MACATAWA BANK CORP
Form 10-K
March 07, 2012

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

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 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 of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§

232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated file, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, as of June 30, 2011, was $69,561,481 based on the closing sale price of $2.77 as reported on the Nasdaq Stock Market. There were 27,082,823 outstanding shares of the Company's common stock as of February 22, 2012.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 8, 2012 are incorporated by reference into Part III of this report.

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

Table of Contents

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Macatawa Bank Corporation. Forward-looking statements are identifiable by words or phrases such as "outlook", "plan" or "strategy"; that an event or trend "may", "should", "will", "is likely", or is "probable" to occur or "continue", has "begun" or "is scheduled" or "on track" or that the Company or its management "anticipates", "believes", "estimates", "plans", "forecasts", "intends", "predicts", "projects", or "expects" a particular result, or is "committed", "confident", "encouraged", "optimistic" or has an "opinion" that an event will occur, or other words or phrases such as "ongoing", "future", "signs", "efforts", "ensure", "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 our credit quality metrics, future capital levels, future charge-off levels, future amounts of provision for loan losses, real estate valuation, future levels of non-performing assets and costs associated with administration and disposition of non-performing assets, the rate of asset dispositions, dividends, future growth and funding sources, future liquidity levels, future profitability levels, future trust service income levels, future FDIC assessment levels, the effects on earnings of changes in interest rates and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, maintain our current level of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, maintain 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 this report. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

PART I

ITEM 1: Business.

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

Overview

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

At December 31, 2011, we had total assets of $1.51 billion, total loans of $1.07 billion, total deposits of $1.22 billion and shareholders’ equity of $94.4 million. We recognized net income of $5.8 million in 2011, a substantial improvement over the prior two years, and we experienced our seventh consecutive quarter of net income to end 2011. During 2011, 2010 and 2009, our interest income accounted for approximately 80%, 81% and 85%, respectively, of our operating revenues and our non-interest income accounted for approximately 20%, 19% and 15%, respectively, of our operating revenues. For additional information about our financial condition and results of operations, see our consolidated financial statements and related notes included in this report.

In response to our losses during 2008, 2009 and the first quarter of 2010, our Board of Directors implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles. The focus of our management team turned from growth in our business to executing these disciplined business and banking procedures and policies designed to limit future losses, preserve capital and improve operational efficiencies. In addition, the Board of Directors added experienced members to provide further oversight and guidance. These and other efforts were reflected in our results of operations for 2011 and 2010 with lower levels of charge-offs and provision for loan losses, reductions in operating expenses and reduction in balance sheet totals resulting in improvement in our regulatory capital and liquidity ratios. We successfully completed our shareholder rights offering and public offering of common stock in June 2011 resulting in net proceeds of $20.3 million and contributed $10.0 million of the proceeds from the stock offering to the Bank retaining the remaining $10.3 million at the holding company. As of December 31, 2011, the Company’s and the Bank’s regulatory capital ratios were the highest they have been since December 31, 1999.

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

(dollars in thousands)	December 31, 2011	December 31, 2010	December 31, 2009
Non-performing loans	$ 28,946	$ 75,361	$ 103,885
Other repossessed assets	---	50	124
Other real estate owned	66,438	57,984	37,184
Total non-performing assets	$ 95,384	$ 133,395	$ 141,193

Total loan delinquencies 30 days or greater past due	$	13,138	$	55,748	$	116,971

Earnings have been severely impacted by high costs associated with administration and disposition of non-performing assets. These costs, including losses on repossessed and foreclosed properties, were $15.6 million and $15.4 million for the years ended December 31, 2011 and 2010, respectively. Going forward, as further reductions in non-performing assets are accomplished, we expect the costs associated with these assets to also decline thereby allowing for improved earnings in future periods.

Table of Contents

Our earnings in 2011 were favorably impacted by negative provision for loan losses of $4.7 million. As discussed in detail later in Item 7 of this report under the heading "Allowance for Loan Losses", this was a result of the decline in our historical charge-off levels from prior years. We do not expect a similar level of negative provision for loan losses in 2012. The following table reflects the provision for loan losses for the past two years along with certain metrics that impact the determination of the level of the provision for loan losses.

(Dollars in thousands)	For The Year Ended December 31	
	2011	2010
Provision for loan losses	$ (4,700)	$ 22,460
Net charge-offs	11,085	29,657
Net charge-offs to average loans	.99 %	2.18 %
Nonperforming loans to total loans	2.70 %	6.19 %
Loans transferred to ORE to average loans	3.42 %	3.32 %
Troubled debt restructurings (“TDRs”) to average loans	5.15 %	1.91 %

The State of Michigan entered into a recession earlier than the rest of the country and has experienced heavy job loss as a result of the concentration the state has related to the automotive industry. Our market areas of Grand Rapids and Holland fared better than the state as a whole, but nevertheless the impact of our local economy on our results has been profound. The recession and job loss impacted housing values, commercial real estate values and consumer activity. Improvement has been evident during 2011, with the State of Michigan being identified in a Bloomberg Economic Evaluation of States as having the second fastest pace of recovery in the U.S., second only to North Dakota. The state’s unemployment rate at the end of 2011 was 9.3%, no longer the highest in the country and down dramatically from 15.2% in June 2009. The Holland area unemployment was 6.5%, and the Grand Rapids area unemployment was 6.5% at the end of 2011. Residential housing values and commercial real estate property values decreased significantly over the past few years, but have shown recent signs of stabilization, with some of our newer appraisals tending to reflect values at or above prior year values.

It also appears that the housing market in our primary market area is beginning to show signs of stabilization. Based on U.S. Census data, housing building permits in the Grand Rapids-Wyoming metropolitan area were up approximately 7.65% in 2010 compared to 2009. In the Holland-Grand Haven metropolitan area, housing building permits were up approximately 9.21% in 2010 compared to 2009.

Over the past two years, we have reduced our balance of loans outstanding, diversified our commercial loan portfolio, reduced concentrations to residential real estate developers and increased our consumer loan portfolio and residential mortgage activity as a percentage of overall production. This has included adding experienced residential mortgage lenders and pulling back on commercial loan production in some cases. Our loans to residential developers have decreased from $95.7 million at December 31, 2010 to $66.3 million at December 31, 2011. In addition, overall commercial real estate loans have decreased from $933.9 million at December 31, 2010 to $795.3 million at December 31, 2011. Consumer loans have decreased at a slower pace, totaling $275.7 million at December 31, 2011, compared to $283.3 million at December 31, 2010. With our improved financial condition and successful capital raise in 2011, we expect our focus will shift from shrinkage in our loan portfolio to stabilizing our loan balances and slight growth in certain portfolios in 2012.

We have no material foreign loans, assets or activities. No material part of our business is dependent on a single customer or very few customers.

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

Table of Contents

Regulatory Developments

Termination of Consent Order with the Bank and its Regulators

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

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

Written Agreement with Macatawa Bank Corporation and its Regulator

Macatawa Bank Corporation has formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB") with an effective date of July 23, 2010. Among other things, the Written Agreement provides that Macatawa Bank Corporation: (i) must take appropriate steps to fully utilize its financial and managerial resources to serve as a source of strength to the Bank; (ii) may not declare or pay any dividends without prior FRB approval; (iii) may not take dividends or any other payment representing a reduction in capital from the Bank without prior FRB approval; (iv) may not make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior FRB approval; (v) may not incur, increase or guarantee any debt without prior FRB approval; (vi) may not purchase or redeem any shares of its stock without prior FRB approval; (vii) must submit a written capital plan to the FRB within 60 days of the Written Agreement; and (viii) 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. Macatawa Bank Corporation separately requested and received approval from the FRB to make its third and fourth quarter 2010 and all of its 2011 quarterly interest payments on its $1.65 million in outstanding subordinated debt. Each quarter Macatawa Bank Corporation intends to request approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the interest amounts due.

Table of Contents

Deposit Gathering Activities

Because the Bank was subject to the Consent Order at December 31, 2011, it could not be categorized as "well-capitalized," regardless of actual capital levels. As a result, at December 31, 2011 the Bank was subject to restrictions in its deposit gathering activities, including limitations on the interest rate paid for deposits and that it could not accept, renew or rollover any brokered deposit unless it had applied for and had been granted a waiver of this prohibition by the FDIC. As a result of the termination of the Consent Order, these restrictions will no longer be applicable to the Bank if it is otherwise categorized as “well capitalized.” We expect the Bank to be categorized as “well capitalized” at March 31, 2012. The Bank has not accepted or renewed brokered deposits since November of 2008 and the final brokered deposit was paid off at maturity in December 2011. The Bank expects to continue its focus on attracting and maintaining core deposits to achieve a non-core funding dependency ratio of below its peer group average.

Products and Services

Loan Portfolio

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

Commercial and Industrial Loans

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

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

Commercial Real Estate Loans

Because of the risks associated with this type of lending, combined with the sharp decline in demand for and resulting values of real estate in our market in recent years, we experienced a significant increase in non-performing loan levels during 2008 and 2009 and the first quarter of 2010 primarily associated with commercial real estate loans. The nonperforming loan balances are more fully discussed in Item 7 of this report under the heading "Loan Portfolio and Asset Quality" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition."

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

Table of Contents

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