MACATAWA BANK CORP
Form 10-K
February 20, 2014

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, 2013
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
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 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 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, 2013, was $126,140,954 based on the closing sale price of $5.04 as reported on the Nasdaq Stock Market. There were 33,788,431 outstanding shares of the Company's common stock as of February 19, 2014.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 6, 2014 are incorporated by reference into Part III of this report.

MACATAWA BANK CORPORATION
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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” 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, 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.

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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, 2013, we had total assets of $1.52 billion, total loans of $1.04 billion, total deposits of $1.25 billion and shareholders' equity of $132.5 million. We recognized net income of $9.5 million in 2013, our third straight full year of profitability post recession. During 2013, 2012 and 2011, our interest income accounted for approximately 75%, 79% and 80%, respectively, of our consolidated operating revenue and our non-interest income accounted for approximately 25%, 21% and 20%, respectively, of our consolidated operating revenue. 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 early 2010, our Board of Directors implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles. These and other efforts were reflected in our results of operations for the past three 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. As of December 31, 2013, the Company's and the Bank's risk-based regulatory capital ratios were among the highest in Company history. The Bank was categorized as "well capitalized" at December 31, 2013.

During 2013, the Company improved its capital structure by prepaying and redeeming its $1.7 million of 11% unsecured subordinated debt, resuming interest payments on its trust preferred securities and completing an exchange of all of the Company's Series A and Series B Preferred Stock for Company common stock and cash, at the election of the holder. Each of these transactions are discussed in detail in Item 7 and in our consolidated financial statements and related notes included in this report.

Within the past four 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 over the past five years.

(dollars in thousands)	December 31,				
	2013	2012	2011	2010	2009
Nonperforming loans	$12,335	$16,003	$28,946	$75,361	$103,885
Other repossessed assets	40	6	---	50	124
Other real estate owned	36,796	51,582	66,438	57,984	37,184
Total nonperforming assets	$49,171	$67,591	$95,384	$133,395	$141,193

Total delinquencies 30 days or greater past due	$5,520	$7,887	$13,138	$55,748	$116,971

Earnings in recent years have been impacted by high costs associated with administration and disposition of nonperforming assets. These costs, including losses on repossessed and foreclosed properties, were $5.5 million, $10.0 million and $15.6 million for the years ended December 31, 2013, 2012 and 2011, respectively. During 2013, we added $3.5 million in other real estate and sold $16.5 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 2014 and continued sales volume, which should allow for reductions in carrying costs in 2014.

Our earnings in 2013, 2012 and 2011 were favorably impacted by a negative provision for loan losses of $4.3 million, $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 recoveries from our collection efforts including 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 2014 as the opportunity for large recoveries appears to be diminishing.

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The following table reflects the provision for loan losses for the past five 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,				
	2013	2012	2011	2010	2009
Provision for loan losses	$(4,250)	$(7,100)	$(4,700)	$22,460	$74,340
Net charge-offs (recoveries)	(1,309)	802	11,085	29,657	57,979
Net charge-offs to average loans	(0.13)%	0.08 %	0.99 %	2.18 %	3.54 %
Nonperforming loans to total loans	1.18 %	1.52 %	2.70 %	6.19 %	6.88 %
Loans transferred to ORE to average loans	0.34 %	0.88 %	3.42 %	3.32 %	1.80 %
Performing troubled debt restructurings ("TDRs") to average loans	5.61 %	6.24 %	5.15 %	1.91 %	1.62 %

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 was profound. The recession and job loss impacted housing values, commercial real estate values and consumer activity. Improvement has been evident during 2012 and 2013. The state's unemployment rate at the end of 2013 was 8.8%, no longer the highest in the country and down dramatically from 15.2% in June 2009. The Holland area unemployment was 5.8%, and the Grand Rapids area unemployment was 5.6% at the end of 2013. Residential housing values and commercial real estate property values decreased significantly during the recession, but have shown 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 has stabilized and is now improving. In the Grand Rapids market during 2013, there were 23% more single family home starts than in 2012. Similarly, in the Holland-Grand Haven/Lakeshore region, there were 32% more single family home starts in 2013 than in 2012. Also, these markets are now seeing activity in duplex, condominium and apartment starts after years of virtually no activity.

In recent years, we have continued to diversify our loan portfolio structure by de-emphasizing commercial real estate loans and cautiously increasing volumes of commercial and industrial loans, residential mortgages and other consumer loans. Commercial real estate loans have decreased from $503.0 million at December 31, 2012 to $472.3 million at December 31, 2013. Consumer loans have increased in 2013, totaling $295.9 million at December 31, 2013, compared to $289.7 million at December 31, 2012. With our improved financial condition, successful capital raise in 2011, and retained earnings growth, our focus has shifted from shrinkage in our loan portfolio to stabilizing our loan balances and growing certain portfolios in 2014.

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

On April 12, 2013, the Federal Deposit Insurance Corporation ("FDIC") and the Michigan Department of Insurance and Financial Services ("DIFS"), the primary banking regulators of the Bank, notified the Bank that the Bank's

Memorandum of Understanding ("MOU") with the FDIC and DIFS had served its purpose and was released. As a result, the Bank is no longer subject to any regulatory order, memorandum of understanding or other similar regulatory directive or proceeding and has returned to a normal regulatory operating environment.

Similarly, by letter dated August 1, 2013, the Federal Reserve Bank of Chicago ("FRB") advised the Company that, based on the overall satisfactory condition of the organization, the FRB poses no objection should the Board of Directors choose to rescind its Board Resolution. Accordingly, the Company's Board of Directors rescinded the Board Resolution as of August 1, 2013.

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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 in 2008 and 2009. 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.

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.

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During the past three years, in an effort to further diversify our loan concentrations, we increased our targeted retention of residential mortgage loans, resulting in a $6.0 million increase in balances held in portfolio at December 31, 2013 compared to December 31, 2012. For 2013, we retained loans representing 37% 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.

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									
	2013		2012		2011		2010		2009	
	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans
Real estate - construction (1)	$86,413	8 %	$89,631	9 %	$90,191	8 %	$133,228	11 %	$162,615	11
Real estate - mortgage	385,927	37	413,328	39	478,076	45	535,961	44	640,437	42
Commercial and industrial	274,099	26	259,700	25	227,051	21	264,679	22	369,523	24
	746,439	72	762,659	72	795,318	74	933,868	77	1,172,575	78

Total commercial										
Residential mortgage	188,648	18	182,625	17	156,891	15	135,227	11	163,074	11
Consumer	107,290	10	107,064	10	118,766	11	148,101	12	175,167	12
Total loans	1,042,377	100%	1,052,348	100%	1,070,975	100%	1,217,196	100%	1,510,816	100
Less: allowance for loan losses	(20,798)		(23,739)		(31,641)		(47,426)		(54,623)	
Total loans receivable, net	$1,021,579		$1,028,609		$1,039,334		$1,169,770		$1,456,193	

(1) Consists of construction and development loans.

At December 31, 2013, 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.

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Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table shows the amount of total loans outstanding at December 31, 2013 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)	$63,730	$15,631	$7,052	$86,413
Real estate - mortgage	59,217	273,973	52,737	385,927
Commercial and industrial	106,745	156,643	10,711	274,099
Total Commercial	229,692	446,247	70,500	746,439
Residential mortgage	2,611	459	185,578	188,648
Consumer	7,923	39,407	59,960	107,290
Total Loans	$240,226	$486,113	$316,038	$1,042,377
	Maturing or Repricing			
Loans above:				
With predetermined interest rates	$73,961	$305,044	$116,217	$495,222
With floating or adjustable rates	467,008	26,996	40,969	534,973
Total (excluding nonaccrual loans)	$540,969	$332,040	$157,186	1,030,195
Nonaccrual loans				12,182
Total Loans				$1,042,377

(1) Consists of construction and development loans.

Nonperforming Assets

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

(Dollars in thousands)	December 31				
	2013	2012	2011	2010	2009
Nonaccrual loans	$12,182	$15,385	$26,876	$74,761	$95,725
Loans 90 days or more delinquent and still accruing	153	618	2,070	600	8,160
Total nonperforming loans	12,335	16,003	28,946	75,361	103,885
Foreclosed assets	36,796	51,582	66,438	57,984	37,184
Repossessed assets	40	6	---	50	124
Total nonperforming assets (NPAs)	49,171	67,591	95,384	133,395	141,193
Accruing troubled debt restructurings (TDRs) (1)	57,790	65,024	55,679	25,395	18,000
Total NPAs and accruing TDRs	$106,961	$132,615	$151,063	$158,790	$159,193
NPLs to total loans	1.18 %	1.52 %	2.70 %	6.19 %	6.88 %
NPAs to total assets	3.24 %	4.33 %	6.33 %	8.45 %	7.71 %

(1) Comprised of approximately $43.6 million, $51.8 million and $40.9 million of commercial loans and $14.2 million, $13.2 million and $14.8 million of residential mortgage and consumer loans at December 31, 2013, 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 $4.7 million was recorded in 2013 on loans that were on a non-accrual status or classified as restructured as of December 31, 2013. Additional interest income of $1.1 million would have been recorded during 2013 on these loans had they been current in accordance with their original terms. More information about the levels of nonperforming loan balances in 2013 and 2012 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."

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Loans at December 31, 2013 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, 2013, 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.

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)	2013	2012	2011	2010	2009
Portfolio loans:					
Average daily balance of loans for the year	$1,030,766	$1,041,833	$1,120,857	$1,360,548	$1,637,143
Amount of loans outstanding at end of period	1,042,377	1,052,348	1,070,975	1,217,196	1,510,816
Allowance for loan losses:					
Balance at beginning of year	23,739	31,641	47,426	54,623	38,262
Provision for loan losses	(4,250)	(7,100)	(4,700)	22,460	74,340
Loans charged-off:					
Real estate - construction	(55)	(1,455)	(3,014)	(9,768)	(29,237)
Real estate - mortgage	(1,010)	(1,751)	(7,967)	(11,499)	(17,952)
Commercial and industrial	(317)	(1,245)	(2,935)	(7,400)	(10,632)
Total Commercial	(1,382)	(4,451)	(13,916)	(28,667)	(57,821)
Residential mortgage	(433)	(2,257)	(1,559)	(1,364)	(613)
Consumer	(389)	(788)	(976)	(1,806)	(1,508)
	(2,204)	(7,496)	(16,451)	(31,837)	(59,942)
Recoveries:					
Real estate - construction	1,568	5,521	2,541	613	142
Real estate - mortgage	573	319	802	663	157
Commercial and industrial	1,134	547	1,727	694	1,608
Total Commercial	3,275	6,387	5,070	1,970	1,907
Residential mortgage	65	142	39	115	13
Consumer	173	165	257	95	43
	3,513	6,694	5,366	2,180	1,963
Net (charge-offs) recoveries	1,309	(802)	(11,085)	(29,657)	(57,979)
Balance at end of year	$20,798	$23,739	$31,641	$47,426	$54,623
Ratios:					
Net charge-offs to average loans outstanding	(0.13)%	0.08%	0.99%	2.18%	3.54%
Allowance for loan losses to loans outstanding at year-end	2.00%	2.26%	2.95%	3.90%	3.62%
Allowance for loan losses to nonperforming loans at year-end	168.61%	148.34%	109.31%	62.93%	52.58%

(1) Consists of construction and development loans.

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Allocation of the Allowance for Loan Losses

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

(Dollars in thousands)	December 31														
	2013			2012			2011			2010			2009		
	Allowance Amount	% of Each Category to total Loans		Amount	% of Total Loans		Amount	% of Total Loans		Amount	% of Total Loans		Amount	% of Total Loans	
Commercial and commercial real estate	$17,095	72	%	$19,952	73	%	$26,820	74	%	$42,011	77	%	$51,856	77	%
Residential mortgage	2,368	18		2,544	17		3,093	15		2,155	11		1,263	11	
Consumer	1,335	10		1,243	10		1,728	11		3,260	12		1,504	12	
Total	$20,798	100	%	$23,739	100	%	$31,641	100	%	$47,426	100	%	$54,623	100	%

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."

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 may utilize 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 brokered deposits. The Bank has not accepted or renewed brokered deposits since November of 2008. We had no brokered deposits at December 31, 2013 or 2012.

Deposit Portfolio Composition

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

(Dollars in thousands)	December 31									
	2013		2012		2011		2010		2009	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
Noninterest bearing demand	$317,332	--- %	$323,368	--- %	$296,926	--- %	$238,974	--- %	$202,978	--- %
Interest bearing demand	272,689	0.1	225,250	0.2	185,591	0.2	224,843	0.3	238,372	0.6
Savings and money market accounts	472,920	0.4	420,553	0.5	369,758	0.6	315,640	0.6	391,758	0.7
Time	171,657	0.9	254,796	1.3	371,870	1.8	534,429	2.8	730,358	3.7
Total deposits	$1,234,598	0.3 %	$1,223,967	0.5 %	$1,224,145	0.7 %	$1,313,886	1.3 %	$1,563,466	2.0 %

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The following table summarizes time deposits in amounts of $100,000 or more by time remaining until maturity as of December 31, 2013 (dollars in thousands).

Three months or less	$6,811
Over 3 months through 6 months	7,835
Over 6 months through 1 year	13,078
Over 1 year	28,977
	$56,701

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,				
	2013	2012	2011	2010	2009
U.S. Treasury and federal agency securities	$54,439	$42,564	$27,613	$8,109	$71,110
U.S. Agency MBS and CMOs	19,365	23,761	3,886	---	---
Tax-exempt state and municipal bonds	46,097	25,093	4,708	83	52,148
Taxable state and municipal bonds	26,328	27,296	16,716	---	---
Corporate bonds	11,212	7,526	1,081	---	5,245
Other equity securities	1,466	1,557	1,042	1,011	1,001
Total	$158,907	$127,797	$55,046	$9,203	$129,504

At December 31, 2013, 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, 2013, we had no investment in securities of issuers outside of the United States.

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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, 2013.

(Dollars in thousands)	Due Within One Year		One to Five Years		Five to Ten Years		After Ten Years		No Contractual Maturity	
	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield
U.S. Treasury and federal agency securities	$6,058	1.47 %	$24,677	1.02 %	$23,704	1.56 %	$---	--- %	$---	--- %
U.S. Agency MBS and CMOs	---	---	---	---	992	1.72	18,373	3.45	---	---
Tax-exempt state and municipal bonds (1)	13,120	1.00	3,162	2.27	22,583	3.62	7,232	3.73	---	---
Taxable state and municipal bonds	1,433	2.59	18,886	2.80	6,009	2.49	---	---	---	---
Corporate bonds	---	---	11,212	1.45	---	---	---	---	---	---
Other equity securities	---	---	---	---	---	---	---	---	1,466	2.34
Total (1)	$20,611	1.25 %	$57,937	1.76 %	$53,288	2.52 %	$25,605	3.53 %	$1,466	2.34 %

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

Trust Services

We began offering trust services in January 1999 to further provide for the financial needs of our customers. As of December 31, 2013, the Trust Department managed assets of approximately $595.1 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, 2013, personal trust assets under management totaled approximately $356.2 million. Our retirement plan services provide all types of qualified retirement plans, including profit sharing, 401(k) and pension plans. As of December 31, 2013, retirement plan assets under management totaled approximately $238.9 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, SpartanNash 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.

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Employees

As of December 31, 2013, we had 361 full-time equivalent employees consisting of 313 full-time and 82 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.

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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 DIFS, 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 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 became 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.

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.

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 addition, if the DIFS deems the Bank's capital to be impaired, the DIFS 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.

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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 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 stock. Additional information regarding the suspension of dividends 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 Item 8 of this report in Notes 1 and 17 to the Consolidated Financial Statements and is here incorporated by reference.

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 DIFS, 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.

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.

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The FDIC's deposit insurance assessment base methodology uses average consolidated total assets less average tangible equity as the assessment base. Under this calculation, most well capitalized banks will pay 5 to 9 basis points annually, increasing up to 35 basis points for banks that pose 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 to be 9 basis points in 2014.

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.

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, 2013, 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.

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Additional information about restrictions on payment of dividends by the Bank may be found 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.

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 DIFS, (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.

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ITEM 1A: Risk Factors.

Risks related to the our Business

Earnings in recent years 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, 2012 and 2013. 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 $4.3 million, $7.1 million and $4.7 million for the years ended December 31, 2013, 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 2014, and non-recurring events with similar levels of positive impact on earnings are not likely to occur in 2014.

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 $49.2 million at December 31, 2013. 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 and State 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.

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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 exposes us to significant risks.

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 may be 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 may result 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.

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, 2013, we had approximately $472.3 million of commercial real estate loans outstanding, which represented approximately 45.3% of our loan portfolio. As of that same date, we had approximately $188.6 million in residential real estate loans outstanding, or approximately 18.1% 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.

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

Our commercial loan portfolio, including commercial mortgages, was approximately $746.4 million at December 31, 2013, comprising approximately 71.6% 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 soft housing market.

Loans to residential developers involved in the development or sale of 1-4 family residential properties were approximately $35.2 million, $48.9 million, $66.3 million, $95.7 million, $153.3 million and $204.4 million at December 31, 2013, 2012, 2011, 2010, 2009 and 2008, respectively. While activity has increased in 2013, the housing market in our market area continues to be soft. While improving, we expect the home builder market to continue to be soft 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.

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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, 2013, the Company has sold an aggregate of $598.1 million of residential mortgage loans on the secondary market. As of December 31, 2013, the Company had five pending make whole requests with respect to loans having an aggregate of $696,000 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, 2013.

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.

During fiscal 2010, 2011, 2012 and 2013, 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 2014. 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 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 became 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.

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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, could lead to market-wide liquidity problems and 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.

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.

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 or acquisitions could be materially limited. Additional information on the capital requirements applicable to the Bank may be found under the heading "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.

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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.

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.

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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.

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, 2013, our gross deferred tax asset was $18.5 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).

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.

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 some or all outstanding shares of its preferred stock.

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.

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Exercise of our outstanding Warrants to purchase common 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. Additional information about the Warrants may be found in Item 8, Note 17 – "Shareholders' Equity."

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

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.

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.

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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.

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ITEM 1B: Unresolved Staff Comments.

None.

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 20, 2014, 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
116 Ottawa Avenue N.W., Grand Rapids	Branch Office (Leased facility, lease expires August 2020)
126 Ottawa Avenue N.W., Grand Rapids	Loan Center (Leased facility, lease expires August 2020)
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, lease expires December 2019)
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.

Smith v. Macatawa Bank Corporation, et al, case no. 14-3604 filed January 27, 2014 in Ottawa County (MI) Circuit Court. The Company's former Chairman and Chief Executive Officer, Mr. Benj. A. Smith III, commenced legal action against the Company claiming that the Company breached an alleged employment agreement pursuant to which he claims entitlement to $20,833 monthly for a period of six years from the date of his resignation in February 2009.

Mr. Smith's complaint seeks damages in an unspecified amount in excess of $25,000. The Company expects to vigorously contest the action.

As of the date of this report, there are no other 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.

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ITEM 4: Mine Safety Disclosures.

Not applicable.

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, 2013 and 2012 are set forth in the table below.

	2013		2012	
Quarter	High	Low	High	Low
First Quarter	$6.10	$2.88	$3.50	$2.20
Second Quarter	6.00	4.70	3.66	3.09
Third Quarter	5.63	4.43	3.47	2.92
Fourth Quarter	5.48	4.68	3.50	2.80

On February 19, 2014, there were approximately <> owners of record and approximately <> beneficial owners of our common stock.

We did not declare dividends on our common stock in 2012 or 2013. Information on restrictions on payments of dividends by us may be found in Item 1 of this report under the heading “Supervision and Regulation”. Information regarding our equity compensation plans may be found in Item 12 of this report and is here incorporated by reference.

Shareholder Return Performance Graph

The following graph shows the cumulative total shareholder return on an investment in the Company’s common stock compared to the Russell 2000 Index and the SNL Bank NASDAQ Index. The comparison assumes a $100 investment on December 31, 2008 at the initial price of $3.47 per share (adjusted for all stock dividends and splits) and assumes that dividends are reinvested. The comparisons in this table are set forth in response to Securities and Exchange Commision (SEC) disclosure requirements and therefore are not intended to forecast or be indicative of future performance of the common stock.

	Period Ending					
Index	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Macatawa Bank Corporation	100.00	60.23	118.73	65.71	83.29	144.09
Russell 2000	100.00	127.17	161.32	154.59	179.86	249.69
SNL Bank NASDAQ	100.00	81.12	95.71	84.92	101.22	145.48

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Issuer Purchases of Equity Securities

The following table provides information regarding the Company's purchase of its own common stock during the fourth quarter of 2013. All employee transactions are under stock compensation plans. These include shares of Macatawa Bank Corporation common stock submitted for cancellation to satisfy tax withholding obligations that occur upon the vesting of restricted shares. The value of the shares withheld is determined based on the closing price of Macatawa Bank Corporation common stock at the date of vesting.

Macatawa Bank Corporation Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share
October 1 - October 31, 2013		
Employee Transactions	---	---
November 1 - November 30, 2013		
Employee Transactions	---	---
December 1 - December 31, 2013		
Employee Transactions	8,906	$ 5.03
Total for Fourth Quarter ended December 31, 2013		
Employee Transactions	8,906	$ 5.03

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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, 2013, 2012, 2011, 2010, and 2009 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 Results of Operations and Financial Condition " included elsewhere in this report.

(Dollars in thousands, except per share data)	As of and for the Year Ended December 31,				
	2013	2012	2011	2010	2009
Financial Condition					
Total assets	$1,517,405	$1,560,718	$1,507,667	$1,578,261	$1,830,172
Securities	158,907	127,797	55,046	9,203	129,504
Loans	1,042,377	1,052,348	1,070,975	1,217,196	1,510,816
Deposits	1,249,734	1,286,261	1,215,289	1,276,620	1,416,337
Long-term debt	41,238	42,888	42,888	42,888	42,888
Other borrowed funds	89,991	91,822	148,603	185,336	278,023
Shareholders' equity	132,522	130,507	94,426	67,842	87,991
Share Information*					
Basic earnings (loss) per common share	$(0.29)	$1.31	$0.26	$(1.01)	$(3.81)
Diluted earnings (loss) per common share	(0.29)	1.31	0.26	(1.01)	(3.81)
Book value per common share	3.92	3.59	2.26	1.96	3.10
Tangible book value per common share	3.92	3.59	2.26	1.94	3.07
Dividends per common share	---	---	---	---	---
Dividend payout ratio	--- %	--- %	--- %	--- %	--- %
Average dilutive common shares outstanding	27,161,888	27,086,792	22,739,990	17,686,362	17,449,943
Common shares outstanding at period end	33,801,097	27,203,825	27,082,823	17,679,621	17,698,108
Operations					
Interest income	$48,620	$57,276	$60,779	$76,003	$95,878
Interest expense	7,337	9,814	14,480	25,436	43,085
Net interest income	41,283	47,462	46,299	50,567	52,793
Provision for loan losses	(4,250)	(7,100)	(4,700)	22,460	74,340
Net interest income (loss) after provision for loan losses	45,533	54,562	50,999	28,107	(21,547)
Total noninterest income	16,141	15,628	14,892	18,023	16,697
Total noninterest expense	47,855	53,283	60,062	62,681	67,391
Income (loss) before income tax	13,819	16,907	5,829	(16,551)	(72,241)
Federal income tax (benefit)	4,270	(18,583)	---	1,303	(8,600)
Net income (loss)	9,549	35,490	5,829	(17,854)	(63,641)
Dividend declared on preferred shares**	(17,575)	---	---	---	2,870
Net income (loss) attributable to common shares	(8,026)	35,490	5,829	(17,854)	(66,511)
Performance Ratios					

Return on average equity	7.11	%	34.39	%	7.08	%	(24.99	)%	(50.60	)%
Return on average assets	0.63		2.37		0.38		(1.08	)	(3.16	)
Yield on average interest-earning assets	3.58		4.21		4.32		4.93		5.10	
Cost on average interest-bearing liabilities	0.69		0.92		1.26		1.88		2.56	
Average net interest spread	2.89		3.29		3.06		3.05		2.54	
Average net interest margin	3.05		3.49		3.29		3.28		2.82	
Efficiency ratio	83.34		84.46		98.15		91.39		96.98	
Capital Ratios										
Period-end equity to total assets	8.73	%	8.36	%	6.26	%	4.30	%	4.81	%
Average equity to average assets	8.90		6.89		5.37		4.30		6.24	
Total risk-based capital ratio (consolidated)	15.69		14.98		13.15		9.65		9.23	
Credit Quality Ratios										
Allowance for loan losses to total loans	2.00	%	2.26	%	2.95	%	3.90	%	3.62	%
Nonperforming assets to total assets	3.24		4.33		6.33		8.45		7.71	
Net charge-offs to average loans	(0.13	)	0.08		0.99		2.18		3.54	

*Retroactively adjusted to reflect the effect of all stock splits and dividends
**2013 reflects effect of induced exchange of preferred stock to common stock

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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 operation 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 depository 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 have 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, 2013, we had total assets of $1.52 billion, total loans of $1.04 billion, total deposits of $1.25 billion and shareholders' equity of $132.5 million. We recognized net income of $9.5 million in 2013 compared to net income of $35.5 million in 2012. With the reversal of our deferred tax asset valuation allowance at December 31, 2012, our earnings for 2013 reflected tax expense of $4.3 million, while 2012 reflected a tax benefit of $18.6 million. As of December 31, 2013, the Company’s and the Bank’s regulatory capital ratios were among the highest levels in the Company’s history. The Bank was categorized as “well capitalized” at December 31, 2013.

On April 12, 2013, the FDIC and the Michigan DIFS, the primary banking regulators of the Bank, notified the Bank that the Bank’s Memorandum of Understanding (“MOU”) with the FDIC and DIFS had served its purpose and was released. As a result, the Bank is no longer subject to any regulatory order, memorandum of understanding or other similar regulatory directive or proceeding and has returned to a normal regulatory operating environment.

Similiarly, by letter dated August 1, 2013, the Federal Reserve Bank of Chicago (“FRB”) advised the Company that, based on the overall satisfactory condition of the organization, the FRB poses no objection should the Board of Directors choose to rescind the Board Resolution. Accordingly, the Company's Board of Directors rescinded the Board Resolution as of August 1, 2013.

During 2013, the Company improved its capital structure by prepaying and redeeming its $1.7 million of 11% unsecured subordinated debt, resuming interest payments on its trust preferred securities and completing an exchange of all of the Company’s Series A and Series B Preferred Stock to Company common stock and cash, at the election of the holder. Each of these transactions are discussed in detail in Item 7 and in our consolidated financial statements and related notes included in this report.

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Over the past five 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, 2013	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009
Nonperforming loans	$ 12,335	$ 16,003	$ 28,946	$ 75,361	$ 103,885
Other repossessed assets	40	6	---	50	124
Other real estate owned	36,796	51,582	66,438	57,984	37,184
Total nonperforming assets	$ 49,171	$ 67,591	$ 95,384	$ 133,395	$ 141,193
Total loan delinquencies 30 days or greater past due	$ 5,520	$ 7,887	$ 13,138	$ 55,748	$ 118,568

Earnings in recent years have been impacted by high costs associated with administration and disposition of nonperforming assets. These costs, including losses on repossessed and foreclosed properties, were $5.5 million, $10.0 million and $15.6 million for the years ended December 31, 2013, 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 2013, 2012 and 2011 were favorably impacted by negative provision for loan losses of $4.3 million, $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", the large negative provision in 2012 was primarily a result of a large recovery taken in the first quarter of 2012. The negative provision in each period was also impacted by other recoveries from our collection efforts and a continual decline in our historical charge-off levels from prior years. We do not expect a similar level of negative provision for loan losses in 2014.

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

	For the year ended December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Provision for loan losses	$ (4,250)	$ (7,100)	$ (4,700)	$ 22,460	$ 74,340
Net charge-offs (recoveries)	(1,309)	802	11,085	29,657	59,942
Net charge-offs to average loans	(0.13)%	0.08 %	0.99 %	2.18 %	3.54 %
Nonperforming loans to total loans	1.18 %	1.52 %	2.70 %	6.19 %	6.88 %
Loans transferred to ORE to average loans	0.34 %	0.88 %	3.42 %	3.32 %	1.80 %
Performing troubled debt restructurings to average loans	5.61 %	6.24 %	5.15 %	1.91 %	1.62 %

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 was profound. The recession and job loss impacted housing values, commercial real estate values and consumer activity. Improvement has been evident during the past three years. The state's unemployment rate at the end of 2013 was 8.8%, no longer the highest in the country and down dramatically from 15.2% in June 2009. The Holland area unemployment was 5.8%, and the Grand Rapids area unemployment was 5.6% at the end of 2013. Residential housing values and commercial real estate property values decreased significantly during the recession, but have shown 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 has stabilized and is now improving. In the Grand Rapids market during 2013, there were 23% more single family home starts than in 2012. Similarly, in the Holland-Grand Haven/Lakeshore region, there were 32% more single family home starts in 2013 than in 2012. Also, these markets are now also seeing activity in duplex, condominium and apartment starts after years of virtually no activity.

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In recent years, we have continued to diversify our loan portfolio structure by de-emphasizing commercial real estate loans and cautiously increasing volumes of commercial and industrial loans, residential mortgages and other consumer loans. Commercial real estate loans have decreased from $503.0 million at December 31, 2012 to $472.3 million at December 31, 2013. Consumer loans have increased in 2013, totaling $295.9 million at December 31, 2013, compared to $289.7 million at December 31, 2012. With our improved financial condition, successful capital raise in 2011, and retained earnings growth, our focus has shifted from shrinkage in our loan portfolio to stabilizing our loan balances and growing certain portfolios in 2014.

RESULTS OF OPERATIONS

Summary: Net income was $9.5 million ($13.8 million on a pretax basis) for 2013, compared to net income of $35.5 million ($16.9 million on a pretax basis) for 2012 and $5.8 million ($5.8 million on a pretax basis) for 2011. Earnings (loss) per common share on a diluted basis was $(0.29) for 2013, $1.31 for 2012 and $0.26 for 2011. Earnings (loss) per share for 2013 was affected by a one-time, non-cash reduction to net income available to common shares of $17.6 million representing the impact of the preferred stock exchange completed on December 30, 2013.

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 the higher 2012 income was the collection of a large prepayment fee of $2.8 million on an individual loan. Earnings in each period were positively impacted by negative provision for loan losses ($4.3 million in 2013, $7.1 million in 2012 and $4.7 million in 2011). These negative provisions resulted from reduced levels of nonperforming loans, improved asset quality and reduced levels of chargeoffs. The negative provision in 2012 was higher due to the recovery of $4.4 million on an individual loan previously charged off. These items are discussed more fully below.

We continued our improvement in nonperforming asset expenses in 2013. Costs associated with nonperforming assets were $5.5 million in 2013, compared to $10.0 million in 2012 and $15.6 million in 2011. Lost interest from nonperforming assets decreased to approximately $2.4 million for 2013, compared to $6.7 million for 2012 and $7.5 million for 2011. Each of these items are discussed more fully below.

Net Interest Income: Net interest income totaled $41.3 million during 2013, compared to $47.5 million during 2012 and $46.3 million in 2011.

The decrease in net interest income during 2013 compared to 2012 was largely due 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. Our net interest income as a percentage of average interest-earning assets (i.e. "net interest margin" or "margin") decreased by 44 basis points compared to 2012. The prepayment fee 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 increased slightly from $1.35 billion in 2012 to $1.36 billion in 2013.

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 margin increased by 20 basis points compared to 2011. The prepayment fee contributed 21 basis points to the margin in 2012. Average interest earning assets decreased from $1.39 billion in 2011 to $1.35 billion in 2012.

The yield on earning assets decreased 63 basis points from 4.21% for 2012 to 3.58% for 2013, and decreased 11 basis points to 4.21% for 2012 from 4.32% for 2011. The decreases were due to decreases in the yield on our commercial, residential and consumer loan portfolios, which repriced in the generally lower rate environment during 2012 and 2013. Our margin was negatively impacted by our decision to hold significant balances in liquid and short-term investments in the past three 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.

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Our net interest margin for 2013 benefitted from a 23 basis point decrease in our cost of funds from 0.92% for 2012 to 0.69% for 2013. Average interest bearing liabilities decreased from $1.06 billion in 2012 to $1.05 billion in 2013. 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. Decreases 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 for each period.

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 and 18 basis points in 2013.

We are encouraged by the slight increase in average earning assets in 2013 and expect these balances to continue to increase in 2014, which should positively affect net interest income.

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The following table shows an analysis of net interest margin for the years ended December 31, 2013, 2012 and 2011.

	For the years ended December 31,			2012			2011		
	2013								
	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
	(Dollars in thousands)								
Assets									
Taxable securities	$108,079	$1,798	1.67 %	$79,379	$1,544	1.94 %	$25,452	$497	1.95 %
Tax-exempt securities (1)	33,930	742	3.44 %	13,769	330	4.03 %	1,235	38	5.24 %
Loans (2)	1,034,775	45,201	4.32 %	1,049,501	54,549	5.14 %	1,123,295	59,334	5.23 %
Federal Home Loan Bank stock	11,236	393	3.45 %	11,236	351	3.08 %	11,539	294	2.51 %
Federal funds sold and other short-term investments	167,833	486	0.29 %	197,423	502	0.25 %	231,417	616	0.26 %
Total interest earning assets (1)	1,355,853	48,620	3.58 %	1,351,308	57,276	4.21 %	1,392,938	60,779	4.32 %
Noninterest earning assets:									
Cash and due from banks	24,033			23,042			23,011		
Other	129,954			124,510			115,552		
Total assets	$1,509,840			$1,498,860			$1,531,501		
Liabilities									
Deposits:									
Interest bearing demand	$272,689	369	0.13 %	$225,250	346	0.15 %	$185,591	424	0.23 %
Savings and money market accounts	472,920	1,999	0.43 %	420,553	2,003	0.48 %	369,758	2,063	0.56 %
Time deposits	171,657	1,625	0.94 %	254,796	3,372	1.32 %	371,870	6,786	1.83 %
Borrowings:									
Other borrowed funds	90,580	1,781	1.94 %	121,300	2,374	1.92 %	175,063	3,609	2.03 %

Long-term debt	41,238	1,450	3.47 %	41,238	1,537	3.67 %	41,238	1,413	3.38 %
Subordinated debt	1,013	113	11.10 %	1,650	182	11.00 %	1,839	185	10.05 %
Total interest bearing liabilities	1,050,097	7,337	0.69 %	1,064,787	9,814	0.92 %	1,145,359	14,480	1.26 %
Noninterest bearing liabilities:									
Noninterest bearing demand accounts	317,332			323,368			296,926		
Other noninterest bearing liabilities	8,070			7,507			6,934		
Shareholders' equity	134,341			103,198			82,282		
Total liabilities and shareholders' equity	$1,509,840			$1,498,860			$1,531,501		
Net interest income		$41,283			$47,462			$46,299	
Net interest spread (1)			2.89 %			3.29 %			3.06 %
Net interest margin (1)			3.05 %			3.49 %			3.29 %
Ratio of average interest earning assets to average interest bearing liabilities	129.12 %			126.91 %			121.62 %		

(1) Yields are presented on a tax equivalent basis using a 35% tax rate.
Loan fees of $548,000, $4.0 million and $678,000 for 2013, 2012 and 2011 are included in interest income.
(2) Includes average nonaccrual loans of approximately $14.7 million, $24.1 million and $51.1 million for 2013, 2012 and 2011.

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The following table presents the dollar amount of changes in net interest income due to changes in volume and rate.

	For the years ended December 31,					
	2013 vs 2012			2012 vs 2011		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest income						
Taxable securities	$501	$(247)	$254	$1,049	$(2)	$1,047
Tax-exempt securities	473	(61)	412	311	(19)	292
Loans	(756)	(8,592)	(9,348)	(3,848)	(937)	(4,785)
Federal Home Loan Bank stock	---	42	42	(8)	65	57
Federal funds sold and other short-term investments	(80)	64	(16)	(87)	(27)	(114)
Total interest income	138	(8,794)	(8,656)	(2,583)	(920)	(3,503)
Interest expense						
Interest bearing demand	$67	(44)	$23	$79	(157)	$(78)
Savings and money market accounts	235	(239)	(4)	263	(323)	(60)
Time deposits	(933)	(814)	(1,747)	(1,822)	(1,592)	(3,414)
Other borrowed funds	(604)	11	(593)	(1,060)	(175)	(1,235)
Long-term debt	---	(87)	(87)	---	124	124
Subordinated debt	(37)	(32)	(69)	(7)	4	(3)
Total interest expense	(1,272)	(1,205)	(2,477)	(2,547)	(2,119)	(4,666)
Net interest income	$1,410	$(7,589)	$(6,179)	$(36)	$1,199	$1,163

Provision for Loan Losses: The provision for loan losses for 2013 was a negative $4.3 million compared to a negative $7.1 million for 2012 and a negative $4.7 million for 2011. The negative provisions in each period were the result of continued significant declines in the level of net charge-offs, reduction in the balances and required reserves on nonperforming loans and stabilizing real estate values on problem credits. The provision for loan losses for 2012 was affected by a $4.4 million recovery on a previously charged-off loan in the first quarter of 2012. Net charge-offs were $58.0 million in 2009, $29.7 million in 2010, $11.1 million in 2011, and $802,000 in 2012 and a net recovery of $1.3 million in 2013. The lower level of net charge-offs was a result of a slowing in the rate of declines in real estate values, success at reducing our levels of nonperforming loans and positive results from our aggressive collection recovery efforts.

We have experienced a decline in the pace of commercial loans migrating to a worse loan grade, which receive higher allocations in our loan loss reserve. In addition to experiencing fewer downgrades of credits, we continue to see an increase in the quality of some credits resulting in an improved loan grade. Over the past two years, we have experienced improvements in our weighted average loan grade. Our weighted average commercial loan grade was 3.88 at December 31, 2013 reflecting improvement compared to 4.01 at December 31, 2012 and 4.19 at December 31, 2011. We believe efforts that began in late 2009 and in early 2010 to improve loan administration and loan risk management practices have had a significant impact, ultimately allowing for the reduction in the level of the allowance for loan losses since then.

The amounts of loan loss provision in each period were the result of establishing our allowance for loan losses at levels believed necessary based upon our methodology for determining the adequacy of the allowance. The sustained lower level of quarterly net charge-offs over the past three years has had a significant effect on the historical loss component of our methodology. More information about our allowance for loan losses and our methodology for establishing its level may be found in this Item 7 of the report under the heading “Allowance for Loan Losses” below

and in Item 8 of this report in Note 3 of the Consolidated Financial Statements.

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Noninterest Income: Noninterest income totaled $16.1 million in 2013, compared to $15.6 million in 2012 and $14.9 million in 2011. The components of noninterest income are shown in the table below (in thousands):

	2013	2012	2011
Service charges and fees on deposit accounts	$3,963	$3,323	$3,692
Net gains on mortgage loans	2,554	2,882	1,728
Trust fees	2,413	2,389	2,543
Gain as sales of securities	120	73	---
ATM and debit card fees	4,325	4,130	3,963
Bank owned life insurance (“BOLI”) income	713	847	942
Investment services fees	943	771	796
Other income	1,110	1,213	1,228
Total noninterest income	$16,141	$15,628	$14,892

Revenue from deposit services was $4.0 million in 2013, compared to $3.3 million in 2012 and $3.7 million in 2011. The increase from 2012 to 2013 was due primarily to increased levels of returned check fees from changes to the overdraft privilege feature of our checking accounts implemented in late 2012. The decrease from 2011 to 2012 was related primarily to decreases in fees driven from account balances, as our average deposit balances were lower in 2012 than in 2011.

Net gains on mortgage loans included gains on the sale of real estate mortgage loans in the secondary market. We sell the majority of the fixed-rate mortgage loans we originate. We do not retain the servicing rights for the loans we sell.

A summary of gain on sales of loans and related loan volume was as follows (in thousands):

	For the Year Ended December 31,		
	2013	2012	2011
Gain on sales of loans	$2,554	$2,882	$1,728
Real estate mortgage loans originated for sale	$107,988	$140,151	$84,470
Real estate mortgage loans sold	116,757	135,929	87,709
Net gain on the sale of mortgage loans as a percent of real estate mortgage loans sold ("Loan sale margin")	2.19 %	2.12 %	1.97 %

As demonstrated in the table above, we realized significant volumes of activity the past few years, peaking in 2012. Mortgage rates increased in the second half of 2013, reducing the residential mortgage volume and thus reducing gains on mortgage loans in the latter half of 2013. This income was up significantly during 2012 as a result of our renewed focus on residential mortgage volume and the addition of experienced mortgage professionals during 2011, and the low interest rate environment that existed throughout 2011 and 2012. During 2013, we saw a shift in our mortgage production from refinance activity to purchase activity. We expect this trend to continue in 2014.

Trust service revenue increased $24,000 in 2013 after having decreased $154,000 in 2012. This increase is due to improvements in general market conditions and our improved financial condition. Our financial performance in previous years and the existence of our previous regulatory orders likely impacted how we were perceived in the marketplace, resulting in challenges to retain trust customers and maintain levels of trust revenue. We believe that our improved financial performance in the past several years and the termination of our previous regulatory orders are having a positive impact on our trust service revenue.

ATM and debit card processing income increased $195,000 in 2013 to $4.3 million, following an increase of $167,000 in 2012 over 2011. These increases reflected a continued increase in usage from current customers and overall growth in the number of debit and ATM card customers. Promotional efforts to increase volume in these low cost transaction alternatives continued to be successful. Our recent rollout of our uChoose Rewards program is expected to have a positive impact on this income in 2014. Recent regulatory changes implementing price controls over what financial institutions can charge for these services may impact the level of such income we recognize in 2014.

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We sold securities in 2013 resulting in net gains of $120,000. In 2012, we sold securities resulting in net gains of $73,000. We did not sell any investment securities during 2011, and therefore had no gains on sale of securities during the year. The sales in 2012 and 2013 were made due to downgrades of the individual investments sold. We continually review our securities portfolio and will dispose of securities that pose higher than desired credit or market risk.

Other categories of noninterest income totaled $2.8 million in 2013, $2.8 million in 2012 and $3.0 million in 2011. Investment service fees were up $172,000 in 2013 due to our focus on these services and improvement in the stock market performance. Earnings from bank owned life insurance decreased $134,000 from 2012 as the underlying investments performed better in 2012 than in 2013. This followed a reduction in bank owned life insurance earnings of $95,000 from 2011 to 2012, again due to the performance of the underlying investments. ORE rental income was $304,000 in 2013, compared to $684,000 in 2012 and $549,000 in 2011. The fluctuations are due to the relative average other real estate owned balances during each period.

Noninterest Expense: Noninterest expense was $47.9 million in 2013, $53.3 million in 2012 and $60.1 million in 2011. The steady decline in our noninterest expense areas reflects our active management of controllable costs to offset the high level of nonperforming assets costs. These costs have decreased dramatically during the periods presented as well. The components of noninterest expense are shown in the table below (in thousands):

	2013	2012	2011
Salaries and benefits	$23,012	$22,986	$22,217
Occupancy of premises	3,756	3,815	3,949
Furniture and equipment	3,224	3,259	3,318
Legal and professional	680	664	971
Marketing and promotion	870	929	834
Data processing	1,351	1,268	1,284
FDIC assessment	1,458	2,196	3,472
ATM and debit card processing	1,300	1,222	1,206
Bond and D&O insurance	740	909	1,512
FHLB Advance prepayment penalty	---	322	---
Administration and disposition of problem assets	5,524	9,960	15,601
Outside services	1,606	1,407	1,540
Other noninterest expense	4,334	4,346	4,158
Total noninterest expense	$47,855	$53,283	$60,062

Salaries and benefit expense were the highest component of noninterest expense and was $23.0 million in 2013 and 2012, and $22.2 million in 2011. The increases in 2013 and 2012 were primarily due to salary and wage cost of living increases and commissions paid for mortgage origination activity, partially offset by reduced medical insurance costs driven by lower claims experience in 2013. Also impacting salary and benefit expense in 2013 was the reinstatement of our 401(k) plan matching contribution, effective January 1, 2013.

Costs associated with nonperforming assets remain elevated, but have decreased significantly each of the past three years, totaling $5.5 million in 2013 compared to $10.0 million in 2012 and $15.6 million in 2011. These costs included legal costs, repossessed and foreclosed property administration expense and losses on repossessed and foreclosed properties. Repossessed and foreclosed property administration expense included survey and appraisal, property maintenance and management and other disposition and carrying costs. Losses on repossessed and foreclosed properties included both net losses on the sale of properties and unrealized losses from value declines for outstanding properties.

These costs are itemized in the following table (in thousands):

	2013	2012	2011
Legal and professional – nonperforming assets	$882	$1,149	$2,389
Repossessed and foreclosed property administration	2,817	3,516	4,841
Losses on repossessed and foreclosed properties	1,825	5,295	8,371
Total	$5,524	$9,960	$15,601

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As problems loans move through the collection process, the costs associated with nonperforming assets have remained elevated, yet have decreased significantly during each of the past three years. During 2013, we added only $3.5 million in other real estate and sold $16.5 million, allowing for a meaningful reduction in our year end balance. This compares to 2012, when we added $9.2 million in other real estate and sold $18.7 million and 2011 when we added $38.4 million in other real estate and sold $21.5 million. Looking forward to 2014, we expect this trend to continue and should see meaningful reductions in the balances of other real estate owned and the related nonperforming asset carry costs.

Legal and professional fees totaled $680,000 in 2013, $664,000 in 2012 and $971,000 in 2011. These expenses have been unusually high in recent years as a result of legal fees associated with consultation related to our previous regulatory orders we had been under and our implementation of additional corporate governance procedures, including more consultation with corporate legal counsel. We anticipate reductions in legal and professional expenses in 2014.

FDIC assessments decreased to $1.5 million in 2013 compared to $2.2 million in 2012 and $3.5 million in 2011 primarily due to the termination of our previous regulatory orders and resulting change in our assessment category and our reduced level of deposits. Further discussion regarding the determination of FDIC assessments for the Bank may be found in Item 1 of this report under the heading "Supervision and Regulation."

Insurance costs for bond and directors and officers (“D&O”) insurance decreased significantly from $1.5 million in 2011 to $909,000 in 2012 and $740,000 in 2013. The reductions experienced in 2012 and 2013 were a result of the improvement in our regulatory status and financial condition, which demonstrated to the insurance carriers lower risk and resulted in a reduction in premiums charged.

Occupancy expense declined $59,000 in 2013 following decreases of $134,000 in 2012 and $107,000 in 2011. Furniture and equipment expense was down $35,000 in 2013 after decreases of $59,000 in 2012 and $236,000 in 2011. These expenses were down due to our continued efforts to reduce facility costs. Marketing expenses decreased $59,000 in 2013 and increased $95,000 in 2012. The increase in 2012 was due to some significant marketing campaigns as we shifted our focus to growth in our market areas.

We incurred a $322,000 prepayment fee in 2012 associated with the early payoff of $20 million in FHLB advances. Other noninterest expenses not discussed above were $5.9 million in 2013, compared to $5.8 million in 2012 and $5.7 million in 2011. The increase in 2013 was primarily due to increases in outside services and donations, partially offset by decreases in electronic banking services. Enhancements to our personal online banking delivery channel contributed to an increase in electronic banking expense of $238,000 in 2012. These increases were largely offset by other declines in 2012 within these expense areas that were the direct result of our continued initiatives to reduce controllable costs. In addition to eliminating or outsourcing certain backroom functions, these initiatives included restructuring third party contracts, acceleration of electronic delivery for certain customers and trimming controllable costs.

Federal Income Tax Expense (Benefit): We recorded federal income tax expense of $4.3 million in 2013, a federal income tax benefit of $18.6 million in 2012 and no federal income tax expense or benefit in 2011. From June 30, 2009 to December 31, 2012, we had concluded that a full valuation allowance needed to be maintained for all of our net deferred tax assets based primarily on our net operating losses in 2008 and 2009 and the continued challenging environment confronting banks that could negatively impact future operating results. With the termination of our previous regulatory orders, cumulative earnings in the most recent three year period and projections showing future taxable income at December 31, 2012, we concluded that the valuation allowance was no longer required and the $18.9 million valuation allowance was reversed at that time. Our effective tax rate for 2013 was 31%.

FINANCIAL CONDITION

Summary: Due to the continuing soft economic conditions, we have been focused on improving our loan portfolio, reducing exposure in higher loan concentration types, building our investment portfolio, and improving our financial condition through diversification of credit risk, improved capital ratios, and reduced reliance on non-core funding. We have experienced positive results in each of these areas over the past three years.

Total assets were $1.517 billion at December 31, 2013, a decrease of $43.3 million from $1.561 billion at December 31, 2012. This change reflected increases of $16.2 million in securities available for sale and $25.0 million of interest-bearing time deposits in other financial institutions, offset by declines of $10.0 million in our loan portfolio and $69.5 million in cash and cash equivalents. Total deposits decreased by $36.5 million, other borrowed funds were down by $1.8 million at December 31, 2013 compared to December 31, 2012 and long-term debt decreased by $1.7 million as we prepaid and redeemed our subordinated debt in 2013.

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In the second half of 2013, we discontinued the deferral and resumed regular payment of quarterly interest payments on our trust preferred securities and paid all accrued and unpaid interest that had been previously deferred became due and payable upon the discontinuance of the deferral. For Macatawa Statutory Trust I, a total of $3.0 million, representing all of the deferred and current interest payment due was distributed on September 30, 2013. For Macatawa Statutory Trust II, a total of $2.7 million, representing all of the deferred and current interest payment due was distributed on October 7, 2013.

Total shareholders' equity increased by $2.0 million from December 31, 2012 to December 31, 2013. Shareholders' equity was increased by $9.5 million of net income in 2013, partially offset by the $4.7 million cash payment made to holders of Series A and Series B Preferred Stock as part of the exchange completed on December 30, 2013. The exchange is discussed further in this section under the heading "Capital Resources". Shareholders' equity was also reduced by $2.9 million in 2013 as a result of an other comprehensive income swing due to the effect of interest rate movement on the fair value of our available for sale securities portfolio. As of December 31, 2013, the Bank was categorized as "well capitalized" under applicable regulatory guidelines.

Cash and Cash Equivalents: Our cash and cash equivalents, which include federal funds sold and short-term investments, were $156.9 million at December 31, 2013 compared to $226.4 million at December 31, 2012. The $69.5 million decrease was partially due to investing $25.0 million of these funds in interest-bearing time deposits with other financial institutions as discussed below. We expect our balances of short term investments to remain elevated until loan demand materially increases and more attractive investment opportunities emerge.

Interest-bearing Time Deposits with Other Financial Institutions: We opened two time deposit accounts with our primary correspondent bank in the first quarter of 2013, each in equal amounts totaling $25.0 million. One of these deposits matures 12 months after issuance and the other 18 months after issuance, and both provide a higher interest rate than federal funds sold or other short-term investments.

Securities: Securities available for sale were $139.7 million at December 31, 2013 compared to $123.5 million at December 31, 2012. We began rebuilding our investment portfolio during the second quarter of 2011 after selling the entire portfolio in the second quarter of 2010. The balance at December 31, 2013 primarily consisted of U.S. agency securities, agency mortgage backed securities and various municipal investments. Our held to maturity portfolio increased from $4.3 million at December 31, 2012 to $19.2 million at December 31, 2013. Our held to maturity portfolio is comprised of state and municipal bonds. We expect to continue to reinvest excess liquidity and selectively rebuild our investment portfolio.

Portfolio Loans and Asset Quality: Total portfolio loans declined by $10.0 million to $1.04 billion at December 31, 2013 compared to $1.05 billion at December 31, 2012. During 2013, our commercial portfolio decreased by $16.2 million, while our residential and consumer portfolios increased by $6.0 million and $226,000, respectively.

We saw a comparable level of volume of residential mortgage loans originated for sale in the first nine months of 2013 compared to the same period in 2012, but this did slow in the fourth quarter of 2013 due to the rise in mortgage rates in the latter part of 2013. Residential mortgage loans originated for sale were $108.0 million in 2013 compared to $140.2 million in 2012.

Our commercial loan portfolio balances declined in recent years reflecting the continuing weak economic conditions in West Michigan and our interest in improving the quality of our loan portfolio through reducing our exposure to these generally higher credit risk assets. We have focused our efforts on reducing our exposure to residential land development loans, diversifying our commercial loan portfolio and improving asset quality. We believe our loan portfolio has stabilized. During the fourth quarter of 2012, we achieved growth in our commercial loan portfolio for the first time since the fourth quarter of 2008. While this portfolio decreased during the first two quarters of 2013, growth returned in the third quarter when the portfolio increased by $12.7 million and the fourth quarter of 2013 when

the portfolio increased by $11.3 million. We plan to continue measured, high quality loan portfolio growth in 2014.

Commercial and commercial real estate loans remained our largest loan segment and accounted for approximately 72% of the total loan portfolio at December 31, 2013 and 73% at December 31, 2012. Residential mortgage and consumer loans comprised approximately 28% of total loans at December 31, 2013 and 27% at December 31, 2012.

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A further breakdown of the composition of the loan portfolio is shown in the table below (in thousands):

	December 31, 2013	Percent of Total Loans	December 31, 2012	Percent of Total Loans
Commercial real estate: (1)				
Residential developed	$18,130	1.8 %	$26,090	2.5 %
Unsecured to residential developers	7,315	0.7	5,547	0.5
Vacant and unimproved	42,988	4.1	56,525	5.3
Commercial development	2,434	0.2	1,799	0.2
Residential improved	76,294	7.3	75,813	7.2
Commercial improved	247,195	23.7	255,738	24.4
Manufacturing and industrial	77,984	7.5	81,447	7.7
Total commercial real estate	472,340	45.3	502,959	47.8
Commercial and industrial	274,099	26.3 %	259,700	24.7 %
Total commercial	746,439	71.6	762,659	72.5
Consumer				
Residential mortgage	188,648	18.1	182,625	17.3
Unsecured	1,337	0.1	1,683	0.2
Home equity	95,961	9.2	92,764	8.8
Other secured	9,992	1.0	12,617	1.2
Total consumer	295,938	28.4	289,689	27.5
Total loans	$1,042,377	100.0 %	$1,052,348	100.0 %

(1) Includes both owner occupied and non-owner occupied commercial real estate.

Commercial real estate loans accounted for approximately 45% of the total loan portfolio at December 31, 2013 and consisted primarily of loans to business owners and developers of owner and non-owner occupied commercial properties and loans to developers of single and multi-family residential properties. In the table above, we show our commercial real estate portfolio by loans secured by residential and commercial real estate, and by stage of development. Improved loans are generally secured by properties that are under construction or completed and placed in use. Development loans are secured by properties that are in the process of development or fully developed. Vacant and unimproved loans are secured by raw land for which development has not yet begun and agricultural land.

Total commercial real estate loans declined $30.6 million since December 31, 2012. Our commercial and industrial loan portfolio increased by $14.4 million to $274.1 million at December 31, 2013 and represented 26% of our commercial portfolio.

Our consumer residential mortgage loan portfolio, which also includes residential construction loans made to individual homeowners, comprised approximately 18% of portfolio loans at December 31, 2013 and 17% at December 31, 2012 as we continue to execute our strategy to diversify our credit risk from commercial real estate. We expect to continue to retain in our loan portfolio certain types of residential mortgage loans (primarily high quality, low loan to value loans) in an effort to continue to diversify our credit risk and deploy our excess liquidity. A large portion of our residential mortgage loan production continues to be sold on the secondary market with servicing released.

We saw a decrease in the volume of residential mortgage loans originated for sale during 2013 compared to 2012 as discussed above, however the decrease began in the third quarter of 2013 as interest rates increased beginning late in

the second quarter of 2013. We expect this trend to continue in 2014. We have not yet had to repurchase any residential mortgage loans sold to historical purchasers; however, due to market conditions many banks are being required to repurchase loans resulting from actual or alleged failure to strictly conform to the investor's purchase criteria.

Our portfolio of other consumer loans includes loans secured by personal property and home equity fixed term and line of credit loans. Consumer loans increased by $226,000 to $107.3 million at December 31, 2013 from $107.1 million at December 31, 2012 due to an increase in home equity loans. Consumer loans comprised approximately 10% of our portfolio loans at both December 31, 2013 and December 31, 2012.

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The following table shows our loan origination activity for portfolio loans during 2013, broken out by loan type and also shows average originated loan size (dollars in thousands):

	Portfolio Originations 2013	Percent of Total Originations	Average Loan Size 2013
Commercial real estate:			
Residential developed	$ 5,440	1.1 %	$ 302
Unsecured to residential developers	---	---	---
Vacant and unimproved	10,273	2.1	367
Commercial development	---	---	---
Residential improved	53,741	10.8	221
Commercial improved	67,748	13.5	560
Manufacturing and industrial	18,662	3.7	622
Total commercial real estate	155,864	31.2	354
Commercial and industrial	237,425	47.5 %	43
Total commercial	393,289	78.7	67
Consumer			
Residential mortgage	61,381	12.3	211
Unsecured	591	0.1	20
Home equity	41,404	8.3	68
Other secured	2,971	0.6	12
Total consumer	106,347	21.3	90
Total loans	$ 499,636	100.0 %	$ 70

Our loan portfolio is reviewed regularly by our senior management, our loan officers, and an internal loan review team that is independent of our loan originators and credit administration. An administrative loan committee consisting of senior management and seasoned lending and collections personnel meets monthly to manage our internal watch list and proactively manage high risk loans.

When reasonable doubt exists concerning collectability of interest or principal of one of our loans, the loan is placed in nonaccrual status. Any interest previously accrued but not collected is reversed and charged against current earnings.

Nonperforming assets are comprised of nonperforming loans, foreclosed assets and repossessed assets. At December 31, 2013, nonperforming assets totaled $49.2 million compared to $67.6 million at December 31, 2012. Additions to other real estate owned in 2013 were just $3.5 million, compared to $9.2 million in 2012. Based on the loans currently in their redemption period, we expect there to be fewer additions to other real estate owned in 2014 than there were in 2013. Proceeds from sales of foreclosed properties were $16.5 million in 2013 resulting in a net gain of $1.1 million. Proceeds from sales of foreclosed properties were $18.7 million in 2012, resulting in a small net realized loss on sale of $59,000. We expect the level of sales of foreclosed properties in 2014 to be similar to the levels experienced in 2013.

Nonperforming loans include loans on nonaccrual status and loans delinquent more than 90 days but still accruing. As of December 31, 2013, nonperforming loans totaled $12.3 million, or 1.18% of total portfolio loans, compared to $16.0 million, or 1.52% of total portfolio loans, at December 31, 2012.

Loans for development or sale of 1-4 family residential properties comprised approximately $2.6 million, or 21.0% of total nonperforming loans, at December 31, 2013 compared to $3.2 million, or 19.7% of total nonperforming loans, at December 31, 2012. The remaining balance of nonperforming loans at December 31, 2013 consisted of $3.1 million of commercial real estate loans secured by various types of non-residential real estate, $5.6 million of commercial and industrial loans, and $1.0 million of consumer and residential mortgage loans.

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Foreclosed and repossessed assets include assets acquired in settlement of loans. Foreclosed assets totaled $36.8 million at December 31, 2013 and $51.6 million at December 31, 2012. Of this balance at December 31, 2013, there were 80 commercial real estate properties totaling approximately $34.8 million. The remaining balance was comprised of 21 residential properties totaling approximately $2.0 million. Four commercial real estate properties comprised $15.6 million, or 43%, of total other real estate owned at December 31, 2013. All properties acquired through or in lieu of foreclosure are initially transferred at their fair value less estimated costs to sell and then evaluated monthly for impairment after transfer using a lower of cost or market approach. Updated property valuations are obtained at least annually on all foreclosed assets.

At December 31, 2013, our foreclosed asset portfolio had a weighted average age held in portfolio of 3.18 years. Below is a breakout of our foreclosed asset portfolio at December 31, 2013 by property type and the percentages the property has been written down since taken into our possession and the combined writedown percentage, including losses taken when the property was loan collateral (dollars in thousands):

Foreclosed Asset Property Type	Carrying Value at December 31, 2013	Foreclosed Asset Writedown	Combined Writedown (Loan and Foreclosed Asset)
Single Family	$ 1,458	4.11 %	32.96 %
Residential Lot	559	32.36	49.59
Multi-Family	---	---	---
Vacant Land	5,607	35.13	50.21
Residential Development	12,393	39.06	74.03
Commercial Office	1,753	32.15	54.42
Commercial Industrial	85	47.96	67.19
Commercial Improved	14,941	22.73	37.82
	$ 36,796	31.11 %	59.12 %

The following table shows the composition and amount of our nonperforming assets (dollars in thousands):

	December 31, 2013	December 31, 2012
Nonaccrual loans	$ 12,182	$ 15,385
Loans 90 days past due and still accruing	153	618
Total nonperforming loans (NPLs)	12,335	16,003
Foreclosed assets	36,796	51,582
Repossessed assets	40	6
Total nonperforming assets (NPAs)	49,171	67,591
Accruing restructured loans (ARLs) (1)	57,790	65,024
Total NPAs and ARLs	$ 106,961	$ 132,615
NPLs to total loans	1.18 %	1.52 %
NPAs to total assets	3.24 %	4.33 %

(1) Comprised of approximately $43.6 million and $51.8 million of commercial loans and $14.2 million and $13.2 million of consumer loans whose terms have been restructured at December 31, 2013 and 2012, respectively. Interest is being accrued on these loans under their restructured terms as they are less than 90 days past due.

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Allowance for loan losses: Determining the appropriate level of the allowance for loan losses is highly subjective. Timely identification of risk rating changes within the commercial loan portfolio is key to our process of establishing an appropriate allowance balance. The internal risk rating system is discussed below.

The allowance for loan losses at December 31, 2013 was $20.8 million, a decrease of $2.9 million, compared to $23.7 million at December 31, 2012. The balance of the allowance for loan losses was 2.00% of total portfolio loans at December 31, 2013 compared to 2.26% of total portfolio loans at December 31, 2012. While this ratio decreased slightly, the allowance for loan losses to nonperforming loan coverage ratio continued to increase, from 148.34% at December 31, 2012 to 168.61% at December 31, 2013.

The following is a summary of our portfolio loan balances and changes in the allowance for loan losses and related ratios:

	December 31		
(Dollars in thousands)	2013	2012	2011
Portfolio loans:			
Average daily balance of loans for the year	$1,030,766	$1,041,833	$1,120,857
Amount of loans outstanding at end of period	1,042,377	1,052,348	1,070,975
Allowance for loan losses:			
Balance at beginning of year	23,739	31,641	47,426
Provision for loan losses	(4,250)	(7,100)	(4,700)
Loans charged-off:			
Real estate - construction	(55)	(1,455)	(3,014)
Real estate - mortgage	(1,010)	(1,751)	(7,967)
Commercial and industrial	(317)	(1,245)	(2,935)
Total Commercial	(1,382)	(4,451)	(13,916)
Residential mortgage	(433)	(2,257)	(1,559)
Consumer	(389)	(788)	(976)
	(2,204)	(7,496)	(16,451)
Recoveries:			
Real estate - construction	1,568	5,521	2,541
Real estate - mortgage	573	319	802
Commercial and industrial	1,134	547	1,727
Total Commercial	3,275	6,387	5,070
Residential mortgage	65	142	39
Consumer	173	165	257
	3,513	6,694	5,366
Net (charge-offs) recoveries	1,309	(802)	(11,085)
Balance at end of year	$20,798	$23,739	$31,641
Ratios:			
Net charge-offs to average loans outstanding	(0.13)%	0.08%	0.99%
Allowance for loan losses to loans outstanding at year-end	2.00%	2.26%	2.95%
Allowance for loan losses tononperforming loans at year-end	168.61%	148.34%	109.31%

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The continued reduction in net charge-offs over the last several years has had a significant effect on the historical loss component of our allowance for loan losses computation as have the improvements in our credit quality metrics.

The table below shows the changes in these metrics over the past five years:

(in millions)	2013	2012	2011	2010	2009
Commercial loans	$746.4	$762.7	$795.3	$933.9	$1,172.6
Nonperforming loans	12.3	16.0	28.9	75.4	103.9
Other real estate owned and repo assets	36.8	51.6	66.4	58.0	37.3
Total nonperforming assets	49.2	67.6	95.4	133.4	141.2
Net charge-offs (recoveries)	(1.3)	0.8	11.1	29.7	58.0
Total delinquencies	5.5	7.9	13.1	55.7	118.6

Nonperforming loans have continually declined since the first quarter of 2010 to $12.3 million at December 31, 2013. As discussed earlier, we have had net loan recoveries in several quarters over the last year and a half and for the full year 2013. Perhaps even more importantly, our total delinquencies have decreased each year since 2009, to just $5.5 million at December 31, 2013.

These factors all provide for a reduction in our allowance for loan losses, and thus impacts our provision for loan losses. The provision for loan losses was a negative $4.3 million for 2013 compared to a negative $7.1 million for 2012 and a negative $4.7 million for 2011. The negative provision in each period was partially due to a smaller level of nonperforming loans as they continue to stabilize at a more reasonable level. We had net recoveries in 2013 totaling $1.3 million. For 2012, we had net charge-offs of $802,000, compared to net charge-offs of $11.1 million in 2011. At December 31, 2013, we have had net recoveries in three of the last five quarters. The ratio of net charge-offs (recoveries) to average loans was -0.13% for 2013, compared to 0.08% for 2013 and 0.99% for 2011.

We are encouraged by the reduced level of charge-offs over the past four years. We do, however, recognize that future charge-offs and resulting provisions for loan losses are expected to be impacted by the timing and extent of changes in the overall economy and the real estate markets. We believe we have seen some stabilization in economic conditions and real estate markets. However, we expect it to take additional time for sustained improvement in the economy and real estate markets in order for us to reduce our nonperforming and impaired loans to acceptable levels.

Our allowance for loan losses is maintained at a level believed appropriate based upon our assessment of the probable estimated losses inherent in the loan portfolio. Our methodology for measuring the appropriate level of allowance and related provision for loan losses relies on several key elements, which include specific allowances for loans considered impaired, general allowance for commercial loans not considered impaired based upon applying our loan rating system, and general allocations based on historical trends for homogeneous loan groups with similar risk characteristics.

Impaired loans declined $14.4 million to $68.9 million at December 31, 2013 compared to $83.3 million at December 31, 2012. The specific allowance for impaired loans decreased $2.2 million to $3.9 million, or 5.6% of total impaired loans, at December 31, 2013 compared to $6.1 million, or 7.3% of total impaired loans, at December 31, 2012. The overall balance of impaired loans remained elevated due to an accounting rule (ASU 2011-02) adopted in 2011 that requires us to identify classified loans that renew at existing contractual rates as troubled debt restructurings (“TDRs”) if the contractual rate is less than market rates for similar loans at the time of renewal. As TDRs are also considered impaired, this increased our impaired loan balance for each period presented as most of our classified loans renewed in this time period.

Specific allowances are established on individually impaired credits where we believe it is probable that a loss may be incurred. Specific allowances are determined based on discounting estimated cash flows over the life of the loan or

based on the fair value of collateral supporting the loan. For commercial real estate loans, generally appraisals are used to estimate the fair value of the collateral and determine the appropriate specific allowance. Estimated selling costs are also considered in the estimate. When it becomes apparent that liquidation of the collateral is the only source of repayment, the collateral shortfall is charged off rather than carried as a specific allowance.

The general allowance (referred to as “formula allowance”) allocated to commercial loans that were not considered to be impaired was based upon the internal risk grade of such loans. We use a loan rating method based upon an eight point system. Loans are stratified between real estate secured and non real estate secured. The real estate secured portfolio is further stratified by the type of real estate. Each stratified portfolio is assigned a loss allocation factor. Generally, a worse grade assigned to a loan category results in a greater allocation percentage. Changes in risk grade of loans affect the amount of the allowance allocation.

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The determination of our loss factors is based upon our actual loss history by loan grade and adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the analysis date. We use a rolling 18 month (6 quarter) actual net charge-off history as the base for our computation for commercial loans. The 18 month period ended December 31, 2013 reflected a sizeable decrease in net charge-off experience. We addressed this volatility in the qualitative factor considerations applied in our allowance computation. Adjustments to the qualitative factors also involved consideration of different loss periods for the Bank, including 12, 24, 36 and 48 month periods. Considering the change in our qualitative factors and changes in our commercial loan portfolio balances, the general commercial loan allowance decreased $471,000 to $14.2 million at December 31, 2013 compared to $14.7 million at December 31, 2012. This resulted in a general reserve percentage allocated at December 31, 2013 of 2.03% of commercial loans, a decrease from 2.12% at December 31, 2012. The qualitative component of our allowance allocated to commercial loans was $13.9 million at December 31, 2013 (up from $13.8 million at December 31, 2012) to maintain the allowance balances despite the reduction in the historical loss rate.

Groups of homogeneous loans, such as residential real estate and open- and closed-end consumer loans, receive allowance allocations based on loan type. A rolling 12 month (4 quarter) historical loss experience period was applied to residential mortgage and consumer loan portfolios. As with commercial loans that are not considered impaired, the determination of the allowance allocation percentage is based principally on our historical loss experience. These allocations are adjusted for consideration of general economic and business conditions, credit quality and delinquency trends, collateral values, and recent loss experience for these similar pools of loans. The homogeneous loan allowance was $2.8 million at December 31, 2013 compared to $3.0 million at December 31, 2012. The decrease was related to improvements in delinquencies in both residential mortgage and consumer loan portfolios.

As noted above, the formula allowance allocated to commercial loans that are not considered to be impaired is calculated by applying historical loss factors to outstanding loans based on the internal risk rating of such loans. We use a loan rating method based upon an eight point system. Loans rated a 4 or better are considered of acceptable risk. Loans rated a 5 exhibit above-normal risk to the Company and warrant a greater level of attention by management. These loans are subject to on-going review and assessment by our Administrative Loan Committee. Loans rated a 6 or worse are considered substandard, doubtful or loss, exhibit a greater relative risk of loss to the Company based upon the rating and warrant an active workout plan administered by our Special Asset Group, as discussed above.

Loans are assigned a loss allocation factor for each loan class based principally on the loss history for each risk rating within each loan category. Commercial real estate loans are stratified and grouped by the type of real estate securing such loans for determining the loan classification category. For 2009 and the first three quarters of 2010, the loss history was based upon the latest 12 month period, as this was considered most representative within the then current economic cycle. However, given the significant improvement in our charge-off history over the 12 month periods in late 2010, we determined that an 18 month (6 quarter) historical period was more appropriate for the fourth quarter 2010 as heavy charge-off months would have rolled off the 12 month period, and would have resulted in a substantially smaller overall allowance balance. Until overall levels of nonperforming loans decline over a sustained period, we believe such a reduction in the allowance balance would be premature. We have continued to use the 18 month historical period in 2011, 2012 and 2013. The historical loss allocation factor used is adjusted for consideration of significant qualitative factors that affect the collectability of the portfolio as of the analysis date. The worse the risk rating assigned to a loan category, the greater the loss allocation factor that is applied.

The qualitative factors assessed and used to adjust historical loss experience reflect our assessment of the impact of economic trends, delinquency and other problem loan trends, trends in valuations supporting underlying collateral, changes in loan portfolio concentrations and changes in internal credit administration practices have on probable losses inherent in our loan portfolio. Qualitative adjustments are inherently subjective and there can be no assurance that these adjustments have properly identified probable losses in our loan portfolio. More information regarding the subjectivity involved in determining the estimate of the allowance for loan losses may be found in this Item 7 of the

report under the heading "Critical Accounting Policies and Estimates."

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The following table shows the allocation of the allowance for loan losses by portfolio type at the dates indicated.

(Dollars in thousands)	December 31, 2013		2012	
	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans
Commercial and commercial real estate	$17,095	72 %	$19,952	73 %
Residential mortgage	2,368	18	2,544	17
Consumer	1,335	10	1,243	10
Total	$20,798	100 %	$23,739	100 %

The components of the allowance for loan losses were as follows:

(Dollars in thousands)	December 31, 2013		2012	
	Balance of Loans	Allowance Amount	Balance of Loans	Allowance Amount
Commercial and commercial real estate:				
Impaired with allowance recorded	$42,434	$2,989	$45,245	$5,338
Impaired with no allowance recorded	12,006	---	23,976	---
Loss allocation factor on non-impaired loans	691,999	14,106	693,438	14,614
	746,439	17,095	762,659	19,952
Residential mortgage and consumer:				
Reserves on troubled debt restructurings	14,483	881	14,086	716
Loss allocation factor	281,455	2,822	275,603	3,071
Total	$1,042,377	$20,798	$1,052,348	$23,739

With the exception of certain TDRs, impaired commercial loans at December 31, 2013 were classified as substandard or worse per our internal risk rating system. The $14.5 million of residential mortgage troubled debt restructurings were associated with programs approved by the U.S. government during 2009 to minimize the number of consumer foreclosures. These loans involved the restructuring of terms on consumer mortgages to allow customers to mitigate foreclosure by meeting a lower loan payment requirement based upon their current cash flow. We have been active at utilizing these programs and working with our customers to reduce the risk of foreclosure. Additional information regarding impaired loans at December 31, 2013 and 2012 may be found in Item 8 of this report in Note 3 to the Consolidated Financial Statements.

The decrease in the level of the allowance for 2013 was due to decreases in net charge-offs from commercial loans, shrinkage in the overall loan portfolio during 2013, a reduction in the level of impaired loans and nonperforming loans, a reduction in specific reserves on these impaired loans, and improvement in the loan grades, which provides a lower allocation. Our weighted average loan grade improved from 4.38 at December 31, 2010 to 4.19 at December 31, 2011, 4.01 at December 31, 2012 and 3.88 at December 31, 2013. The decrease of $2.9 million in reserves on commercial loans was due to a $624,000 decrease in the loss allocation factor on non-impaired loans, and a $2.3 million decrease in specific reserves on impaired loans. The decrease in the losses incurred during this period, and a general improvement in the credit quality and overall risk ratings of commercial loans were the primary reasons for

this decrease.

The general allowance for residential real estate and consumer loans was $2.8 million at December 31, 2013, compared to $3.1 million at December 31, 2012.

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Of the $20.8 million allowance at December 31, 2013, 19% related to specific allocations on impaired loans, 68% related to formula allowance on commercial loans and 13% related to general allocations for homogeneous loans. Of the $23.7 million allowance at December 31, 2012, 25% related to specific allocations on impaired loans, 62% related to formula allowance on commercial loans and 13% related to general allocations for homogeneous loans. Of the $16.9 million total formula based allowance for loan loss allocations at December 31, 2013, $16.4 million is from general/environmental allocations with $506,000 driven from historical experience. Of the $17.7 million total formula based allowance for loan loss allocations at December 31, 2012, $15.2 million is from general/environmental allocations with $2.5 million driven from historical experience.

The above allocations are not intended to imply limitations on usage of the allowance. The entire allowance is available for any loan losses without regard to loan type.

More information regarding steps to address the elevated levels of substandard, impaired and nonperforming loans may be found in this Item 7 of the report under the heading "Loan Portfolio and Asset Quality" above and in Item 8 of this report in Note 3 to the Consolidated Financial Statements.

Although we believe our allowance for loan losses has captured the losses that are probable in our portfolio as of December 31, 2013, there can be no assurance that all losses have been identified or that the allowance is sufficient. The additional efforts by management to accelerate the identification and disposition of problem assets discussed above, and the impact of the lasting economic slowdown, may result in additional losses in 2014.

Premises and Equipment: Premises and equipment totaled $53.6 million at December 31, 2013 and was unchanged from December 31, 2012 as capital additions were offset by depreciation of current facilities during 2013.

Deposits and Other Borrowings: Total deposits decreased $36.5 million to $1.250 billion at December 31, 2013, as compared to $1.286 billion at December 31, 2012. Non-interest checking account balances increased $5.0 million in 2013. Interest bearing demand account balances increased $8.7 million and savings and money market account balances decreased $7.3 million in 2013. We decreased higher costing certificates of deposits by $42.9 million in 2013. The increase in balances of checking accounts was caused by normal seasonal inflows from municipalities and some shifting between deposit types. We believe our success in maintaining the balances of personal and business checking and savings accounts was primarily attributable to our focus on quality customer service, the desire of customers to deal with a local bank, the convenience of our branch network and the breadth and depth of our product line.

Noninterest bearing demand accounts comprised 28% of total deposits at December 31, 2013 compared to 26% of total deposits at December 31, 2012. Because of the generally low rates paid on interest bearing account alternatives, many of our business customers chose to keep their balances in these more liquid noninterest bearing demand account types. Interest bearing demand, money market and savings accounts, comprised 60% of total deposits at December 31, 2013 and 2012. Time accounts as a percentage of total deposits were 12% at December 31, 2013 and 15% at December 31, 2012.

Borrowed funds totaled $131.2 million at December 31, 2013; including $90.0 million in Federal Home Loan Bank advances and $41.2 million in long-term debt associated with trust preferred securities. During the third quarter of 2013, we prepaid and redeemed $1.65 million in subordinated debt. Borrowed funds totaled $134.7 million at December 31, 2012; including $91.8 million of Federal Home Loan Bank advances, $41.2 million in long-term debt associated with trust preferred securities and $1.65 million in subordinated debt. Borrowed funds decreased by $3.5 million in 2013 as a result of an annual payment on an amortizing Federal Home Loan Bank advance in the first quarter of 2013 and the prepayment and redemption of subordinated debt in the third quarter of 2013.

During the second quarter of 2013, we modified the terms of six of our existing FHLB advances (totaling $60.0 million) having the effect of extending the weighted average maturity for all outstanding advances from 3.22 years to 4.86 years and reducing the weighted average interest rate from 1.95% to 1.94%. As the modifications did not result in the terms being substantially different (as defined in ASC 470-50-40-10), the transaction was accounted for as a modification, not extinguishment of debt. Accordingly, the prepayment fees that were incurred are amortized as an adjustment of the yield over the remaining life of each advance.

The Company has outstanding $40.0 million aggregate liquidation amount of pooled trust preferred securities ("TRUPs") issued through its wholly-owned subsidiary grantor trusts, Macatawa Statutory Trust I (issued $20.0 million aggregate liquidation amount with floating interest rate of three-month LIBOR plus 3.05%) and Macatawa Statutory Trust II (issued $20.0 million aggregate liquidation amount with a floating interest rate of three-month LIBOR plus 2.75%). In December 2009, the Company exercised its right to defer interest payments on the TRUPs for 20 consecutive quarters or until such earlier time as is determined by further action of the Board of Directors. Through June 30, 2013, the Company had deferred interest payments on the TRUPs for 15 quarters. In the second half of 2013, we discontinued the deferral and resumed regular payment of quarterly interest payments on our trust preferred securities and paid all accrued and unpaid interest that had been previously deferred and became due and payable upon the discontinuance of the deferral. For Macatawa Statutory Trust I, a total of $3.0 million, representing all of the deferred and current interest payment due was distributed on September 30, 2013. For Macatawa Statutory Trust II, a total of $2.7 million, representing all of the deferred and current interest payment due was distributed on October 7, 2013.

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In 2009, the Company received proceeds of $1,650,000 from the issuance of unsecured subordinated debt in the form of 11% subordinated notes due in 2017. On August 13, 2013, the Company prepaid and redeemed all of the subordinated notes for $1,650,000 plus interest accrued through the prepayment date.

Information regarding our off-balance sheet commitments may be found in Item 8 of this report in Note 15 to the Consolidated Financial Statements.

CAPITAL RESOURCES

Total shareholders' equity of $132.5 million at December 31, 2013 increased $2.0 million from $130.5 million at December 31, 2012. The increase was primarily a result of net income of $9.5 million earned in 2013, offset in part by payout of $4.7 million in cash pursuant to the exchange of Series A and Series B Preferred Stock completed on December 30, 2013 and unrealized losses of $2.9 million on securities available for sale during 2013 due to changes in interest rates, particularly in the second half of 2013.

Our regulatory capital ratios (on a consolidated basis) improved in 2013 and ended at the highest year-end levels in the Company’s history. The Bank was categorized as “well capitalized” at December 31, 2013. The following table shows our regulatory capital ratios (on a consolidated basis) for the past five years.

	December 31,				
	2013	2012	2011	2010	2009
Total capital to risk weighted assets	15.7%	15.0%	13.2%	9.7 %	9.2 %
Tier 1 capital to average assets	10.6	10.4	8.3	5.8	6.0

On December 30, 2013, we completed the cancellation and exchange (the “Exchange”) of each share of issued and outstanding Series A and Series B Preferred Stock for shares of Company stock and, at the election of the holder, cash. Pursuant to the Exchange, we canceled and exchanged each share of Preferred Stock for shares of Company common stock, no par value, in an amount equal to $1,000, the preferred stocks’ liquidation preference amount, divided by $5.25 plus, at the election of the holder, an amount of cash equal to $142.00, in the case of Series A Preferred Stock, or $182.00, in the case of Series B Preferred Stock, or a number of shares of Company common stock equal to this cash amount divided by $5.25. The one-time cash payments approximated a 5.0% and 4.5% dividend rate for the Series A and Series B, respectively, after considering previous dividends paid. The Exchange resulted in cash payments of $4.4 million for the Series A Preferred Stock and $319,000 for Series B Preferred Stock. Under the accounting guidance, the cash payments were recorded as a reduction to common stock, rather than retained earnings, as we had a retained deficit at December 30, 2013.

In addition to the cash payment discussed above, the Exchange resulted in the issuance of 5,973,519 shares of Company common stock in exchange for the Series A Preferred Stock and 457,159 shares in exchange for the Series B Preferred Stock. The total of the fair value of the new common shares issued and the $4.7 million cash payment exceeded the fair value of the securities issuable according to the original conversion terms by $17.6 million, which amount is reflected as a reduction of net income available to common shares in the computation of earnings per share for the year ended December 31, 2013.

We expect to assess our ability to resume the payment of dividends on our common stock if and when current levels of cash, earnings and capital are at acceptable levels and the prospects are positive for sustained economic growth and improved performance. The declaration and payment of future dividends to common shareholders will be considered by the Board of Directors in its discretion and will depend on a number of factors, including our financial condition and anticipated profitability.

All of the $40.0 million of trust preferred securities outstanding at December 31, 2013 qualified as Tier 1 capital. Our regulatory capital ratios have increased each quarter since March 31, 2010 through June 30, 2013 due to declines in risk weighted assets, positive earnings for each quarter and the stock offering completed in the second quarter of 2011.

Capital sources include, but are not limited to, additional private and public common stock offerings, preferred stock offerings and subordinated debt.

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On July 3, 2013, the FDIC Board of Directors approved the Regulatory Capital Interim Final Rule, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. Banks are required to transition into the new rule beginning on January 1, 2015. Based on our capital levels and balance sheet composition at December 31, 2013, we believe implementation of the new rule will have no material impact on our capital needs.

Macatawa Bank:

The Bank was categorized as "well capitalized" at December 31, 2013 and 2012. The following table shows the Bank's regulatory capital ratios for the past five years.

	December 31,				
	2013	2012	2011	2010	2009
Average equity to average assets	11.2%	9.2 %	7.8 %	6.7 %	8.0 %
Total risk-based capital	15.4	14.5	12.5	9.7	9.1
Tier 1 risk-based capital	14.2	13.3	11.2	8.4	7.8
Tier 1 capital to average assets	10.5	10.3	8.4	7.1	6.6

LIQUIDITY

Liquidity of Macatawa Bank: The liquidity of a financial institution reflects its ability to manage a variety of sources and uses of funds. Our Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus on developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for our investment and loan portfolios. Our sources of liquidity include our borrowing capacity with the FRB's discount window, the Federal Home Loan Bank, federal funds purchased lines of credit and other secured borrowing sources with our correspondent banks, loan payments by our borrowers, maturity and sales of our securities available for sale, growth of our deposits, federal funds sold and other short-term investments, and the various capital resources discussed above.

Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds. Our liquidity management involves periodic monitoring of our assets considered to be liquid and illiquid, and our funding sources considered to be core and non-core and short-term (less than 12 months) and long-term. We have established parameters that monitor, among other items, our level of liquid assets to short-term liabilities, our level of non-core funding reliance and our level of available borrowing capacity. We maintain a diversified wholesale funding structure and actively manage our maturing wholesale sources to reduce the risk to liquidity shortages. We have also developed a contingency funding plan to stress test our liquidity requirements arising from certain events that may trigger liquidity shortages, such as rapid loan growth in excess of normal growth levels or the loss of deposits and other funding sources under extreme circumstances.

We have actively pursued initiatives to further strengthen our liquidity position. The Bank reduced its reliance on non-core funding sources, including brokered deposits, and focused on achieving a non-core funding dependency ratio below its peer group average. We have had no brokered deposits on our balance sheet since December 2011. We also reduced other borrowed funds by $56.8 million in 2012 and by $1.8 million in 2013. We continue to maintain significant on-balance sheet liquidity. At December 31, 2013, the Bank held $118.2 million of federal funds sold and other short-term investments and $25.0 million in time deposits with other financial institutions with maturities of less than 18 months. In addition, the Bank's available borrowing capacity from correspondent banks has been improved and was approximately $186.5 million as of December 31, 2013.

In the normal course of business, we enter into certain contractual obligations, including obligations which are considered in our overall liquidity management.

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The table below summarizes our significant contractual obligations at December 31, 2013.

(Dollars in thousands)	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long term debt	$---	$---	$---	$41,238
Time deposit maturities	84,591	55,998	7,636	---
Other borrowed funds	1,884	23,934	54,173	10,000
Total	$86,475	$79,932	$61,809	$51,238

In addition to normal loan funding, we also maintain liquidity to meet customer financing needs through unused lines of credit, unfunded loan commitments and standby letters of credit. The level and fluctuation of these commitments is also considered in our overall liquidity management. At December 31, 2013, we had a total of $313.2 million in unused lines of credit, $87.5 million in unfunded loan commitments and $10.8 million in standby letters of credit.

Liquidity of Holding Company: The primary sources of liquidity for the Company are dividends from the Bank, existing cash resources and the various capital resources discussed above. Banking regulations and the laws of the State of Michigan in which our Bank is chartered limit the amount of dividends the Bank may declare and pay to the Company in any calendar year. Under the state law limitations, the Bank is restricted from paying dividends to the Company in excess of retained earnings. From 2010 through the third quarter of 2013, the Company had not received dividends from the Bank, and the Company has suspended payment of dividends on its common and preferred stock. With the release of the Bank's MOU by its regulators effective April 12, 2013, the Bank is no longer required to obtain prior regulatory approval to pay dividends to the Company. In December 2013, the Bank paid a dividend of $5.0 million to the Company in anticipation of the preferred stock exchange transaction. The Company paid a total of $4.8 million, including transaction expenses, in cash as a result of the preferred stock exchange transaction. At December 31, 2013, the Bank had a retained earnings balance of approximately $9.5 million.

The Company continued to suspend payments of cash dividends on its preferred stock during 2010, 2011, 2012 and through the third quarter of 2013. During the period that the Company does not declare and pay cash dividends on its preferred stock, it may not declare and pay cash dividends on its common stock. With the completion of the preferred stock exchange transaction, this restriction on payment of cash dividends on Company common stock has been removed.

The Company has the right to defer interest payments for 20 consecutive quarters on its trust preferred securities if necessary for liquidity purposes. During any deferral period, the Company may not declare or pay any dividends on its common stock or preferred stock or make any payment on any outstanding debt obligations that rank equally with or junior to the trust preferred securities.

The Company's cash balance at December 31, 2013 was $1.9 million. In accordance with the Company's tax allocation agreement with the Bank, in the first quarter of 2014, the Bank will pay the Company approximately $1.3 million to settle the intercompany tax positions for the 2013 tax year. The Company believes it has sufficient liquidity to meet its cash flow requirements.

CRITICAL ACCOUNTING POLICIES AND 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 future results could differ. The allowance for loan losses, other real estate owned valuation, loss contingencies and income taxes are deemed critical due to the

required level of management judgment and the use of estimates, making them particularly subject to change.

Our methodology for determining the allowance for loan losses and the related provision for loan losses is described above in the "Allowance for Loan Losses" discussion. This area of accounting requires significant judgment due to the number of factors which can influence the collectability of a loan. Unanticipated changes in these factors could significantly change the level of the allowance for loan losses and the related provision for loan losses. Although, based upon our internal analysis, and in our judgment, we believe that we have provided an adequate allowance for loan losses, there can be no assurance that our analysis has properly identified all of the probable losses in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different than the levels that we recorded in 2013.

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Assets acquired through or instead of foreclosure, primarily other real estate owned, are initially recorded at fair value less estimated costs to sell when acquired, establishing a new cost basis. New real estate appraisals are generally obtained at the time of foreclosure and are used to establish fair value. If fair value declines, a valuation allowance is recorded through expense. Estimating the initial and ongoing fair value of these properties involves a number of factors and judgments including holding time, costs to complete, holding costs, discount rate, absorption and other factors.

Loss contingencies are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. This, too, is an accounting area that involves significant judgment. Although, based upon our judgment, internal analysis, and consultations with legal counsel we believe that we have properly accounted for loss contingencies, future changes in the status of such contingencies could result in a significant change in the level of contingent liabilities and a related impact to operating earnings.

Our accounting for income taxes involves the valuation of deferred tax assets and liabilities primarily associated with differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. At December 31, 2013, we had gross deferred tax assets of $18.5 million and gross deferred tax liabilities of $2.3 million resulting in a net deferred tax asset of $16.2 million. Accounting standards require that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. From mid 2009 through the end of 2012, we had maintained a full valuation allowance on our net deferred tax asset. At December 31, 2012, we considered all reasonably available positive and negative evidence and determined that with completing our eleventh consecutive profitable quarter, continued significant improvement in asset quality measures for the third straight year, the termination of our previous regulatory orders and our moving to a cumulative income position in the most recent three year period, that it was “more likely than not” that we will be able to realize our deferred tax assets and, as such, the full $18.9 million valuation allowance was reversed as of December 31, 2012. With the positive results in 2013, we concluded at December 31, 2013 that no valuation allowance on our net deferred tax asset was required. Changes in tax laws, changes in tax rates, changes in ownership and our future level of earnings can impact the ultimate realization of our net deferred tax asset.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Macatawa Bank has only limited agricultural-related loan assets, and therefore has no significant exposure to changes in commodity prices.

Our balance sheet has sensitivity, in various categories of assets and liabilities, to changes in prevailing rates in the U.S. for prime rate, mortgage rates, U.S. Treasury rates and various money market indexes. Our asset/liability management process aids us in providing liquidity while maintaining a balance between interest earning assets and interest bearing liabilities.

We utilize a simulation model as our primary tool to assess the direction and magnitude of variations in net interest income and the economic value of equity (“EVE”) resulting from potential changes in market interest rates. Key assumptions in the model include contractual cash flows and maturities of interest-sensitive assets and interest-sensitive liabilities, prepayment speeds on certain assets, and changes in market conditions impacting loan and deposit pricing. We also include pricing floors on discretionary priced liability products which limit how low various checking and savings products could go under declining interest rates. These floors reflect our pricing philosophy in response to changing interest rates.

We forecast the next twelve months of net interest income under an assumed environment of gradual changes in market interest rates under various scenarios. The resulting change in net interest income is an indication of the sensitivity of our earnings to directional changes in market interest rates. The simulation also measures the change in EVE, or the net present value of our assets and liabilities, under an immediate shift, or shock, in interest rates under various scenarios, as calculated by discounting the estimated future cash flows using market-based discount rates.

The following table shows the impact of changes in interest rates on net interest income over the next twelve months and EVE based on our balance sheet as of December 31, 2013 (dollars in thousands).

Interest Rate Scenario	Economic Value of Equity	Percent Change	Net Interest Income	Percent Change
Interest rates up 200 basis points	$150,284	(1.10)%	$42,765	3.00 %
Interest rates up 100 basis points	153,006	0.69	42,155	1.53
No change	151,958	---	41,520	---
Interest rates down 100 basis points	146,825	(3.38)	41,435	(0.20)
Interest rates down 200 basis points	148,534	(2.25)	41,151	(0.89)

If interest rates were to increase, this analysis suggests that we are positioned for an improvement in net interest income over the next twelve months.

We also forecast the impact of immediate and parallel interest rate shocks on net interest income under various scenarios to measure the sensitivity of our earnings under extreme conditions.

The quarterly simulation analysis is monitored against acceptable interest rate risk parameters by the Asset/Liability Committee and reported to the Board of Directors.

In addition to changes in interest rates, the level of future net interest income is also dependent on a number of other variables, including: the growth, composition and absolute levels of loans, deposits, and other earning assets and

interest-bearing liabilities; economic and competitive conditions; potential changes in lending, investing and deposit gathering strategies; and client preferences.

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ITEM 8: Financial Statements and Supplementary Data.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Macatawa Bank Corporation
Holland, Michigan

We have audited the accompanying consolidated balance sheets of Macatawa Bank Corporation as of December 31, 2013 and 2012 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Macatawa Bank Corporation at December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Macatawa Bank Corporation's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 20, 2014 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Grand Rapids, Michigan
February 20, 2014

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MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(Dollars in thousands, except per share data)

	2013	2012
ASSETS		
Cash and due from banks	$38,714	$33,556
Federal funds sold and other short-term investments	118,178	192,802
Cash and cash equivalents	156,892	226,358
Interest-bearing time deposits in other financial institutions	25,000	---
Securities available for sale, at fair value	139,659	123,497
Securities held to maturity (fair value 2013 - $19,278 and 2012 - $4,301)	19,248	4,300
Federal Home Loan Bank (FHLB) stock	11,236	11,236
Loans held for sale, at fair value	1,915	8,130
Total loans	1,042,377	1,052,348
Allowance for loan losses	(20,798)	(23,739)
Net loans	1,021,579	1,028,609
Premises and equipment – net	53,641	53,576
Accrued interest receivable	3,231	3,411
Bank-owned life insurance	27,517	26,804
Other real estate owned	36,796	51,582
Net deferred tax asset	16,200	18,780
Other assets	4,491	4,435
Total assets	$1,517,405	$1,560,718
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$344,550	$339,520
Interest-bearing	905,184	946,741
Total deposits	1,249,734	1,286,261
Other borrowed funds	89,991	91,822
Long-term debt	41,238	41,238
Subordinated debt	---	1,650
Accrued expenses and other liabilities	3,920	9,240
Total liabilities	1,384,883	1,430,211
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 31,290 shares issued and outstanding at December 31, 2012	---	30,604
Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,600 shares issued and outstanding at December 31, 2012	---	2,560
Common stock, no par value, 200,000,000 shares authorized; 33,801,097 shares issued and outstanding at December 31, 2013 and 27,203,825 shares issued and outstanding at December 31, 2012	216,263	187,718
Retained deficit	(81,786)	(91,335)

Accumulated other comprehensive income (loss)	(1,955)	960
Total shareholders' equity	132,522	130,507
Total liabilities and shareholders' equity	$1,517,405	$1,560,718

See accompanying notes to consolidated financial statements

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2013, 2012 and 2011
(Dollars in thousands, except per share data)

	2013	2012	2011
Interest income			
Loans, including fees	$45,201	$54,549	$59,334
Securities			
Taxable	1,798	1,544	497
Tax-exempt	742	330	38
FHLB Stock	393	351	294
Federal funds sold and other short-term investments	486	502	616
Total interest income	48,620	57,276	60,779
Interest expense			
Deposits	3,993	5,721	9,273
Other borrowings	1,781	2,374	3,609
Subordinated and long-term debt	1,563	1,719	1,598
Total interest expense	7,337	9,814	14,480
Net interest income	41,283	47,462	46,299
Provision for loan losses	(4,250)	(7,100)	(4,700)
Net interest income after provision for loan losses	45,533	54,562	50,999
Noninterest income			
Service charges and fees	3,963	3,323	3,692
Net gains on mortgage loans	2,554	2,882	1,728
Trust fees	2,413	2,389	2,543
ATM and debit card fees	4,325	4,130	3,963
Gain on sales of securities	120	73	---
Other	2,766	2,831	2,966
Total noninterest income	16,141	15,628	14,892
Noninterest expense			
Salaries and benefits	23,012	22,986	22,217
Occupancy of premises	3,756	3,815	3,949
Furniture and equipment	3,224	3,259	3,318
Legal and professional	680	664	971
Marketing and promotion	870	929	834
Data processing	1,351	1,268	1,284
FDIC assessment	1,458	2,196	3,472
ATM and debit card processing	1,300	1,222	1,206
Bond and D&O Insurance	740	909	1,512
FHLB Advance prepayment penalty	---	322	---
Losses on repossessed and foreclosed properties	1,825	5,295	8,371
Administration and disposition of problem assets	3,699	4,665	7,230
Other	5,940	5,753	5,698
Total noninterest expenses	47,855	53,283	60,062
Income before income tax	13,819	16,907	5,829
Income tax expense (benefit)	4,270	(18,583)	---
Net income	$9,549	$35,490	$5,829

Effect of induced exchange of preferred stock	17,575	---	---
Net income (loss) available to common shares	$(8,026)	$35,490	$5,829
Basic earnings (loss) per common share	$(0.29)	$1.31	$0.26
Diluted earnings (loss) per common share	$(0.29)	$1.31	$0.26
Cash dividends per common share	$---	$---	$---

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2013, 2012 and 2011
(Dollars in thousands)

	2013	2012	2011
Net income	$9,549	$35,490	$5,829
Other comprehensive income (loss):			
Unrealized gains (losses):			
Net change in unrealized gains (losses) on securities available for sale	(4,365)	968	565
Tax effect	1,528	(339)	(198)
Net change in unrealized gains (losses) on securities available for sale, net of tax	(2,837)	629	367
Less: reclassification adjustments:			
Reclassification for gains included in net income	120	73	---
Tax effect	(42)	(26)	---
Reclassification for gains included in net income, net of tax	78	47	---
Other comprehensive income (loss), net of tax	(2,915)	582	367
Comprehensive income	$6,634	$36,072	$6,196

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2013, 2012 and 2013
(Dollars in thousands, except per share data)

	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2011	$30,604	$2,560	$167,321	$(132,654)	$ 11	$ 67,842
Net income				5,829		5,829
Net change in unrealized gain (loss) on securities available for sale, net of tax					367	367
Net proceeds from sale of 8,912,372 shares of common stock on June 7, 2011 and June 29, 2011			19,319			19,319
Conversion of subordinated note to 491,830 shares of common stock on June 29, 2011			1,003			1,003
Stock compensation expense			66			66
Balance, December 31, 2011	30,604	2,560	187,709	(126,825)	378	94,426
Net income				35,490		35,490
Net change in unrealized gain (loss) on securities available for sale, net of tax					582	582
Stock compensation expense			9			9
Balance, December 31, 2012	30,604	2,560	187,718	(91,335)	960	130,507
Net income				9,549		9,549
Conversion of 300 shares of Preferred Stock Series B to 50,000 shares of common stock		(300)	300			---
Preferred stock exchange:						
Exchange of 31,290 shares of Preferred Stock Series A to 5,973,519 shares of common stock	(30,604)		30,604			---
Exchange of 2,300 shares of Preferred Stock Series B to 457,159 shares of common stock		(2,260)	2,260			---
Cash portion of exchange consideration, including exchange-related expenses			(4,734)			(4,734)
Net change in unrealized gain (loss) on securities available for sale, net of tax					(2,915)	(2,915)
Repurchase of 8,906 shares for taxes withheld on vested restricted stock			(45)			(45)
Stock compensation expense			160			160
Balance, December 31, 2013	$---	$---	$216,263	$(81,786)	$ (1,955)	$ 132,522

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013, 2012 and 2011
(Dollars in thousands)

	2013	2012	2011
Cash flows from operating activities			
Net income	$9,549	$35,490	$5,829
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	3,067	2,970	3,117
Stock compensation expense	160	9	66
Provision for loan losses	(4,250)	(7,100)	(4,700)
Origination of loans for sale	(107,988)	(140,151)	(84,470)
Proceeds from sales of loans originated for sale	116,757	135,929	87,709
Net gains on mortgage loans	(2,554)	(2,882)	(1,728)
Gain on sales of securities	(120)	(73)	---
Write-down of other real estate	2,922	5,236	9,879
Net (gain) loss on sales of other real estate	(1,098)	59	(1,515)
Loss on disposal of fixed assets	---	89	---
Decrease (increase) in net deferred tax asset	4,150	(18,858)	---
FHLB advance prepayment penalty	---	322	---
Decrease (increase) in accrued interest receivable and other assets	124	2,149	(1,980)
Earnings in bank-owned life insurance	(713)	(847)	(943)
Increase (decrease) in accrued expenses and other liabilities	(3,694)	1,153	889
Net cash from operating activities	16,312	13,495	12,153
Cash flows from investing activities			
Loan originations and payments, net	7,741	8,657	96,778
Change in interest-bearing deposits in other financial institutions	(25,000)	---	---
Purchases of securities available for sale	(42,594)	(115,248)	(72,944)
Purchases of securities held to maturity	(19,732)	(4,000)	(300)
Proceeds from:			
Maturities and calls of securities available for sale	13,159	40,042	27,495
Sales of securities available for sale	5,241	4,595	---
Principal paydowns on securities	6,100	3,884	273
Redemption of FHLB stock	---	---	696
Sales of other real estate	16,501	18,729	21,540
Additions to premises and equipment	(2,407)	(707)	(1,031)
Net cash from investing activities	(40,991)	(44,048)	72,507
Cash flows from financing activities			
Change in in-market deposits	(36,527)	70,972	(13,159)
Decrease in brokered deposits	---	---	(48,172)
Proceeds from other borrowed funds	---	---	10,000
Proceeds from issuance of subordinated note	---	---	1,000
Repayments of other borrowed funds and subordinated debt	(3,481)	(57,103)	(46,733)
Repurchase shares for taxes withheld on vested restricted stock	(45)	---	---
Cash paid in preferred stock exchange	(4,734)	---	---
Proceeds from sale of common stock, net	---	---	19,319

Net cash from financing activities	(44,787)	13,869	(77,745)
Net change in cash and cash equivalents	(69,466)	(16,684)	6,915
Cash and cash equivalents at beginning of period	226,358	243,042	236,127
Cash and cash equivalents at end of period	$156,892	$226,358	$243,042

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
Years ended December 31, 2013, 2012 and 2011
(Dollars in thousands)

	2013	2012	2011
Supplemental cash flow information			
Interest paid	$11,886	$8,473	$13,364
Income taxes paid	120	275	---
Supplemental noncash disclosures:			
Transfers from loans to other real estate	3,539	9,168	38,358
Security settlement	1,626	1,626	---
Conversion of subordinated note to 491,830 shares of common stock	---	---	1,003
Conversion of 300 shares of Preferred Series B to 50,000 shares of common stock	300	---	---
Exchange of 31,290 shares of Preferred Series A to 5,973,519 shares of common stock	30,604	---	---
Exchange of 2,300 shares of Preferred Series B to 457,159 shares of common stock	2,260	---	---

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Macatawa Bank Corporation ("Macatawa" or the "Company") 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 securities of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are discussed in a separate note. Under generally accepted accounting principles, these trusts are not consolidated into the financial statements of the Company.

Regulatory Developments:

On April 12, 2013, the Federal Deposit Insurance Corporation (“FDIC”) and the Michigan Department of Insurance and Financial Services (“DIFS”), the primary banking regulators of the Bank, notified the Bank that the Bank’s Memorandum of Understanding (“MOU”) with the FDIC and DIFS had served its purpose and was released. As a result, the Bank is no longer subject to any regulatory order, memorandum of understanding or other similar regulatory directive or proceeding and has returned to a normal regulatory operating environment.

In connection with the termination of the Company’s Written Agreement by the Federal Reserve Bank of Chicago (“FRB”) on October 26, 2012, the Board of Directors of the Company adopted a resolution (the “Board Resolution”) requiring the Company to obtain written approval from the FRB before declaring or paying any dividends, increasing holding company debt, or redeeming any capital stock. By letter dated August 1, 2013, the FRB advised the Company that, based on the overall satisfactory condition of the organization, the FRB poses no objection should the Board of Directors choose to rescind the Board Resolution. Accordingly, the Company's Board of Directors rescinded the Board Resolution as of August 1, 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.

Concentration of Credit Risk: Loans are granted to, and deposits are obtained from, customers primarily in the western Michigan area as described above. Substantially all loans are secured by specific items of collateral, including residential real estate, commercial real estate, commercial assets and consumer assets. Commercial real estate loans are the largest concentration, comprising 45% of total loans. Commercial and industrial loans total 26%, while residential real estate and consumer loans make up the remaining 28%. Other financial instruments, which potentially subject the Company to concentrations of credit risk, include deposit accounts in other financial institutions.

Cash Flow Reporting: Cash and cash equivalents include cash on hand, demand deposits with other financial institutions and short-term securities (securities with maturities equal to or less than 90 days and federal funds sold). Cash flows are reported net for customer loan and deposit transactions, interest-bearing time deposits with other financial institutions and short-term borrowings with maturities of 90 days or less.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities available for sale consist of those securities which might be sold prior to maturity due to changes in interest rates, prepayment risks, yield and availability of alternative investments, liquidity needs or other factors. Securities classified as available for sale are reported at their fair value and the related unrealized holding gain or loss is reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level yield method without anticipating prepayments. Gains and losses on sales are based on the amortized cost of the security sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under ASC Topic 320, Investments — Debt and Equity Instruments.

In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. Management has determined that no OTTI charges were necessary during 2013, 2012 and 2011.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value. Management has determined that there is no impairment of FHLB stock. Both cash and stock dividends are reported as income.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors. As of December 31, 2013 and 2012, these loans had a net unrealized gain of $42,000 and $195,000, respectively, which are reflected in their carrying value. Changes in fair value of loans held for sale are included in net gains on mortgage loans. Loans are sold servicing released; therefore no mortgage servicing right assets are established.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs and an allowance for loan losses.

Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income over the respective term of the loan using the level yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management believed the estimated allowance for loan losses 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 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.

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 environmental factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class as well as the loan risk grade assignment for commercial loans. At December 31, 2013, an 18 month (six quarter) annualized historical loss experience was used for commercial loans and a 12 month (four quarter) historical loss experience period was applied to residential mortgage and consumer loan portfolios. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative environmental 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 for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

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 so that the loan is reported, net, 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, accordingly, 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.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 15 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank-Owned Life Insurance (BOLI): The Bank has purchased life insurance policies on certain officers. Bank-owned life insurance is recorded at its currently realizable cash surrender value. Changes in cash surrender value are recorded in other income.

Goodwill and Acquired Intangible Assets: Goodwill resulting from business combinations represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. The Company had no goodwill at December 31, 2013 and 2012.

Acquired intangible assets consist of core deposit and customer relationship intangible assets arising from acquisitions. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives, which range from ten to sixteen years. The Company had a core deposit intangible asset with a balance of $64,000 at December 31, 2011 which was fully amortized at December 31, 2013 and 2012.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Mortgage Banking Derivatives: Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as derivatives not qualifying for hedge accounting. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. At times, the Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its commitments to fund the loans.

Changes in the fair values of these interest rate lock and forward commitment derivatives are included in net gains on mortgage loans. The net fair value of mortgage banking derivatives was approximately $51,000 and $15,000 at December 31, 2013 and 2012, respectively.

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 December 31, 2013, the total notional amount of such agreements was $20.0 million and resulted in a derivative asset with a fair value of $94,000 which was included in other assets and a derivative liability of $94,000 which was included in other liabilities.

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.

The Company recognizes 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.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Common Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. All outstanding unvested restricted stock awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options and the conversion of the Company's convertible preferred stock (for periods before the fourth quarter of 2013 when the convertible preferred stock was exchanged for common stock). In the event of a net loss, our unvested restricted stock awards are excluded from both basic and diluted earnings per share.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank of $4,417,000 and $4,534,000 at December 31, 2013 and 2012, respectively, was required to meet regulatory reserve and clearing requirements.

Stock Splits and Dividends: Stock dividends in excess of 20% are reported by transferring the par value of the stock issued from retained earnings to common stock. Stock dividends for 20% or less are reported by transferring the fair value, as of the ex dividend date, of the stock issued from retained earnings to common stock and additional paid in capital. Fractional share amounts are paid in cash with a reduction in retained earnings. All share and per share amounts are retroactively adjusted for stock splits and dividends.

Dividend Restriction: Banking regulations require maintaining certain capital levels and impose limitations on dividends paid by the Bank to the Company and by the Company to shareholders.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed separately. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on-and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

Segment Reporting: The Company, through the branch network of the Bank, provides a broad range of financial services to individuals and companies in western Michigan. These services include demand, time and savings deposits; lending; ATM and debit card processing; cash management; and trust and brokerage services. While the Company's management team monitors the revenue streams of the various Company products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company's banking operations are considered by management to be aggregated in one operating segment – commercial banking.

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards: The Financial Accounting Standards Board ("FASB") has issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU is intended to improve the reporting of reclassifications out of accumulated other comprehensive income. The ASU requires an entity to report, either on the face of the statement where net income is presented or in the notes to the financial statements, the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in their entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments in this ASU apply to all entities that issue financial statements that are presented in conformity with U.S. GAAP and that report items of other comprehensive income. For public entities, the amendments in this ASU are effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted this ASU on January 1, 2013 by including the required disclosures in Note 2 to the consolidated financial statements.

Newly Issued Not Yet Effective Standards: 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.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 – SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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				
State and municipal bonds	$19,248	$ 46	$ (16)	$19,278
2012				
Available for Sale:				
U.S. Treasury and federal agency securities	$42,245	$ 340	$ (21)	$42,564
U. S. Agency MBS and CMOs	23,495	272	(6)	23,761
Tax-exempt state and municipal bonds	20,598	244	(49)	20,793
Taxable state and municipal bonds	26,726	619	(49)	27,296
Corporate bonds	7,456	77	(7)	7,526
Other equity securities	1,500	57	---	1,557
	$122,020	$ 1,609	$ (132)	$123,497
Held to Maturity:				
State and municipal bonds	$4,300	$ 1	$ ---	$4,301

Proceeds from the sale of securities available for sale were $5.2 million and $4.6 million, respectively, for the years ended December 31, 2013 and 2012, resulting in net gains on sale of $120,000 and $73,000, respectively, as reported in the consolidated statements of income. This resulted in reclassifications of $120,000 ($78,000 net of tax) and $73,000 ($47,000 net of tax) respectively, from accumulated other comprehensive income to gain on sale of securities in the consolidated statements of income in years ended December 31, 2013 and 2012. There were no sales of securities in 2011.

Contractual maturities of debt securities at December 31, 2013 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	$12,655	$12,676	$7,891	$7,956

Due from one to five years	625	624	57,365	57,312
Due from five to ten years	5,688	5,693	49,436	47,600
Due after ten years	280	285	26,475	25,325
	$19,248	$19,278	$141,167	$138,193

NOTE 2 – SECURITIES (Continued)

Securities with unrealized losses at December 31, 2013 and 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
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)

	Less than 12 Months		12 Months or More		Total	
December 31, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$10,977	$ (21)	$---	$ ---	$10,977	$ (21)
U.S. Agency MBS and CMOs	3,373	(6)	---	---	3,373	(6)
Tax-exempt state and municipal bonds	4,613	(49)	---	---	4,613	(49)
Taxable state and municipal bonds	4,661	(49)	---	---	4,661	(49)
Corporate bonds	3,945	(7)	---	---	3,945	(7)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$27,569	$ (132)	$---	$ ---	$27,569	$ (132)

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during 2013, 2012 and 2011.

Securities with a carrying value of approximately $1.0 million and $7.4 million were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law at December 31, 2013 and 2012, respectively.

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NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	December 31, 2013	December 31, 2012
Commercial and industrial	$274,099	$259,700
Commercial real estate:		
Residential developed	18,130	26,090
Unsecured to residential developers	7,315	5,547
Vacant and unimproved	42,988	56,525
Commercial development	2,434	1,799
Residential improved	76,294	75,813
Commercial improved	247,195	255,738
Manufacturing and industrial	77,984	81,447
Total commercial real estate	472,340	502,959
Consumer		
Residential mortgage	188,648	182,625
Unsecured	1,337	1,683
Home equity	95,961	92,764
Other secured	9,992	12,617
Total consumer	295,938	289,689
Total loans	1,042,377	1,052,348
Allowance for loan losses	(20,798)	(23,739)
	$1,021,579	$1,028,609

NOTE 3 – LOANS (Continued)

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2013, 2012 and 2011 (dollars in thousands):

2013	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,459	$ 13,457	$ 3,787	$ 36	$ 23,739
Charge-offs	(317)	(1,065)	(822)	---	(2,204)
Recoveries	1,134	2,141	238	---	3,513
Provision for loan losses	(1,102)	(3,665)	500	17	(4,250)
Ending Balance	$ 6,174	$ 10,868	$ 3,703	$ 53	$ 20,798

2012	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,313	$ 20,475	$ 4,821	$ 32	$ 31,641
Charge-offs	(1,245)	(3,206)	(3,045)	---	(7,496)
Recoveries	547	5,840	307	---	6,694
Provision for loan losses	844	(9,652)	1,704	4	(7,100)
Ending Balance	$ 6,459	$ 13,457	$ 3,787	$ 36	$ 23,739

2011	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,012	$ 34,973	$ 5,415	$ 26	$ 47,426
Charge-offs	(2,935)	(10,981)	(2,535)	---	(16,451)
Recoveries	1,727	3,343	296	---	5,366
Provision for loan losses	509	(6,860)	1,645	6	(4,700)
Ending Balance	$ 6,313	$ 20,475	$ 4,821	$ 32	$ 31,641

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):

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

December 31, 2012:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 2,920	$ 2,418	$ 716	$ ---	$ 6,054
Collectively evaluated for impairment	3,539	11,039	3,071	36	17,685
Total ending allowance balance	$ 6,459	$ 13,457	$ 3,787	$ 36	$ 23,739
Loans:					
Individually reviewed for impairment	$ 14,390	$ 54,831	$ 14,086	$ ---	$ 83,307
Collectively evaluated for impairment	245,310	448,128	275,603	---	969,041
Total ending loans balance	$ 259,700	$ 502,959	$ 289,689	$ ---	$ 1,052,348

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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):

	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

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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, 2012 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ 2,515	$ 2,512	$ ---
Commercial real estate:			
Residential developed	7,136	6,283	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	2,321	2,136	---
Commercial development	213	213	---
Residential improved	3,293	3,019	---
Commercial improved	7,268	6,127	---
Manufacturing and industrial	3,686	3,686	---
	23,917	21,464	---
Consumer:			
Residential mortgage	4,614	3,062	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	4,614	3,062	---
	$ 31,046	$ 27,038	$ ---
With an allowance recorded:			
Commercial and industrial	$ 11,878	$ 11,878	$ 2,920
Commercial real estate:			
Residential developed	1,524	1,524	337
Unsecured to residential developers	---	---	---
Vacant and unimproved	1,688	1,688	34
Commercial development	---	---	---
Residential improved	10,063	10,063	842
Commercial improved	15,386	15,386	1,071
Manufacturing and industrial	4,706	4,706	134
	33,367	33,367	2,418
Consumer:			
Residential mortgage	10,220	10,220	664
Unsecured	---	---	---
Home equity	804	804	52
Other secured	---	---	---

	11,024	11,024	716
	$ 56,269	$ 56,269	$ 6,054
Total	$ 87,315	$ 83,307	$ 6,054

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NOTE 3 – LOANS (Continued)

The following table presents information regarding average balances of impaired loans and interest recognized on impaired loans for the years ended December 31, 2013, 2012 and 2011 (dollars in thousands):

	2013	2012	2011
Average of impaired loans during the period:			
Commercial and industrial	$14,333	$14,928	$7,622
Commercial real estate:			
Residential developed	6,357	8,162	12,509
Unsecured to residential developers	---	---	559
Vacant and unimproved	2,804	3,851	5,710
Commercial development	398	216	407
Residential improved	11,549	13,192	9,721
Commercial improved	20,191	17,975	18,195
Manufacturing and industrial	6,305	9,125	7,335
Consumer	14,532	15,857	12,433
Interest income recognized during impairment:			
Commercial and industrial	1,278	1,291	464
Commercial real estate	1,974	2,736	2,039
Consumer	537	538	413
Cash-basis interest income recognized			
Commercial and industrial	1,273	1,295	536
Commercial real estate	1,971	2,740	1,997
Consumer	532	550	406

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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 December 31, 2013 and 2012:

December 31, 2013	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$ 5,625	$ ---
Commercial real estate:		
Residential developed	2,590	153
Unsecured to residential developers	---	---
Vacant and unimproved	---	---
Commercial development	23	---
Residential improved	429	---
Commercial improved	2,511	---
Manufacturing and industrial	---	---
	5,553	153
Consumer:		
Residential mortgage	639	---
Unsecured	33	---
Home equity	332	---
Other secured	---	---
	1,004	---
Total	$ 12,182	$ 153

December 31, 2012	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$ 7,657	$ ---
Commercial real estate:		
Residential developed	3,024	---
Unsecured to residential developers	---	---
Vacant and unimproved	706	---
Commercial development	2	196
Residential improved	1,159	---
Commercial improved	1,521	422
Manufacturing and industrial	225	---
	6,637	618
Consumer:		
Residential mortgage	447	---
Unsecured	19	---
Home equity	625	---
Other secured	---	---
	1,091	---

Total	$ 15,385	$ 618

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NOTE 3 – LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of December 31, 2013 by class of loans (dollars in thousands):

	30-90 Days	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	$---	$---	$---	$274,099	$274,099
Commercial real estate:					
Residential developed	143	2,296	2,439	15,691	18,130
Unsecured to residential developers	---	---	---	7,315	7,315
Vacant and unimproved	---	---	---	42,988	42,988
Commercial development	---	23	23	2,411	2,434
Residential improved	98	50	148	76,146	76,294
Commercial improved	438	2,056	2,494	244,701	247,195
Manufacturing and industrial	---	---	---	77,984	77,984
	679	4,425	5,104	467,236	472,340
Consumer:					
Residential mortgage	78	---	78	188,570	188,648
Unsecured	9	---	9	1,328	1,337
Home equity	317	---	317	95,644	95,961
Other secured	12	---	12	9,980	9,992
	416	---	416	295,522	295,938
Total	$1,095	$4,425	$5,520	$1,036,857	$1,042,377

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

	30-90 Days	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	$395	$219	$614	$259,086	$259,700
Commercial real estate:					
Residential developed	---	35	35	26,055	26,090
Unsecured to residential developers	---	---	---	5,547	5,547
Vacant and unimproved	17	652	669	55,856	56,525
Commercial development	---	199	199	1,600	1,799
Residential improved	520	192	712	75,101	75,813
Commercial improved	2,502	1,436	3,938	251,800	255,738
Manufacturing and industrial	200	25	225	81,222	81,447

	3,239	2,539	5,778	497,181	502,959
Consumer:					
Residential mortgage	647	110	757	181,868	182,625
Unsecured	---	---	---	1,683	1,683
Home equity	415	264	679	92,085	92,764
Other secured	59	---	59	12,558	12,617
	1,121	374	1,495	288,194	289,689
Total	$4,755	$3,132	$7,887	$1,044,461	$1,052,348

The Company had allocated $3,870,000 and $6,005,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings ("TDRs") as of December 31, 2013 and 2012, respectively. These loans involved the restructuring of terms to allow customers to mitigate the risk of foreclosure by meeting a lower loan payment requirement based upon their current cash flow. These may also include loans that renewed at existing contractual rates, but below market rates for comparable credit. The Company has been active at utilizing these programs and working with its customers to reduce the risk of foreclosure. For commercial loans, these modifications typically include an interest only period and, in some cases, a lowering of the interest rate on the loan. In some cases, the modification will include separating the note into two notes with the first note structured to be supported by current cash flows and collateral, and the second note made for the remaining unsecured debt. The second note is charged off immediately and collected only after the first note is paid in full. This modification type is commonly referred to as an A-B note structure. For consumer mortgage loans, the restructuring typically includes a lowering of the interest rate to provide payment and cash flow relief. For each restructuring, a comprehensive credit underwriting analysis of the borrower's financial condition and prospects of repayment under the revised terms is performed to assess whether the structure can be successful and that cash flows will be sufficient to support the restructured debt. An analysis is also performed to determine whether the restructured loan should be on accrual status. Generally, if the loan is on accrual at the time of restructure, it will remain on accrual after the restructuring. In some cases, a nonaccrual loan may be placed on accrual at the time of restructure if the loan's actual payment history demonstrates it would have cash flowed under the restructured terms. After six consecutive payments under the restructured terms, a nonaccrual restructured loan is reviewed for possible upgrade to accruing status.

Typically, once a loan is identified as a TDR, it will retain that designation until it is paid off, since the restructured loans generally are not at market rates at the time of restructuring. An exception to this would be a loan that is modified under an A-B note structure. If the remaining "A" note is at a market rate at the time of restructuring (taking into account the borrower's credit risk and prevailing market conditions), the loan can be removed from TDR designation in a subsequent calendar year after six months of performance in accordance with the new terms. The market rate relative to the borrower's credit risk is determined through analysis of market pricing information gathered from peers and use of a loan pricing model. The general objective of the model is to achieve a consistent return on equity from one credit to the next, taking into consideration their differences in credit risk. In the model, credits with higher risk receive a higher potential loss allocation, and therefore require a higher interest rate to achieve the target return on equity. In general, when a loan is removed from TDR status it would no longer be considered impaired. As a result, allowance allocations for loans removed from TDR status would be based on the historical based allocation for the applicable loan grade and loan class. During 2013, 2012 and 2011, no loans were removed from TDR status. Given the nature of the TDRs outstanding at December 31, 2013, it is unlikely that any such loans will be removed from TDR status in 2014.

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

The following table presents information regarding troubled debt restructurings as of December 31, 2013 and 2012 (dollars in thousands):

	December 31, 2013		December 31, 2012	
	Number of Loans	Outstanding Recorded Balance	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	43	$ 7,787	58	$ 14,485
Commercial real estate	122	45,774	142	49,936
Consumer	106	14,531	86	13,634
	271	$ 68,092	286	$ 78,055

NOTE 3 – LOANS (Continued)

The following table presents information regarding troubled debt restructurings executed during the year ended December 31, 2013 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Balance	Principal Writedown upon Modification
Commercial and industrial	5	$ 1,085	$ ---
Commercial real estate	13	4,298	---
Consumer	36	5,833	---
	54	$ 11,216	$ ---

The following table presents information regarding troubled debt restructurings executed during the year ended December 31, 2012 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Balance	Principal Writedown upon Modification
Commercial and industrial	16	$ 1,462	$ 9
Commercial real estate	52	15,413	332
Consumer	10	1,518	261
	78	$ 18,393	$ 602

The following table presents information regarding troubled debt restructurings executed during the year ended December 31, 2011 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Balance	Principal Writedown upon Modification
Commercial and industrial	95	$ 9,726	$ 570
Commercial real estate	106	44,122	961
Consumer	16	2,509	---
	217	$ 56,357	$ 1,531

According to the accounting standards, not all loan modifications are TDRs. TDRs are modifications or renewals where the Company has granted a concession to a borrower in financial distress. The Company reviews all modifications and renewals for determination of TDR status. In some situations a borrower may be experiencing financial distress, but the Company does not provide a concession. These modifications are not considered TDRs. In other cases, the Company might provide a concession, such as a reduction in interest rate, but the borrower is not experiencing financial distress. This could be the case if the Company is matching a competitor's interest rate. These modifications would also not be considered TDRs. Finally, any renewals at existing terms for borrowers not

experiencing financial distress would not be considered TDRs.

NOTE 3 – LOANS (Continued)

The following table presents information regarding modifications and renewals executed during the years ended December 31, 2013, 2012 and 2011 that are not considered TDRs (dollars in thousands):

	2013		2012		2011	
	Number of Loans	Outstanding Recorded Balance	Number of Loans	Outstanding Recorded Balance	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	485	$ 101,988	557	$ 138,174	584	$ 88,196
Commercial real estate	368	115,785	384	141,715	436	129,002
Consumer	62	1,979	79	3,126	112	4,626
	915	$ 219,752	1,020	$ 283,015	1,132	$