MACATAWA BANK CORP
Form 10-Q
July 24, 2014

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

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

For the transition period from _______ to _______

Commission file number: 000-25927

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

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

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

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

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

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

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

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

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 33,788,431 shares of the Company's Common Stock (no par value) were outstanding as of July 24, 2014.

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 or that the Company or its management “anticipates”, “believes”, “estimates”, “plans”, “forecasts”, “intends”, “predicts”, “proj “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 “focus”, “starting”, “initiative,” “trend”, “poised” 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, future levels of earning assets, statements related to stabilization of our loan portfolio, trends in credit quality metrics, future capital levels and capital needs, including the impact of Basel III, real estate valuation, future levels of repossessed and foreclosed properties and nonperforming assets, future levels of losses and costs associated with the administration and disposition of repossessed and foreclosed properties and nonperforming assets, future levels of loan charge-offs, future levels of other real estate owned, future levels of provisions for loan losses, the rate of asset dispositions, future dividends, future growth and funding sources, future cost of funds, future liquidity levels, future profitability levels, future FDIC assessment levels, future net interest margin levels, building and improving our investment portfolio, diversifying our credit risk, the effects on earnings of changes in interest rates, future economic conditions, future effects of new or changed accounting standards, future loss recoveries, future balances of short-term investments, future loan demand and loan growth, future levels of mortgage banking revenue and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, maintain our current levels of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, originate high quality loans, maintain or improve mortgage banking income, realize the benefit of our deferred tax assets, and improve profitability is not entirely within our control and is not assured. The future effect of changes in the real estate, financial and credit markets and the national and regional economy on the banking industry, generally, and Macatawa Bank Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (“risk factors”) that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Macatawa Bank Corporation does not undertake to update forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2013. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

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Part I Financial Information
Item 1.

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of June 30, 2014 (unaudited) and December 31, 2013
(Dollars in thousands, except per share data)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$37,533	$38,714
Federal funds sold and other short-term investments	80,432	118,178
Cash and cash equivalents	117,965	156,892
Interest-bearing time deposits in other financial institutions	32,500	25,000
Securities available for sale, at fair value	152,227	139,659
Securities held to maturity (fair value 2014 - $19,184 and 2013 - $19,278)	19,123	19,248
Federal Home Loan Bank (FHLB) stock	11,236	11,236
Loans held for sale, at fair value	1,409	1,915
Total loans	1,043,529	1,042,377
Allowance for loan losses	(20,049)	(20,798)
Net loans	1,023,480	1,021,579
Premises and equipment – net	53,308	53,641
Accrued interest receivable	3,264	3,231
Bank-owned life insurance	27,845	27,517
Other real estate owned	31,523	36,796
Net deferred tax asset	13,053	16,200
Other assets	4,209	4,491
Total assets	$1,491,142	$1,517,405
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$383,102	$344,550
Interest-bearing	832,622	905,184
Total deposits	1,215,724	1,249,734
Other borrowed funds	88,774	89,991
Long-term debt	41,238	41,238
Accrued expenses and other liabilities	7,314	3,920
Total liabilities	1,353,050	1,384,883
Commitments and contingent liabilities	---	---
Shareholders' equity		
Common stock, no par value, 200,000,000 shares authorized; 33,788,431 shares issued and outstanding at June 30, 2014 and 33,801,097 shares issued and outstanding at December 31, 2013	216,308	216,263
Retained deficit	(77,745)	(81,786)
Accumulated other comprehensive income (loss)	(471)	(1,955)

Total shareholders' equity	138,092	132,522
Total liabilities and shareholders' equity	$1,491,142	$1,517,405

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three and Six Month Periods Ended June 30, 2014 and 2013
(unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Interest income				
Loans, including fees	$10,547	$11,493	$21,491	$23,161
Securities				
Taxable	499	448	998	877
Tax-exempt	264	155	519	296
FHLB Stock	104	97	260	196
Federal funds sold and other short-term investments	114	114	230	210
Total interest income	11,528	12,307	23,498	24,740
Interest expense				
Deposits	620	982	1,360	2,067
Other borrowings	426	444	857	894
Subordinated and long-term debt	326	418	650	832
Total interest expense	1,372	1,844	2,867	3,793
Net interest income	10,156	10,463	20,631	20,947
Provision for loan losses	(1,000)	(1,000)	(2,000)	(1,750)
Net interest income after provision for loan losses	11,156	11,463	22,631	22,697
Noninterest income				
Service charges and fees	1,065	1,017	2,056	1,969
Net gains on mortgage loans	468	708	726	1,533
Trust fees	701	625	1,332	1,213
ATM and debit card fees	1,203	1,132	2,255	2,109
Gain on sales of securities	41	61	51	80
Other	590	668	1,158	1,270
Total noninterest income	4,068	4,211	7,578	8,174
Noninterest expense				
Salaries and benefits	5,544	5,732	11,367	11,525
Occupancy of premises	932	905	1,940	1,851
Furniture and equipment	751	845	1,591	1,595
Legal and professional	238	183	443	373
Marketing and promotion	238	246	477	492
Data processing	583	589	1,172	1,135
FDIC assessment	320	345	647	817
Interchange and other card expense	265	361	537	652
Bond and D&O Insurance	163	183	327	368
Net losses on repossessed and foreclosed properties	371	294	185	353
Administration and disposition of problem assets	516	1,005	1,172	1,908
Other	1,317	1,187	2,550	2,387
Total noninterest expenses	11,238	11,875	22,408	23,456

Income before income tax	3,986	3,799	7,801	7,415
Income tax expense	1,231	1,196	2,408	2,338
Net income	$2,755	$2,603	$5,393	$5,077
Dividends declared on preferred shares	---	---	---	---
Net income available to common shares	$2,755	$2,603	$5,393	$5,077
Basic earnings per common share	$0.08	$0.10	$0.16	$0.19
Diluted earnings per common share	$0.08	$0.10	$0.16	$0.19
Cash dividends per common share	$0.02	$---	$0.04	$---

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three and Six Month Periods Ended June 30, 2014 and 2013
(unaudited)
(Dollars in thousands)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income	$ 2,755	$ 2,603	$ 5,393	$ 5,077
Other comprehensive income (loss):				
Unrealized gains (losses):				
Net change in unrealized gains (losses) on securities available for sale	1,190	(3,460)	2,334	(3,603)
Tax effect	(416)	1,211	(817)	1,261
Net change in unrealized gains (losses) on securities available for sale, net of tax	774	(2,249)	1,517	(2,342)
Less: reclassification adjustments:				
Reclassification for gains included in net income	41	61	51	80
Tax effect	(14)	(21)	(18)	(28)
Reclassification for gains included in net income, net of tax	27	40	33	52
Other comprehensive income (loss), net of tax	747	(2,289)	1,484	(2,394)
Comprehensive income	$ 3,502	$ 314	$ 6,877	$ 2,683

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Six Month Periods Ended June 30, 2014 and 2013
(unaudited)
(Dollars in thousands, except per share data)

	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2013	$30,604	$2,560	$187,718	$(91,335)	$ 960	$ 130,507
Net income for the six months ended June 30, 2013				5,077		5,077
Conversion of 300 shares of Preferred Stock Series B to 50,000 shares of Common Stock		(300)	300			---
Net change in unrealized gain (loss) on securities available for sale, net of tax					(2,394)	(2,394)
Stock compensation expense			62			62
Balance, June 30, 2013	$30,604	$2,260	$188,080	$(86,258)	$ (1,434)	$ 133,252
Balance, January 1, 2014	$---	$---	$216,263	$(81,786)	$ (1,955)	$ 132,522
Net income for the six months ended June 30, 2014				5,393		5,393
Common stock issuance costs			(102)			(102)
Cash dividends at $.04 per share				(1,352)		(1,352)
Net change in unrealized gain (loss) on securities available for sale, net of tax					1,484	1,484
Stock compensation expense			147			147
Balance, June 30, 2014	$---	$---	$216,308	$(77,745)	$ (471)	$ 138,092

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2014 and 2013
(unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Cash flows from operating activities		
Net income	$5,393	$5,077
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,558	1,452
Stock compensation expense	147	62
Provision for loan losses	(2,000)	(1,750)
Origination of loans for sale	(26,760)	(63,160)
Proceeds from sales of loans originated for sale	27,992	68,270
Net gains on mortgage loans	(726)	(1,533)
Gain on sales of securities	(51)	(80)
Write-down of other real estate	661	967
Net gain on sales of other real estate	(476)	(614)
Decrease in net deferred tax asset	2,348	2,283
Decrease (increase) in accrued interest receivable and other assets	249	(964)
Earnings in bank-owned life insurance	(328)	(358)
Increase in accrued expenses and other liabilities	2,841	2,838
Net cash from operating activities	10,848	12,490
Cash flows from investing activities		
Loan originations and payments, net	(2,175)	36,966
Change in interest-bearing deposits in other financial institutions	(7,500)	(25,000)
Purchases of securities available for sale	(21,210)	(27,049)
Purchases of securities held to maturity	---	(1,100)
Proceeds from:		
Maturities and calls of securities available for sale	4,500	8,319
Sales of securities available for sale	5,164	3,778
Principal paydowns on securities	1,675	3,290
Sales of other real estate	7,362	8,138
Additions to premises and equipment	(910)	(889)
Net cash from investing activities	(13,094)	6,453
Cash flows from financing activities		
Change in in-market deposits	(34,010)	(86,683)
Repayments of other borrowed funds	(1,217)	(1,164)
Cash dividends paid	(1,352)	---
Common stock issuance costs	(102)	---
Net cash from financing activities	(36,681)	(87,847)
Net change in cash and cash equivalents	(38,927)	(68,904)

Cash and cash equivalents at beginning of period	156,892	226,358
Cash and cash equivalents at end of period	$117,965	$157,454

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Six Month Periods Ended June 30, 2014 and 2013
(unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Supplemental cash flow information		
Interest paid	$ 2,873	$ 3,061
Income taxes paid	50	55
Supplemental noncash disclosures:		
Transfers from loans to other real estate	2,274	2,754
Security settlement	(553)	(1,626)
Conversion of 300 shares of Preferred Series B to 50,000 shares of common stock	---	300

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

Operating results for the three and six month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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

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

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class and the loan risk grade assignment for commercial loans. At June 30, 2014, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage loans and consumer loans. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative factors, including economic trends, credit quality trends, valuation trends, concentration risk, quality of loan review, changes in personnel, external factors and other considerations.

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

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

Derivatives: Certain of our commercial loan customers have entered into interest rate swap agreements directly with the Bank. At the same time the Bank enters into a swap agreement with its customer, the Bank enters into a corresponding interest rate swap agreement with a correspondent bank at terms mirroring the Bank's interest rate swap with its commercial loan customer. This is known as a back-to-back swap agreement. Under this arrangement the Bank has two freestanding interest rate swaps, both of which are carried at fair value. As the terms mirror each other, there is no income statement impact to the Bank. At June 30, 2014 and December 31, 2013, the total notional amount of such agreements was $20.0 million and resulted in derivative assets with fair values of $168,000 and $94,000, respectively, which were included in other assets and derivative liabilities of $168,000 and $94,000, respectively, which were included in other liabilities.

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

Newly Issued Standards:
The Financial Accounting Standards Board ("FASB") has issued Accounting Standards Update (ASU) No. 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real

Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments are intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additional disclosures are required. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. The impact of adoption of this ASU by the Company is not expected to be material.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The amendments in this Update change the requirements for reporting discontinued operations. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The amendments in this Update require an entity to present, for each comparative period, the assets and liabilities of a disposal group that includes a discontinued operation separately in the asset and liability sections, respectively, of the statement of financial position. This Update also requires additional disclosures about discontinued operations including pretax profit or loss, and any ongoing involvement with the discontinued operation. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. The impact of adoption of this ASU by the Company is not expected to be material.

FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The amendments in this Update creates a new topic in the FASB Accounting Standards Codification® (ASC or Codification), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606 establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, Other Assets and Deferred Costs: Contracts with Customers, to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantees other than product or service warranties, and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. The impact of adoption of this ASU by the Company is not expected to be material.

FASB has also issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists. This update requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. However, to the extent that a net operating loss carryforward or tax credit carryforward at the reporting date is not available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit is to be presented in the statement of financial position as a liability. No new recurring disclosures are required. The amendments are effective for public business entities for annual periods beginning after December 15, 2013, and interim periods within those periods. The amendments are to be applied on a prospective basis to all unrecognized tax benefits that exist at the effective date, although retrospective application is permitted. The impact of prospective adoption of this ASU by the Company in the first quarter of 2014 was not material.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2014				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 60,051	$ 68	$ (744)	$ 59,375
U.S. Agency MBS and CMOs	18,459	42	(299)	18,202
Tax-exempt state and municipal bonds	34,899	235	(400)	34,734
Taxable state and municipal bonds	25,087	438	(112)	25,413
Corporate bonds and other debt securities	12,956	85	(32)	13,009
Other equity securities	1,500	---	(6)	1,494
	$ 152,952	$ 868	$ (1,593)	$ 152,227
Held to Maturity				
Tax-exempt state and municipal bonds	$ 19,123	$ 102	$ (41)	$ 19,184
December 31, 2013				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 55,701	$ 92	$ (1,354)	$ 54,439
U. S. Agency MBS and CMOs	20,029	9	(673)	19,365
Tax-exempt state and municipal bonds	27,920	47	(1,118)	26,849
Taxable state and municipal bonds	26,306	307	(285)	26,328
Corporate bonds and other debt securities	11,211	64	(63)	11,212
Other equity securities	1,500	---	(34)	1,466
	$ 142,667	$ 519	$ (3,527)	$ 139,659
Held to Maturity:				
Tax-exempt state and municipal bonds	$ 19,248	$ 46	$ (16)	$ 19,278

Proceeds from the sale of securities available for sale were $4.6 million in the three month period ended June 30, 2014 and $5.2 million in the six month period ended June 30, 2014 resulting in net gains on sale of $41,000 and $51,000, respectively, as reported in the Consolidated Statements of Income. This resulted in reclassifications of $41,000 ($27,000 net of tax) and $51,000 ($33,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the Consolidated Statements of Income in the three and six month periods ended June 30, 2014. Proceeds from the sale of securities available for sale were $3.2 million in the three month period ended June 30, 2013 and $3.8 million in the six month period ended June 30, 2013 resulting in net gains on sale of $61,000 and $80,000, respectively, as reported in the Consolidated Statements of Income. This resulted in reclassifications of $61,000 ($40,000 net of tax) and $80,000 ($52,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the Consolidated Statements of Income in the three and six month periods ended June 30, 2013.

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NOTE 2 – SECURITIES (Continued)

Contractual maturities of debt securities at June 30, 2014 were as follows (dollars in thousands):

	Held–to-Maturity Securities		Available-for-Sale Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$12,700	$12,700	$4,028	$4,062
Due from one to five years	630	632	70,537	70,788
Due from five to ten years	5,533	5,599	51,123	50,491
Due after ten years	260	253	25,764	25,392
	$19,123	$19,184	$151,452	$150,733

Securities with unrealized losses at June 30, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
June 30, 2014	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$8,109	$ (31)	$40,374	$ (713)	$48,483	$ (744)
U.S. Agency MBS and CMOs	4,298	(34)	10,599	(265)	14,897	(299)
Tax-exempt state and municipal bonds	21,946	(103)	13,104	(338)	35,050	(441)
Taxable state and municipal bonds	1,635	(4)	4,503	(108)	6,138	(112)
Corporate bonds and other debt securities	1,613	(6)	1,979	(26)	3,592	(32)
Other equity securities	---	---	1,500	(6)	1,500	(6)
Total temporarily impaired	$37,601	$ (178)	$72,059	$ (1,456)	$109,660	$ (1,634)

	Less than 12 Months		12 Months or More		Total	
December 31, 2013	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$43,212	$ (1,354)	$---	$ ---	$43,212	$ (1,354)
U.S. Agency MBS and CMOs	18,494	(673)	---	---	18,494	(673)
Tax-exempt state and municipal bonds	21,359	(1,066)	831	(68)	22,190	(1,134)
Taxable state and municipal bonds	9,599	(256)	1,015	(29)	10,614	(285)
Corporate bonds and other debt securities	3,928	(63)	---	---	3,928	(63)
Other equity securities	1,466	(34)	---	---	1,466	(34)
Total temporarily impaired	$98,058	$ (3,446)	$1,846	$ (97)	$99,904	$ (3,543)

NOTE 2 – SECURITIES (Continued)

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during the six month periods ended June 30, 2014 and 2013.

Securities with a carrying value of approximately $1.0 million were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law at June 30, 2014 and December 31, 2013.

NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	June 30, 2014	December 31, 2013
Commercial and industrial	$284,152	$274,099
Commercial real estate:		
Residential developed	15,859	18,130
Unsecured to residential developers	7,131	7,315
Vacant and unimproved	42,186	42,988
Commercial development	4,468	2,434
Residential improved	72,241	76,294
Commercial improved	246,414	247,195
Manufacturing and industrial	76,295	77,984
Total commercial real estate	464,594	472,340
Consumer		
Residential mortgage	189,052	188,648
Unsecured	1,096	1,337
Home equity	94,484	95,961
Other secured	10,151	9,992
Total consumer	294,783	295,938
Total loans	1,043,529	1,042,377
Allowance for loan losses	(20,049)	(20,798)
	$1,023,480	$1,021,579

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NOTE 3 – LOANS (Continued)

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

Three months ended June 30, 2014	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,087	$ 10,372	$ 3,875	$ 49	$20,383
Charge-offs	---	(23)	(69)	---	(92)
Recoveries	327	363	68	---	758
Provision for loan losses	307	(1,371)	59	5	(1,000)
Ending Balance	$ 6,721	$ 9,341	$ 3,933	$ 54	$20,049

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

Six months ended June 30, 2014	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,174	$ 10,868	$ 3,703	$ 53	$20,798
Charge-offs	(39)	(23)	(112)		(174)
Recoveries	366	953	106		1,425
Provision for loan losses	220	(2,457)	236	1	(2,000)
Ending Balance	$ 6,721	$ 9,341	$ 3,933	$ 54	$20,049

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

NOTE 3 – LOANS (Continued)

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

June 30, 2014	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 3,006	$ 839	$ 884	$ ---	$ 4,729
Collectively evaluated for impairment	3,715	8,502	3,049	54	15,320
Total ending allowance balance	$ 6,721	$ 9,341	$ 3,933	$ 54	$ 20,049
Loans:					
Individually reviewed for impairment	$ 10,371	$ 38,946	$ 14,547	$ ---	$ 63,864
Collectively evaluated for impairment	273,781	425,648	280,236	---	979,665
Total ending loans balance	$ 284,152	$ 464,594	$ 294,783	$ ---	$ 1,043,529

December 31, 2013	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 1,981	$ 1,008	$ 881	$ ---	$ 3,870
Collectively evaluated for impairment	4,193	9,860	2,822	53	16,928
Total ending allowance balance	$ 6,174	$ 10,868	$ 3,703	$ 53	$ 20,798
Loans:					
Individually reviewed for impairment	$ 13,155	$ 41,285	$ 14,483	$ ---	$ 68,923
Collectively evaluated for impairment	260,944	431,055	281,455	---	973,454
Total ending loans balance	$ 274,099	$ 472,340	$ 295,938	$ ---	$ 1,042,377

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2014 (dollars in thousands):

June 30, 2014	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ 2,892	$ 2,892	$ ---
Commercial real estate:			
Residential developed	4,358	3,425	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	---	---	---
Commercial development	263	263	---
Residential improved	1,453	1,453	---
Commercial improved	473	473	---
Manufacturing and industrial	253	253	---
	6,800	5,867	---
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	$ 9,692	$ 8,759	$ ---
With an allowance recorded:			
Commercial and industrial	$ 7,479	$ 7,479	$ 3,006
Commercial real estate:			
Residential developed	596	596	34
Unsecured to residential developers	---	---	---
Vacant and unimproved	1,625	1,625	37
Commercial development	203	203	5
Residential improved	7,546	7,546	234
Commercial improved	18,102	18,102	454
Manufacturing and industrial	5,007	5,007	75
	33,079	33,079	839
Consumer:			
Residential mortgage	9,577	9,577	582
Unsecured	---	---	---
Home equity	4,970	4,970	302
Other secured	---	---	---

	14,547	14,547	884
	$ 55,105	$ 55,105	$ 4,729
Total	$ 64,797	$ 63,864	$ 4,729

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NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2013 (dollars in thousands):

December 31, 2013	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ 3,287	$ 3,284	$ ---
Commercial real estate:			
Residential developed	5,273	4,340	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	3	3	---
Commercial development	362	362	---
Residential improved	1,493	1,493	---
Commercial improved	2,797	2,272	---
Manufacturing and industrial	252	252	---
	10,180	8,722	---
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	$ 13,467	$ 12,006	$ ---
With an allowance recorded:			
Commercial and industrial	$ 9,871	$ 9,871	$ 1,981
Commercial real estate:			
Residential developed	618	618	33
Unsecured to residential developers	---	---	---
Vacant and unimproved	1,900	1,900	47
Commercial development	207	207	5
Residential improved	9,534	9,534	342
Commercial improved	14,450	14,450	479
Manufacturing and industrial	5,854	5,854	102
	32,563	32,563	1,008
Consumer:			
Residential mortgage	9,454	9,454	575
Unsecured	---	---	---
Home equity	5,029	5,029	306
Other secured	---	---	---

	14,483	14,483	881
	$ 56,917	$ 56,917	$ 3,870
Total	$ 70,384	$ 68,923	$ 3,870

NOTE 3 – LOANS (Continued)

The following table presents information regarding average balances of impaired loans and interest recognized on impaired loans for the three and six month periods ended June 30, 2014 and 2013 (dollars in thousands):

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Average of impaired loans during the period:				
Commercial and industrial	$11,908	$14,823	$13,096	$16,027
Commercial real estate:				
Residential developed	4,085	6,553	4,308	6,841
Unsecured to residential developers	---	---	---	---
Vacant and unimproved	1,650	3,031	1,735	3,339
Commercial development	483	14	505	15
Residential improved	9,863	11,678	10,141	12,102
Commercial improved	18,133	21,032	18,212	21,488
Manufacturing and industrial	6,404	6,136	6,562	6,577
Consumer	14,400	15,183	14,408	14,917
Interest income recognized during impairment:				
Commercial and industrial	273	784	611	1,127
Commercial real estate	454	816	907	1,434
Consumer	137	137	269	260
Cash-basis interest income recognized				
Commercial and industrial	276	599	615	935
Commercial real estate	471	879	922	1,469
Consumer	137	133	271	257

NOTE 3 – LOANS (Continued)

Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of June 30, 2014 and December 31, 2013:

June 30, 2014	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$ 3,485	$ ---
Commercial real estate:		
Residential developed	2,249	---
Unsecured to residential developers	---	