MACATAWA BANK CORP
Form 10-Q
April 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 March 31, 2011

OR

[ ] 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

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 [ ]

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 [ ] No [ ]

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 [ ] Accelerated filer [ ] Non-accelerated filer [ ] 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 [ ] No [X]

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 17,679,621 shares of the Company's Common Stock (no par value) were outstanding as of April 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, capital raising activities, dividends, future growth and funding sources, future liquidity levels, future profitability 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 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 fully comply with our Consent Order and Written Agreement, raise capital, improve regulatory capital ratios, sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, address regulatory issues, improve internal controls over financial reporting, 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 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 March 31, 2011 (unaudited) and December 31, 2010

(dollars in thousands)	March 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 24,265	$ 21,274
Federal funds sold and other short-term investments	238,362	214,853
Cash and cash equivalents	262,627	236,127
Securities available for sale, at fair value	12,660	9,120
Securities held to maturity (fair value 2010 - $83)	---	83
Federal Home Loan Bank stock	11,932	11,932
Loans held for sale, at fair value	942	2,537
Total loans	1,153,992	1,217,196
Allowance for loan losses	(42,343)	(47,426)
Net loans	1,111,649	1,169,770
Premises and equipment - net	56,410	56,988
Accrued interest receivable	3,721	3,845
Bank-owned life insurance	25,229	25,014
Other real estate owned	64,992	57,984
Other assets	7,073	4,861
Total assets	$ 1,557,235	$ 1,578,261
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 282,050	$ 255,897
Interest-bearing	982,615	1,020,723
Total deposits	1,264,665	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	6,259	5,575
Total liabilities	1,488,082	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; 17,679,621 shares issued and outstanding	167,338	167,321
Retained deficit	(131,363)	(132,654)
Accumulated other comprehensive income	14	11
Total shareholders' equity	69,153	67,842
Total liabilities and shareholders' equity	$ 1,557,235	$ 1,578,261

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three Month Periods Ended March 31, 2011 and 2010 (unaudited)

(dollars in thousands, except per share data)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Interest income		
Loans, including fees	$ 15,582	$ 19,623
Securities	27	1,191
FHLB Stock	76	62
Federal funds sold and other short-term investments	168	61
Total interest income	15,853	20,937
Interest expense		
Deposits	2,912	5,408
Debt and other borrowed funds	1,343	2,501
Total interest expense	4,255	7,909
Net interest income	**11,598**	**13,028**
Provision for loan losses	(1,450)	19,710
Net interest income (loss) after provision for loan losses	**13,048**	**(6,682)**
Noninterest income		
Service charges and fees	949	1,065
Net gains on mortgage loans	435	181
Trust fees	651	890
ATM and debit card fees	852	785
Other	792	547
Total noninterest income	3,679	3,468
Noninterest expense		
Salaries and benefits	5,347	5,450
Occupancy of premises	1,011	1,052
Furniture and equipment	817	981
Legal and professional	270	769
Marketing and promotion	224	215
Data processing	304	346
FDIC assessment	978	1,257
ATM and debit card processing	271	310
Bond and D&O Insurance	379	548
Losses on repossessed and foreclosed properties	2,493	3,643
Administration of problem assets	1,941	1,892
Other	1,401	1,463
Total noninterest expenses	15,436	17,926
Net income (loss) before income tax	**1,291**	**(21,140)**
Income tax expense (benefit)	0	0
Net income (loss)	**1,291**	**(21,140)**
Dividends declared on preferred shares	0	0
Net income (loss) available to common shares	**$ 1,291**	**$ (21,140)**
Basic earnings (loss) per common share	$ .07	$ (1.19)
Diluted earnings (loss) per common share	$ .07	$ (1.19)
Cash dividends per common share	$ 0.00	$ 0.00

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three Month Periods Ended March 31, 2011 and 2010
(unaudited)

(dollars in thousands)	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
Net income (loss)	$	1,291	$	(21,140)
Other comprehensive income (loss), net of tax:				
Net change in unrealized gains on securities available for sale		3		38
Comprehensive income (loss)	**$**	**1,294**	**$**	**(21,102)**

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three Month Periods Ended March 31, 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 three months ended March 31, 2010				(21,140)		(21,140)
Other comprehensive income (loss), net of tax:						
Net change in unrealized gain (loss) on securities available for sale					38	38
Comprehensive loss						(21,102)
Stock compensation expense			28			28
Balance, March 31, 2010	**$30,604**	**$2,560**	**$167,211**	**$(135,940)**	**$2,482**	**$66,917**
Balance, January 1, 2011	**$30,604**	**$2,560**	**$167,321**	**(132,654)**	**$ 11**	**67,842**
Net income for three months ended March 31, 2011				1,291		1,291
Other comprehensive income (loss), net of tax:						
Net change in unrealized gain (loss) on securities available for sale					3	3
Comprehensive income						1,294
Stock compensation expense			17			17
Balance, March 31, 2011	**$30,604**	**$2,560**	**$167,338**	**$(131,363)**	**$ 14**	**$69,153**

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Month Periods Ended March 31, 2011 and 2010 (unaudited)

(dollars in thousands)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash flows from operating activities		
Net income (loss)	$ 1,291	$ (21,140)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	781	896
Stock compensation expense	17	28
Provision for loan losses	(1,450)	19,710
Origination of loans for sale	(16,671)	(9,744)
Proceeds from sales of loans originated for sale	18,701	9,052
Net gains on mortgage loans	(435)	(181)
Write-down of other real estate	2,699	3,516
Net (gain) loss on sales of other real estate	(212)	120
Decrease (increase) in accrued interest receivable and other assets	(2,157)	80
Earnings in bank-owned life insurance	(215)	(200)
Increase (decrease) in accrued expenses and other liabilities	684	(473)
Net cash from operating activities	3,033	1,664
Cash flows from investing activities		
Loan originations and payments, net	45,092	41,204
Purchases of securities available for sale	(10,549)	0
Proceeds from:		
Maturities and calls of securities available for sale	6,988	13,986
Principal paydowns on securities	85	82
Sales of other real estate	4,984	5,711
Additions to premises and equipment	(112)	(201)
Net cash from investing activities	46,488	60,782
Cash flows from financing activities		
Net decrease in in-market deposits	(6,360)	(3,505)
Net decrease in brokered deposits	(5,595)	(42,065)
Proceeds from other borrowed funds	---	20,000
Repayments of other borrowed funds	(11,066)	(66,020)
Net cash from financing activities	(23,021)	(91,590)
Net change in cash and cash equivalents	26,500	(29,144)
Cash and cash equivalents at beginning of period	236,127	78,749
Cash and cash equivalents at end of period	$ 262,627	$ 49,605
Supplemental cash flow information		
Interest paid	$ 3,950	$ 7,805
Supplemental noncash disclosures:		
Transfers from loans to other real estate	14,479	17,954

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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 month period ended March 31, 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.

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™ 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. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010 and have been added to Note 3. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010 and have been added to 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 are effective for periods beginning after December 15, 2009. The disclosures about the reconciliation of information in Level 3 recurring fair value measurements are required for periods beginning after December 15, 2010. Adoption of this standard did not have a significant impact on our quarterly 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* (April 2011). 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.

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 requirements of the Consent Order are summarized in our 2010 Form 10-K.

The Consent Order covers various aspects of the Bank's financial condition and performance; loan administration; and capital planning.

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 March 31, 2011, the Bank's Tier 1 Leverage Capital Ratio was 7.1% and the Total Risk Based Capital Ratio was 10.4%, which would ordinarily categorize the Bank as "well capitalized" under the regulatory capital standards absent the Consent Order. The Bank needed a capital injection of approximately $14.0 million as of March 31, 2011 to comply with the Tier 1 Leverage Capital Ratio requirement and needed a capital injection of approximately $7.1 million to comply with the Total Risk Based Capital Ratio requirement of the Consent Order. This has declined significantly since March 31, 2010, when the Company needed $43.2 million to comply with the Tier 1 Leverage Capital Ratio requirement.

The Company has developed a capital plan including evaluation of alternatives to reach and maintain the capital levels required by the Consent Order. Achievement of these capital levels could be impacted, positively or negatively, by certain uncertainties, including, but not limited to, earnings levels, changing economic conditions, asset quality, property values and the receptiveness of capital markets to new capital offerings of the Company.

Strategies to increase the Bank's regulatory capital ratios in order to comply with the capital requirements of the Consent Order include reducing operating costs, shrinking assets of the Bank without weakening its liquidity position, preserving capital through suspension of dividends, and raising additional capital. More information regarding these strategies is included in our 2010 Form 10-K.

The Company earlier increased its capital through the sale of $31.3 million of Series A Preferred Stock in the fourth quarter of 2008. During second and third quarters of 2009, the Company increased its capital by $5.9 million through the issuance of Series B Preferred Stock, common stock and subordinated debt.

The Company also remains active at exploring alternatives to raise new capital. In February 2011, the Company filed a registration statement with the Securities and Exchange Commission to offer shares of common stock in a rights offering and a public offering in order to raise equity capital. On March 25, 2011, the Company's shareholders approved an increase in authorized common shares from 40 million to 200 million.

We believe that, as of March 31, 2011, the Bank was in compliance in all material respects with all of the provisions of the Consent Order, other than the minimum capital requirements.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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) 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 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.

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 to be submitted by 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.

Other than acceptance by the FRB of a capital plan and a plan for meeting cash flow obligations for 2011, the Company believes that, as of March 31, 2011, it 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, it cannot be categorized as "well-capitalized," regardless of actual capital levels. As a result, the Bank 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 maturing brokered deposits under its current liquidity contingency program.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management 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 factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative environmental factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class as well as the loan risk grade assignment for commercial loans. At March 31, 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 for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

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

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.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 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 March 31, 2011, the need to maintain a full valuation allowance was based primarily on our net operating losses for in 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.

NOTE 2 - SECURITIES

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

March 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale:				
U.S. Treasury and federal agency securities	$ 11,638	$ 27	$ (13)	$ 11,652
Other equity securities	1,000	8	---	1,008
	$ 12,638	$ 35	$ (13)	$ 12,660
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 month periods ended March 31, 2011 and 2010.

Contractual maturities of debt securities at March 31, 2011 were as follows (dollars in thousands):

	Available-for-Sale Securities	
	Amortized Cost	Fair Value
Due in one year or less	$ 1,000	$ 1,000

Due from one to five years	9,545	9,548
Due from five to ten years	1,019	1,028
Due after ten years	74	76
	$ 11,638	$ 11,652

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NOTE 2 - SECURITIES(Continued)

Securities with unrealized losses at March 31, 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	$ 5,033	$ (13)	$ ---	$ ---	$ 5,033	$ (13)
State and municipal bonds	---	---	---	---	---	---
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$ 5,033	$ (13)	$ ---	$ ---	$ 5,033	$ (13)

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 first quarter of 2011 and all of 2010.

At March 31, 2011 and December 31, 2010, securities with a carrying value of approximately $1,970,000 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):

	March 31, 2011	December 31, 2010
Commercial and industrial	$ 260,669	$ 264,679
Commercial real estate:		
Residential developed	47,663	46,835
Unsecured to residential developers	2,621	7,631
Vacant and unimproved	68,193	71,528
Commercial development	5,576	8,952
Residential improved	91,690	96,784
Commercial improved	330,842	355,899
Manufacturing and industrial	79,162	81,560
Total commercial real estate	625,747	669,189
Consumer		
Residential mortgage	127,405	135,227
Unsecured	2,300	2,867
Home equity	119,166	125,866
Other secured	18,705	19,368
Total consumer	267,576	283,328
Total loans	1,153,992	1,217,196
Allowance for loan losses	(42,343)	(47,426)
	$ 1,111,649	$ 1,169,770

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

Three months ended March 31, 2011:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,012	$ 34,973	$ 5,415	$ 26	$ 47,426
Charge-offs	(804)	(2,397)	(931)	---	(4,132)
Recoveries	193	250	56	---	499
Provision for loan losses	790	(2,119)	(117)	(4)	(1,450)
Ending Balance	$ 7,191	$ 30,707	$ 4,423	$ 22	$ 42,343

Three months ended March 31, 2010:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,086	$ 45,759	$ 2,767	$ 11	$ 54,623
Charge-offs	(3,721)	(9,620)	(895)	---	(14,236)
Recoveries	271	391	23	---	685
Provision for loan losses	3,353	14,838	1,518	1	19,710
Ending Balance	$ 5,989	$ 51,368	$ 3,413	$ 12	$ 60,782

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MACATAWA BANK CORPORATION
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NOTE 3 - LOANS (Continued)

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

March 31, 2011:

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 2,152	$ 5,910	$ 533	$ ---	$ 8,595
Collectively evaluated for impairment	5,039	24,797	3,890	22	33,748
Total ending allowance balance	$ 7,191	$ 30,707	$ 4,423	$ 22	$ 42,343
Loans:					
Individually reviewed for impairment	$ 4,556	$ 57,755	$ 14,388	$ ---	$ 76,699
Collectively evaluated for impairment	256,113	567,992	253,188	---	1,077,293
Total ending loans balance	$ 260,669	$ 625,747	$ 267,576	$ ---	$ 1,153,992

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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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 - LOANS (Continued)

Impaired loans were as follows (dollars in thousands)

	March 31, 2011	December 31, 2010
Impaired commercial loans with no allocated allowance for loan losses	$ 26,030	$ 48,519
Impaired loans with allocated allowance for loan losses:		
Impaired commercial loans	36,281	29,915
Consumer mortgage loans modified under a troubled debt restructuring	14,388	13,752
	50,669	43,667
Total impaired loans	$ 76,699	$ 92,186
Amount of the allowance for loan losses allocated	$ 8,595	$ 7,368

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Average of impaired loans during the period:		
Commercial and industrial	$ 4,725	$ 12,179
Commercial real estate:		
Residential developed	16,141	22,536
Unsecured to residential developers	915	1,278
Vacant and unimproved	4,948	6,908
Commercial development	825	1,152
Residential improved	8,695	12,140
Commercial improved	21,909	30,589
Manufacturing and industrial	8,349	11,657
Consumer	12,755	11,098
Interest income recognized during impairment:		
Commercial and industrial	(14)	154
Commercial real estate	523	60
Consumer	110	100
Cash-basis interest income recognized		
Commercial and industrial	52	118
Commercial real estate	509	358
Consumer	110	121

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MACATAWA BANK CORPORATION
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NOTE 3 - LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of March 31, 2011 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$ ---	$ ---	$ ---
Commercial real estate:			
Residential developed	24,221	6,903	---
Unsecured to residential developers	2,550	279	---
Vacant and unimproved	3,541	3,541	---
Commercial development	---	---	---
Residential improved	3,616	3,616	---
Commercial improved	10,900	10,100	---
Manufacturing and industrial	2,061	1,591	---
	46,889	26,030	
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	---	---	---
	$ 46,889	$ 26,030	$ ---
With an allowance recorded:			
Commercial and industrial	$ 4,556	$ 4,556	$ 2,152
Commercial real estate:			
Residential developed	7,470	7,470	2,343
Unsecured to residential developers	2,364	609	227
Vacant and unimproved	2,322	2,322	3
Commercial development	223	223	22
Residential improved	5,798	5,780	1,009
Commercial improved	6,913	6,736	1,258
Manufacturing and industrial	8,585	8,585	1,048
	33,675	31,725	5,910
Consumer:			
Residential mortgage	14,388	14,388	533
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	14,388	14,388	533
Total	$ 57,175	$ 50,669	$ 8,595

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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 March 31, 2011:

	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$ 10,769	$ ---
Commercial real estate:		
Residential developed	10,085	---
Unsecured to residential developers	888	---
Vacant and unimproved	7,043	411
Commercial development	833	---
Residential improved	9,234	---
Commercial improved	14,544	---
Manufacturing and industrial	412	---
	43,039	411
Consumer:		
Residential mortgage	1,489	---
Unsecured	24	---
Home equity	291	71
Other secured	---	3
	1,804	74
Total	$ 55,612	$ 485

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 March 31, 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	$ 783	$ 4,824	$ 5,607	$ 255,062	$ 260,669
Commercial real estate:					
Residential developed	1,022	3,647	4,669	42,994	47,663
Unsecured to residential developers	279	609	888	1,733	2,621
Vacant and unimproved	161	4,251	4,412	63,781	68,193
Commercial development	---	808	808	4,768	5,576
Residential improved	1,130	5,683	6,813	84,877	91,690
Commercial improved	3,787	9,724	13,511	317,331	330,842
Manufacturing and industrial	169	412	581	78,581	79,162
	6,548	25,134	31,682	594,065	625,747
Consumer:					
Residential mortgage	1,485	1,027	2,512	124,893	127,405
Unsecured	48	---	48	2,252	2,300
Home equity	1,101	151	1,252	117,914	119,166
Other secured	117	2	119	18,586	18,705
	2,751	1,180	3,931	263,645	267,576
Total	$ 10,082	$ 31,138	$ 41,220	$ 1,112,772	$ 1,153,992

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
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 - LOANS (Continued)

The Company has allocated $996,000 and $1,361,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of March 31, 2011 and December 31, 2010, respectively. These loans involved the restructuring of terms to allow customers to mitigate 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 March 31, 2011 (dollars in thousands):

	Number of Loans	Outstanding Recorded Balance
Commercial and industrial	15	$ 2,644
Commercial real estate	43	22,666
Consumer	76	14,388

Included in these totals are $458,000 of nonperforming commercial and industrial restructurings, $1,534,000 of nonperforming commercial real estate restructurings and $1,295,000 of nonperforming consumer loan restructurings as of March 31, 2011.

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MACATAWA BANK CORPORATION
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NOTE 3 - LOANS (Continued)

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 give 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 though the loan review process. The credit will stay on the ALR until either its grade has improved to a 4 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.

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 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.

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MACATAWA BANK CORPORATION
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NOTE 3 - LOANS (Continued)

As of March 31, 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	$ 381	$ 1,369	$ 52,939	$ 148,891	$ 37,292	$ 9,027	$ 10,770	$ ---
Commercial real estate:								
Residential developed	---	---	1,319	9,935	15,039	11,285	10,085	---
Unsecured to residential developers	---	---	237	858	173	465	888	---
Vacant and unimproved	---	---	6,444	37,527	13,467	3,712	7,043	---
Commercial development	---	---	---	3,022	1,523	198	833	---
Residential improved	---	---	2,909	49,396	15,939	14,213	9,234	---
Commercial improved	---	---	69,936	181,791	41,315	23,256	14,544	---
Manufacturing and industrial	---	238	14,809	37,481	20,974	5,247	412	---
	$ 381	$ 1,607	$ 148,593	$ 468,901	$ 145,722	$ 67,403	$ 53,809	$ ---

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	$ ---

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):

March 31, 2011	Residential Mortgage	Consumer Unsecured	Home Equity	Consumer Other
Performing	$ 126,378	$ 2,300	$ 119,015	$ 18,703
Nonperforming	1,027	---	151	2
Total	$ 127,405	$ 2,300	$ 119,166	$ 18,705

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 3 - LOANS (Continued)

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

	March 31, 2011	December 31, 2010
Not classified as impaired	$ 58,901	$ 65,533
Classified as impaired	62,311	78,434
Total loans classified substandard or worse	$ 121,212	$ 143,967

At March 31, 2011, approximately $53.8 million of the $121.2 million of loans classified as substandard or worse were on nonaccrual status, while the remaining $71.4 million of these loans were on accrual status.

At December 31, 2010, approximately $74.8 million of the $144.0 million of loans classified as substandard or worse were on nonaccrual status, while the remaining $69.2 million of these loans were on accrual status.

NOTE 4 - OTHER REAL ESTATE OWNED

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

	Three Months Ended March 31, 2011	Year Ended December 31, 2010	Three Months Ended March 31, 2010
Beginning balance	$ 68,388	$ 41,987	$ 41,987
Additions, transfers from loans	14,479	45,248	17,954
Proceeds from sales of other real estate owned	(4,984)	(16,003)	(5,711)
Valuation allowance reversal upon sale	(1,083)	(2,677)	(710)
Gain (loss) on sale of other real estate owned	212	(167)	(120)
	77,012	68,388	53,400
Less: valuation allowance	(12,020)	(10,404)	(7,610)
Ending balance	$ 64,992	$ 57,984	$ 45,790

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Beginning balance	$ 10,404	$ 4,804
Additions charged to expense	2,699	3,516
Deletions upon disposition	(1,083)	(710)

Ending balance	$	12,020	$	7,610

Net realized gains on sales of other real estate were $212,000 for the three month period ended March 31, 2011. Net realized losses on sales of other real estate were $120,000 for the three month period ended March 31, 2010.

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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.

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: Nonrecurring adjustments to certain 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.

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NOTE 5 - FAIR VALUE (Continued)

Assets and liabilities 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)
Assets:				
March 31, 2011				
U.S. Treasury and federal agency securities	$ 11,652	$ ---	$ 11,652	$ ---
Other equity securities	1,008	---	1,008	---
Loans held for sale	942	---	942	---
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 and liabilities 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)
Assets:				
March 31, 2011				
Impaired loans	$ 25,050	$ ---	$ ---	$ 25,050
Other real estate owned	45,019	---	---	45,019
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 March 31, 2011 and December 31, 2010 (dollars in thousands).

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 262,627	$ 262,627	$ 236,127	$ 236,127
Securities held to maturity	---	---	83	83
FHLB stock	11,932	N/A	11,932	N/A
Loans, net	1,111,649	1,118,394	1,169,770	1,169,497
Accrued interest receivable	3,721	3,721	3,845	3,845
Financial liabilities				
Deposits	(1,264,665)	(1,267,213)	(1,276,620)	(1,280,238)
Other borrowed funds	(174,270)	(175,455)	(185,336)	(187,104)
Long-term debt	(41,238)	(34,555)	(41,238)	(34,506)
Subordinated debt	(1,650)	(1,650)	(1,650)	(1,650)
Accrued interest payable	(2,706)	(2,706)	(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):

	March 31, 2011	December 31, 2010
Noninterest-bearing demand	$ 282,050	$ 255,897
Interest bearing demand	182,700	216,827
Savings and money market accounts	384,932	355,657
Certificates of deposit	414,983	448,239
	$ 1,264,665	$ 1,276,620

Approximately $175.6 million and $192.7 million in certificates of deposit were in denominations of $100,000 or more at March 31, 2011 and December 31, 2010, respectively.

Brokered deposits totaled approximately $42.6 million and $48.2 million at March 31, 2011 and December 31, 2010, respectively. At both March 31, 2011 and December 31, 2010, brokered deposits had interest rates ranging from 3.75% to 4.55%. The remaining balance of $42.6 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
March 31, 2011			
Single maturity fixed rate advances	$ 160,000	May 2011 to November 2015	1.94%
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. Putable advances are fixed rate advances that can be changed to a variable rate at the option of the FHLB. If the FHLB exercises that option, these advances may be repaid without penalty. These advances were collateralized by residential and commercial real estate loans totaling $373.7 million and $420.5 million under a physical loan collateral delivery arrangement at March 31, 2011 and December 31, 2010, respectively.

Scheduled repayments of FHLB advances as of March 31, 2011 were as follows (in thousands):

2011	$ 35,667
2012	66,781
2013	31,831
2014	21,884
2015	11,938
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 March 31, 2011 and 2010 are as follows (dollars in thousands, except per share data):

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net income (loss)	$ 1,291	$ (21,140)
Dividends declared on preferred shares	---	---
Net income (loss) available to common shares	$ 1,291	$ (21,140)
Weighted average shares outstanding, including participating stock awards - Basic	17,679,621	17,696,922
Dilutive potential common shares:		
Stock options	---	---
Conversion of preferred stock	---	---
Stock warrants	---	---
Weighted average shares outstanding - Diluted	17,679,621	17,696,922
Basic earnings (loss) per common share	$ 0.07	$ (1.19)
Diluted earnings (loss) per common share (1)	0.07	(1.19)

(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 714,766 and 918,437 shares of common stock for the three month periods ended March 31, 2011 and 2010, respectively, were not considered in computing diluted earnings per 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 March 31, 2011	Three Months Ended March 31, 2010
Current	$ (2)	$ (21)
Deferred (benefit) expense	2	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):

	2011	2010
Statutory rate	35%	35%
Statutory rate applied to income (loss) before taxes	$ 452	$ (7,399)
Add (deduct)		
Change in valuation allowance	(355)	7,652
Tax-exempt interest income	---	(167)
Bank-owned life insurance	(75)	(70)
Other, net	(22)	(16)
	$ ---	$ ---

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.

At March 31, 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 March 31, 2011, the valuation allowance was $25.3 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. If the Company returns to consistent, sustained profitability, the need for the valuation allowance would diminish.

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

	March 31, 2011	December 31, 2010
Deferred tax asset		
Allowance for loan losses	$ 14,820	$ 16,599
Nonaccrual loan interest	387	548
Valuation allowance on other real estate owned	4,207	3,641
Net operating loss carryforward	7,744	6,656
Other	885	975
Gross deferred tax assets	28,043	28,419
Valuation allowance	(25,294)	(25,649)
Total net deferred tax assets	2,749	2,770

Deferred tax liabilities		
Depreciation	(1,932)	(1,984)
Purchase accounting adjustments	(89)	(113)
Unrealized gain on securities available for sale	(8)	(6)
Prepaid expenses	(407)	(347)
Other	(313)	(320)
Gross deferred tax liabilities	(2,749)	(2,770)
Net deferred tax asset	$ ---	$ ---

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NOTE 9 - FEDERAL INCOME TAXES (Continued)

At March 31, 2011, we had federal net operating loss carryforwards of $22.1 million that expire in 2030.

There were no unrecognized tax benefits at March 31, 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 of March 31, 2011, there were no material pending legal proceedings, other than routine litigation incidental to the business of banking, 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.

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.

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NOTE 11 - SHAREHOLDERS' EQUITY (Continued)

At March 31, 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
March 31, 2011								
Total capital (to risk weighted assets)								
Consolidated	$ 125,730	10.3%	$ 97,266	8.0%	N/A	N/A	N/A	N/A
Bank	126,578	10.4	97,201	8.0	$ 121,502	10.0%	$ 133,652	11.0%
Tier 1 capital (to risk weighted assets)								
Consolidated	91,389	7.5	48,633	4.0	N/A	N/A	N/A	N/A
Bank	111,050	9.1	48,601	4.0	72,901	6.0	N/A	N/A
Tier 1 capital (to average assets)								
Consolidated	91,389	5.8	62,608	4.0	N/A	N/A	N/A	N/A
Bank	111,050	7.1	62,518	4.0	78,148	5.0	125,037	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 $22.8 million and $22.4 million of trust preferred securities outstanding at March 31, 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 March 31, 2011 and December 31, 2010. The Bank's regulatory capital ratios exceeded the levels ordinarily required to be categorized as "well capitalized" at March 31, 2011. However, because the Bank is subject to the Consent Order, the Bank cannot be categorized as "well capitalized" regardless of actual capital levels.

As part of the Consent Order, the Bank is required 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%. The Bank needed a capital injection of approximately $14.0 million as of March 31, 2011 to comply with the Tier 1 Leverage Capital Ratio requirement and needed a capital injection of approximately $7.1 million at March 31, 2011 to comply with the Total Risk Based Ratio requirement of the Consent Order. The ability of the Bank to achieve these requirements is largely dependent on the success of capital raising initiatives in process by the Company as discussed previously. 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 $37.9 million at March 31, 2011.

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MACATAWA BANK CORPORATION
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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 has an interest rate of 2%, compounded quarterly in arrears. Accrued interest is payable in full at maturity, or at the date the principal is paid in full. The note has a maturity date of April 30, 2018. The Company may prepay the note in whole or in part at any time from and after September 30, 2011. If and when the Company conducts a registered public offering of its common stock prior to April 30, 2012, the note allows 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 has 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.

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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 March 31, 2011, we had total assets of $1.56 billion, total loans of $1.15 billion, total deposits of $1.26 billion and shareholders' equity of $69.2 million. During the first quarter of 2011, we recognized net income of $1.3 million compared to a net loss of $21.1 million in the first quarter of 2010. This represented our fourth 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. As of March 31, 2011, the Bank's capital ratios returned to levels ordinarily required to be categorized "well capitalized" under applicable regulatory guidelines, but are below the requirements in our Consent Order. As a result, we remained categorized as "adequately capitalized" at March 31, 2011.

The weak local and national economic conditions that persisted over the past few years contributed to the 2010 operating loss and the $38.9 million and $63.6 million of annual operating losses reported by us during 2008 and 2009. 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 it could 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 improve our internal operations and to work out of our problem loans and assets. We believe our improved results over the past four 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 March 31, 2011, we believe that the Bank was in compliance in all material respects with all of the provisions of the Consent Order, other than the minimum capital requirements. As of the same date, we believe that we were in compliance in all material respects with all of the provisions of the Written Agreement, other than acceptance by the FRB of a capital plan and a plan for meeting cash flow obligations for 2011. 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 March 31, 2011 was $1.3 million, compared to first quarter 2010 net loss of $21.1 million. Net income per common share on a diluted basis was $0.07 for the first quarter of 2011 compared to a net loss per common share of $1.19 for the same period in 2010.

The improvement in earnings in the first quarter of 2011 was due primarily to a significantly lower level of net chargeoffs from $13.6 million in the first quarter of 2010 to $3.6 million in the first quarter of 2011, our lowest quarterly level of net chargeoffs since the third quarter of 2008. This, coupled with a decline in non-performing and impaired loan levels, resulted in a decrease of $21.1 million in the provision for loan losses. The provision for loan losses was a negative $1.45 million for the three month period ended March 31, 2011 compared to $19.7 million for the same period in 2010.

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 were $4.4 million for the first quarter of 2011 compared to $5.5 million for the first quarter of 2010. Lost interest from elevated levels of nonperforming assets was approximately $2.1 million and $2.6 million for the first quarter of 2011 and 2010, respectively. Each of these items is discussed more fully below.

Net Interest Income: Net interest income totaled $11.6 million for the first quarter of 2011 compared to $13.0 million for the first quarter of 2010.

The decrease in net interest income was due primarily to a $211.5 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 3.22% for the first quarters of both 2011 and 2010.

Average interest earning assets decreased from $1.65 billion for the first three months of 2010 to $1.44 billion for the same period in 2011. Our average yield on earning assets for the first three months of 2011 declined 73 basis points from 5.15% to 4.42%.

The declines 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 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.

The cost of funds decreased 74 basis points to 1.42% in the first quarter of 2011 from 2.16% 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 impacted 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.

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The following table shows an analysis of net interest margin for the three month periods ended March 31, 2011 and 2010.

	For the three months ended March 31,					
	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	$ 11,632	$ 26	0.91%	$ 68,221	$ 666	3.91%
Tax-exempt securities (1)	76	1	6.95%	50,115	525	6.46%
Loans (2)	1,184,429	15,582	5.27%	1,474,356	19,623	5.23%
Federal Home Loan Bank stock	11,932	76	2.56%	12,275	62	2.02%
Federal funds sold and other short-term investments	229,569	168	0.29%	44,154	61	0.56%
Total interest earning assets (1)	1,437,638	15,853	4.42%	1,649,121	20,937	5.15%
Noninterest earning assets:						
Cash and due from banks	21,868			23,712		
Other	106,276			112,453		
Total assets	$ 1,565,782			$ 1,785,286		
Liabilities						
Deposits:						
Interest bearing demand	$ 178,942	$ 103	0.23%	$ 245,394	$ 231	0.38%
Savings and money market accounts	370,640	543	0.59%	335,423	487	0.59%
Time deposits	434,534	2,266	2.11%	600,840	4,690	3.17%
Borrowings:						
Other borrowed funds	186,340	1,000	2.15%	258,981	2,180	3.37%
Long-term debt	41,238	343	3.34%	41,238	321	3.12%
Total interest bearing liabilities	1,211,694	4,255	1.42%	1,481,876	7,909	2.16%
Noninterest bearing liabilities:						
Noninterest bearing demand accounts	278,998			213,044		
Other noninterest bearing liabilities	6,166			6,674		
Shareholders' equity	68,924			83,692		
Total liabilities and shareholders' equity	$ 1,565,782			$ 1,785,286		
Net interest income		$ 11,598			$ 13,028	
Net interest spread (1)			3.00%			2.99%
Net interest margin (1)			3.22%			3.22%
Ratio of average interest earning assets to			&nb			