MACATAWA BANK CORP
Form 10-Q
July 28, 2011

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

FORM 10-Q

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

For the quarterly period ended June 30, 2011
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______

Commission file number: 000-25927

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

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

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

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

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

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes oNo x

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 27,083,823 shares of the Company's Common Stock (no par value) were outstanding as of July 28, 2011.

Forward-Looking Statements

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

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2010. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

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Part I Financial Information
Item 1.

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of June 30, 2011 (unaudited) and December 31, 2010

(dollars in thousands)	June 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$21,889	$21,274
Federal funds sold and other short -term investments	244,816	214,853
Cash and cash equivalents	266,705	236,127
Securities available for sale, at fair value	22,735	9,120
Securities held to maturity (fair value 2010 - $83)	---	83
Federal Home Loan Bank stock	11,236	11,932
Loans held for sale, at fair value	467	2,537
Total loans	1,099,176	1,217,196
Allowance for loan losses	(37,477)	(47,426)
Net loans	1,061,699	1,169,770
Premises and equipment – net	56,155	56,988
Accrued interest receivable	3,588	3,845
Bank-owned life insurance	25,480	25,014
Other real estate owned	65,432	57,984
Other assets	5,135	4,861
Total assets	$1,518,632	$1,578,261
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$295,667	$255,897
Interest-bearing	906,889	1,020,723
Total deposits	1,202,556	1,276,620
Other borrowed funds	174,270	185,336
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	6,765	5,575
Total liabilities	1,426,479	1,510,419
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 31,290 shares issued and outstanding	30,604	30,604
Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,600 shares issued and outstanding	2,560	2,560

Common stock, no par value, 200,000,000 shares authorized; 27,083,823 and 17,679,621 shares issued and outstanding at June 30, 2011 and December 31, 2010	187,788	167,321
Retained deficit	(128,962)	(132,654)
Accumulated other comprehensive income	163 163	11
Total shareholders' equity	92,153	67,842
Total liabilities and shareholders' equity	$1,518,632	$1,578,261

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

(dollars in thousands, except per share data)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Interest income				
Loans, including fees	$15,194	$18,824	$30,776	$38,447
Securities	85	581	112	1,772
FHLB Stock	74	60	150	123
Federal funds sold and other short-term investments	137	72	305	133
Total interest income	15,490	19,537	31,343	40,475
Interest expense				
Deposits	2,416	4,691	5,327	10,099
Debt and other borrowed funds	1,292	2,028	2,636	4,530
Total interest expense	3,708	6,719	7,963	14,629
Net interest income	11,782	12,818	23,380	25,846
Provision for loan losses	(2,000)	1,800	(3,450)	21,510
Net interest income after provision for loan losses	13,782	11,018	26,830	4,336
Noninterest income				
Service charges and fees	969	1,063	1,918	2,128
Net gains on mortgage loans	262	399	697	580
Trust fees	620	797	1,270	1,686
Gain on sale of securities	---	2,715	---	2,715
ATM and debit card fees	1,027	957	1,946	1,800
Other	738	391	1,464	881
Total noninterest income	3,616	6,322	7,295	9,790
Noninterest expense				
Salaries and benefits	5,600	5,554	10,947	11,005
Occupancy of premises	989	989	2,001	2,041
Furniture and equipment	829	888	1,646	1,869
Legal and professional	322	391	591	1,160
Marketing and promotion	224	215	448	429
Data processing	334	327	638	674
FDIC assessment	841	1,192	1,819	2,450
ATM and debit card processing	311	264	581	575
Bond and D&O Insurance	378	553	757	1,102
Losses on repossessed and foreclosed properties	2,121	850	4,613	4,493
Administration of problem assets	1,620	1,614	3,562	3,506
Other	1,428	1,452	2,830	2,911

Total noninterest expenses	14,997	14,289	30,433	32,215
Income (loss) before income tax	2,401	3,051	3,692	(18,089)
Income tax expense (benefit)	---	1,303	---	1,303
Net income (loss)	2,401	1,748	3,692	(19,392)
Dividends declared on preferred shares	---	---	---	---
Net income (loss) available to common shares	$2,401	$1,748	$3,692	$(19,392)
Basic earnings (loss) per common share	$0.13	$0.10	$0.20	$(1.10)
Diluted earnings (loss) per common share	$0.13	$0.10	$0.20	$(1.10)
Cash dividends per common share	$0.00	$0.00	$0.00	$0.00

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

(dollars in thousands)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income (loss)	$2,401	$1,748	$3,692	$(19,392)
Other comprehensive income (loss), net of tax:				
Net change in unrealized gains on securities available for sale	149	(694)	152	(656)
Less: reclassification adjustment for gain recognized in earnings, net of tax	---	(1,765)	---	(1,765)
Other comprehensive loss, net of tax	149	(2,459)	152	(2,421)
Comprehensive income (loss)	$2,550	$(711)	$3,844	$(21,813)

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

(dollars in thousands, except per share data)	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Retained (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2010	$30,604	$2,560	$167,183	$(114,800)	$ 2,444	$ 87,991
Net loss for six months ended June 30, 2010				(19,392)		(19,392)
Net change in unrealized gain (loss) on securities available for sale, net of tax					(2,421)	(2,421)
Stock compensation expense			62			62
Balance, June 30, 2010	$30,604	$2,560	$167,245	$(134,192)	$ 23	$ 66,240
Balance, January 1, 2011	$30,604	$2,560	$167,321	$(132,654)	$11	$67,842
Net income for six months ended June 30, 2011				3,692		3,692
Net change in unrealized gain (loss) on securities available for sale, net of tax					152	152
Net proceeds from sale of 8,912,372 shares of common stock on June 7, 2011 and June 29, 2011			19,426			19,426
Conversion of subordinated note to 491,830 shares of common stock on June 29, 2011			1,003			1,003
Stock compensation expense			38			38
Balance, June 30, 2011	$30,604	$2,560	$187,788	$(128,962)	$163	$92,153

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MACATAWA BANK CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2011 and 2010
(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities		
Net income (loss)	$3,692	$(19,392)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	1,539	1,403
Stock compensation expense	38	62
Provision for loan losses	(3,450)	21,510
Deferred tax asset valuation allowance	---	8,015
Origination of loans for sale	(28,945)	(22,185)
Proceeds from sales of loans originated for sale	31,712	21,780
Net gains on mortgage loans	(697)	(580)
Gain on sales of securities	---	(2,715)
Write-down of other real estate	5,351	4,264
Net (gain) loss on sales of other real estate	(745)	218
Decrease (increase) in accrued interest receivable and other assets	(230)	(5,532)
Earnings in bank-owned life insurance	(466)	(280)
Increase (decrease) in accrued expenses and other liabilities	1,193	1,079
Net cash from operating activities	8,992	7,647
Cash flows from investing activities		
Loan originations and payments, net	88,137	99,504
Purchases of securities available for sale	(21,415)	(18,973)
Proceeds from:		
Maturities and calls of securities available for sale	7,988	21,625
Maturities and calls of securities held to maturity	---	277
Sales of securities available for sale	---	105,553
Principal paydowns on securities	87	84
Sales of other real estate	11,330	10,613
Redemption of FHLB stock	696	---
Additions to premises and equipment	(533)	(287)
Net cash from investing activities	86,290	218,396
Cash flows from financing activities		
Net decrease in in-market deposits	(39,255)	(10,450)
Net decrease in brokered deposits	(34,809)	(93,186)
Proceeds from other borrowed funds	10,000	90,000
Repayments of other borrowed funds	(21,066)	(146,020)
Proceeds from issuance of subordinated note	1,000	---
Proceeds from sale of common stock, net	19,426	---
Net cash from financing activities	(64,704)	(159,656)

Net change in cash and cash equivalents	30,578	66,387
Cash and cash equivalents at beginning of period	236,127	78,749
Cash and cash equivalents at end of period	$266,705	$145,136
Supplemental cash flow information		
Interest paid	$7,446	$14,444
Supplemental noncash disclosures:		
Transfers from loans to other real estate	23,384	26,584

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

Operating results for the three and six month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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

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

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 and the loan risk grade assignment for commercial loans. At June 30, 2011, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage and consumer loan portfolios. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative 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 a concession has been made, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carryback losses to available tax years. In assessing the need for a valuation allowance, we consider all relevant positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and available tax planning strategies.

As of January 1, 2010, we no longer have the ability to carryback losses to prior years. The realization of our deferred tax assets is largely dependent on generating income in future years. At June 30, 2011, the need to maintain a full valuation allowance was based primarily on our net operating losses for recent years and the continuing weak economic conditions that could impact our ability to generate future earnings. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required.

Adoption of New Accounting Standards: In July 2010, FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The ASU amends FASB Accounting Standards Codification(TM) Topic 310, Receivables, to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. Disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010 and are included in Note 3. Disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010 and are also included in Note 3.

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

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Newly Issued Not Yet Effective Accounting Standards: The FASB has issued ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This ASU provides guidance for companies when determining whether a loan modification is a troubled debt restructuring. The ASU also provides additional disclosure requirements. It is effective for public companies for interim and annual periods beginning on or after June 15, 2011. The guidance is to be applied retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. This guidance is not expected to have a material effect on our identification of troubled debt restructurings or disclosures.

The FASB has issued ASU 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. The ASU is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. In a typical repo transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Codification Topic 860, Transfers and Servicing, prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repo agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. The amendments to the Codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Adoption of this ASU is not expected to have any effect as the Company does not currently hold any such repurchase agreements.

The FASB has issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the Codification in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The impact of adoption of this ASU is not expected to be material.

The FASB has issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends accounting standards to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We anticipate early adopting this standard with our 2011 annual financial statements by adding a statement of comprehensive income.

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Regulatory Developments:

Consent Order with Macatawa Bank and its Regulators

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 (our "2010 Form 10-K"), on February 22, 2010, Macatawa Bank entered into a Consent Order (the "Consent Order") with the Federal Deposit Insurance Corporation ("FDIC") and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Bank agreed to the terms of the negotiated Consent Order without admitting or denying any charges of unsafe or unsound banking practices. The Consent Order imposes no fines or penalties on the Bank. The Consent Order will remain in effect and enforceable until it is modified, terminated, suspended, or set aside by the FDIC and the OFIR.

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

The Consent Order requires the Bank to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. At June 30, 2011, these levels were achieved through the Bank's continued efforts to improve profitability and reduce risk weighted assets and the Company's successful capital raise that closed in June 2011. At June 30, 2011, the Bank's Tier 1 Leverage Capital Ratio was 8.2% and the Total Risk Based Capital Ratio was 11.9%, which would ordinarily categorize the Bank as "well capitalized" under the regulatory capital standards absent the Consent Order. However, as long as the Bank remains under the Consent Order, the highest it can be categorized is "adequately capitalized", regardless of actual capital levels. At June 30, 2011, the Bank was categorized as "adequately capitalized".

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

Written Agreement with Macatawa Bank Corporation and its Regulator

As discussed in our 2010 Form 10-K, the Company formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB") effective July 23, 2010. Among other things, the Written Agreement provides that: (i) the Company must take appropriate steps to fully utilize its financial and managerial resources to serve as a source of strength to Macatawa Bank; (ii) the Company may not declare or pay any dividends without prior FRB approval; (iii) the Company may not take dividends or any other payment representing a reduction in capital from Macatawa Bank without prior FRB approval; (iv) the Company may not make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior FRB approval; (v) the Company may not incur, increase or guarantee any debt without prior FRB approval; (vi) the Company may not purchase or redeem any shares of its stock without prior FRB approval; (vii) the Company must submit to the FRB an acceptable written plan to maintain sufficient capital on a consolidated basis; (viii) the Company must submit to the FRB a written statement of the Company's planned sources and uses of cash for debt service, operating expenses, and other purposes for 2010 and subsequent years; and (ix) the Company may not appoint any new director or senior executive officer, or change the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, without prior regulatory approval.

The Company requested and received approval from the FRB to make its first and second quarter 2011 interest payments on its $1.65 million in outstanding subordinated debt. Each quarter, the Company requests approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the amounts due.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Deposit Gathering Activities

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

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

The Bank cannot accept, renew or rollover any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC. The Bank has not accepted or renewed brokered deposits since November of 2008. The Bank expects it will be able to fund the remaining maturing brokered deposits under its current liquidity contingency program.

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NOTE 2 – SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2011				
Available for Sale:				
U.S. Treasury and federal agency securities	$15,681	$145	$---	$15,826
State and municipal bonds	5,803	105	$(21)	$5,887
Other equity securities	1,000	22	---	1,022
	$22,484	$272	$(21)	$22,735
December 31, 2010				
Available for Sale:				
U.S. Treasury and federal agency securities	$8,103	$6	$---	$8,109
Other equity securities	1,000	11	---	1,011
	$9,103	$17	$---	$9,120
Held to Maturity:				
State and municipal bonds	$83	$---	$---	$83
	$83	$---	$---	$83

There were no sales of securities in the three and six month periods ended June 30, 2011 or in the three month period ended March 31, 2010. During the three month period ended June 30, 2010, we completed the disposition of nearly all of the municipal, corporate and U.S. agency securities then in our available-for-sale investment portfolio through sales in the open market. Proceeds from these sales totaled $105.6 million and resulted in a net gain of $2.7 million.

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

	Available-for-Sale Securities Amortized Cost	Fair Value
Due in one year or less	$ ---	$ ---
Due from one to five years	15,488	15,657
Due from five to ten years	5,924	5,983
Due after ten years	72	73
	$ 21,484	$ 21,713

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NOTE 2 – SECURITIES (Continued)

Securities with unrealized losses at June 30, 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S federal agency securities	$---	$---	$---	$---	$---	$---
State and municipal bonds	1,501	(21)	---	---	1,501	(21)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$1,501	$(21)	$---	$---	$1,501	$(21)

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

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during the six month periods ended June 30, 2011 and 2010.

At June 30, 2011 and December 31, 2010, securities with a carrying value of approximately $2,008,000 and $2,250,000, respectively, were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law.

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NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	June 30, 2011	December 31, 2010
Commercial and industrial	$ 231,670	$ 264,679
Commercial real estate:		
Residential developed	43,896	46,835
Unsecured to residential developers	2,036	7,631
Vacant and unimproved	61,643	71,528
Commercial development	4,972	8,952
Residential improved	87,843	96,784
Commercial improved	325,090	355,899
Manufacturing and industrial	79,441	81,560
Total commercial real estate	604,921	669,189
Consumer		
Residential mortgage	126,668	135,227
Unsecured	2,111	2,867
Home equity	116,202	125,866
Other secured	17,604	19,368
Total consumer	262,585	283,328
Total loans	1,099,176	1,217,196
Allowance for loan losses	(37,477)	(47,426)
	$ 1,061,699	$ 1,169,770

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

Three months ended June 30, 2011:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,191	$ 30,707	$ 4,423	$ 22	$ 42,343
Charge-offs	(783)	(3,129)	(518)	---	(4,430)
Recoveries	1,083	387	94	---	1,564
Provision for loan losses	(2,000)	(1,150)	1,116	34	(2,000)
Ending Balance	$ 5,491	$ 26,815	$ 5,115	$ 56	$ 37,477

Three months ended June 30, 2010:	Commercial and	Commercial Real Estate	Consumer	Unallocated	Total

	Industrial				
Beginning balance	$ 5,989	$ 51,368	$ 3,413	$ 12	$ 60,782
Charge-offs	(912)	(5,422)	(517)	---	(6,851)
Recoveries	138	344	73	---	555
Provision for loan losses	906	813	61	20	1,800
Ending Balance	$ 6,121	$ 47,103	$ 3,030	$ 32	$ 56,286

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS (Continued)

Six months ended June 30, 2011:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,012	$ 34,973	$ 5,415	$ 26	$ 47,426
Charge-offs	(1,587)	(5,526)	(1,449)	---	(8,562)
Recoveries	1,277	637	149	---	2,063
Provision for loan losses	(1,211)	(3,269)	1,000	30	(3,450)
Ending Balance	$ 5,491	$ 26,815	$ 5,115	$ 56	$ 37,477

Six months ended June 30, 2010:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,086	$ 45,759	$ 2,767	$ 11	$ 54,623
Charge-offs	(4,634)	(15,042)	(1,411)	---	(21,087)
Recoveries	409	735	96	---	1,240
Provision for loan losses	4,260	15,651	1,578	21	21,510
Ending Balance	$ 6,121	$ 47,103	$ 3,030	$ 32	$ 56,286

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

June 30, 2011:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 1,321	$ 4,837	$ 756	$ ---	$ 6,914
Collectively evaluated for impairment	4,170	21,978	4,359	56	30,563
Total ending allowance balance	$ 5,491	$ 26,815	$ 5,115	$ 56	$ 37,477
Loans:					
Individually reviewed for impairment	$ 3,992	$ 53,013	$ 14,661	$ ---	$ 71,666
Collectively evaluated for impairment	227,678	551,908	247,924	---	1,027,510
Total ending loans balance	$ 231,670	$ 604,921	$ 262,585	$ ---	$ 1,099,176

December 31, 2010:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					

Individually reviewed for impairment	$ 1,576	$ 5,334	$ 458	$ ---	$ 7,368
Collectively evaluated for impairment	5,436	29,639	4,957	26	40,058
Total ending allowance balance	$ 7,012	$ 34,973	$ 5,415	$ 26	$ 47,426
Loans:					
Individually reviewed for impairment	$ 7,757	$ 70,677	$ 13,752	$ ---	$ 92,186
Collectively evaluated for impairment	256,922	598,512	269,576	---	1,125,010
Total ending loans balance	$ 264,679	$ 669,189	$ 283,328	$ ---	$ 1,217,196

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NOTE 3 – LOANS (Continued)

Impaired loans were as follows (dollars in thousands)

	June 30, 2011	December 31, 2010
Impaired commercial loans with no allocated allowance for loan losses	$18,768	$48,519
Impaired loans with allocated allowance for loan losses:		
Impaired commercial loans	38,237	29,915
Consumer mortgage loans modified under a troubled debt restructuring	14,661	13,752
	52,898	43,667
Total impaired loans	$71,666	$92,186
Amount of the allowance for loan losses allocated	$6,914	$7,368

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Average of impaired loans during the period:		
Commercial and industrial	$ 5,532	$ 9,812
Commercial real estate:		
Residential developed	14,414	25,867
Unsecured to residential developers	864	2,231
Vacant and unimproved	5,483	4,324
Commercial development	567	2,155
Residential improved	9,144	14,490
Commercial improved	20,158	29,182
Manufacturing and industrial	7,613	7,141
Consumer	12,594	13,058
Interest income recognized during impairment:		
Commercial and industrial	65	145
Commercial real estate	969	389
Consumer	207	221
Cash-basis interest income recognized		

Commercial and industrial	122	485
Commercial real estate	907	617
Consumer	213	250

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NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2011 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ ---	$ ---	$ ---
Commercial real estate:			
Residential developed	9,643	3,488	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	6,114	5,522	---
Commercial development	---	---	---
Residential improved	586	586	---
Commercial improved	10,349	9,172	---
Manufacturing and industrial	---	---	---
	26,692	18,768	
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	$ 26,692	$ 18,768	$ ---
With an allowance recorded:			
Commercial and industrial	$ 3,992	$ 3,992	$ 1,321
Commercial real estate:			
Residential developed	8,210	8,210	2,343
Unsecured to residential developers	2,364	609	134
Vacant and unimproved	175	175	14
Commercial development	223	223	17
Residential improved	8,536	8,518	1,078
Commercial improved	10,437	9,883	1,029
Manufacturing and industrial	6,627	6,627	222
	36,572	34,245	4,837
Consumer:			
Residential mortgage	14,661	14,661	756
Unsecured	---	---	---
Home equity	---	---	---

Other secured		---		---		---
		14,661		14,661		756
Total	$	55,225	$	52,898	$	6,914

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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, 2010 (dollars in thousands):

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

Total	$ 46,150	$ 43,667	$ 7,368

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MACATAWA BANK CORPORATION
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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 table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of June 30, 2011:

	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$ 4,792	$ 22
Commercial real estate:		
Residential developed	7,473	---
Unsecured to residential developers	609	---
Vacant and unimproved	6,333	---
Commercial development	429	---
Residential improved	5,847	---
Commercial improved	12,858	---
Manufacturing and industrial	166	---
	33,715	---
Consumer:		
Residential mortgage	1,091	---
Unsecured	24	---
Home equity	550	247
Other secured	---	4
	1,665	251
Total	$ 40,172	$ 273

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2010:

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

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

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of June 30, 2011 by class of loans (dollars in thousands):

	30-90 Days	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	$923	$2,052	$2,975	$228,695	$231,670
Commercial real estate:					
Residential developed	---	2,672	2,672	41,224	43,896
Unsecured to residential developers	---	609	609	1,427	2,036
Vacant and unimproved	466	3,666	4,132	57,511	61,643
Commercial development	---	816	816	4,156	4,972
Residential improved	1,294	1,942	3,235	84,608	87,843
Commercial improved	1,257	10,266	11,524	313,566	325,090
Manufacturing and industrial	---	166	166	79,275	79,441
	3,017	20,137	23,154	581,767	604,921
Consumer:					
Residential mortgage	891	774	1,665	125,003	126,668
Unsecured	81	---	81	2,030	2,111
Home equity	1,536	679	2,215	113,987	116,202
Other secured	295	4	299	17,305	17,604
	2,803	1,457	4,260	258,325	262,585
Total	$6,743	$23,646	$30,389	$1,068,787	$1,099,176

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 by class of loans (dollars in thousands):

	30-90 Days	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	$825	$5,389	$6,214	$258,465	$264,679
Commercial real estate:					
Residential developed	438	4,568	5,006	41,829	46,835
Unsecured to residential developers	---	999	999	6,632	7,631
Vacant and unimproved	670	4,367	5,037	66,491	71,528
Commercial development	---	1,144	1,144	7,808	8,952
Residential improved	1,929	6,353	8,282	88,502	96,784
Commercial improved	901	21,440	22,341	333,558	355,899

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

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS (Continued)

The Company has allocated $1,297,000 and $1,361,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2011 and December 31, 2010, respectively. These loans involved the restructuring of terms to allow customers to mitigate the risk of foreclosure by meeting a lower loan payment requirement based upon their current cash flow. The Company has been active at utilizing these programs and working with its customers to reduce the risk of foreclosure.

The following table presents information regarding troubled debt restructurings as of June 30, 2011 (dollars in thousands):

	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	8	$ 2,066
Commercial real estate	29	16,422
Consumer mortgage	79	14,661

Included in these totals are $206,000 of nonperforming commercial and industrial restructurings, $626,000 of nonperforming commercial real estate restructurings and $933,000 of nonperforming consumer mortgage loan restructurings as of June 30, 2011.

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

1. Excellent - Borrowings supported by extremely strong financial condition or secured by the Bank's own deposits. Minimal risk to the Bank and the probability of serious rapid financial deterioration is extremely small.

2. Above Average - Borrowings supported by sound financial statements that indicate the ability to repay or borrowings secured (and margined properly) with marketable securities. Nominal risk to the Bank and probability of

serious financial deterioration is highly unlikely. The overall quality of these credits is very high.

3. Good Quality - Average borrowings supported by satisfactory asset quality and liquidity, good debt capacity coverage, and good management in all critical positions. Loans are secured by acceptable collateral with adequate margins. There is a slight risk of deterioration if adverse market conditions prevail.

4. Acceptable Risk - This is an acceptable risk to the Bank, which may be slightly below average quality. The borrower has limited financial strength with considerable leverage. There is some probability of deterioration if adverse market conditions prevail. These credits should be monitored closely by the Relationship Manager.

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MACATAWA BANK CORPORATION
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NOTE 3 – LOANS (Continued)

5. Marginally Acceptable - Loans are of marginal quality with above normal risk to the Bank. The borrower shows acceptable asset quality but very little liquidity with high leverage. There is inconsistent earning performance without the ability to sustain adverse market conditions. The primary source of repayment is questionable, but the secondary source of repayment still remains an option. Very close attention by the Relationship Manager and management is needed.

6. Substandard - Loans are inadequately protected by the net worth and paying capacity of the borrower or the collateral pledged. The primary and secondary sources of repayment are questionable. Heavy debt condition may be evident and volume and earnings deterioration may be underway. It is possible that the Bank will sustain some loss if the deficiencies are not immediately addressed and corrected.

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

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

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

	1	2	3	4	5	6	7	8
Commercial and industrial	$277	$1,103	$46,840	$139,072	$30,486	$9,099	$4,793	$---
Commercial real estate:								
Residential developed	---	---	1,261	10,377	14,392	10,393	7,473	---
Unsecured to residential developers	---	---	195	709	183	340	609	---
Vacant and unimproved	---	---	8,688	25,964	16,540	4,118	6,333	---
Commercial development	---	---	34	2,793	1,493	223	429	---
Residential improved	---	---	2,829	47,422	17,512	14,233	5,847	---
Commercial improved	---	---	66,261	185,935	37,825	22,211	12,858	---
Manufacturing and industrial	---	229	13,078	40,135	19,697	6,136	166	---
	$277	$1,332	$139,186	$452,407	$138,128	$66,753	$38,508	$---

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

	1	2	3	4	5	6	7	8
Commercial and industrial	$442	$1,583	$51,558	$148,880	$41,467	$9,165	$11,584	$---
Commercial real estate:								
Residential developed	---	---	240	6,682	14,705	14,360	10,848	---
Unsecured to residential developers	---	---	4,784	907	500	515	925	---
Vacant and unimproved	---	794	5,450	38,808	14,978	3,982	7,516	---
Commercial development	---	---	---	4,240	2,765	295	1,652	---
Residential improved	---	---	3,321	49,905	18,715	14,985	9,858	---
Commercial improved	---	---	71,622	191,772	41,490	23,199	27,816	---
Manufacturing and industrial	---	246	14,299	37,487	22,261	5,697	1,570	---
	$442	$2,623	$151,274	$478,681	$156,881	$72,198	$71,769	$---

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NOTE 3 – LOANS (Continued)

Commercial loans rated a 6 or worse per the Company's internal risk rating system are considered substandard, doubtful or loss. Commercial loans classified as substandard or worse were as follows at period-end (dollars in thousands):

	June 30, 2011	December 31, 2010
Not classified as impaired	$ 55,266	$ 65,533
Classified as impaired	49,995	78,434
Total commercial loans classified substandard or worse	$ 105,261	$ 143,967

At June 30, 2011, approximately $38.5 million of the $105.3 million of commercial loans classified as substandard or worse were on nonaccrual status, while the remaining $66.8 million of these loans were on accrual status.

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

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

June 30, 2011	Residential Mortgage	Consumer Unsecured	Home Equity	Consumer Other
Performing	$125,894	$2,111	$115,523	$17,600
Nonperforming	774	---	679	4
Total	$126,668	$2,111	$116,202	$17,604

December 31, 2010	Residential Mortgage	Consumer Unsecured	Home Equity	Consumer Other
Performing	$133,738	$2,867	$124,939	$19,358
Nonperforming	1,489	---	927	10
Total	$135,227	$2,867	$125,866	$19,368

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NOTE 4 – OTHER REAL ESTATE OWNED

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

	Six Months Ended June 30, 2011	Year Ended December 31, 2010	Six Months Ended June 30, 2010
Beginning balance	$68,388	$41,987	$41,987
Additions, transfers from loans	23,384	45,248	26,584
Proceeds from sales of other real estate owned	(11,330)	(16,003)	(10,613)
Valuation allowance reversal upon sale	(1,730)	(2,677)	(1,117)
Gain (loss) on sale of other real estate owned	745	(167)	(218)
	79,457	68,388	56,623
Less: valuation allowance	(14,025)	(10,404)	(7,951)
Ending balance	$65,432	$57,984	$48,672

Activity in the valuation allowance was as follows (dollars in thousands):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Beginning balance	$12,020	$7,610	$10,404	$4,804
Additions charged to expense	2,653	749	5,351	4,264
Reversals upon sale	(648)	(408)	(1,730)	(1,117)
Ending balance	$14,025	$7,951	$14,025	$7,951

Net realized gains on sales of other real estate were $533,000 and $745,000, respectively, for the three and six month periods ended June 30, 2011. Net realized losses on sales of other real estate were $98,000 and $218,000, respectively, for the three and six month period ended June 30, 2010.

NOTE 5 – FAIR VALUE

ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value include:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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NOTE 5 – FAIR VALUE (Continued)

Investment Securities: The fair values of investment securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Loans Held for Sale: The fair value of loans held for sale is based upon binding quotes from 3rd party investors (Level 2 inputs)

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned: Adjustments to commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized through a valuation allowance.

Assets measured at fair value on a recurring basis are summarized below (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2011				
U.S. Treasury and federal agency securities	$15,826	$---	$15,826	$ ---
State and municipal bonds	5,887	---	5,887	---
Other equity securities	1,022	---	1,022	---
Loans held for sale	467	---	467	---
December 31, 2010				
U.S. federal agency securities	$8,109	$---	$8,109	$ ---
State and municipal bonds	---	---	---	---
Other equity securities	1,011	---	1,011	---
Loans held for sale	2,537	---	2,537	---

Assets measured at fair value on a non-recurring basis are summarized below (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2011				
Impaired loans	$13,401	$---	$---	$ 13,401
Other real estate owned	57,444	---	---	57,444
December 31, 2010				
Impaired loans	$37,173	$---	$---	$ 37,173
Other real estate owned	32,262	---	---	32,262

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NOTE 5 – FAIR VALUE (Continued)

The carrying amounts and estimated fair values of financial instruments, not previously presented, were as follows at June 30, 2011 and December 31, 2010 (dollars in thousands).

	June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$266,705	$266,705	$236,127	$236,127
Securities held to maturity	---	---	83	83
FHLB stock	11,236	N/A	11,932	N/A
Loans, net	1,061,699	1,071,233	1,169,770	1,169,497
Accrued interest receivable	3,588	3,588	3,845	3,845
Financial liabilities				
Deposits	(1,202,556)	(1,203,433)	(1,276,620)	(1,280,238)
Other borrowed funds	(174,270)	(176,727)	(185,336)	(187,104)
Long-term debt	(41,238)	(34,564)	(41,238)	(34,506)
Subordinated debt	(1,650)	(1,650)	(1,650)	(1,650)
Accrued interest payable	(2,918)	(2,918)	(2,401)	(2,401)
Off-balance sheet credit-related items				
Loan commitments	---	---	---	---

The methods and assumptions used to estimate fair value are described as follows.

Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, accrued interest receivable and payable, demand deposits, and variable rate loans or deposits that reprice frequently and fully. Security fair values are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities as discussed above. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk (including consideration of widening credit spreads). Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet credit-related items is not significant.

NOTE 6 – DEPOSITS

Deposits are summarized as follows (in thousands):

	June 30, 2011	December 31, 2010
Noninterest-bearing demand	$295,667	$255,897

Interest bearing demand	183,356	216,827
Savings and money market accounts	364,616	355,657
Certificates of deposit	358,917	448,239
	$1,202,556	$1,276,620

Approximately $135.7 million and $192.7 million in certificates of deposit were in denominations of $100,000 or more at June 30, 2011 and December 31, 2010, respectively.

Brokered deposits totaled approximately $13.4 million and $48.2 million at June 30, 2011 and December 31, 2010, respectively. At June 30, 2011 and December 31, 2010, brokered deposits had interest rates ranging from 4.50% to 4.55% and 3.75% to 4.55%, respectively. The remaining balance of $13.4 million in brokered deposits will mature in 2011.

Additional information about restrictions on the Bank's deposit gathering activities may be found in Note 1 under the heading "Regulatory Developments."

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NOTE 7 - OTHER BORROWED FUNDS

Other borrowed funds include advances from the Federal Home Loan Bank and borrowings from the Federal Reserve Bank.

Federal Home Loan Bank Advances

At period-end, advances from the Federal Home Loan Bank were as follows (dollars in thousands):

Principal Terms	Advance Amount	Range of Maturities	Weighted Average Interest Rate	
June 30, 2011				
Single maturity fixed rate advances	$160,000	December 2011 to November 2015	1.93	%
Amortizable mortgage advances	14,270	March 2018 to July 2018	3.77	%
	$174,270			

Principal Terms	Advance Amount	Range of Maturities	Weighted Average Interest Rate	
December 31, 2010				
Single maturity fixed rate advances	$170,000	March 2011 to November 2015	1.95	%
Amortizable mortgage advances	15,336	March 2018 to July 2018	3.77	%
	$185,336			

Each advance is subject to a prepayment penalty if paid prior to its maturity date. Fixed rate advances are payable at maturity. Amortizable mortgage advances are fixed rate advances with scheduled repayments based upon amortization to maturity. These advances were collateralized by residential and commercial real estate loans totaling $375.2 million and $420.5 million under a physical loan collateral delivery arrangement at June 30, 2011 and December 31, 2010, respectively.

Scheduled repayments of FHLB advances as of June 30, 2011 were as follows (in thousands):

2011	$25,667
2012	66,781
2013	31,831
2014	21,884
2015	21,938
Thereafter	6,169

$174,270

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NOTE 8 - EARNINGS (LOSS) PER COMMON SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings (loss) per common share for the three month periods ended June 30, 2011 and 2010 are as follows (dollars in thousands, except per share data):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income (loss)	$2,401	$1,748	$3,692	$(19,392)
Dividends declared on preferred shares	---	---	---	---
Net income (loss) available to common shares	$2,401	$1,748	$3,692	$(19,392)
Weighted average shares outstanding, including participating stock awards - Basic	18,964,150	17,692,231	18,325,434	17,694,269
Dilutive potential common shares:				
Stock options	---	---	---	---
Conversion of preferred stock	---	---	---	---
Stock warrants	---	---	---	---
Weighted average shares outstanding - Diluted	18,964,150	17,692,231	18,325,434	17,694,269
Basic earnings (loss) per common share	$0.13	$0.10	$0.20	$(1.10)
Diluted earnings (loss) per common share (1)	$0.13	$0.10	$0.20	$(1.10)

(1) For any period in which a loss is recorded, the assumed exercise of stock options would have an anti-dilutive impact on loss per share and thus are ignored in the diluted per common share calculation.

Stock options for 705,390 and 710,522 shares of common stock for the three and six month periods ended June 30, 2011, respectively, were not considered in computing diluted earnings per share because they were antidilutive. Stock options for 886,656 and 914,872 shares of common stock for both the three and six month periods ended June 30, 2010, respectively, were not considered in computing diluted earnings per common share because they were antidilutive. Potential common shares associated with convertible preferred stock and stock warrants were excluded from dilutive potential common shares as they were antidilutive.

NOTE 9 - FEDERAL INCOME TAXES

Income tax expense (benefit) was as follows (dollars in thousands):

	Three Months Ended June 30, 2011	Three Months Ended	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010

	June 30, 2011			
Current	(80)	---	$ (82)	$ (21)
Deferred (benefit) expense	80	---	82	21
	$ ---	$ ---	$ ---	$ ---

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NOTE 9 - FEDERAL INCOME TAXES (Continued)

The difference between the financial statement tax expense (benefit) and amount computed by applying the statutory federal tax rate to pretax income was reconciled as follows (dollars in thousands):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Statutory rate	35 %	35 %	35 %	35 %
Statutory rate applied to income (loss) before taxes	$840	$1,068	$1,292	$(6,331)
Add (deduct)				
Change in valuation allowance	(654)	342	(1,009)	7,994
Tax-exempt interest income	(69)	(99)	(69)	(266)
Bank-owned life insurance	(88)	(28)	(163)	(98)
Other, net	(29)	20	(51)	4
	$---	$1,303	$---	$1,303

The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carryback losses to available tax years. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and tax planning strategies. As the Company returns to consistent, sustained profitability, the need for the valuation allowance diminishes.

At June 30, 2011, the need for a valuation allowance was based primarily on the Company's net operating loss for 2009 and 2008, and the challenging environment currently confronting banks that could impact future operating results. As a result, an $18.0 million valuation allowance on deferred tax assets was charged to federal income tax expense in 2009. As a result of losses incurred in 2010, the Company increased the valuation allowance to $25.6 million at December 31, 2010. At June 30, 2011, the valuation allowance was $24.6 million. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required.

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NOTE 9 - FEDERAL INCOME TAXES (Continued)

The net deferred tax asset recorded included the following amounts of deferred tax assets and liabilities (dollars in thousands):

	June 30, 2011	December 31, 2010
Deferred tax assets		
Allowance for loan losses	$13,117	$16,599
Nonaccrual loan interest	288	548
Valuation allowance on other real estate owned	4,909	3,641
Net operating loss carryforward	8,027	6,656
Other	1,112	975
Gross deferred tax assets	27,453	28,419
Valuation allowance	(24,640)	(25,649)
Total net deferred tax assets	2,813	2,770
Deferred tax liabilities		
Depreciation	(1,938)	(1,984)
Purchase accounting adjustments	(67)	(113)
Unrealized gain on securities available for sale	(88)	(6)
Prepaid expenses	(407)	(347)
Other	(313)	(320)
Gross deferred tax liabilities	(2,813)	(2,770)
Net deferred tax asset	$---	$---

At June 30, 2011, we had federal net operating loss carryforwards of $22.9 million that expire in 2030.

There were no unrecognized tax benefits at June 30, 2011 or December 31, 2010 and the Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. The Company is no longer subject to examination by the Internal Revenue Service for years before 2007.

NOTE 10 – CONTINGENCIES

We and our subsidiaries periodically become defendants in certain claims and legal actions arising in the ordinary course of business. As June 30, 2011, there were no material pending legal proceedings to which we or any of our subsidiaries are a party or which any of our properties are the subject.

NOTE 11 – SHAREHOLDERS' EQUITY

Regulatory Capital

The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

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NOTE 11 – SHAREHOLDERS' EQUITY (Continued)

The prompt corrective action regulations provide five categories, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If a bank is only adequately capitalized, regulatory approval is required to, among other things, accept, renew or roll-over brokered deposits. If a bank is undercapitalized, capital distributions and growth and expansion are limited, and plans for capital restoration are required.

At June 30, 2011 and December 31, 2010, actual capital levels and minimum required levels were (in thousands):

	Actual		Minimum Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations		Minimum Required Under Consent Order	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2011								
Total capital (to risk weighted assets)								
Consolidated	$148,014	12.7 %	$93,161	8.0 %	N/A	N/A	N/A	N/A
Bank	139,005	11.9	93,148	8.0	$116,435	10.0 %	$128,079	11.0 %
Tier 1 capital (to risk weighted assets)								
Consolidated	122,020	10.5	46,580	4.0	N/A	N/A	N/A	N/A
Bank	124,158	10.7	46,574	4.0	69,861	6.0	N/A	N/A
Tier 1 capital (to average assets)								
Consolidated	122,020	8.1	60,523	4.0	N/A	N/A	N/A	N/A
Bank	124,158	8.2	60,422	4.0	75,527	5.0	120,843	8.0
December 31, 2010								
Total capital (to risk weighted assets)								
Consolidated	$125,483	9.7 %	$104,013	8.0 %	N/A	N/A	N/A	N/A
Bank	125,797	9.7	103,970	8.0	$129,963	10.0 %	$142,960	11.0 %
Tier 1 capital (to risk weighted assets)								
Consolidated	89,585	6.9	52,007	4.0	N/A	N/A	N/A	N/A
Bank	109,160	8.4	51,985	4.0	77,978	6.0	N/A	N/A
Tier 1 capital (to average assets)								
Consolidated	89,585	5.8	61,605	4.0	N/A	N/A	N/A	N/A
Bank	109,160	7.1	61,520	4.0	76,901	5.0	123,041	8.0

Approximately $30.5 million and $22.4 million of trust preferred securities outstanding at June 30, 2011 and December 31, 2010, respectively, qualified as Tier 1 capital. Refer to our 2010 Form 10-K for more information on the trust preferred securities.

The Bank was categorized as "adequately capitalized" at June 30, 2011 and December 31, 2010. The Bank’s regulatory capital ratios exceeded the levels ordinarily required to be categorized as "well capitalized" at June 30, 2011. However, because the Bank is subject to the Consent Order, the Bank cannot be categorized as "well capitalized" regardless of actual capital levels.

The Consent Order also prohibits the Bank from declaring or paying any cash dividend without the prior written consent of its regulators. The payment of future cash dividends by the Company is largely dependent upon dividends received from the Bank out of its earnings. Under Michigan law, the Bank is also restricted from paying dividends to the Company until its deficit retained earnings has been restored. The Bank had a retained deficit of approximately $34.9 million at June 30, 2011.

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NOTE 11 – SHAREHOLDERS' EQUITY (Continued)

Additional information about the Consent Order may be found in Note 1 under the heading "Regulatory Developments."

In order to temporarily replenish the Company's liquidity pending the Company's planned public offering of common stock, on April 21, 2011, the Company issued and sold a 2% Subordinated Note due 2018 in the aggregate principal amount of $1,000,000 to a director of the Company. The note had an interest rate of 2%, compounded quarterly in arrears. Accrued interest was payable in full at maturity, or at the date the principal was paid in full. The note had a maturity date of April 30, 2018. The Company could prepay the note in whole or in part at any time from and after September 30, 2011. The note allowed the holder to purchase shares offered in the public offering and to pay the cash price of shares purchased in the public offering by delivering the note to the Company at a value equal to the principal and interest accrued. The holder also had a continuing right to convert the note in full into common stock with the stock to be valued at book value and the note to be valued at principal and interest accrued.

On June 7, 2011, the Company closed on a rights offering to existing shareholders, issuing 4,456,186 shares of common stock for $2.30 per share. On June 29, 2011, the Company closed on its public offering, issuing 4,456,186 shares of common stock for $2.30 per share. In addition, on June 29, 2011, the director discussed above executed his right to convert the 2% Subordinated Note into 491,830 shares of common stock. The net proceeds from the offerings and subordinated note conversion were $20.4 million. The Company contributed $10.0 million to the Bank on June 30, 2011 and held the remaining $10.4 million at the holding company at June 30, 2011.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 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 June 30, 2011, we had total assets of $1.52 billion, total loans of $1.10 billion, total deposits of $1.20 billion and shareholders' equity of $92.2 million. During the second quarter of 2011, we recognized net income of $2.4 million compared to net income of $1.7 million in the second quarter of 2010. This represented our fifth consecutive quarter of profitability following six consecutive quarters of net losses. As described more fully below, a meaningful reduction in charge-offs and nonperforming loans led to a negative loan loss provision for the most recent quarter. For the first six months of 2011, we recognized net income of $3.7 million compared to a net loss of $19.4 million in 2010. In June 2011, we completed a successful rights offering (with over 25% of existing shares exercising their rights) and public offering of our common stock. The offerings resulted in the issuance of 8,912,372 additional shares at $2.30 per share, netting $19.4 million in offering proceeds. The conversion of our 2% Subordinated Note due 2018 resulted in the issuance of 491,380 shares of common stock and an additional $1.0 million in capital. As of June 30, 2011, the Bank’s capital ratios returned to levels comfortably exceeding those ordinarily required to be categorized “well capitalized” under applicable regulatory guidelines, and above the requirements in our Consent Order. However, as long as we remain under the Consent Order, we cannot be categorized higher than “adequately capitalized”, regardless of actual capital levels. As a result, we remained categorized as “adequately capitalized” at June 30, 2011.

The weak local and national economic conditions that persisted over the past few years contributed to the annual operating losses reported by us during 2010, 2009 and 2008. The losses for these prior periods were largely attributable to loan losses, lost interest on non-performing assets and costs of administering problem assets associated with problem loans and other real estate assets. We also incurred a non-cash charge of $18.0 million included in federal income tax expense in 2009 associated with a valuation allowance for deferred tax assets and non-cash, after tax impairment charges for goodwill and intangible assets of $27 million in 2008. There will be no further negative affect on our results of operations associated with deferred tax assets or goodwill, as these assets have been written off or reserved for in their entirety. Under certain conditions according to accounting standards, as we return to sustained profitability, the need for the valuation allowance diminishes and it would be possible to reverse the established valuation on our deferred tax assets through earnings.

Our Board of Directors and management remain focused on efforts to work out of our problem loans and assets. We believe our improved results over the past five quarters reflect the impact of these efforts. The Bank's Board of Directors has implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles intended to comply with regulatory standards. Our management team continues to execute these disciplined business and banking procedures and policies intended to limit future losses, preserve capital and improve operational efficiencies.

We have also worked closely with our regulators at the FRB and the Bank's regulators at the FDIC and the OFIR to put in place improved controls and procedures. On February 22, 2010, Macatawa Bank entered into a Consent Order with the FDIC and OFIR, the primary banking regulators of the Bank. The Company also formally entered into a

Written Agreement with the FRB with an effective date of July 23, 2010. As of June 30, 2011, we believe that the Bank was in compliance in all material respects with all of the provisions of the Consent Order. As of the same date, we believe that the Company was in compliance in all material respects with all of the provisions of the Written Agreement. See Note 1 to the Consolidated Financial Statements for more information.

Additional information further describing changes in our business, including those in response to the Consent Order and the Written Agreement, are described in detail in our 2010 Form 10-K.

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RESULTS OF OPERATIONS

Summary: Net income available to common shares for the quarter ended June 30, 2011 was $2.4 million, compared to second quarter 2010 net income of $1.7 million. Net income per common share on a diluted basis was $0.13 for the second quarter of 2011 compared to $0.10 for the same period in 2010. Net income available to common shares for the six months ended June 30, 2011 was $3.7 million compared to a net loss of $19.4 million for the same period in the prior year. Net income per common share was $0.20 for the six months ended June 30, 2011 compared to a net loss per common share of $1.10 for the same period in 2010.

The improvement in earnings in the second quarter of 2011 is a continuation of improvement in the past several quarters, led by a significantly lower level of net chargeoffs from $6.3 million in the second quarter of 2010 to $2.9 million in the second quarter of 2011. This, coupled with a decline in non-performing and impaired loan levels, resulted in a decrease of $3.8 million in the provision for loan losses. The provision for loan losses was a negative $2.0 million for the three month period ended June 30, 2011 compared to $1.8 million for the same period in 2010. The improvement is even more dramatic when comparing the year to date periods given the substantial losses incurred in the first quarter of 2010. For the six months ended June 30, 2011, we recognized $6.5 million in net chargeoffs, compared to $19.8 million for the same period in 2010. As a result, the provision for loan losses decreased substantially from $21.5 million for the first six months of 2010 compared to a negative $3.5 million for the same period in 2011.

Operating results in recent periods have been significantly impacted by the cost associated with problem loans and nonperforming assets. Apart from the provision for loan losses, costs associated with nonperforming assets (including administration costs and losses) were $3.7 million for the second quarter of 2011 compared to $2.5 million for the second quarter of 2010. For the first half of 2011, such expenses totaled $8.2 million for 2011, compared to $8.0 million for 2010. Lost interest from elevated levels of nonperforming assets was approximately $2.0 million and $4.0 million, respectively, for the three and six months ended June 30, 2011 compared to $2.7 million and $5.3 million, respectively, for the three and six months ended June 30, 2010. Each of these items is discussed more fully below.

Net Interest Income: Net interest income totaled $11.8 million for the second quarter of 2011 compared to $12.8 million for the second quarter of 2010. For the first half of 2011, net interest income totaled $23.4 million, compared to $25.8 million for the same period in 2010.

The decrease in net interest income in the second quarter of 2011 was due primarily to a $179.9 million reduction in our average interest earning assets as a result of our focus on reducing credit exposure within certain segments of our loan portfolio, liquidity improvement and capital preservation. The net interest margin was 3.39% for the second quarter of 2011 compared to 3.29% for the second quarter of 2010. Average interest earning assets decreased from $1.56 billion for the second quarter of 2010 to $1.38 billion for the same period in 2011. Our average yield on earning assets for second quarter of 2011 declined 55 basis points from 5.02% to 4.47%. Margin improvement for the quarter was driven by a significant reduction in the average cost of interest bearing liabilities.

Average interest earning assets decreased from $1.60 billion for the first six months of 2010 to $1.41 million for the same period in 2011. This decrease was partially offset by improvement in net interest margin of 5 basis points driven by a 71 basis points decline in the average cost of interest bearing liabilities as we continue to payoff brokered deposits and wholesale funding as they mature. Our average yield on earning assets declined 65 basis points in comparison to the six month period in 2010.

The declines in yields on interest earning assets for the three and six month periods ended June 30, 2011 were from slight decreases in the yield on our residential and consumer loan portfolios, which have repriced in the generally lower rate environment during this period, and due to a reduction in the balance of our securities portfolio relative to total earning assets. We sold nearly our entire securities portfolio during the second quarter of 2010. The majority of these funds have been initially reinvested in lower yielding liquid money market balances. We expect these higher than normal liquid balances will continue to put downward pressure on margin in the near term.

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The cost of funds decreased 68 basis points to 1.28% in the second quarter of 2011 from 1.96% in 2010. Our cost of funds decreased 71 basis points to 1.35% for the first six months of 2011 compared to 2.06% for the same period in 2010. A decrease in the rates paid on our deposit accounts in response to declining market rates and the rollover of time deposits and other borrowings at lower rates within the current rate environment caused the reduction in our cost of funds. Also contributing to the reduction was a shift in our deposit mix from higher costing time deposits to lower costing demand and savings accounts.

The following table shows an analysis of net interest margin for the three month periods ended June 30, 2011 and 2010.

	For the three months ended June 30,							
		2011				2010		
	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	$16,783	85	2.02	%	$42,961	$333	3.09	%
Tax-exempt securities (1)	22	---	5.59	%	23,016	248	6.61	%
Loans (2)	1,139,593	15,194	5.29	%	1,410,376	18,824	5.29	%
Federal Home Loan Bank stock	11,764	74	2.47	%	12,275	60	1.95	%
Federal funds sold and other short-term investments	207,351	137	0.26	%	66,744	72	0.43	%
Total interest earning assets (1)	1,375,513	15,490	4.47	%	1,555,372	19,537	5.02	%
Noninterest earning assets:								
Cash and due from banks	22,569				24,880			
Other	115,425				106,059			
Total assets	$1,513,507				$1,686,311			
Liabilities								
Deposits:								
Interest bearing demand	$184,989	108	0.23	%	$225,265	188	0.34	%
Savings and money market accounts	373,104	527	0.57	%	317,651	452	0.57	%
Time deposits	380,743	1,781	1.88	%	554,395	4,050	2.93	%
Borrowings:								
Other borrowed funds	174,261	943	2.14	%	229,203	1,689	2.91	%
Long-term debt	41,238	349	3.35	%	41,238	340	3.26	%
Total interest bearing liabilities	1,154,335	3,708	1.28	%	1,367,752	6,719	1.96	%
Noninterest bearing liabilities:								
Noninterest bearing demand accounts	278,417				243,931			
	8,202				6,895			

Other noninterest bearing liabilities								
Shareholders' equity	72,553				67,733			
Total liabilities and shareholders' equity	$1,513,507				$1,686,311			
Net interest income		$11,782				$12,818		
Net interest spread (1)			3.19	%			3.06	%
Net interest margin (1)			3.39	%			3.29	%
Ratio of average interest earning assets to average interest bearing liabilities	119.16 %				113.72 %			

(1) Yield adjusted to fully tax equivalent.

(2) Includes non-accrual loans of approximately $55.1 million and $95.5 million for the three months ended June 30, 2011 and 2010.

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The following table shows an analysis of net interest margin for the six month periods ended June 30, 2011 and 2010.

	For the six months ended June 30,							
		2011				2010		
	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	$14,222	111	1.56	%	$55,521	$1,000	3.60	%
Tax-exempt securities (1)	49	1	6.66	%	36,491	772	6.52	%
Loans (2)	1,161,887	30,776	5.28	%	1,442,190	38,447	5.31	%
Federal Home Loan Bank stock	11,847	150	2.52	%	12,275	123	1.98	%
Federal funds sold and other short-term investments	218,399	305	0.25	%	55,511	133	0.48	%
Total interest earning assets (1)	1,406,404	31,343	4.44	%	1,601,988	40,475	5.09	%
Noninterest earning assets:								
Cash and due from banks	22,221				24,299			
Other	110,875				109,238			
Total assets	$1,539,500				$1,735,525			
Liabilities								
Deposits:								
Interest bearing demand	$181,982	211	0.23	%	$235,274	420	0.36	%
Savings and money market accounts	371,879	1,070	0.58	%	326,488			