive with other banks in our market area.

We have also utilized alternative funding sources as needed, including short-term borrowings, advances from the Federal Home Loan Bank of Indianapolis or the Federal Reserve Bank of Chicago, securities sold under agreements to repurchase ("repo borrowings") and certificates of deposit purchased from brokers.

Before November of 2008, we purchased brokered deposits to supplement funding needs from time to time. These are time accounts originated outside of our local market area. The Bank has not accepted or renewed brokered deposits since November of 2008. There were no brokered deposits remaining at December 31, 2012 or 2011.

Deposit Portfolio Composition

The following table sets forth the average deposit balances and the weighted average rates paid (dollars in thousands).

	2012			2011			2010		
	Average Amount	Average Rate		Average Amount	Average Rate		Average Amount	Average Rate	
Noninterest bearing demand	$323,368	---		$296,926	---		$238,974	---	
Interest bearing demand	225,250	0.2	%	185,591	0.2	%	224,843	0.3	%
Savings and money market accounts	420,553	0.5	%	369,758	0.6	%	315,640	0.6	%
Time	254,796	1.3	%	371,870	1.8	%	534,429	2.8	%
Total deposits	$1,223,967	0.5	%	$1,224,145	0.7	%	$1,313,886	1.3	%

Table of Contents

The following table summarizes time deposits in amounts of $100,000 or more by time remaining until maturity as of December 31, 2012 (dollars in thousands)

Three months or less	$9,769
Over 3 months through 6 months	12,573
Over 6 months through 1 year	14,830
Over 1 year	32,055
Total	$69,227

As of the date of this report, the Bank had no material foreign deposits.

Securities Portfolio

Our securities portfolio is classified as either "available for sale" or "held to maturity." Securities classified as "available for sale" may be sold prior to maturity due to changes in interest rates, prepayment risks, and availability of alternative investments, or to meet our liquidity needs.

The primary objective of our investing activities is to provide for the safety of the principal invested. Our secondary considerations include the maximization of earnings, liquidity and to help decrease our overall exposure to changes in interest rates. We have generally invested in bonds with lower credit risk; primarily those secured by government agencies or insured municipalities, to assist in the diversification of credit risk within our asset base. We have not experienced any credit losses within our investment portfolio.

The following table reflects the composition of our securities portfolio as of the dates indicated.

(Dollars in thousands)	December 31		
	2012	2011	2010
U.S. Treasury and federal agency securities	$ 42,564	$ 27,613	$ 8,109
U. S. Agency MBS and CMOs	23,761	3,886	---
Tax-exempt state and municipal bonds	25,093	4,708	83
Taxable state and municipal bonds	27,296	16,716	---
Corporate bonds	7,526	1,081	---
Other equity securities	1,557	1,042	1,011
Total	$ 127,797	$ 55,046	$ 9,203

At December 31, 2012, other than our holdings in U.S. Treasury and U.S. Government Agency Securities, we had no investments in securities of any one issuer with an aggregate book value in excess of 10% of shareholders' equity. At December 31, 2012, we had no investment in securities of issuers outside of the United States.

Schedule of Maturities of Investment Securities and Weighted Average Yields

The following is a schedule of investment securities maturities and their weighted average yield by category at December 31, 2012.

(Dollars in thousands)	Due Within One Year	One to Five Years	Five to Ten Years	After Ten Years	No Contractual Maturity

	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Treasury and federal agency securities	$---	---	$22,553	1.22 %	$20,011	1.32 %	$---	---	$---	---
U.S. Agency MBS and CMOs	---	---	16	8.50 %	---	---	23,745	1.92 %	---	---
Tax-exempt state and municipal bonds (1)	4,000	1.00 %	1,791	2.84 %	7,987	3.94 %	11,315	3.73 %	---	---
Taxable state and municipal bonds	301	0.90 %	17,617	2.80 %	9,378	2.74 %	---	---	---	---
Corporate bonds	---	---	7,526	1.42 %	---	---	---	---	---	---
Other equity securities	---	---	---	---	---	---	---	---	1,557	3.22 %
Total (1)	$4,301	.99 %	$49,503	1.88 %	$37,376	2.21 %	$35,060	2.50 %	$1,557	3.22 %

(1) Yields on tax-exempt securities are computed on a fully taxable-equivalent basis.

Table of Contents

Trust Services

We began offering trust services in January 1999 to further provide for the financial needs of our customers. As of December 31, 2012, the Trust Department managed assets of approximately $547.9 million. Our types of service include both personal trust and retirement plan services.

Our personal trust services include financial planning, investment management services, trust and estate administration and custodial services. As of December 31, 2012, personal trust assets under management totaled approximately $364.5 million. Our retirement plan services provide all types of qualified retirement plans, including profit sharing, 401(k) and pension plans. As of December 31, 2012, retirement plan assets under management totaled approximately $183.4 million.

Market Area

Our primary market area includes Ottawa, Kent and northern Allegan Counties, all located in Western Michigan. This area includes two mid-sized cities, Grand Rapids and Holland, and rural areas. Grand Rapids is the second largest city in Michigan. Holland is the largest city in Ottawa County. Both cities and surrounding areas have a solid and diverse economic base, which includes health and life sciences, tourism, office and home furniture, automotive components and assemblies, pharmaceutical, transportation, equipment, food and construction supplies. Grand Valley State University, a 24,000-student regional university with nearly 2,000 employees, has its three main campuses in our market area. GVSU and several smaller colleges and university affiliates located in our market area help stabilize the local economy because they are not as sensitive to the fluctuations of the broader economy. Companies operating in the market area include the Van Andel Institute, Steelcase, Herman Miller, Alticor, Gentex, Spectrum Health, Haworth, Wolverine World Wide, Johnson Controls, General Motors, Gerber, Magna, Spartan Stores and Meijer.

Competition

There are many bank, thrift, credit union and other financial institution offices located within our market area. Most are branches of larger financial institutions. We also face competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds and other providers of financial services. Many of our competitors have been in business a number of years, have established customer bases, are larger and have higher lending limits than we do. We compete for loans, deposits and other financial services based on our ability to communicate effectively with our customers, to understand and meet their needs and to provide high quality customer service. Our management believes that our personal service philosophy, our local decision-making and diverse delivery channels enhances our ability to compete favorably in attracting individuals and small businesses. We actively solicit customers by offering our customers personal attention, professional service, and competitive interest rates.

Employees

As of December 31, 2012, we had 365 full-time equivalent employees consisting of 315 full-time and 89 part-time employees. We have assembled a staff of experienced, dedicated and qualified professionals whose goal is to meet the financial needs of our customers while providing outstanding service. The majority of our management team has at least 10 years of banking experience, and several key personnel have more than 20 years of banking experience. None of our employees are represented by collective bargaining agreements with us.

Table of Contents

SUPERVISION AND REGULATION

The following is a summary of statutes and regulations affecting Macatawa Bank Corporation and Macatawa Bank. A change in applicable laws or regulations may have a material effect on us and our business.

General

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), the FDIC, the State of Michigan's Office of Financial and Insurance Regulation ("OFIR"), the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies can be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and declaration and payment of dividends. The system of supervision and regulation applicable to us and our bank establishes a comprehensive framework for our respective operations and is intended primarily for the protection of the FDIC's deposit insurance fund, our depositors, and the public, rather than our shareholders.

Federal law and regulations establish supervisory standards applicable to our lending activities, including internal controls, credit underwriting, loan documentation and loan-to-value ratios for loans secured by real property.

Recent Developments

Dodd-Frank Act: The Dodd-Frank Act was signed into law by President Obama on July 21, 2010. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, established the new federal Consumer Financial Protection Bureau ("CFPB"), and requires the CFPB and other federal agencies to implement many new and significant rules and regulations. The CFPB has issued significant new regulations that impact consumer mortgage lending and servicing. Those regulations become effective in January 2014. In addition, the CFPB is drafting regulations that will change the disclosure requirements and forms used under the Truth in Lending Act and Real Estate Settlement and Procedures Act. Compliance with these new laws and regulations and other regulations under consideration by the CFPB will likely result in additional costs, which could be significant and could adversely impact the Company's results of operations, financial condition or liquidity.

Deposit Insurance: The FDIC finalized changes to its deposit insurance assessment base effective April 1, 2011, which uses average consolidated total assets less average tangible equity as the assessment base instead of quarterly deposits. Additional information about these changes may be found in this Item 1 below under the heading "Macatawa Bank – Deposit Insurance."

As a result of provisions of the Dodd-Frank Act, all funds in a "noninterest-bearing transaction account" were insured in full by the FDIC from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the general FDIC deposit insurance coverage of up to $250,000 available to depositors. The temporary coverage for noninterest-bearing transaction accounts expired as scheduled on December 31, 2012. Large depositors may look to reduce their exposure to individual institutions and spread their deposits among various institutions. While we don't believe the impact of the expiring deposit insurance will have a significant impact on the Bank or its customers, it is possible that large depositors could remove their uninsured balances from the Bank. However, the Bank could also benefit from movement of large uninsured balances from other financial institutions to Macatawa. The increase in maximum deposit insurance coverage to $250,000 was made permanent under the Dodd-Frank Act.

Debit Card Interchange Fees and Routing: The Federal Reserve Board in June 2011 issued a rule to implement a provision in the Dodd-Frank Act that requires it to set debit-card interchange fees so they are "reasonable and proportional" in relation to the cost of the transaction incurred by the card issuer. The rule could result in a significant reduction in banks' debit-card interchange revenue. Though the rule technically does not apply to institutions with less than $10 billion, there is concern that the price controls will harm community banks, such as Macatawa Bank, which will be pressured by the marketplace to lower their own interchange rates.

Table of Contents

Macatawa Bank Corporation

General. Macatawa Bank Corporation is registered with, and subject to regulation by, the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA"). Under the BHCA, Macatawa Bank Corporation is subject to periodic examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic reports of our operations and such additional information as the Federal Reserve Board may require.

In accordance with Federal Reserve Board policy, Macatawa Bank Corporation is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where we might not do so absent such policy. In addition, if the OFIR deems the Bank's capital to be impaired, the OFIR may require the Bank to restore its capital by a special assessment upon Macatawa Bank Corporation as the Bank's sole shareholder. If Macatawa Bank Corporation were to fail to pay any such assessment, the directors of the Bank would be required, under Michigan law, to sell the shares of the Bank's stock owned by Macatawa Bank Corporation to the highest bidder at either a public or private auction and use the proceeds of the sale to restore the Bank's capital.

Investments and Activities. In general, any direct or indirect acquisition by us of any voting shares of any bank which would result in our direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation between us and another financial holding company or bank holding company, will require the prior written approval of the Federal Reserve Board under the BHCA.

The merger or consolidation of the Bank with another bank, or the acquisition by the Bank of assets of another bank, or the assumption of liability by the Bank to pay any deposits of another bank, will require the prior written approval of the responsible federal depository institution regulatory agency under the Bank Merger Act. In addition, in certain such cases, an application to, and the prior approval of, the Federal Reserve Board under the BHCA or the OFIR under the Michigan Banking Code, may be required.

Capital Requirements. The Federal Reserve Board uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other items, be denied approval to acquire or establish additional banks or non-bank businesses.

Additional information on our capital ratios may be found in Item 7 of this report under the heading "Capital Resources" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in the Notes to the Consolidated Financial Statements, and is here incorporated by reference.

Dividends. Macatawa Bank Corporation is a corporation separate and distinct from the Bank. Most of our revenues are dividends paid by the Bank. Thus, Macatawa Bank Corporation's ability to pay dividends to our shareholders is indirectly limited by restrictions on the Bank's ability to pay dividends described below. Further, in a policy statement, the Federal Reserve Board has expressed its view that a bank holding company should not pay cash dividends if its net income available to shareholders for the past four quarters, net of dividends paid during that period, is not sufficient to fully fund the dividends, its prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition, or it will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve Board also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. Similar enforcement powers over our bank are possessed by the FDIC. The "prompt corrective action" provisions of federal law and regulation authorizes the FDIC to restrict the payment of dividends to Macatawa Bank Corporation by our bank if it fails to meet specified capital levels.

In addition, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if after the distribution a corporation, like Macatawa Bank Corporation, can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution.

Macatawa Bank Corporation has suspended the payment of dividends on common and preferred stock and deferred interest payments on trust preferred securities. Additional information regarding the suspension of dividends and deferral of interest payments may be found in Item 5 of this report, Item 7 of this report under the heading "Capital Resources" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in the Notes to the Consolidated Financial Statements, and is here incorporated by reference. Additional information about restrictions on the payment of dividends by the Bank may be found in this Item 1 under the heading "Regulatory Developments" and in Item 8 of this report in Notes 1 and 17 to the Consolidated Financial Statements and is here incorporated by reference.

Table of Contents

Federal Securities Regulation. Our common stock is registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We are subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act. We are subject to the Sarbanes-Oxley Act, which imposes numerous reporting, accounting, corporate governance and business practices on companies, as well as financial and other professionals who have involvement with the U.S. public markets. We are generally subject to these requirements and applicable SEC rules and regulations.

Macatawa Bank

General. Macatawa Bank is a Michigan banking corporation, and its deposit accounts are insured by the Deposit Insurance Fund (the "DIF") of the FDIC. As a DIF-insured Michigan-chartered bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the OFIR, as the chartering authority for Michigan banks, and the FDIC, as administrator of the DIF. These agencies, and the federal and state laws applicable to the Bank and its operations, extensively regulate various aspects of the banking business, including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of non-interest bearing reserves on deposit accounts, and the safety and soundness of banking practices.

As discussed in this Item 1 under the heading “Regulatory Developments,” the Bank’s Consent Order was terminated effective March 2, 2012 and, in connection with termination of the Consent Order, the Bank reached an understanding with its regulators in the form of the MOU. This information is here incorporated by reference.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which all insured depository institutions are placed into one of four categories and assessed insurance premiums, based upon their respective levels of capital and results of supervisory evaluation. Institutions categorized as well-capitalized (as defined by the FDIC) and considered healthy pay the lowest premium, while institutions that are categorized as less than adequately capitalized (as defined by the FDIC) and considered of substantial supervisory concern pay the highest premium. Risk classification of all insured institutions is made by the FDIC for each semi-annual assessment period.

The FDIC is required to establish assessment rates for insured depository institutions at levels that will maintain the DIF at a Designated Reserve Ratio (DRR) selected by the FDIC within a range of 1.15% to 1.50% of estimated insured deposits. The FDIC is allowed to manage the pace at which the reserve ratio varies within this range. Due to recent disruptions in the financial markets and large numbers of bank failures in recent years, the DRR fell below 1.15%. The FDIC has adopted an Amended Restoration Plan which established the time within which the reserve ratio must be returned to 1.15% at seven years. The FDIC imposed a special assessment on all insured depository institutions that was collected on September 30, 2009. The FDIC may impose additional special assessments under certain circumstances. Additionally, in the fourth quarter of 2009, insured institutions were required to prepay their estimated risk-based assessments for all of 2010, 2011 and 2012 based on a 5% annual growth rate.

The FDIC implemented changes to its deposit insurance assessment base effective April 1, 2011, which uses average consolidated total assets less average tangible equity as the assessment base instead of quarterly deposits. Under this new calculation, most well capitalized banks will pay 5 to 9 basis points annually, increasing up to 35 basis points for banks that post significant supervisory concerns. This base rate may be adjusted for the level of unsecured debt and brokered deposits, resulting in adjusted rates ranging from 2.5 to 9 basis points annually for most well capitalized banks to 30 to 45 basis points for banks that pose significant supervisory concerns. We estimate our annual assessment rate under these new guidelines to be 14 basis points in 2013.

FICO Assessments. The Bank, as a member of the DIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation ("FICO"). From now until the maturity of the outstanding FICO obligations in 2019, DIF members will share the cost of the interest on the FICO bonds on a pro rata basis. It is estimated that FICO assessments during this period will be less than 0.025% of deposits.

Capital Requirements. The FDIC has established the following minimum capital standards for FDIC insured banks: a leverage requirement consisting of a ratio of Tier 1 capital to total average assets and risk-based capital requirements consisting of a ratio of total capital to total risk-weighted assets and a ratio of Tier 1 capital to total risk-weighted assets. Tier 1 capital consists principally of shareholders' equity.

Table of Contents

Federal regulations define these capital categories as follows:

	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Leverage Ratio
Well capitalized	10% or above	6% or above	5% or above
Adequately capitalized	8% or above	4% or above	4% or above
Undercapitalized	Less than 8%	Less than 4%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 3%	Less than 3%
Critically undercapitalized	--	--	A ratio of tangible equity to total assets of 2% or less

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution, following receipt of a less-than-satisfactory rating on its most recent examination report, to correct the deficiency.

As of December 31, 2012, the Bank was categorized as “well capitalized”. Additional information on our capital ratios may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements, and is here incorporated by reference.

Dividends. Under Michigan law, the Bank is restricted as to the maximum amount of dividends it may pay on its common stock. The Bank may not pay dividends except out of net income after deducting its losses and bad debts. A Michigan state bank may not declare or pay a dividend unless the bank will have surplus amounting to at least 20% of its capital after the payment of the dividend.

Federal law generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. The FDIC may prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, the FDIC may prohibit the payment of dividends by our bank, if such payment is determined to be an unsafe and unsound banking practice.

Additional information about restrictions on payment of dividends by the Bank may be found in this Item 1 under the heading "Regulatory Developments" and in Item 8 of this report in Notes 1 and 17 to the Consolidated Financial Statements, and is here incorporated by reference.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on any extensions of credit to Macatawa or any subsidiary of Macatawa, on investments in the stock or other securities of Macatawa or any subsidiary of Macatawa and the acceptance of the stock or other securities of Macatawa or any subsidiary of

Macatawa as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by our bank to its directors and officers, to Macatawa's directors and officers, to our principal shareholders and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of our company or any subsidiary or a principal shareholder in our company may obtain credit from banks with which our bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines to promote the safety and soundness of federally insured depository institutions. These guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

Investments and Other Activities. Under federal law and FDIC regulations, FDIC insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law, as implemented by FDIC regulations, also prohibits FDIC insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the DIF. Impermissible investments and activities must be divested or discontinued within certain time frames set by the FDIC in accordance with federal law.

Table of Contents

Consumer Protection Laws. The Bank's business includes making a variety of types of loans to individuals. In making these loans, we are subject to state usury and regulatory laws and to various federal laws and regulations, including the privacy of consumer financial information provisions of the Gramm-Leach-Bliley Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Home Mortgage Disclosure Act, which prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of the Bank, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing. In receiving deposits, the Bank is subject to extensive regulation under state and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Bank Secrecy Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon the Bank and its directors and officers.

Branching Authority. Michigan banks have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan law permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of OFIR, (1) acquisition of Michigan banks by FDIC-insured banks, savings banks or savings and loan associations located in other states, (2) sale by a Michigan bank of branches to an FDIC-insured bank, savings bank or savings and loan association located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan. A Michigan bank holding company may acquire a non-Michigan bank and a non-Michigan bank holding company may acquire a Michigan bank.

Table of Contents

ITEM 1A: Risk Factors.

Risks related to the our Business

Earnings in 2011 and 2012 were supported, in part, by negative provisions for loan losses and non-recurring events, which will not necessarily be available in future years.

We were profitable in 2011 and 2012. Earnings in these years were supported, in part, by negative provisions for loan losses and non-recurring events. We have recorded negative provisions for loan losses of $7.1 million and $4.7 million for the years ended December 31, 2012 and 2011, respectively. Earnings in 2012 were significantly impacted by the reversal of an $18.9 million valuation allowance on our deferred tax assets, the receipt of a large prepayment fee of $2.8 million, and large recoveries of previously charged-off loans. We do not expect a similar level of negative provisions for loan losses in 2013, and non-recurring events with similar levels of positive impact on earnings are not likely to occur in 2013.

Our elevated level of nonperforming assets and other problem loans could continue to have an adverse effect on the Company's results of operations and financial condition.

Our nonperforming assets (which includes non-accrual loans, foreclosed properties and other accruing loans past due 90 days or more) were approximately $67.6 million at December 31, 2012. These elevated levels could continue to negatively impact operating results through higher loan losses, lost interest and higher costs to administer problem assets. Until these elevated levels of problem assets are reduced, the Company could record operating losses that further materially deteriorate the Company's financial condition and reduce capital levels, further exposing the Company to additional risk factors discussed below.

National, state and local economic conditions could have a material adverse effect on the Company's results of operations and financial condition.

The results of operations for financial institutions, including our Bank, may be materially and adversely affected by changes in prevailing national, state and local economic conditions. Our profitability is heavily influenced by the quality of the Company's loan portfolio and the stability of the Company's deposits. Unlike larger national or regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in Ottawa, Kent and Allegan Counties of Western Michigan. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services, and the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities, financial, capital or credit markets or other factors, could impact national and local economic conditions and have a material adverse effect on the Company's results of operations and financial condition.

Our credit losses could increase and our allowance for loan losses may not be adequate to cover actual loan losses.

The risk of nonpayment of loans is inherent in all lending activities and nonpayment of loans may have a material adverse effect on our earnings and overall financial condition, and the value of our common stock. We make various assumptions and judgments about the collectability of our loan portfolio and provide an allowance for potential losses based on a number of factors. If our assumptions are wrong, our allowance for loan losses may not be sufficient to cover our losses, which could have an adverse affect on our operating results, and may cause us to increase the allowance in the future. The actual amount of future provisions for loan losses cannot now be determined and may exceed the amounts of past provisions for loan losses. Federal banking regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to increase our provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses could have a negative effect on our regulatory capital ratios, net income, financial condition and results of operations.

Table of Contents

Failure to comply with our Memorandum of Understanding could result in enforcement proceedings.

In connection with the termination of the Consent Order, the Bank has reached an understanding in the form of the MOU with its regulators. Failure to comply with the terms of the MOU could result in enforcement orders or penalties from its regulators, under the terms of which the Bank could, among other things, become subject to restrictions on its ability to develop any new business and restrictions on its existing business, and it could be required to raise additional capital, dispose of certain assets and liabilities within a prescribed period of time, or both. The terms of any such enforcement order or action could have a material negative effect on our business, operations, financial condition, results of operations or the value of our common stock.

We are subject to liquidity risk in our operations, which could adversely affect our ability to fund various obligations.

Liquidity risk is the possibility of being unable to meet obligations as they come due, pay deposits when withdrawn, and fund loan and investment opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, mortgage originations, withdrawals by depositors, repayment of debt, operating expenses and capital expenditures. Liquidity of the Bank is derived primarily from retail deposit growth and retention, principal and interest payments on loans and investment securities, net cash provided from operations and access to other funding sources. Liquidity is essential to our business. We must maintain sufficient funds to respond to the needs of depositors and borrowers. An inability to raise funds through deposits, borrowings, the sale or pledging as collateral of loans and other assets could have a material adverse effect on our liquidity. An inability to retain the current level of deposits, including the loss of one or more of the Bank's larger deposit relationships, could have a material adverse effect on the Bank's liquidity. Our access to funding sources in amounts adequate to finance activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of the business activity due to a market down turn or regulatory action that limits or eliminates access to alternate funding sources, including brokered deposits discussed above. Our ability to borrow could also be impaired by factors that are nonspecific to the Company, such as severe disruption of the financial markets or negative expectations about the prospects for the financial services industry as a whole.

Our construction and development lending has exposed us to significant risks and has resulted in a disproportionate amount of the increase in our provision for loan losses in 2008 through 2010.

Construction and development loans consist of loans to commercial customers for the construction of their business facilities. They also include construction loans to builders and developers for the construction of one- to four-family residences and the development of one- to four-family lots, residential subdivisions, condominium developments and other commercial developments. This portfolio has been particularly adversely affected by job losses, declines in real estate values, declines in home sale volumes, and declines in new home building. Declining real estate values have resulted in sharp increases in losses, particularly in the land development and construction loan portfolios to residential developers. This type of lending is generally considered to have more complex credit risks than traditional single-family residential lending because the principal is concentrated in a limited number of loans with repayment dependent on the successful completion and sales of the related real estate project. Consequently, these loans are often more sensitive to adverse conditions in the real estate market or the general economy than other real estate loans. These loans are generally less predictable and more difficult to evaluate and monitor and collateral may be difficult to dispose of in a market decline. Additionally, we may experience significant construction loan losses if independent appraisers or project engineers inaccurately estimate the cost and value of construction loan projects. The Company curtailed this type of lending beginning in 2008. During 2009 through 2012, the Company also made a significant effort to reduce its exposure to residential land development and other construction and development loans.

Construction and development loans have contributed disproportionately to the increase in our provisions for loan losses in recent periods. As of December 31, 2012, we had approximately $48.9 million in loans to residential developers, or approximately 4.6% of our loan portfolio. Approximately $28.9 million, or 49.8%, of our net charge-offs during 2009, approximately $9.2 million, or 31.0%, of our net charge-offs during 2010, approximately $473,000, or 4.3%, of our net charge-offs during 2011 and approximately $351,000, or 43.8% of our net charge-offs during 2012, were attributable to construction and development loans. Further deterioration in our construction and development loan portfolio could result in additional increases in the provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

We have significant exposure to risks associated with commercial and residential real estate.

A substantial portion of our loan portfolio consists of commercial and residential real estate-related loans, including real estate development, construction and residential and commercial mortgage loans. As of December 31, 2012, we had approximately $498.0 million of commercial real estate loans outstanding, which represented approximately 47% of our loan portfolio. As of that same date, we had approximately $182.6 million in residential real estate loans outstanding, or approximately 17% of our loan portfolio. Consequently, real estate-related credit risks are a significant concern for us. The adverse consequences from real estate-related credit risks tend to be cyclical and are often driven by national economic developments that are not controllable or entirely foreseeable by us or our borrowers. General difficulties in our real estate markets have recently contributed to significant increases in our nonperforming loans, charge-offs, and decreases in our income.

Commercial loans may expose us to greater financial and credit risk than other loans.

Our commercial loan portfolio, including commercial mortgages, was approximately $762.7 million at December 31, 2012, comprising approximately 73% of our total loan portfolio. Commercial loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans. Any significant failure to pay on time by our customers would hurt our earnings. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. In addition, when underwriting a commercial or industrial loan, we may take a security interest in commercial real estate, and, in some instances upon a default by the borrower, we may foreclose on and take title to the property, which may lead to potential financial risks for us under applicable environmental laws. If hazardous substances were discovered on any of these properties, we may be liable to governmental agencies or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination.

Our loan portfolio has and will continue to be affected by the ongoing correction in residential real estate prices and reduced levels of home sales.

Loans to residential developers involved in the development or sale of 1-4 family residential properties were approximately $48.9 million, $66.3 million, $95.7 million, $153.3 million and $204.4 million at December 31, 2012, 2011, 2010, 2009 and 2008, respectively. While activity has increased in 2012, the housing market in our market area continues to be soft, reflecting declining prices and excess inventories of houses to be sold. As a result, home builders have experienced financial deterioration. We expect the home builder market to continue to be volatile and anticipate continued pressure on the home builder segment. As we continue our on-going portfolio monitoring, we will make credit and reserve decisions based on the current conditions of the borrower or project combined with our expectations for the future. If the housing market deteriorates, we could experience higher charge-offs and delinquencies in this portfolio.

We may face increasing pressure from historical purchasers of our residential mortgage loans to repurchase those loans or reimburse purchasers for losses related to those loans.

We generally sell the fixed rate long-term residential mortgage loans we originate on the secondary market and retain adjustable rate mortgage loans for our portfolios. In response to the financial crisis, purchasers of residential mortgage loans, such as government sponsored entities, are increasing their efforts to seek to require sellers of residential mortgage loans to either repurchase loans previously sold or reimburse purchasers for losses related to loans previously sold when losses are incurred on a loan previously sold due to actual or alleged failure to strictly conform to the purchaser's purchase criteria. As a result, while we have not yet been required to repurchase such loans, we may face increasing pressure from historical purchasers of our residential mortgage loans to repurchase those loans or reimburse purchasers for losses related to those loans and we may face increasing expenses to defend against such claims. If we are required in the future to repurchase loans previously sold, reimburse purchasers for losses related to loans previously sold, or if we incur increasing expenses to defend against such claims, our financial condition and results of operations would be negatively affected, and would lower our capital ratios as a result of increasing assets and lowering income through expenses and any loss incurred.

For the five-year period ended December 31, 2012, the Company has sold an aggregate of $650.6 million of residential mortgage loans on the secondary market. As of December 31, 2012, the Company had two pending make whole requests with respect to loans having an aggregate of $152,000 in principal amount, and had not realized any loss, related to residential mortgage loans sold on the secondary market during the five-year period ended December

31, 2012.

Changes in interest rates may negatively affect our earnings and the value of our assets.

Our earnings and cash flows depend substantially upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and investment securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors that are beyond our control, including general economic conditions, competition and policies of various governmental and regulatory agencies and, in particular, the policies of the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investment securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect: (i) our ability to originate loans and obtain deposits; (ii) the fair value of our financial assets and liabilities, including our securities portfolio; and (iii) the average duration of our interest-earning assets. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rates indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk), including a prolonged flat or inverted yield curve environment. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse affect on our financial condition and results of operations.

Table of Contents

The global market crisis has triggered a series of cuts in interest rates. During fiscal 2010, 2011 and 2012, the Federal Open Market Committee kept the target federal funds between 0% and 0.25% and we expect the low interest rate environment to continue in 2013. The low interest rate environment has compressed our net interest spread and reduced our spread-based revenues, which has had an adverse impact on our revenue and results of operations.

The Dodd-Frank Act may adversely impact the Company's results of operations, financial condition or liquidity.

The Dodd-Frank Act was signed into law by President Obama on July 21, 2010. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, established the new federal Consumer Financial Protection Bureau (the "CFPB"), and requires the CFPB and other federal agencies to implement many new and significant rules and regulations. The CFPB has issued significant new regulations that impact consumer mortgage lending and servicing. Those regulations will become effective in January 2014. In addition, the CFPB is drafting regulations that will change the disclosure requirements and forms used under the Truth in Lending Act and Real Estate Settlement and Procedures Act. Compliance with these new laws and regulations and other regulations under consideration by the CFPB will likely result in additional costs, which could be significant, and could adversely impact the Company's results of operations, financial condition or liquidity.

We are subject to significant government regulation, and any regulatory changes may adversely affect us.

The banking industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers and the Deposit Insurance Fund, not our creditors or shareholders. We are subject to extensive regulation by the Federal Reserve, the FDIC and OFIR, in addition to other regulatory and self-regulatory organizations. Future regulatory changes or accounting pronouncements may increase our regulatory capital requirements or adversely affect our regulatory capital levels. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of such changes, which could have a material adverse effect on our profitability or financial condition.

The Company could be adversely affected by the soundness of other financial institutions, including defaults by larger financial institutions.

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of credit, trading, clearing, counterparty or other relationships between financial institutions. The Company has exposure to multiple counterparties, and the Company routinely executes transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the Company or by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the Company interacts on a daily basis, and therefore could adversely affect the Company.

We rely heavily on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our management team and other key personnel. Losing the services of one or more key members of our management team could adversely affect our operations.

Table of Contents

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. If we fail to identify and remediate control deficiencies, it is possible that a material misstatement of interim or annual financial statements will not be prevented or detected on a timely basis. In addition, any failure or circumvention of our other controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

The Bank may be required to pay additional insurance premiums to the FDIC, which could negatively impact earnings.

Insured institution failures, as well as deterioration in banking and economic conditions, have significantly increased FDIC loss provisions, resulting in a decline in the designated reserve ratio to historical lows. The reserve ratio may continue to decline in the future. In addition, the limit on FDIC coverage has been increased to $250,000. Depending upon any future losses that the FDIC insurance fund may suffer, there can be no assurance that there will not be additional premium increases in order to replenish the fund. The FDIC may need to set a higher base rate schedule or impose special assessments due to future financial institution failures and updated failure and loss projections. Increased FDIC assessment rates could have an adverse impact on our results of operations.

If we cannot raise additional capital when needed, our ability to further expand our operations through organic growth and acquisitions could be materially impaired.

We are required by federal and state regulatory authorities to maintain specified levels of capital to support our operations. We may need to raise additional capital to support our current level of assets or our growth. Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. We cannot assure that we will be able to raise additional capital in the future on terms acceptable to us or at all. If we cannot raise additional capital when needed, our ability to maintain our current level of assets or to expand our operations through organic growth and acquisitions could be materially limited. Additional information on the capital requirements applicable to the Bank may be found under the heading “Capital Requirements” in Item 1 and "Regulatory Capital" in Note 17 in Item 8.

We may be a defendant in a variety of litigation and other actions, which may have a material adverse effect on our financial condition and results of operations.

We may be involved from time to time in a variety of litigation arising out of our business. Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation or cause us to incur unexpected expenses, which could be material in amount. Should the ultimate expenses, judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our financial condition and results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, and we may not be able to obtain adequate replacement of our existing policies with acceptable terms, if at all.

Our future success is dependent on our ability to compete effectively in the highly competitive banking industry.

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. We compete for deposits, loans and other financial services with numerous Michigan-based and out-of-state banks, thrifts, credit unions and other financial institutions as well as other entities which provide financial services. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as we are. Most of our competitors have been in business for many years, have established customer bases, are larger, and have substantially higher lending limits than we do. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services. Competition for limited, high-quality lending opportunities and core deposits in an increasingly competitive marketplace may adversely affect our results of operations.

Evaluation of investment securities for other-than-temporary impairment involves subjective determinations and could materially impact our results of operations and financial condition.

The evaluation of impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or future recovery prospects, the effects of changes in interest rates or credit spreads and the expected recovery period. Estimating future cash flows involves incorporating information received from third-party sources and making internal assumptions and judgments regarding the future performance of the underlying collateral and assessing the probability that an adverse change in future cash flows has occurred. The determination of the amount of other-than-temporary impairments is based upon our periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. Our management considers a wide range of factors about the security issuer and uses reasonable judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Impairments to the carrying value of our investment securities may need to be taken in the future, which could have a material adverse effect on our results of operations and financial condition.

Table of Contents

We depend upon the accuracy and completeness of information about customers.

In deciding whether to extend credit to customers, we rely on information provided to us by our customers, including financial statements and other financial information. We also rely on representations of customers as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. Our financial condition and results of operations could be negatively impacted to the extent that we extend credit in reliance on financial statements or other information provided by customers that is false, misleading or incomplete.

Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of computer systems or otherwise, or failure or interruption of the Company's communication or information systems, could severely harm the Company’s business.

As part of its business, the Company collects, processes and retains sensitive and confidential client and customer information on behalf of the Company and other third parties. Despite the security measures the Company has in place for its facilities and systems, and the security measures of its third party service providers, the Company may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors or other similar events.

The Company relies heavily on communications and information systems to conduct its business. Any failure or interruption of these systems could result in failures or disruptions in the Company’s customer relationship management, general ledger, deposit, loan and other systems. In addition, customers could lose access to their accounts and be unable to conduct financial transactions during a period of failure or interruption of these systems.

Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by the Company or by its vendors, or failure or interruption of the Company's communication or information systems, could severely damage the Company’s reputation, expose it to risks of regulatory scrutiny, litigation and liability, disrupt the Company’s operations, or result in a loss of customer business, the occurrence of any of which could have a material adverse effect on the Company’s business.

We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. There can be no assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

Table of Contents

An "ownership change" for purposes of Section 382 of the Internal Revenue Code could materially impair our ability to use our deferred tax assets.

At December 31, 2012, our gross deferred tax asset was $21.7 million. Our ability to use our deferred tax assets to offset future taxable income will be limited if we experience an "ownership change" as defined in Section 382 of the Internal Revenue Code. In general, an ownership change will occur if there is a cumulative increase in our ownership by "5-percent shareholders" (as defined in the Code) that exceeds 50 percentage points over a rolling three-year period. A corporation that experiences an ownership change will generally be subject to an annual limitation on the use of its pre-ownership change deferred tax assets equal to the equity value of the corporation immediately before the ownership change, multiplied by the long-term tax-exempt rate.

If an "ownership change" occurs, we could realize a permanent loss of a significant portion of our U.S. federal deferred tax assets (related to net operating loss carryforwards) and lose certain built-in losses that have not been recognized for tax purposes. The amount of the permanent loss would depend on the size of the annual limitation (which is in part a function of our market capitalization at the time of an "ownership change") and the remaining carry forward period (U.S. federal net operating losses generally may be carried forward for a period of 20 years).

Under the MOU, the Bank is restricted from paying any dividends to Macatawa Bank Corporation without the prior written consent of the Bank's regulators. While Macatawa Bank Corporation believes it had sufficient cash and cash equivalents as of the date of this report to meet its financial obligations as they come due during 2013, if the Bank is unable to pay dividends to Macatawa Bank Corporation and Macatawa Bank Corporation is unable to access additional funds through capital raising efforts or other funding sources, it could be unable to meet its financial obligations as they came due in future years.

Under the terms of the MOU, the Bank may not declare or pay any dividends to Macatawa Bank Corporation without the prior written approval of the FDIC and OFIR. At December 31, 2012, Macatawa Bank Corporation held at the holding company level cash and cash equivalents of $9.8 million and Macatawa Bank Corporation believes this level of cash and cash equivalents will be sufficient to meet its financial obligations as they come due in 2013.

In December 2009, we exercised our right to defer interest payments on our trust preferred securities for 20 consecutive quarters or until such earlier time as is determined by further action of the Board of Directors. Through December 31, 2012, we have deferred interest payments for thirteen quarters. We continue to accrue interest during the deferral period and at December 31, 2012 total interest accrued for trust preferred securities was $4.7 million, compared to $3.1 million at December 31, 2011. If we defer interest payments for the full 20 quarters, total interest accrued for the trust preferred securities will be approximately $7.8 million, payment of which would be due during the fourth quarter of 2014, and required quarterly interest payments on our trust preferred securities would resume thereafter, unless we again exercise our right to defer interest payments on our trust preferred securities.

If the Bank is unable to pay dividends to Macatawa Bank Corporation and Macatawa Bank Corporation is unable to access additional funds through capital raising efforts or other funding sources, it could be unable to meet its financial obligations as they came due in future years.

Risks Associated With the Company's Stock

The market price of our common stock can be volatile, which may make it more difficult to resell our common stock at a desired time and price.

Stock price volatility may make it more difficult for a shareholder to resell our common stock when a shareholder wants to and at prices a shareholder finds attractive or at all. Our stock price can fluctuate significantly in response to a variety of factors, regardless of operating results. These factors include, among other things:

- Variations in our anticipated or actual operating results or the results of our competitors;
- Changes in investors' or analysts' perceptions of the risks and conditions of our business;
- The size of the public float of our common stock;
- Regulatory developments, including changes to regulatory capital levels, components of regulatory capital and how regulatory capital is calculated;
- Interest rate changes or credit loss trends;
- Trading volume in our common stock;
- Market conditions; and
- General economic conditions.

Table of Contents

The Company may issue additional shares of its common stock in the future, which could dilute a shareholder's ownership of common stock.

The Company's articles of incorporation authorize its Board of Directors, without shareholder approval, to, among other things, issue additional shares of common or preferred stock. The issuance of any additional shares of common or preferred stock could be dilutive to a shareholder's ownership of Company common stock. The Company may offer additional shares of its common stock in exchange for its outstanding 11% Subordinated Notes due in 2017 and may seek to issue additional shares of common stock in exchange for some or all outstanding shares of its preferred stock.

As of December 31, 2012, subordinated notes (comprised of the 11% Subordinated Notes due in 2017) having an aggregate principal amount of $1,650,000 were outstanding. The Company has no present plans to issue any additional shares of common stock in exchange for subordinated notes.

To the extent that the Company issues options or warrants to purchase common stock in the future and the options or warrants are exercised, the Company's shareholders may experience further dilution. Holders of shares of Company common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, shareholders may not be permitted to invest in future issuances of Company common or preferred stock.

Exercise of our outstanding Warrants to purchase common stock or conversion of our outstanding preferred stock could substantially dilute a shareholder's ownership of common stock.

We have issued Warrants to purchase a total of 1,478,811 shares of our common stock at an exercise price of $9.00 per share. We have outstanding 31,290 shares of Class A Preferred Stock, which are convertible into approximately 3,496,032 shares of our common stock at a conversion price of $8.95 per share. We have outstanding 2,600 shares of Class B Preferred Stock, which are convertible into approximately 433,333 shares of our common stock at a conversion price of $6.00 per share. Additional information about the preferred stock and Warrants may be found in Item 8, Note 17 – "Shareholders' Equity."

The exercise or conversion, in whole or in part, of these securities into shares of our common stock could substantially dilute a shareholder's ownership of common stock.

The Company's ability to pay dividends is limited and it may be unable to pay future dividends.

We have suspended payment of dividends on our common and preferred stock in order to preserve capital and we do not expect to resume payment of dividends in the near term. Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient regulatory capital. The ability of the Bank to pay dividends to Macatawa Bank Corporation is limited by its obligation to maintain sufficient capital and by other general restrictions on dividends that are applicable to us. Under Michigan law, the Bank may not pay dividends to the Company in excess of its retained earnings. The Bank had retained earnings of approximately $3.6 million at December 31, 2012.

In addition, the Company may not pay dividends on shares of common stock if the Company has not paid full cash dividends for the most recently completed dividend period for both the Series A and Series B Preferred Stock. Additional information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings "Regulatory Developments" and "Supervision and Regulation," in Item 7 of this report under the heading "Capital Resources" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in Notes 1 and 17 to the Consolidated Financial Statements, and is here incorporated by reference.

Although publicly traded, our common stock has substantially less liquidity than the average liquidity of stocks listed on The Nasdaq Global Select Market.

Although our common stock is listed for trading on The Nasdaq Global Select Market, our common stock has substantially less liquidity than the average liquidity for companies listed on The Nasdaq Global Select Market. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This marketplace depends on the individual decisions of investors and general economic and market conditions over which we have no control. This limited market may affect a shareholder's ability to sell their shares on short notice, and the sale of a large number of shares at one time could temporarily depress the market price of our common stock. For these reasons, our common stock should not be viewed as a short-term investment.

Table of Contents

The Company's common stock is not insured by any governmental entity.

Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity. Investment in Company common stock is subject to risk, including possible loss.

The Company may issue debt and equity securities that are senior to Company common stock as to distributions and in liquidation, which could negatively affect the value of Company common stock.

The Company has in the past and may in the future increase its capital by entering into debt or debt-like financing or issuing debt or equity securities, which could include issuances of senior notes, subordinated notes, preferred stock or common stock. In the event of the Company's liquidation, its lenders and holders of its debt securities would receive a distribution of the Company's available assets before distributions to the holders of Company common stock. The Company's decision to incur debt and issue securities in future offerings will depend on market conditions and other factors beyond its control. The Company cannot predict or estimate the amount, timing or nature of its future offerings and debt financings. Future offerings could reduce the value of shares of Company common stock and dilute a shareholder's interest in the Company.

Our articles of incorporation and bylaws and Michigan laws contain certain provisions that could make a takeover more difficult.

Our articles of incorporation and bylaws, and the laws of Michigan, include provisions which are designed to provide our Board of Directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions could discourage potential acquisition proposals and could delay or prevent a change in control. The provisions also could diminish the opportunities for a holder of our common stock to participate in tender offers, including tender offers at a price above the then-current price for our common stock. These provisions could also prevent transactions in which our shareholders might otherwise receive a premium for their shares over then current market prices, and may limit the ability of our shareholders to approve transactions that they may deem to be in their best interests.

The Michigan Business Corporation Act contains provisions intended to protect shareholders and prohibit or discourage certain types of hostile takeover activities. In addition to these provisions and the provisions of our articles of incorporation and bylaws, federal law requires the Federal Reserve Board's approval prior to acquisition of "control" of a bank holding company. All of these provisions may have the effect of delaying or preventing a change in control of the Company without action by our shareholders, and therefore, could adversely affect the price of our common stock.

If an entity holds as little as a 5% interest in our outstanding securities, that entity could, under certain circumstances, be subject to regulation as a "bank holding company."

Any entity, including a "group" composed of natural persons, owning or controlling with the power to vote 25% or more of our outstanding securities, or 5% or more if the holder otherwise exercises a "controlling influence" over us, may be subject to regulation as a "bank holding company" in accordance with the Bank Holding Company Act of 1956, as amended (the "BHC Act"). In addition, any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve Board under the BHC Act to acquire or retain 5% or more of our outstanding securities. Becoming a bank holding company imposes statutory and regulatory restrictions and obligations, such as providing managerial and financial strength for its bank subsidiaries. Regulation as a bank holding company could require the holder to divest all or a portion of the holder's investment in our securities or those nonbanking investments that may be deemed impermissible or incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

Any person not defined as a company by the BHC Act may be required to obtain the approval of the Federal Reserve Board under the Change in Bank Control Act of 1978, as amended, to acquire or retain 10% or more of our outstanding securities.

Any person not otherwise defined as a company by the BHC Act and its implementing regulations may be required to obtain the approval of the Federal Reserve Board under the Change in Bank Control Act of 1978, as amended, to acquire or retain 10% or more of our outstanding securities. Applying to obtain this approval could result in a person incurring substantial costs and time delays. There can be no assurance that regulatory approval will be obtained.

ITEM 1B:Unresolved Staff Comments.

None.

Table of Contents

ITEM 2:Properties.

We own or lease facilities located in Ottawa County, Allegan County and Kent County, Michigan. Our administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424. Our administrative offices are approximately 49,000 square feet and contain our administration, human resources, trust, loan underwriting and processing, and deposit operations. We believe our facilities are well-maintained and adequately insured. We own each of the facilities except those identified in the "Use" column as "(Leased facility)". Our facilities as of February 21, 2013, were as follows:

Location of Facility	Use
10753 Macatawa Drive, Holland	Main Branch, Administrative, and Loan Processing Offices
815 E. Main Street, Zeeland	Branch Office
126 Ottawa Avenue N.W., Grand Rapids	Branch Office (Leased facility)
141 E. 8th Street, Holland	Branch Office
489 Butternut Dr., Holland	Branch Office
701 Maple Avenue, Holland	Branch Office
699 E. 16th Street, Holland	Branch Office
41 N. State Street, Zeeland	Branch Office
2020 Baldwin Street, Jenison	Branch Office
6299 Lake Michigan Dr., Allendale	Branch Office
132 South Washington, Douglas	Branch Office
4758 – 136th Street, Hamilton	Branch Office (Leased facility)
3526 Chicago Drive, Hudsonville	Branch Office
20 E. Lakewood Blvd., Holland	Branch Office
3191 – 44th Street, S.W., Grandville	Branch Office
2261 Byron Center Avenue S.W., Byron Center	Branch Office
5271 Clyde Park Avenue, S.W., Wyoming	Branch Office and Loan Center
4590 Cascade Road, Grand Rapids	Branch Office
3177 Knapp Street, N.E., Grand Rapids	Branch Office and Loan Center
15135 Whittaker Way, Grand Haven	Branch Office and Loan Center
12415 Riley Street, Holland	Branch Office
2750 Walker N.W., Walker	Branch Office
1575 – 68th Street S.E., Grand Rapids	Branch Office
2820 – 10 Mile Road, Rockford	Branch Office
520 Baldwin Street, Jenison	Branch Office
2440 Burton Street, S.E., Grand Rapids	Branch Office
6330 28th Street, S.E., Grand Rapids	Branch Office

ITEM 3: Legal Proceedings.

As of the date of this report, there are no material pending legal proceedings, other than routine litigation incidental to the business of banking, to which Macatawa Bank Corporation or the Bank are a party or of which any of our properties are the subject.

ITEM 4: Mine Safety Disclosures.

Not applicable.

Table of Contents

PART II

ITEM 5: Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is quoted on the Nasdaq Global Select Market under the symbol MCBC. High and low closing prices (as reported on the Nasdaq Global Select Market) of our common stock for each quarter for the years ended December 31, 2012 and 2011 are set forth in the table below.

	2012		2011	
Quarter	High	Low	High	Low
First Quarter	$3.50	$2.20	$4.91	$2.42
Second Quarter	$3.66	$3.09	$2.82	$2.24
Third Quarter	$3.47	$2.92	$3.15	$2.55
Fourth Quarter	$3.50	$2.80	$2.95	$2.06

On February 21, 2013, there were approximately 778 owners of record and approximately 6,330 beneficial owners of our common stock.

We did not declare dividends on our common stock in 2011 or 2012. Information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings “Regulatory Developments” and “Supervision and Regulation,” in Item 7 of this report under the under the heading "Capital Resources" included in "Management’s Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in Notes 1 and 17 to the Consolidated Financial Statements, and is here incorporated by reference. Information regarding our equity compensation plans may be found in Item 12 of this report and is here incorporated by reference.

Table of Contents

ITEM 6: Selected Financial Data.

The following unaudited table sets forth selected historical consolidated financial information as of and for the years ended December 31, 2012, 2011, 2010, 2009, and 2008 which is derived from our audited consolidated financial statements. You should read this information in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

(Dollars in thousands, except per share data)	As of and for the Year Ended December 31				
	2012	2011	2010	2009	2008
Financial Condition					
Total assets	$1,560,718	$1,507,667	$1,578,261	$1,830,172	$2,149,372
Securities	127,797	55,046	9,203	129,504	186,516
Loans	1,052,348	1,070,975	1,217,196	1,510,816	1,774,063
Deposits	1,286,261	1,215,289	1,276,620	1,416,337	1,665,761
Long term debt	42,888	42,888	42,888	42,888	41,238
Other borrowed funds	91,822	148,603	185,336	278,023	284,790
Shareholders' equity	130,507	94,426	67,842	87,991	149,213
Share Information*					
Basic earnings (loss) per common share	$1.31	$.26	$(1.01)	$(3.81)	$(2.33)
Diluted earnings (loss) per common share	1.31	.26	(1.01)	(3.81)	(2.33)
Book value per common share	3.59	2.26	1.96	3.10	6.91
Tangible book value per common share	3.59	2.26	1.94	3.07	6.88
Dividends per common share	$---	$---	$---	$---	$.26
Dividend payout ratio	---	---	---	---	(11.16)%
Average dilutive common shares outstanding	27,086,792	22,739,990	17,686,362	17,449,943	17,044,893
Common shares outstanding at end of period	27,203,825	27,082,823	17,679,621	17,698,108	17,161,515
Operations					
Interest income	$57,276	$60,779	$76,003	$95,878	$116,075
Interest expense	9,814	14,480	25,436	43,085	57,944
Net interest income	47,462	46,299	50,567	52,793	58,131
Provision for loan losses	(7,100)	(4,700)	22,460	74,340	37,435
Net interest income (loss) after provision for loan losses	54,562	50,999	28,107	(21,547)	20,696
Total noninterest income	15,628	14,892	18,023	16,697	18,144
Total noninterest expense	53,283	60,062	62,681	67,391	86,067
Income (loss) before tax	16,907	5,829	(16,551)	(72,241)	(47,227)
Federal income tax (benefit)	(18,583)	---	1,303	(8,600)	(8,373)
Net income (loss)	35,490	5,829	(17,854)	(63,641)	(38,854)
Dividend declared on preferred shares	---	---	---	2,870	817

Net income (loss) available to common shares	$35,490	$5,829	$(17,854)	$(66,511)	$(39,671)
Performance Ratios					
Return on average equity	34.39%	7.08%	(24.99)%	(50.60)%	(24.06)%
Return on average assets	2.37	.38	(1.08)	(3.16)	(1.82)
Yield on average interest-earning assets	4.21	4.32	4.93	5.10	5.86
Cost on average interest-bearing liabilities	0.92	1.26	1.88	2.56	3.23
Average net interest spread	3.29	3.06	3.05	2.54	2.63
Average net interest margin	3.49	3.29	3.28	2.82	2.94
Efficiency ratio	84.46	98.15	91.39	96.98	112.84
Capital Ratios					
Period-end equity to assets	8.36%	6.26%	4.30%	4.81%	6.94%
Average equity to average assets	6.89	5.37	4.30	6.24	7.58
Total risk-based capital ratio (consolidated)	14.98	13.15	9.65	9.23	11.26
Credit Quality Ratios					
Allowance for loan losses to total loans	2.26%	2.95%	3.90%	3.62%	2.16%
Nonperforming assets to total assets	4.33	6.33	8.45	7.71	5.21
Net charge-offs to average loans	.08	.99	2.18	3.54	1.85

*Retroactively adjusted to reflect the effect of all stock splits and dividends.

Table of Contents

ITEM 7: Management’s Discussion and Analysis of Results of Operations and Financial Condition.

Management's discussion and analysis of results of operations and financial condition contains forward-looking statements. Please refer to the discussion of forward-looking statements at the beginning of this report.

The following section presents additional information to assess our results of operations and financial condition. This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this report.

OVERVIEW

Macatawa Bank Corporation is a Michigan corporation and a registered bank holding company. It wholly-owns Macatawa Bank, Macatawa Statutory Trust I and Macatawa Statutory Trust II. Macatawa Bank is a Michigan chartered bank with deposit accounts insured by the FDIC. The Bank operates twenty-six branch offices and a lending and operational service facility, providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Statutory Trusts I and II are grantor trusts and issued $20.0 million each of pooled trust preferred securities. These trusts are not consolidated in our Consolidated Financial Statements. For further information regarding consolidation, see the Notes to the Consolidated Financial Statements.

At December 31, 2012, we had total assets of $1.56 billion, total loans of $1.05 billion, total deposits of $1.29 billion and shareholders’ equity of $130.5 million. We recognized net income of $35.5 million in 2012, a substantial improvement over the prior two years, and we experienced our eleventh consecutive quarter of net income to end 2012. Positively impacting our net income for 2012 was an $18.9 million reversal of our deferred tax asset valuation allowance as we determined it to be more likely than not that we will be able to utilize our deferred tax asset against future taxable income. During 2012, 2011 and 2010, our interest income accounted for approximately 79%, 80% and 81%, respectively, of our operating revenues and our non-interest income accounted for approximately 21%, 20% and 19%, respectively, of our operating revenues. For additional information about our financial condition and results of operations, see our consolidated financial statements and related notes included in this report.

In response to our losses during 2008, 2009 and the first quarter of 2010, our Board of Directors implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles. The focus of our management team turned from growth in our business to executing these disciplined business and banking procedures and policies designed to limit future losses, preserve capital and improve operational efficiencies. In addition, the Board of Directors added experienced members to provide further oversight and guidance. These and other efforts were reflected in our results of operations for the past two years with lower levels of charge-offs and provision for loan losses, reductions in operating expenses and reduction in balance sheet totals resulting in improvement in our regulatory capital and liquidity ratios. We successfully completed our shareholder rights offering and public offering of common stock in June 2011 resulting in net proceeds of $20.3 million and contributed $10.0 million of the proceeds from the stock offering to the Bank, retaining the remaining $10.3 million at the holding company. As of December 31, 2012, the Company’s and the Bank’s risk-based regulatory capital ratios were the highest they have ever been. The Bank was categorized as “well capitalized” at December 31, 2012.

On February 22, 2010, Macatawa Bank entered into a Consent Order with the FDIC and OFIR, the primary banking regulators of the Bank. The Company also entered into a Written Agreement with the FRB with an effective date of July 23, 2010. Upon completion of the Bank’s 2011 joint examination, the FDIC and OFIR terminated the Bank’s Consent Order effective March 2, 2012. In connection with the termination of the Consent Order, the Bank reached an understanding with the regulators in the form of a MOU. As of December 31, 2012, we believe that the Bank was in compliance in all material respects with all of the provisions of the MOU.

On October 26, 2012, the FRB terminated the Written Agreement. In connection with the termination of the Written Agreement, the Board of Directors adopted a resolution requiring the Company to obtain written approval from the FRB before declaring or paying any dividends, increasing holding company level debt (including the issuance of trust preferred securities), or redeeming any capital stock.

For more information about the Consent Order, Written Agreement and MOU, see "Regulatory Developments" and our consolidated financial statements and related notes included in this report.

Table of Contents

Also within the past three years, much progress has been made at reducing our nonperforming assets. The following table reflects period end balances of these nonperforming assets as well as total loan delinquencies.

(dollars in thousands)	December 31, 2012	December 31, 2011	December 31, 2010
Nonperforming loans	$ 16,003	$ 28,946	$ 75,361
Other repossessed assets	6	---	50
Other real estate owned	51,582	66,438	57,984
Total nonperforming assets	$ 67,591	$ 95,384	$ 133,395
Total loan delinquencies 30 days or greater past due	$ 7,887	$ 13,138	$ 55,748

Earnings in recent years have been severely impacted by high costs associated with administration and disposition of nonperforming assets. These costs, including losses on repossessed and foreclosed properties, were $10.0 million and $15.6 million for the years ended December 31, 2012 and 2011, respectively. Going forward, as further reductions in nonperforming assets are accomplished, we expect the costs associated with these assets to continue to decline thereby allowing for improved earnings in future periods.

Our earnings in 2012 and 2011 were favorably impacted by negative provision for loan losses of $7.1 million and $4.7 million, respectively. As discussed in detail later in Item 7 of this report under the heading "Allowance for Loan Losses", this was primarily a result of a large recovery taken in the first quarter of 2012 and also impacted by a decline in our historical charge-off levels from prior years. We do not expect a similar level of negative provision for loan losses in 2013.

The following table reflects the provision for loan losses for the past three years along with certain metrics that impact the determination of the level of the provision for loan losses.

(dollars in thousands)	For The Year Ended December 31		
	2012	2011	2010
Provision for loan losses	$(7,100)	$(4,700)	$22,460
Net charge-offs	802	11,085	29,657
Net charge-offs to average loans	0.08 %	0.99 %	2.18 %
Nonperforming loans to total loans	1.52 %	2.70 %	6.19 %
Loans transferred to ORE to average loans	0.88 %	3.42 %	3.32 %
Performing troubled debt restructurings (“TDRs”) to average loans	6.24 %	5.15 %	1.91 %

The State of Michigan entered into a recession earlier than the rest of the country and has experienced heavy job loss as a result of the concentration the state has related to the automotive industry. Our market areas of Grand Rapids and Holland fared better than the state as a whole, but nevertheless the impact of our local economy on our results has been profound. The recession and job loss impacted housing values, commercial real estate values and consumer activity. Improvement has been evident during 2011 and 2012. The state’s unemployment rate at the end of 2012 was 8.9%, no longer the highest in the country and down dramatically from 15.2% in June 2009. The Holland area unemployment was 5.5%, and the Grand Rapids area unemployment was 5.6% at the end of 2012. Residential housing values and commercial real estate property values decreased significantly over the past few years, but have shown recent signs of stabilization, with some of our newer appraisals tending to reflect values at or above prior year values.

It also appears that the housing market in our primary market area is beginning to show signs of stabilization. In the Grand Rapids market during 2012, there were 28% more single family home starts than in 2011. Similarly, in the Holland-Grand Haven/Lakeshore region, there were 42% more single family home starts in 2012 than in 2011. Also, these markets are now also seeing activity in duplex, condominium and apartment starts after years of virtually no activity.

Over the past two years, we have reduced our balance of loans outstanding, diversified our commercial loan portfolio, reduced concentrations to residential real estate developers and increased our consumer loan portfolio and residential mortgage activity as a percentage of overall production. This has included adding experienced residential mortgage lenders and pulling back on commercial loan production in some cases. Our loans to residential developers have decreased from $66.3 million at December 31, 2011 to $48.9 million at December 31, 2012. In addition, overall commercial real estate loans have decreased from $795.3 million at December 31, 2011 to $762.7 million at December 31, 2012. Consumer loans have increased in 2012, totaling $289.7 million at December 31, 2012, compared to $275.7 million at December 31, 2011. With our improved financial condition and successful capital raise in 2011, our focus has shifted from shrinkage in our loan portfolio to stabilizing our loan balances and growing certain portfolios in 2013.

RESULTS OF OPERATIONS

Summary: Net income available to common shares was $35.5 million or $1.31 per common share for 2012 compared to $5.8 million or $0.26 per common share for 2011.

The results for 2012 were significantly impacted by the reversal of an $18.9 million valuation allowance on our deferred tax assets (“DTA”) as we determined it to be more likely than not that we will be able to utilize the DTA against future taxable income. Also contributing to net income in 2012 was a negative provision for loan losses of $7.1 million (due to a large loan loss recovery collected in the first quarter of 2012 and favorable trends in credit quality metrics) and a large loan prepayment fee of $2.8 million collected in the third quarter of 2012. The results for 2011 were impacted by a negative provision for loan losses of $4.7 million, a result of a significantly lower level of net charge-offs experienced over the prior two years, along with a reduction in the overall level of nonperforming loans in 2011. These items are discussed more fully below.

The overall improvement in financial results for 2012 compared to 2011 (excluding the impact of the DTA valuation allowance reversal) related primarily to the performance of the loan portfolio. The provision for loan losses was a negative $7.1 million for 2012 compared to a negative $4.7 million for 2011. Net charge-offs of loans were down sharply in 2012 at just $802,000, compared to $11.1 million in 2011, which was down $18.6 million from 2010. Costs associated with nonperforming assets were $10.0 million in 2012, compared to $15.6 million in 2011. Lost interest from nonperforming assets decreased to approximately $6.7 million for 2012 compared to $7.5 million for 2011. Each of these items is discussed more fully below.

Net Interest Income: Net interest income totaled $47.5 million during 2012 compared to $46.3 million during 2011.

The increase in net interest income during 2012 compared to 2011 was due primarily to the collection of a one-time prepayment fee of $2.8 million related to prepayment on a commercial loan in the third quarter of 2012. Partially offsetting this was the impact of a $41.6 million decrease in average earning assets as a result of our focus on reducing credit exposure within certain segments of our loan portfolio and liquidity improvement. Our net interest income as a percentage of average interest-earning assets (i.e. "net interest margin" or "margin") increased by 20 basis points compared to 2011. The prepayment fee discussed above contributed 21 basis points to the margin in 2012. As is customary in the banking industry, interest income on tax-exempt securities is adjusted in the computation of the yield on tax-exempt securities and net interest margin using a 35% tax rate to report these items on a fully taxable equivalent basis. Average interest earning assets decreased from $1.39 billion to $1.35 billion throughout 2012.

The yield on earning assets decreased 11 basis points to 4.21% for 2012 from 4.32% for 2011. The decrease was due to decreases in the yield on our commercial, residential and consumer loan portfolios, which repriced in the generally lower rate environment during 2012. Our margin was negatively impacted by our decision to hold significant balances in liquid and short-term investments in the past two years. Going forward, as we deploy these balances into higher yielding assets within the investment securities and loan portfolios, we expect our net interest margin to be positively impacted.

Our net interest margin for 2012 benefitted from a 34 basis point decrease in our cost of funds from 1.26% for 2011 to 0.92% for 2012. Average interest bearing liabilities decreased from $1.15 billion in 2011 to $1.06 billion in 2012. A decrease in the rates paid on our deposit accounts in response to declining market rates and the rollover of time deposits and other borrowings at lower rates within the current rate environment caused the reduction in our cost of funds.

Margin continued to be dampened by the impact of our elevated levels of nonperforming assets, including other real estate owned and nonaccrual loans. However, as we work to further reduce these levels, our margin is expected to benefit. The estimated negative impact of these nonperforming assets on net interest margin decreased from 54 basis points in 2011 to 37 basis points in 2012.

The continued decline in the level of average earning assets may have a further negative impact on net interest income in 2013; however, we expect the balances to stabilize and begin to grow in 2013.

Table of Contents

The following table shows an analysis of net interest margin for the years ended December 31, 2012, 2011 and 2010.

	For the years ended December 31,								
	2012			2011			2010		
(Dollars in Thousands)	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned Or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
Assets:									
Taxable securities	$ 79,379	$ 1,544	1.94 %	$ 25,452	$ 497	1.95 %	$ 36,332	$ 1,049	2.79 %
Tax-exempt securities (1)	13,769	330	4.03 %	1,235	38	5.24 %	18,137	775	6.58 %
Loans (2)	1,049,501	54,549	5.14 %	1,123,295	59,334	5.23 %	1,364,207	73,544	5.34 %
Federal Home Loan Bank stock	11,236	351	3.08 %	11,539	294	2.51 %	12,234	230	1.86 %
Federal funds sold and other short-term investments	197,423	502	0.25 %	231,417	616	0.26 %	104,236	405	0.39 %
Total interest earning assets (1)	1,351,308	57,276	4.21 %	1,392,938	60,779	4.32 %	1,535,146	76,003	4.93 %
Noninterest earning assets:									
Cash and due from banks	23,042			23,011			24,307		
Other	124,510			115,552			101,456		
Total assets	$ 1,498,860			$ 1,531,501			$ 1,660,909		
Liabilities and Shareholders' Equity:									
Deposits:									