

**FORM 10-K**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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

For the fiscal year ended December 31, 2005

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**  
(State of other jurisdiction of  
incorporation or organization)

**38-3391345**  
(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: None

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock.

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

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 ☐ No ☒

Indicate by check mark whether the issuer: (1) 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 ☒ No ☐

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. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

As of June 30, 2005, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$345,652,547 based on the closing sale price of \$34.69 as reported on the National Association of Securities Dealers Automated Quotation System. As of March 3, 2006, there were 10,271,465 outstanding shares of the Company's common stock (no par value). Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held April 20, 2006 are incorporated by reference into Part II and Part III of the Report.

## PART I

### ITEM 1: Business

*As used in this Annual Report, the terms "we," "us," "our" and "Macatawa" mean Macatawa Bank Corporation and its subsidiaries, unless the context indicates another meaning.*

#### General

Macatawa Bank Corporation is a Michigan corporation and is a financial holding company and the bank holding company for its wholly owned banking subsidiary, Macatawa Bank, as well as Macatawa Investment Services, Inc., Macatawa Statutory Trust I and Macatawa Statutory Trust II. Effective January 9, 2002, Macatawa Bank Corporation elected to become a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. Macatawa Bank commenced operations on November 25, 1997. Grand Bank was formed in 1987 and operated from a single location in Grand Rapids, Michigan. Grand Bank became a wholly owned subsidiary effective April 1, 2002 upon the completion of the acquisition of Grand Bank Financial Corporation (GBFC), and its results are included in the consolidated statements of income since this effective date. To achieve further synergies from the Grand Bank acquisition, we merged Grand Bank into Macatawa Bank effective January 1, 2003 with the combined bank named Macatawa Bank. At the same time, Grand Bank Mortgage Company was merged into Macatawa Bank Mortgage Company.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates twenty-three branch offices and a lending and operational service facility offering commercial and personal banking services, including checking and savings accounts (including certificates of deposit), cash management, safe deposit boxes, travelers checks, money orders, trust services and commercial, mortgage and consumer loans in Kent County, Ottawa County, and northern Allegan County, Michigan. Other service delivery channels we offer include ATMs, internet banking, telephone banking and debit cards. Macatawa Investment Services was formed in October 2001 and gained approval in June 2002 from the NASD to commence operations as a broker/dealer. Macatawa Investment Services provides various brokerage services including discount brokerage, personal financial planning and consultation regarding mutual funds. Macatawa Statutory Trust I is a grantor trust that issued a pooled trust preferred security in July, 2003. Macatawa Statutory Trust II is a grantor trust that issued a pooled trust preferred security in March, 2004. Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, originates and sells residential mortgage loans into the secondary market on a servicing released basis. As of December 31, 2005, we had total assets of \$1.87 billion, total deposits of \$1.51 billion, approximately 87,000 deposit accounts and shareholders' equity of \$141.7 million.

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](http://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 such reports with the Securities and Exchange Commission. The reference to our website address does not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

## Products and Services

**Deposit Services.** We offer a broad range of deposit services, including checking accounts, savings accounts and time deposits of various types. Transaction accounts and savings and time certificates are tailored to the principal market area at rates competitive with those offered in the area. All deposit accounts are insured by the FDIC up to the maximum amount permitted by law. We solicit these accounts from individuals, businesses, associations, churches, nonprofit organizations, financial institutions and government authorities. We may also use alternative funding sources as needed, including short-term borrowings, advances from Federal Home Loan Banks, certificates of deposit purchased from brokers and the packaging of loans for securitization and sale.

Deposits are gathered primarily from the communities we serve through our network of 23 branches. We offer business and consumer checking accounts, regular and money market savings accounts, and certificates of deposit having many options in their terms.

We set our deposit pricing to be competitive with other banks in our market area. This has enabled us to increase deposits from new, as well as existing customers, while maintaining a healthy net interest margin. We periodically purchase brokered deposits to supplement funding needs. These are time accounts originated outside of our local market area. Brokered deposits comprised approximately 19% of total deposits at December 31, 2005 and approximately 11% at December 31, 2004. We operate in a very competitive environment, competing with other local banks similar in size and significantly larger regional banks. We monitor rates at other financial institutions in the area to ascertain that our rates are competitive with the market. We also attempt to offer a wide variety of products to meet the needs of our customers.

**Deposit Portfolio Composition.** The following table sets forth the average deposit balances and the weighted average rates paid thereon.

(Dollars in thousands)

	Average for the Year					
	2005		2004		2003	
	Amount	Average Rate	Amount	Average Rate	Amount	Average Rate
Noninterest bearing demand	\$ 164,184	--	\$ 139,510	--	\$ 110,670	--
Interest bearing demand	608,718	2.0%	587,834	1.2%	395,697	0.9%
Savings	40,674	0.5%	38,266	0.2%	35,172	0.4%
Time	576,843	3.5%	435,005	2.8%	432,231	3.1%
Total deposits	\$ 1,390,419	2.3%	\$ 1,200,615	1.6%	\$ 973,770	1.7%

The following table summarizes time deposits in amounts of \$100,000 or more by time remaining until maturity as of December 31, 2005:

(Dollars in thousands)

	Amount
Three months or less	\$ 119,322
Over 3 months through 6 months	81,477
Over 6 months through 1 year	107,276
Over 1 year	207,697
Total	\$ 515,772

***Lending Activities.***

***Loan Portfolio Composition.*** The following table reflects the composition of our loan portfolio and the corresponding percentage of our total loans represented by each class of loans as of the dates indicated.

(Dollars in thousands)

	Year Ended December 31									
	2005		2004		2003		2002		2001	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate	\$ 793,919	51%	\$ 676,637	48%	\$ 536,884	46%	\$417,757	44%	\$133,428	25%
Residential real estate	223,390	15%	218,999	16%	172,647	15%	133,843	14%	67,655	12%
Other commercial	359,036	23%	338,398	24%	312,131	27%	279,923	29%	269,993	49%
Consumer	171,534	11%	162,353	12%	135,445	12%	129,515	13%	74,617	14%
Total loans	\$1,547,879	100%	\$1,396,387	100%	\$1,157,107	100%	\$961,038	100%	\$545,693	100%
Less:										
Allowance for loan losses	(20,992)		(19,251)		(16,093)		(13,472)		(7,699)	
Total loans receivable, net	\$1,526,887		\$1,377,136		\$1,141,014		\$947,566		\$537,994	

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

**December 31**

(Dollars in thousands)	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Nonaccrual loans	\$ 3,977	\$ 3,249	\$ 1,717	\$ 2,539	\$ 2,084
Loans 90 days or more delinquent and still accruing	227	772	2,308	259	298
Restructured loans	--	--	--	--	--
Total nonperforming loans	\$ 4,204	\$ 4,021	\$ 4,025	\$ 2,798	\$ 2,382
Foreclosed assets	527	1,850	464	388	--
Repossessed assets	165	--	4	58	--
Total nonperforming assets	\$ 4,896	\$ 5,871	\$ 4,493	\$ 3,244	\$ 2,382
Nonperforming loans to total loans	.27%	.29%	.35%	.29%	.43%
Nonperforming assets to total assets	.26%	.35%	.32%	.28%	.36%

**Loan Loss Experience.** The following is a summary of our loan balances at the end of each period and the daily average balances of these loans. It also includes changes in the allowance for loan losses arising from loans charged-off and recoveries on loans previously charged-off, and additions to the allowance which we have expensed.

**December 31**

(Dollars in thousands)	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Loans:					
Average daily balance of loans for the year	\$1,473,558	\$1,295,887	\$1,046,723	\$831,709	\$474,318
Amount of loans outstanding at end of period	1,547,879	1,396,387	1,157,107	961,038	545,693
Allowance for loan losses:					
Balance at beginning of year	\$ 19,251	\$ 16,093	\$ 13,472	\$ 7,699	\$ 5,854
Balances from GBFC acquisition	--	--	--	3,464	--
Addition to allowance charged to operations	3,675	7,890	4,105	3,321	2,285
Loans charged-off:					
Commercial	(1,842)	(4,833)	(1,308)	(1,143)	(485)
Residential Real Estate	(24)	(21)	(50)	--	(1)
Consumer	(371)	(91)	(187)	(128)	(27)
Recoveries:					
Commercial	261	180	26	249	63
Residential Real Estate	17	11	17	--	1
Consumer	25	22	18	10	9
Balance at end of year	\$ 20,992	\$ 19,251	\$ 16,093	\$ 13,472	\$ 7,699
Ratios:					
Net charge-offs to average loans outstanding	.13%	.37%	.14%	.12%	.09%
Allowance for loan losses to loans outstanding at year end	1.36%	1.38%	1.39%	1.40%	1.41%

**Allocation of the Allowance for Loan Losses.** The following table shows the allocation of the allowance for loan loss at the dates indicated to the extent specific allocations have been determined relative to particular loans.

(Dollars in thousands)

		Year Ended December 31									
		2005		2004		2003		2002		2001	
		Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans
Commercial and commercial real estate		\$ 18,883	74.5%	\$ 17,324	72.7%	\$ 14,371	73.4%	\$ 11,207	72.6%	\$ 6,391	73.9%
Real estate mortgages		463	14.4%	476	15.7%	360	14.9%	326	13.9%	196	12.4%
Consumer		1,646	11.1%	1,243	11.6%	1,074	11.7%	950	13.5%	564	13.7%
Unallocated		--	--	208	--	288	--	989	--	548	--
Total		\$ 20,992	100%	\$ 19,251	100%	\$ 16,093	100.0%	\$ 13,472	100.0%	\$ 7,699	100.0%

**Maturities and Sensitivities of Loans to Changes in Interest Rates.** The following table shows the amount of total loans outstanding as of December 31, 2005 which, based on remaining scheduled repayments of principal, are due in the periods indicated.

(dollars in thousands)

		Maturing			
		Within One Year	After One, But Within Five Years	After Five Years	Total
Commercial real estate	\$	305,484	\$ 453,716	\$ 34,719	\$ 793,919
Residential real estate		71,887	42,427	109,076	223,390
Other commercial		210,832	143,789	4,415	359,036
Consumer		9,979	46,879	113,462	171,534
Totals	\$	599,396	\$ 686,811	\$ 261,672	\$ 1,547,879
Allowance for loan losses					(20,992)
Total loans receivable, net					\$ 1,526,887

**Interest Sensitivity.** Below is a schedule of the loan amounts maturing or repricing which are classified according to their sensitivity to changes in interest rates at December 31, 2005.

(dollars in thousands)

	Fixed Rate	Variable Rate	Total
Due within 3 months	\$ 33,534	\$ 918,204	\$ 951,738
Due after 3 months, but within 1 year	82,875	8,461	91,336
Due after one but within 5 years	390,552	51,916	442,468
Due after 5 years	61,342	995	62,337
Total	\$ 568,303	\$ 979,576	\$ 1,547,879
Allowance for loan losses			(20,992)
Total loans receivable, net			\$ 1,526,887

**Residential Real Estate Loans.** We originate residential mortgage loans, which are generally long-term with either fixed or variable interest rates. Our general policy, which is subject to review by our management as a result of changing market and economic conditions and other factors, is to sell in the secondary market the majority of residential mortgage loans originated. Residential mortgage loan originations derive from a number of sources, including advertising, direct solicitation, real estate broker referrals, existing borrowers and depositors, builders and walk-in customers. Loan applications are accepted at most of our offices. The substantial majority of these loans are secured by properties in our market area.

Our variable rate mortgage loans are fully amortizing loans with contractual maturities of up to 30 years. These loans generally carry interest rates which are reset to a stated margin over an independent index, generally the one-, three- or five-year constant maturity treasury index. Increases or decreases in the interest rate of our variable rate mortgage loans are generally limited to 2% annually with lifetime interest rate caps of 6% over the initial interest rate. Our variable rate mortgage loans may be convertible into fixed rate loans upon payment of a fee, do not contain prepayment penalties and do not produce negative amortization. Initial interest rates offered on our variable rate mortgage loans may be below the fully indexed rate, although borrowers are generally qualified at the fully indexed rate.

We also offer fixed rate mortgage loans to owner occupants with maturities up to 30 years, which conform to secondary market standards. Interest rates charged on these fixed rate loans are priced on a daily basis according to market conditions. These loans generally do not include prepayment penalties. We currently sell in the secondary market, long-term, conforming fixed-rate loans with terms of 15 years or greater which we originated.

Generally we originate residential mortgage loans with loan-to-value ratios not to exceed 80%. For loans with loan-to-value ratios that equal or exceed 90% at origination, we require private mortgage insurance in an amount sufficient to reduce our exposure to 80% or less of the lower of the appraised value or purchase price of the underlying collateral. In underwriting one- to four-family residential real estate loans, we evaluate both the borrower's ability to make monthly payments and the value of the property securing the loan. Properties securing one- to four-family residential real estate loans that we made are appraised by independent appraisers. We require borrowers to obtain title insurance and fire, property and, if necessary, flood insurance.

**Multi-Family and Commercial Real Estate Loans.** We originate permanent loans secured by multi-family and commercial real estate. Our permanent multi-family and commercial real estate loan portfolio includes loans secured by apartment buildings, condominiums, small office buildings, small business facilities, medical facilities and other non-residential building properties, substantially all of which are located within our primary market area.

Permanent multi-family and commercial real estate loans have a maximum maturity of 10 years with an amortization period of up to 20 years. Most of these loans, however, have maturities of 5 years or less with amortization periods of 15 and 20 years. Multi-family loans and commercial real estate loans are generally written in amounts of up to 80% of the lesser of the appraised value of the property or the purchase price, and borrowers are generally personally liable for all or part of the indebtedness.

Appraisals on properties securing multi-family and commercial real estate loans that we originate are primarily performed by independent appraisers who we designate at the time the loan is made. Management reviews all appraisals on multi-family and commercial real estate loans. In addition, our underwriting procedures generally require verification of the borrower's credit history, income and financial statements, banking relationships, references, and historical and projected cash flows for the property that indicate minimum debt service coverage ratios.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. For example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations, cash flow from the project will be reduced.

**Construction and Development Loans.** We make construction loans to individuals for the construction of their residences. Construction loans are also made 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.

Construction loans to individuals for their residences are structured to be converted to permanent loans at the end of the construction phase, which typically runs six to nine months. These construction loans have rates and terms which generally match one- to four-family loans then offered by us, except that during the construction phase, the borrower pays interest only. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential loans.

Construction loans to builders of one- to four-family residences generally require the payment of interest only for up to one year with adjustable rates. These loans may also provide for the payment of loan fees from loan proceeds. We also make loans to builders for the purpose of developing one- to four-family lots and residential condominium projects. These loans typically have terms of two years or less with maximum loan to value ratios of 80%. These loans may provide for the payment of loan fees from loan proceeds. Loan principal is typically paid down as lots or units are sold.

Construction and development loans are obtained principally through continued business from developers and builders who have previously borrowed from us, as well as referrals from existing customers. As part of the application process, the applicant must submit accurate plans, specifications and costs of the project to be constructed or developed to us. These items are used as a basis to determine the appraised value of the subject property. Loans are based on the lesser of current appraised value and/or the cost of construction (land plus building). Construction and development loans to borrowers other than owner-occupants involve many of the same risks discussed above regarding multi-family and commercial real estate loans and tend to be more sensitive to general economic conditions than many other types of loans. Further, because of the uncertainties inherent in estimating development and construction costs and the market for the project upon completion, it is relatively difficult to evaluate accurately the total loan funds required to complete a project, the related loan-to-value ratios and the likelihood of ultimate success of the project.

**Commercial Business Loans.** Our commercial business lending portfolio contains loans with a variety of purposes and security, including loans to finance operations and equipment. Generally, our commercial business lending has been limited to borrowers headquartered, or doing business, in our primary market area.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and 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. 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.

**Consumer Loans.** We originate a variety of different types of consumer loans, including automobile loans, home equity lines of credit and installment loans, home improvement loans, deposit account loans and other loans for household and personal purposes. Our automobile loans typically are originated at fixed interest rates with terms up to 60 months for new and used vehicles. Loans secured by automobiles are generally originated for up to 80% of the National Automobile Dealers Association book value of the automobile securing the loan.

Our home equity installment loans are written so that the total commitment amount, when combined with the balance of the first mortgage lien, generally will not exceed the greater of 90% of the appraised value of the property or 90% of two times the Michigan real estate assessment value. These loans have a maximum maturity of 5 years with an amortization period of up to 15 years, and carry fixed rates of interest.

We also originate home equity lines of credit utilizing the same underwriting standards as for home equity installment loans. Home equity lines of credit are revolving line of credit loans. The majority of our existing home equity line of credit portfolio has adjustable rates, interest only payments and a maximum maturity of ten years.



The underwriting standards that we employ for consumer loans include a determination of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

**Securities.** Our security portfolio is classified as either "available for sale" or "held to maturity." Securities classified as "available for sale" may be sold prior to maturity due to changes in interest rates, prepayment risks, and availability of alternative investments, or to meet our liquidity needs. The primary objective of our investing activities is to provide for the safety of the principal invested. Our secondary considerations include the maximization of earnings, liquidity and to help decrease our overall exposure to changes in interest rates. The following table reflects the composition of our securities portfolio as of the dates indicated.

(Dollars in thousands)

	Year Ended December 31		
	2005	2004	2003
U.S. Treasury and U.S. Government Agencies	\$ 108,561	\$ 91,399	\$ 76,225
State and municipal bonds	51,049	48,402	33,448
Other equity securities	993	---	---
Total	<u>\$ 160,603</u>	<u>\$ 139,801</u>	<u>\$ 109,673</u>

Excluding our investment portfolio holdings in U.S. Treasury and U.S. Government Agency Securities, we had no investments in securities of any one issuer which exceeded 10% of shareholders' equity.

**Schedule of Maturities of Investment Securities and Weighted Average Yields.** The following is a schedule of investment security maturities and their weighted average yield by category at December 31, 2005.

	Due Within One Year		One to Five Years		Five to Ten Years		After Ten Years		Investments with No Contractual Maturity	
	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield	Amount	Average Yield
U.S. Treasury and U.S. Government Agencies	\$ 2,059	5.44%	\$106,226	3.98%	--	--	\$ 275	5.21%	--	--
Tax-exempt state and municipal bonds (1)	715	4.26%	2,129	5.82%	14,190	6.47%	34,016	6.09%	--	--
Other equity securities	--	--	--	--	--	--	--	--	993	3.85%
Total (1)	<u>\$ 2,774</u>	<u>5.14%</u>	<u>\$108,355</u>	<u>4.02</u>	<u>\$ 14,190</u>	<u>6.47%</u>	<u>\$ 34,291</u>	<u>6.08%</u>	<u>993</u>	<u>3.85%</u>

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

**Trust Services.** We began offering trust services in January 1999, to further provide for the financial needs of our customers. With the acquisition of Grand Bank in April 2002 our trust assets increased by over \$500 million and as of December 31, 2005, the Trust Department had assets of approximately \$915.2 million. Our types of service include both personal trust and retirement plan services.

Our personal trust services include financial planning, investment management services, trust and estate administration and custodial services. As of December 31, 2005, our personal trust assets totaled approximately \$795.5 million.

Our retirement plan services provide all types of qualified retirement plans including profit sharing, 401(k)s and pension plans. As of December 31, 2005, our retirement plan assets totaled approximately \$119.7 million.

## **Market Area**

Our market area of Ottawa, Kent and northern Allegan Counties are located in western Michigan. This area consists of two mid-sized cities, Grand Rapids and Holland, and rural areas. Grand Rapids is the second largest city in Michigan and Holland is the largest city in Ottawa County. Both cities and surrounding areas have a solid and diverse economic base, which includes tourism, office furniture, automotive components and assemblies, health services, pharmaceutical, transportation, equipment, food and construction supplies. Companies operating in the market area include Steelcase, Herman Miller, Alticor, Gentex, Spectrum Health, Haworth, Johnson Controls, General Motors, Gerber, SPX, Magna Donnelly, and Meijer.

Much of our success as a retail and small to mid-sized business lender has been due to our market area's favorable population, housing and income demographics. Population within our three county market area grew by 20.6% from 1990 to 2002. Household income levels in our market area exceed state and national levels while unemployment levels are generally below state levels but above national levels.

## **Competition**

Our primary market area includes Ottawa County, Kent County and northern Allegan County, all located in Western Michigan. There are many bank, thrift and credit union offices located within our market area. Most are branches of larger financial institutions. We also face competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds and other providers of financial services. Many of our competitors have been in business a number of years, have established customer bases, are larger and have higher lending limits than we do. We compete for loans principally through our ability to communicate effectively with our customers and to understand and meet their needs. Our management believes that our personal service philosophy enhances our ability to compete favorably in attracting individuals and small businesses. We actively solicit customers and compete for deposits by offering our customers personal attention, professional service, and competitive interest rates.

## **Environmental Matters**

We do not believe that existing environmental regulations will have any material effect upon our capital expenditures, our earnings or our competitive position.

## **Employees**

As of December 31, 2005, we had 323 full-time and 125 part-time employees. We have assembled a staff of experienced, dedicated and highly qualified professionals whose goal is to provide outstanding service. The majority of our management team has at least 10 years of banking experience, and several key personnel have more than 20 years of banking experience. None of our employees is represented by collective bargaining agreements with us.

## **Acquisition of Grand Bank**

On April 1, 2002, Grand Bank Financial Corporation was merged into Macatawa Bank Corporation. Macatawa Bank Corporation became the holding company for Grand Bank. Effective January 1, 2003, Grand Bank was merged into Macatawa Bank.

## SUPERVISION AND REGULATION

*The following is a summary of certain statutes and regulations affecting Macatawa Bank Corporation and Macatawa Bank. This summary is qualified in its entirety by such statutes and regulations. A change in applicable laws or regulations may have a material effect on us and our business.*

### General

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”), the FDIC, the Commissioner of the Michigan Office of Financial and Insurance Services (“Commissioner”), the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies can be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to us and our bank establishes a comprehensive framework for our respective operations and is intended primarily for the protection of the FDIC’s deposit insurance funds, our depositors, and the public, rather than our shareholders.

Federal law and regulations establish supervisory standards applicable to the lending activities of our bank, including internal controls, credit underwriting, loan documentation and loan-to-value ratios for loans secured by real property.

Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, and Macatawa Investment Services, Inc., a subsidiary of Macatawa Bank Corporation, are subject to various state and federal regulations.

### Macatawa Bank Corporation

**General.** On January 9, 2002, Macatawa Bank Corporation became a financial holding company, within the meaning of the Gramm-Leach-Bliley Act of 1999 (“GLB Act”), and is registered with, and subject to regulation by, the Federal Reserve Board under the Bank Holding Company Act, as amended (the “BHCA”). Under the BHCA, we are subject to periodic examination by the Federal Reserve Board, and are required to file with the Federal Reserve Board periodic reports of our operations and such additional information as the Federal Reserve Board may require.

In accordance with Federal Reserve Board policy, we are expected to act as a source of financial strength to Macatawa Bank and to commit resources to support Macatawa Bank in circumstances where we might not do so absent such policy. In addition, if the Commissioner deems Macatawa Bank’s capital to be impaired, the Commissioner may require Macatawa Bank to restore its capital by a special assessment upon us as the bank’s sole shareholder. If we were to fail to pay any such assessment, the directors of Macatawa Bank would be required, under Michigan law, to sell the shares of the bank’s stock owned by us to the highest bidder at either a public or private auction and use the proceeds of the sale to restore the bank’s capital.

**Investments and Activities.** In general, any direct or indirect acquisition by us of any voting shares of any bank which would result in our direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation between us and another financial holding company or bank holding company, will require the prior written approval of the Federal Reserve Board under the BHCA. No Federal Reserve Board approval is required for us to acquire a company, other than a bank holding company or bank, engaged in activities that are financial in nature as determined by the Federal Reserve Board.

The merger or consolidation of an existing bank subsidiary of ours with another bank, or the acquisition by such a subsidiary of assets of another bank, or the assumption of liability by such a subsidiary to pay any deposits in another bank, will require the prior written approval of the responsible Federal depository institution regulatory agency under the Bank Merger Act. In addition, in certain such cases an application to, and the prior approval of, the Federal Reserve Board under the BHCA and/or the Commissioner under the Michigan Banking Code, may be required.

Financial holding companies, like us, may engage in various lending, advisory, insurance and insurance underwriting, securities underwriting, dealing and market making, and merchant banking activities (as well as those activities previously approved for bank holding companies by the Federal Reserve Board) together with such other activities as may be determined by the Federal Reserve Board (in coordination with other regulatory authorities) to be financial in nature, incidental to any such financial activity, or complimentary to any such financial activity, and which do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. In order to maintain the benefits and flexibility of being a financial holding company, each of our subsidiary depository institutions must continue to be “well-capitalized” and “well-managed” under applicable regulatory standards and each subsidiary depository institution must maintain at least a satisfactory or above Community Reinvestment Act rating.

**Capital Requirements.** The Federal Reserve Board uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other items, be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve Board’s capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a leverage capital requirement expressed as a percentage of total average assets, and (ii) a risk-based requirement expressed as a percentage of total risk-weighted assets. The leverage capital requirement consists of a minimum ratio of Tier 1 capital (which consists principally of shareholders’ equity) to total average assets of 3% for the most highly rated companies, with minimum requirements of 4% to 5% for all others. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital.

**Dividends.** Macatawa Bank Corporation is a corporation separate and distinct from Macatawa Bank. Most of our revenues are dividends paid by our bank. Thus, our ability to pay dividends to our shareholders is indirectly limited by statutory restrictions on our bank’s ability to pay dividends described below. Further, in a policy statement, the Federal Reserve Board has expressed its view that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company’s financial health, such as by borrowing. Additionally, the Federal Reserve Board possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. Similar enforcement powers over our bank are possessed by the FDIC. The “prompt corrective action” provisions of federal law and regulation authorizes the Federal Reserve Board to restrict the payment of dividends by us for an insured bank which fails to meet specified capital levels.

In addition to the restrictions on dividends imposed by the Federal Reserve Board, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if after the distribution a corporation, like us, can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution.

**Federal Securities Regulation.** Our common stock is registered with the Securities and Exchange Commission (“SEC”) under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. The Sarbanes-Oxley Act of 2002 provides for numerous changes to the reporting, accounting, corporate governance and business practices of companies as well as financial and other professionals who have involvement with the U.S. public markets. The SEC continues to issue new and proposed rules implementing various provisions of the Sarbanes-Oxley Act.

## Macatawa Bank

**General.** Macatawa Bank is a Michigan banking corporation, and its deposit accounts are insured by the Bank Insurance Fund (the “BIF”) of the FDIC. As a BIF insured Michigan chartered bank, Macatawa Bank is subject to the examination, supervision, reporting and enforcement requirements of the Commissioner, as the chartering authority for Michigan banks, and the FDIC, as administrator of BIF. These agencies and the federal and state laws applicable to our bank and its operations, extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of non-interest bearing reserves on deposit accounts, and the safety and soundness of banking practices. Grand Bank was also subject to the same supervision and regulation until its merger into Macatawa Bank effective January 1, 2003.

**Deposit Insurance.** As an FDIC-insured institution, we are required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which all insured depository institutions are placed into one of nine categories and assessed insurance premiums, based upon their respective levels of capital and results of supervisory evaluation. Institutions classified as well-capitalized (as defined by the FDIC) and considered healthy pay the lowest premium while institutions that are less than adequately capitalized (as defined by the FDIC) and considered of substantial supervisory concern pay the highest premium. Risk classification of all insured institutions is made by the FDIC for each semi-annual assessment period.

The Federal Deposit Insurance Act (“FDIA”) requires the FDIC to establish assessment rates at levels which will maintain the Deposit Insurance Fund at a mandated reserve ratio of not less than 1.25% of estimated insured deposits. For several years, the BIF reserve ratio has been at or above the mandated ratio and assessments have ranged from 0% of deposits for institutions in the lowest risk category to .27% of deposits in the highest risk category.

**FICO Assessments.** Our bank, as a member of the BIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation (“FICO”). FICO was created to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC’s Savings Association Insurance Fund (the “SAIF”) which insures the deposits of thrift institutions. From now until the maturity of the outstanding FICO obligations in 2019, BIF members and SAIF members will share the cost of the interest on the FICO bonds on a *pro rata* basis. It is estimated that FICO assessments during this period will be less than 0.025% of deposits.

**Commissioner Assessments.** Michigan banks are required to pay supervisory fees to the Commissioner to fund the operations of the Commissioner. The amount of supervisory fees paid by a bank is based upon the bank’s total assets, as reported to the Commissioner.

**Capital Requirements.** The FDIC has established the following minimum capital standards for state-chartered, FDIC insured non-member banks, such as Macatawa Bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total average assets of 3% for the most highly-rated banks with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders’ equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions.

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." Federal regulations define these capital categories as follows:

	<b>Total Risk-Based Capital Ratio</b>	<b>Tier 1 Risk-Based Capital Ratio</b>	<b>Leverage Ratio</b>
Well capitalized	10% or above	6% or above	5% or above
Adequately capitalized	8% or above	4% or above	4% or above
Undercapitalized	Less than 8%	Less than 4%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 3%	Less than 3%
Critically undercapitalized	--	--	A ratio of tangible equity to total assets of 2% or less

As of December 31, 2005, each of Macatawa Bank's ratios exceeded minimum requirements for the well capitalized category.

Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution, following receipt of a less-than-satisfactory rating on its most recent examination report, to correct the deficiency.

**Dividends.** Under Michigan law, our bank is restricted as to the maximum amount of dividends it may pay on its common stock. Our bank may not pay dividends except out of net income after deducting its losses and bad debts. A Michigan state bank may not declare or pay a dividend unless the bank will have surplus amounting to at least 20% of its capital after the payment of the dividend.

Federal law generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. The FDIC may prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, the FDIC may prohibit the payment of dividends by our bank, if such payment is determined, by reason of the financial condition of our bank, to be an unsafe and unsound banking practice.

**Insider Transactions.** Our bank is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to us or our subsidiaries, on investments in the stock or other securities of our or our subsidiaries and the acceptance of the stock or other securities of us or our subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by our bank to its directors and officers, to our directors and officers, the directors and officers of our bank, to our principal shareholders and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of our company or one of its subsidiaries or a principal shareholder in our company may obtain credit from banks with which our bank maintains a correspondent relationship.

**Safety and Soundness Standards.** The federal banking agencies have adopted guidelines to promote the safety and soundness of federally insured depository institutions. These guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

**Investments and Other Activities.** Under federal law and FDIC regulations, FDIC insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law, as implemented by FDIC regulations, also prohibits FDIC insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. Impermissible investments and activities must be divested or discontinued within certain time frames set by the FDIC in accordance with federal law. These restrictions are not currently expected to have a material impact on the operations of our bank.

**Consumer Protection Laws.** Our bank's business includes making a variety of types of loans to individuals. In making these loans, we are subject to State usury and regulatory laws and to various federal statutes, including the privacy of consumer financial information provisions of the Gramm-Leach-Bliley Act and regulations promulgated thereunder, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Home Mortgage Disclosure Act, and the regulations promulgated thereunder, which prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of our bank, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing. In receiving deposits, our bank is subject to extensive regulation under State and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Bank Secrecy Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon our bank and its directors and officers.

**Branching Authority.** Michigan banks have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the Michigan Office of Financial and Insurance Services, Division of Financial Institutions, (1) acquisition of Michigan banks by FDIC-insured banks, savings banks or savings and loan associations located in other states, (2) sale by a Michigan bank of branches to an FDIC-insured bank, savings bank or savings and loan association located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan.

#### **ITEM 1A: Risk Factors**

*You should carefully consider the following risk factors, together with the other information provided in this Annual Report on Form 10-K.*

#### ***Changes in economic conditions or interest rates may negatively affect our earnings, capital and liquidity.***

The results of operations for financial institutions, including our bank, may be materially and adversely affected by changes in prevailing local and national economic conditions, including declines in real estate market values, rapid increases or decreases in interest rates and changes in the monetary and fiscal policies of the federal government. Our profitability is heavily influenced by the spread between the interest rates we earn on investments and loans and the interest rates we pay on deposits and other interest-bearing liabilities. Substantially all our loans are to businesses and individuals in western Michigan and any decline in the economy of this area could adversely affect us. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors that influence market interest rates and our ability to respond to changes in such rates. At any given time, our assets and liabilities may be such that they are affected differently by a given change in interest rates.

***Our credit losses could increase and our allowance for loan losses may not be adequate to cover actual loan losses.***

The risk of nonpayment of loans is inherent in all lending activities and nonpayment, if it occurs, may have a material adverse affect on our earnings and overall financial condition as well as the value of our common stock. We make various assumptions and judgments about the collectibility of our loan portfolio and provide an allowance for potential losses based on a number of factors. If our assumptions are wrong, our allowance for loan and lease losses may not be sufficient to cover our losses, thereby having an adverse affect on our operating results, and may cause us to increase the allowance in the future. The actual amount of future provisions for loan losses cannot now be determined and may exceed the amounts of past provisions. Additionally, federal banking regulators, as an integral part of their supervisory function, periodically review our allowance for credit losses. These regulatory agencies may require us to increase our provision for credit losses or to recognize further loan or lease charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for credit losses could have a negative effect on our net income, financial condition and results of operations.

***Our business is subject to various lending risks depending on the nature of the borrower's business, its cashflow and our collateral.***

*Repayment of our commercial loans is often dependent on cash flow of the borrower, which may be unpredictable, and collateral securing these loans may fluctuate in value.* Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

*Our commercial real estate loans involve higher principal amounts than other loans, and repayment of these loans may be dependent on factors outside our control or the control of our borrowers.* Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Because payments on loans secured by commercial real estate often depend upon the successful operating and management of the properties, repayment of such loans may be affected by factors outside the borrower's control, such as adverse conditions in the real estate market or the economy or changes in government regulation. If the cash flow from the project is reduced, the borrower's ability to repay the loan and the value of the security for the loan may be impaired.

*Our construction loans are based upon estimates of costs to construct and value associated with the completed project.* These estimates may be inaccurate. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. Delays in completing the project may arise from labor problems, material shortages and other unpredictable contingencies. If the estimate of the cash of construction is inaccurate, we may be required to advance additional funds to complete construction. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of the project.



*Our consumer loans generally have a higher risk of default than our other loans.* Consumer loans entail greater risk than our other loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy, all of which increase when the economy is weak. Furthermore, the application of various Federal and state laws, including Federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

***Litigation involving Trade Partners may have a material adverse effect on our financial condition.***

Item 3 of this Form 10-K includes information about the Trade Partners, Inc. receivership and pending legal actions involving Trade Partners, Inc., the Macatawa Bank Corporation and Macatawa Bank. If one or more of these legal actions is determined adversely to the Macatawa Bank Corporation and Macatawa Bank, or if one or more of these legal actions results in Macatawa Bank Corporation or Macatawa Bank paying a substantial settlement, then such adverse determination or settlement may have a material adverse effect on our financial condition.

***We may experience difficulties in managing our growth.***

To sustain our continued growth, we require additional capital to fund our expanding lending activities. As part of our strategy for continued growth, we intend to open additional branches. New branches often experience a period of unprofitability due to the impact of overhead expenses and the start-up phase of generating loans and deposits. To the extent that we continue to open additional branches, we may experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse affect on our levels of net income, return on average equity and return on average assets.

In addition, we may acquire banks and related businesses that we believe provide a strategic fit with our business. To the extent that we grow through acquisitions, we cannot assure you that we will be able to adequately or profitably manage such growth. Acquiring other banks and businesses involves risks commonly associated with acquisitions.

***We rely heavily on our management and other key personnel, and the loss of any of them may adversely effect our operations.***

We are and will continue to be dependent upon the services of our management team, including our Chairman and Chief Executive Officer, the President and Chief Executive Officer of Macatawa Bank, and our other senior managers and commercial lenders. Losing one or more key members of the management team could adversely affect our operations. We do not maintain key man life insurance on any of our officers or directors.

***Our future success is dependent on our ability to compete effectively in the highly competitive banking industry.***

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. We compete for deposits, loans and other financial services with numerous Michigan-based and out-of-state banks, thrifts, credit unions and other financial institutions as well as other entities which provide financial services. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as we are. Most of our competitors have been in business for many years, have established customer bases, are larger, and have substantially higher lending limits than we do. The primary competitors in our market area include Fifth Third Bancorp, Huntington Bancshares, LaSalle Bank, and National City Corp. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

***We are subject to significant government regulation, and any regulatory changes may adversely affect us.***

The banking industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers, not our creditors or shareholders. As a bank holding company, we are also subject to extensive regulation by the Federal Reserve, in addition to other regulatory and self-regulatory organizations. Our ability to establish new facilities or make acquisitions is conditioned upon the receipt of the required regulatory approvals from these organizations. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of such changes, which could have a material adverse effect on our profitability or financial condition.

***We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements.***

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. There can be no assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

***Our articles of incorporation and by-laws and Michigan laws contain certain provisions that could make a takeover more difficult.***

Our articles of incorporation and by-laws, and the laws of Michigan, include provisions which are designed to provide our board of directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions, however, could discourage potential acquisition proposals and could delay or prevent a change in control. The provisions also could diminish the opportunities for a holder of our common stock to participate in tender offers, including tender offers at a price above the then-current price for our common stock. These provisions could also prevent transactions in which our shareholders might otherwise receive a premium for their shares over then current market prices, and may limit the ability of our shareholders to approve transactions that they may deem to be in their best interests.

The Michigan Business Corporation Act contains provisions intended to protect shareholders and prohibit or discourage certain types of hostile takeover activities. In addition to these provisions and the provisions of our articles of incorporation and by-laws, Federal law requires the Federal Reserve Board's approval prior to acquisition of "control" of a bank holding company. All of these provisions may have the effect of delaying or preventing a change in control at the company level without action by our shareholders, and therefore, could adversely affect the price of our common stock.

***Our ability to pay dividends is limited by law and contract.***

We are a holding company and substantially all of our assets are held by our bank. Our ability to continue to make dividend payments to our shareholders will depend primarily on available cash resources at the holding company and dividends from our bank. Dividend payments or extensions of credit from our bank are subject to regulatory limitations, generally based on capital levels and current and retained earnings, imposed by regulatory agencies with authority over our bank. The ability of our bank to pay dividends is also subject to its profitability, financial condition, capital expenditures and other cash flow requirements. We also are prohibited from paying dividends on our common stock if the required payments on our subordinated debentures have not been made. We cannot assure you that our bank will be able to pay dividends to us in the future.

***The market price for our common stock fluctuates.***

The market price for our common stock has fluctuated, ranging between \$26.48 and \$40.00 for 2005. The overall market and the price of our common stock may continue to fluctuate. There may be a significant impact on the market price for our common stock due to, among other things:

- Variations in our anticipated or actual operating results or the results of our competitors;
- Changes in investors' or analysts' perceptions of the risks and conditions of our business;
- The size of the public float of our common stock;
- Regulatory developments;
- Market conditions; and
- General economic conditions.

Additionally, the average daily trading volume for our common stock as reported on the Nasdaq National Market was 22,404 shares during 2005, with daily volume ranging from a low of 4,200 shares to a high of 98,000 shares. There can be no assurance that a more active or consistent trading market in our common stock will develop. As a result, relatively small trades could have a significant impact on the price of our common stock.

**ITEM 2: Properties.**

We own or lease facilities located in Ottawa County, Allegan County and Kent County, Michigan. Our administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424. Our administrative offices are approximately 49,000 square feet and contain our administration, human resources, trust, loan underwriting and processing, and deposit operations.

Our facilities as of February 24, 2006, were as follows:

<u>Location of Facility</u>	<u>Use</u>
10753 Macatawa Drive, Holland	Main Branch, Administrative, and Loan Processing Offices
815 E. Main Street, Zeeland	Branch Office
125 Ottawa Avenue N.W., Grand Rapids*	Trust and Mortgage Offices
126 Ottawa Avenue N.W., Grand Rapids*	Branch Office
124 E. 8th Street, Holland*	Branch Office
489 Butternut Dr., Holland	Branch Office
701 Maple Avenue, Holland	Branch Office
699 E. 16th Street, Holland	Branch Office
41 N. State Street, Zeeland	Branch Office
2020 Baldwin Street, Jenison	Branch Office
6299 Lake Michigan Dr., Allendale	Branch Office
132 South Washington, Douglas	Branch Office
4758 - 136th Street, Hamilton*	Branch Office
3526 Chicago Drive, Hudsonville	Branch Office
20 E. Lakewood Blvd., Holland	Branch Office
3191 - 44th Street, S.W., Grandville	Branch Office
8233 Byron Center Avenue S.W., Byron Center*	Branch Office
5271 Clyde Park Avenue, S.W., Wyoming	Branch Office and Loan Center
4590 Cascade Road, Grand Rapids	Branch Office
3177 Knapp Street, N.E., Grand Rapids	Branch Office and Loan Center
15135 Whittaker Way, Grand Haven	Branch Office and Loan Center
12415 Riley Street, Holland	Branch Office
2750 Walker N.W., Walker	Branch Office
1575 - 68th Street S.W., Grand Rapids	Branch Office
2820 - 10 Mile Road, Rockford	Branch Office

\* Leased facility

We believe our facilities are well-maintained and adequately insured. Because of our growth, we are continually evaluating the need for additional space and branches.

### Item 3. LEGAL PROCEEDINGS.

Please refer to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, (Part II, Item 1 Legal Proceedings) for information concerning legal proceedings related to Trade Partners, Inc.

A lawsuit was filed in April 2003 by John and Kathryn Brand in Oklahoma state court against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The complaint seeks damages for the asserted breach of certain escrow agreements for which Grand Bank served as custodian and escrow agent. The Company and Grand Bank have answered this complaint, denying the material allegations and raising certain affirmative defenses. The trial court had entered an order in February 2005 staying this case, but the stay order was reversed on appeal in May 2005. A trial date of May 1, 2006 has been set.

In May 2003, a purported class action complaint was filed by Forrest W. Jenkins and Russell S. Vail against the Company in the United States District Court for the District of Western Michigan. The purported class included investors who invested in limited liability companies formed by Trade Partners. On November 6, 2003, the court permitted the plaintiffs to amend their complaint to expand the purported class to include all individuals who invested in Trade Partners viatical investments. The class has not been certified. The court had stayed this action to avoid interference with the process of the receivership proceedings, but the stay was lifted in July 2005. The plaintiffs allege that Grand Bank breached certain escrow agreements, breached its fiduciary duties, acted negligently or grossly negligently with respect to the plaintiff's investments and violated the Michigan Uniform Securities Act. The amended complaint seeks certification of the action as a class action, unspecified damages and other relief. The Company has answered this complaint denying the material allegations and raising certain affirmative defenses.

In late July 2005 counsel to the Trade Partners Receiver filed another purported class action on behalf of Kelly Priest and certain trusts controlled by Gary Towle and his wife, making substantially the same allegations as in the Jenkins complaint but on behalf of a class which is asserted to comprise all investors who are holders of allowed claims in the Trade Partners receivership, described below. The Company has answered this complaint denying the material allegations and raising certain affirmative defenses.

The Company believes it has meritorious defenses and intends to vigorously defend these cases.

On April 15, 2003, the United States District Court for the Western District of Michigan appointed a receiver for Trade Partners. In order to prevent or minimize any loss to investors in the viaticals sold by Trade Partners to investors, the court-appointed receiver has been coordinating the payment of premiums on the approximately 1,000 outstanding viaticated insurance policies in the Trade Partners portfolio so that the policies do not lapse. The receiver informed the Company that nine policies with a total face value of approximately \$1.4 million lapsed for failure to pay premiums prior to the receiver's coordination efforts. In addition, about \$700,000 is being contested as to lapses.

The receiver has received court permission to pool the death benefits of any of the Trade Partners viaticated policies that mature and use the benefits to pay premiums on other viaticated policies. As of January 15, 2006, the Receiver reported that he had received since the inception of the receivership cash payments for death benefit claims aggregating about \$28.3 million. He reported at the same time that all premium payments were current. As of January 15, 2006 the receiver reported cash on hand of approximately \$10.2 million. As additional viaticated policies mature, death benefits from those policies could provide a source of funding for continued premium payments, though the receiver's ability to so use such benefits may be limited or eliminated by the terms of the sale of the portfolio to Universal Settlements International, Inc., described below.

On July 1, 2003, the United States District Court for the Western District of Michigan authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank agreed to extend a \$4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

The receiver in June 2004 proposed a plan of distribution of the assets of Trade Partners. No hearing has yet been set on the plan. The receiver in July 2005 received authorization from the Court to sell the entire portfolio with a face value of approximately \$170 million to Universal Settlements International, Inc., a Canadian company, for an amount equal to 26.58% of face value or approximately \$43 million. Under the terms of the sale, payments are to be made by Universal Settlements to the receivership as policy transfers are processed by the issuing insurance companies. The receiver has reported that as of January 15, 2006 payments aggregating approximately \$8.2 million had been received on policies transferred pursuant to the sale agreement. The receiver had previously indicated that, depending on the outcome of the motion to sell the portfolio, he might propose a new plan of distribution, but to date no such plan has been proposed. The receiver reported as of January 15, 2006 that claims against the receivership estate totaling \$143,089,859.75 have been allowed, and reported total active claims of \$185,095,837.42.

The Company has no information on the amount of distributions the receiver may propose to make to investors, or when such distributions might begin.

It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, Management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. One carrier has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity pursuant to a reservation letter asserting certain coverage defenses.

As of the date hereof, except as disclosed above, 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 of or which any of our properties are the subject.

#### **ITEM 4: Submission of Matters to a Vote of Security Holders.**

No matters were submitted during the fourth quarter of 2005 to a vote of our shareholders.

#### **ADDITIONAL ITEM: Executive Officers of the Registrant.**

The list below identifies those persons designated as executive officers of Macatawa Bank Corporation and Macatawa Bank.

Name	Age	Year Elected an Executive Officer	Positions Held
Benj. A. Smith, III	62	1997	Chairman of the Board and Chief Executive Officer of Macatawa Bank Corporation.
Philip J. Koning	51	1997	President and Chief Executive Officer of Macatawa Bank and Treasurer and Secretary of Macatawa Bank Corporation.
Ronald L. Haan	52	2005	Executive Vice President of Macatawa Bank.
Jon W. Swets	40	2002	Senior Vice President and Chief Financial Officer of Macatawa Bank Corporation and Macatawa Bank.
Ray D. Tooker	62	2000	Senior Vice President Loan Administration of Macatawa Bank.

## PART II

### ITEM 5: Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is quoted on the Nasdaq National Market. High and low sales prices (as reported on the Nasdaq National Market) for each quarter are included in the following table. The information in the following table has been retroactively adjusted to reflect the effect of all stock dividends paid.

Quarter	2005			2004		
	High	Low	Dividends Declared	High	Low	Dividends Declared
First Quarter	\$ 32.76	\$ 26.48	\$ 0.13	\$ 24.35	\$ 21.03	\$ 0.10
Second Quarter	\$ 36.00	\$ 26.51	\$ 0.15	\$ 24.78	\$ 20.87	\$ 0.10
Third Quarter	\$ 40.00	\$ 32.50	\$ 0.15	\$ 25.00	\$ 21.63	\$ 0.10
Fourth Quarter	\$ 39.25	\$ 31.70	\$ 0.18	\$ 28.69	\$ 22.48	\$ 0.13

On February 23, 2006, there were approximately 785 owners of record and, in addition, approximately 7,116 beneficial owners of our common stock.

The Company declared its first cash dividend, amounting to \$.05 per share, during the fourth quarter of 2000. Quarterly cash dividends totaling \$.22 were paid during 2001, and a 3% stock dividend was declared during the second quarter of 2001. Quarterly cash dividends totaling \$.27 were paid during 2002, and a 4% stock dividend was declared during the second quarter of 2002. Quarterly cash dividends totaling \$.35 were paid during 2003, and a 5% stock dividend was declared during the second quarter of 2003. Quarterly cash dividends totaling \$.43 were paid during 2004, and a 5% stock dividend was declared during the second quarter of 2004. Quarterly cash dividends totaling \$.61 were paid during 2005, and a 15% stock dividend was declared during the second quarter of 2005. All of these cash dividend amounts have been retroactively adjusted to reflect the effect of the stock dividends.

We intend to continue to declare quarterly cash dividends in the future. We may also consider declaring further stock dividends. We expect to obtain the funds for the payment of future cash dividends from cash currently held and from the dividends we receive from Macatawa Bank out of its earnings. However, there can be no assurance that we will have the financial resources to continue to pay dividends in the future.

### ITEM 6: Selected Financial Data.

The information set forth under the caption "Selected Consolidated Financial Data" in our Annual Report to Shareholders for the year ended December 31, 2005, is incorporated by reference and is filed as part of Exhibit 13 to this form 10-K Annual Report.

**ITEM 7: Management's Discussion and Analysis of Results of Operations and Financial Condition.**

The information set forth under the caption "Management's Discussion and Analysis of Results of Operations and Financial Condition," in our Annual Report to Shareholders for the year ended December 31, 2005, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 7A: Quantitative and Qualitative Disclosures About Market Risk.**

The information set forth under the captions "Management's Discussion and Analysis of Results of Operations and Financial Condition – Sensitivity to Market Risk" in our Annual Report to Shareholders for the year ended December 31, 2005, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 8: Financial Statements and Supplementary Data.**

The information set forth under the captions "Quarterly Financial Data," "Report of Independent Registered Public Accounting Firm on Financial Statements," "Consolidated Balance Sheets," "Consolidated Statements of Income," "Consolidated Statements of Changes in Shareholders' Equity," "Consolidated Statements of Cash Flows," and "Notes to Consolidated Financial Statements" in our Annual Report to Shareholders for the year ended December 31, 2005, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 9: Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

There have been no disagreements with our independent public accountants.

**ITEM 9A: Controls and Procedures.**

(a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Report, have concluded that as of the end of the period covered by this Report the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the company, particularly during the period in which this Form 10-K Annual Report was being prepared.

(b) Management's Report on Internal Control over Financial Reporting.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Company management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we believe that, as of December 31, 2005, the Company's internal control over financial reporting is effective based on those criteria.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, has been audited by Crowe Chizek and Company LLC, an independent registered certified public accounting firm, as stated in their report included in Exhibit 13 to this Annual Report on Form 10-K which is incorporated herein by reference.



(c) Changes in Internal Controls.

There were no significant changes in the Company's internal controls over financial reporting during the fourth quarter ended December 31, 2005, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B: Other Information.**

None.

**PART III**

**ITEM 10: Directors and Executive Officers of the Registrant.**

The information set forth on pages 3-4, under the caption "Information About Directors" and on page 19 under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive Proxy Statement dated March 6, 2006, relating to our 2006 Annual Meeting of Shareholders and the information within that section is incorporated by reference. Information relating to our Executive Officers is included in Part I hereof entitled "Executive Officers of the Registrant." There are no family relationships between or among the above-named executive officers. There are no arrangements or understandings between any of the above-named officers pursuant to which any of them was named an officer.

We have adopted a Senior Officer Code of Ethics. A copy of our Senior Officer Code of Ethics is available upon request by writing to the Chief Financial Officer, Macatawa Bank Corporation, 10753 Macatawa Drive, Holland, Michigan 49424.

**ITEM 11: Executive Compensation.**

Information relating to compensation of our executive officers and directors is contained under the captions "Compensation of Directors" and "Executive Compensation," in our definitive Proxy Statement dated March 6, 2006, relating to our 2006 Annual Meeting of Shareholders and the information within those sections is incorporated by reference.

**ITEM 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Information relating to security ownership of certain beneficial owners and management is contained on Page 2 under the caption "Voting Securities and Principal Holders Thereof" and on page 10 under the caption "Security Ownership of Management" in our definitive Proxy Statement dated March 6, 2006, relating to our 2006 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

The Equity Compensation Plan Information table on page 11 in our definitive Proxy Statement dated March 6, 2006, relating to our 2006 Annual Meeting of Shareholders is incorporated by reference.

**ITEM 13: Certain Relationships and Related Transactions.**

Information relating to certain relationships and related transactions is contained on page 17, under the caption “Transactions Involving Management” in our definitive Proxy Statement dated March 6, 2006, relating to our 2006 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

**ITEM 14: Principal Accountant Fees and Services.**

Information relating to principal accountant fees and services is contained on page 20, under the caption “Principal Accounting Firm Fees” in our definitive Proxy Statement dated March 6, 2005, relating to our 2006 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

## PART IV

### ITEM 15: Exhibits, Financial Statement Schedules.

(a) Financial Statements.

1. The following documents are filed as part of Item 8 of this report:

Report of Independent Registered Public Accounting Firm on Financial Statements  
Consolidated Balance Sheets as of December 31, 2005 and 2004  
Consolidated Statements of Income for the years ended December 31, 2005, 2004 and 2003  
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2005, 2004 and 2003  
Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003  
Notes to Consolidated Financial Statements

2. Schedules to the consolidated financial statements required by Article 9 of Regulation S-X are not required under the related instructions or are inapplicable, and therefore have been omitted.

3. The following exhibits are filed as part of this report: Reference is made to the exhibit index which follows the signature page of this report.

The Registrant will furnish a copy of any exhibits listed on the Exhibit Index to any shareholder of the Registrant without charge upon written request to Chief Financial Officer, Macatawa Bank Corporation, 10753 Macatawa Drive, Holland, Michigan 49424.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, dated February 24, 2006.

### MACATAWA BANK CORPORATION

/s/ Benj. A. Smith, III

Benj. A. Smith, III  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

/s/ Jon W. Swets

Jon W. Swets  
Senior Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 24, 2006 by the following persons on behalf of the Registrant and in the capacities indicated. Each director of the Registrant, whose signature appears below, hereby appoints Benj. A. Smith, III and Philip J. Koning, and each of them severally, as his attorney-in-fact, to sign in his name and on his behalf, as a director of the Registrant, and to file with the Commission any and all Amendments to this Report on Form 10-K.

### Signature

/s/ Benj. A. Smith, III

February 24, 2006

Benj. A. Smith, III, Principal Executive Officer and a Director

/s/ Jon W. Swets

February 24, 2006

Jon W. Swets, Principal Financial and Accounting Officer

/s/ G. Thomas Boylan

February 24, 2006

G. Thomas Boylan, Director

/s/ Robert E. DenHerder

February 24, 2006

Robert E. DenHerder, Director

/s/ John F. Koetje

February 24, 2006

John F. Koetje, Director

/s/ Philip J. Koning

February 24, 2006

Philip J. Koning, Director and President

/s/ Arend D. Lubbers

February 24, 2006

Arend D. Lubbers, Director

EXHIBIT INDEX

**Exhibit Number and Description**

- 3.1 Articles of Incorporation of Macatawa Bank Corporation, as amended, incorporated by reference to Exhibit 3.1 to the Macatawa Bank Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.
- 3.2 Bylaws of Macatawa Bank Corporation, incorporated by reference to Exhibit 3.2 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755).
- 4 Specimen stock certificate of Macatawa Bank Corporation, incorporated by reference to Exhibit 4 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755).
- 10.1 Macatawa Bank Corporation Stock Compensation Plan, incorporated by reference to Exhibit 10.1 to the Registrant's Form SB-2 Registration Statement (No. 333-45755), as amended by the First Amendment included as Appendix B to the Macatawa Bank Corporation Proxy Statement dated March 5, 1999, for the Annual Meeting of Shareholders held April 15, 1999, as further amended by the Second Amendment included as Appendix A to the Macatawa Bank Corporation Proxy Statement dated March 7, 2002, for the Annual Meeting of Shareholders held April 18, 2002, both of which amendments are incorporated herein by reference.
- 10.2 Macatawa Bank Corporation 1998 Directors' Stock Option Plan incorporated by reference to Exhibit 10.2 to the Registrant's Form SB-2 Registration Statement (No. 333-45755), as amended by the First Amendment included as Appendix B to the Macatawa Bank Corporation Proxy Statement dated March 7, 2002, for the Macatawa Bank Corporation Annual Meeting of Shareholders held April 18, 2002, which is incorporated herein by reference.
- 10.3 Employment Agreement between Benj. A Smith III and Macatawa Bank Corporation dated August 25, 2004, incorporated by reference to Exhibit 10.1 to the Macatawa Bank Corporation Report on Form 8-K dated August 26, 2004.
- 10.4 Form of Indemnity Agreement between Macatawa Bank Corporation and each of its directors, incorporated by reference to Exhibit 10.2 to the Macatawa Bank Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2003.
- 10.5 Investment Management Agreement between Macatawa Bank and Smith & Associates Investment Management Services dated March 11, 2004, incorporated by reference to Exhibit 10.5 to the Macatawa Bank Corporation Annual Report on Form 10-K for the year ended December 31, 2003.
- 10.6 Form of Stock Option Agreement, incorporated by reference to Exhibit 10.6 to the Macatawa Bank Corporation Annual Report on Form 10-K for the year ended December 31, 2004.

- 13 Annual Report to Shareholders for the year ended December 31, 2005. This exhibit, except for those portions expressly incorporated by reference in this filing, is furnished for the information of the Securities and Exchange Commission and is not deemed “filed” as part of this filing. This information was delivered to the Company’s shareholders in compliance with Rule 14a-3 of the Securities Exchange Act of 1934, as amended.
- 21 Subsidiaries of the Registrant
- 23 Consent of Crowe Chizek and Company LLC, independent registered public accounting firm
- 24 Power of Attorney (included on the signature page on page 28 of the Annual Report on Form 10-K)
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certificate of the Chief Executive Officer and Chief Financial Officer of Macatawa Bank Corporation pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

March 9, 2006

To Our Shareholders:

We are very pleased to report that Macatawa Bank completed its seventh straight year of strong growth and profitability in 2005. In a highly competitive marketplace, we continue to add new customers who appreciate our local focus, exceptional customer service, competitive rates and innovative products.

For the year just ended, Macatawa again achieved record results and we wanted to share a few of the highlights with you:

- o Our earnings per share were \$2.00 for 2005, an increase of 61 percent over 2004 -and a record for the bank.
- o Our return on equity increased 51 percent to 15.30 percent – again, another record.
- o Our return on assets increased 41 percent to 1.17 percent – a new high for Macatawa.
- o Our number of accounts grew approximately 10 percent, showing continued market growth.
- o We provided a payroll in excess of \$17.4 million for West Michigan residents, employing more than 450 full- and part-time workers in 26 locations.

These exceptional results allowed us to share the benefits of our success with you through dividend increases. For the fifth time in five years, we increased our dividend. The latest was a 20 percent increase to \$0.18 per share per quarter. In addition to our traditional five percent stock dividend, we also paid shareholders a special one-time 10 percent stock dividend in 2005.

The stock market has responded favorably to our results and to the strength of our business model. Macatawa's stock rose 30 percent during 2005 at a time when many large banks found their share prices stagnant or declining. While we cannot control the markets or the movement of our stock price, we believe that if we perform well and share those rewards with our shareholders, the market will look on us favorably. That was certainly the case in 2005. Macatawa Bank has come a long way since our inception in 1997, and we owe that to our relationships – with our customers, our employees, the communities in which we operate and with you, our shareholders.

#### **BUILDING ON OUR RELATIONSHIPS:**

##### **Growing Geographically**

The strength of these relationships has allowed us, in only eight years, to become the number one bank in Ottawa County based on market share. During 2005, we continued to invest in the lakeshore, relocating our Main Street Zeeland branch in order to capture more business from this dynamic community.

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Additionally, we broke ground on a new branch on Eighth Street in downtown Holland, which underscores our commitment to maintain a strong and visible presence in this key community. We are both pleased and humbled to be named the top Ottawa County bank, for the second consecutive year. We will continue working to both deserve and grow our leadership role in this important market.

At the same time, we want to expand and strengthen our presence in Kent County, where we see tremendous growth potential. While the area is home to many banks, we feel that Macatawa's brand of service is unique – and appeals to both personal and business customers.

Our goal is to become the dominant player in this market and we will continue to dedicate significant resources to translate this vision into a reality. In June 2005, we opened a new branch in Rockford, making it our 10th location in the greater Grand Rapids area.

We are well underway with our 2006 expansion plans. We have already broken ground on a new Jenison office – our second in that growing community. Our storefront location in Byron Center will be relocating to a new full-service branch later this year. In addition, we are finalizing plans on two other strategic locations that will allow us to expand both our geographic footprint and the strength of the Macatawa name.

## **BUILDING ON OUR RELATIONSHIPS:**

### **Growing our Products and Services**

Listening to the market and responding with innovative products and services gives Macatawa an edge in competing for new customers. We take customer feedback to heart and use it to expand our product offerings.

During 2005, we launched several new initiatives that have already been well received in the market:

- o Health Savings Accounts: Macatawa is one of the first banks in West Michigan to offer health savings accounts, or HSAs. An HSA allows individuals to set aside funds to pay for healthcare expenses on a pre-tax basis. As rising healthcare costs remain a concern for everyone, HSAs have become a popular and economical way for handling payments. We are very pleased that area health service providers endorse our program, which assists greatly in our marketing efforts.
  - o Homeowner CD: We recognize that saving for a home or a home improvement project can be a daunting task. To make the process more manageable, we introduced the Homeowners CD, a five-year certificate of deposit with a competitive rate. This program makes it easier for customers to set aside as little as \$25 at a time toward a down payment or home improvement.
  - o Reverse Mortgages: Again, Macatawa is one of the first banks in the area to offer a reverse mortgage. A reverse mortgage allows seniors to take out a loan against the equity in their home. Unlike a traditional mortgage, the reverse mortgage has the lender making payments to the homeowner. This product increases the funds available to seniors so they may enjoy their retirement years to the fullest.
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We are currently developing and evaluating new products and services, with the intention of expanding our offerings in 2006. We plan to continue focusing on ways to increase our non interest revenue. As the pressure on net interest margins intensifies, it will be particularly important for us to diversify our revenue sources and develop new products that provide value for our customers.

#### **BUILDING ON OUR RELATIONSHIPS:**

##### **Encouraging Personal Growth**

When you walk into a Macatawa Bank office, it is our sincere hope that you feel a true difference, from the moment you are welcomed until your transaction is completed.

It is often the little things that distinguish great service from good service. Macatawa is small enough so that our tellers get to know you personally and whether your children prefer grape or root beer lollipops. Yet we are big enough to offer a broad and sophisticated array of products and services that meet the changing financial needs of both individuals and businesses.

We empower our employees to serve customers and solve their problems. We invest in our employees through ongoing training to ensure that new employees absorb the Macatawa culture – and all employees embrace our culture every day. We are committed to grow from within through leadership programs that allow our employees to stretch and reach new challenges.

Macatawa Bank is a great place to work. We have an unparalleled staff who is friendly, caring and professional. They are simply the best at what they do. Key to that, is their dedication to providing extraordinary customer service at every level throughout our organization.

We owe so much of the growth and success of Macatawa Bank in the past eight years to this wonderful team and the relationships they have forged in the community. To give you a better understanding of how these issues are intertwined, we thought we would let our customers tell you in their own words just what a difference Macatawa Bank employees have made in their lives.

**Thank you again for your continued confidence and support.**

/s/ Benj. A. Smith III  
BENJAMIN A. SMITH III  
CHAIRMAN & CEO / MACATAWA BANK CORPORATION

/s/ Philip J. Koning  
PHILIP J. KONING  
PRESIDENT & CEO / MACATAWA BANK

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## Selected Consolidated Financial Data

The following selected consolidated financial and other data are derived from the Company's Financial Statements and should be read with the Consolidated Financial Statements and Notes thereto, and Management's Discussion and Analysis of Results of Operations and Financial Condition. The Consolidated Balance Sheets as of December 31, 2005 and 2004, and the Consolidated Statements of Income for the years ended December 31, 2005, 2004, and 2003, are included elsewhere in this Annual Report.

(Dollars in thousands, except per share data)

### As of and For the Year Ended December 31

	2005	2004	2003	2002	2001
<b>Financial Condition</b>					
Total assets	\$ 1,869,990	\$ 1,672,606	\$ 1,401,111	\$ 1,176,583	\$ 670,203
Securities	160,603	139,801	109,673	90,170	64,316
Loans	1,547,879	1,396,387	1,157,107	961,038	545,693
Deposits	1,507,772	1,351,516	1,109,399	920,873	526,192
FHLB advances	145,161	123,985	145,680	106,897	75,638
Shareholders' equity	141,744	129,074	121,900	113,974	66,502
<b>Share Information*</b>					
Basic earnings per common share	\$ 2.05	\$ 1.26	\$ 1.17	\$ 1.02	\$ .85
Diluted earnings per common share	2.00	1.24	1.15	1.01	.84
Book value per common share	13.86	12.72	12.06	11.39	9.50
Dividends per common share	.61	.43	.35	.27	.22
Weighted average dilutive shares outstanding	10,466,711	10,319,011	10,249,652	9,465,016	6,080,719
Shares outstanding at end of period	10,227,992	10,150,937	10,106,863	10,005,438	6,998,021
<b>Operations</b>					
Interest income	\$ 105,395	\$ 78,329	\$ 64,435	\$ 57,252	\$ 42,685
Interest expense	42,558	26,309	22,341	22,902	20,927
Net interest income	62,837	52,020	42,094	34,350	21,758
Provision for loan losses	3,675	7,890	4,105	3,321	2,285
Net interest income after provision for loan losses	59,162	44,130	37,989	31,029	19,473
Total noninterest income	13,004	10,042	10,154	7,877	3,683
Total noninterest expense	41,423	35,400	30,575	24,741	15,543
Income before tax	30,743	18,772	17,568	14,165	7,613
Federal income tax	9,854	5,996	5,788	4,652	2,497
Net income	\$ 20,889	\$ 12,776	\$ 11,780	\$ 9,513	\$ 5,116
<b>Performance Ratios</b>					
Return on average equity	15.30%	10.15%	9.91%	9.46%	9.58%
Return on average assets	1.17%	.83%	.94%	.95%	.88%
Yield on average interest-earning assets	6.37%	5.47%	5.55%	6.16%	7.82%
Cost on average interest-bearing liabilities	2.87%	2.07%	2.19%	2.82%	4.39%
Average net interest spread	3.50%	3.40%	3.36%	3.34%	3.43%
Average net interest margin	3.81%	3.64%	3.63%	3.69%	3.98%
Efficiency ratio	54.62%	57.04%	58.52%	58.59%	61.09%
<b>Capital Ratios</b>					
Equity to assets	7.58%	7.72%	8.70%	9.69%	9.92%
Total risk-based capital ratio	11.07%	11.12%	10.92%	9.89%	12.85%
<b>Credit Quality Ratios</b>					
Allowance for loan losses to total loans	1.36%	1.38%	1.39%	1.40%	1.41%
Nonperforming assets to total assets	.26%	.35%	.32%	.28%	.36%
Net charge-offs to average loans	.13%	.37%	.14%	.12%	.09%

\*Retroactively adjusted to reflect the effect of all stock dividends.

**Quarterly Financial Data (unaudited)**

A summary of selected quarterly results of operations for the years ended December 31, 2005 and 2004 follows:

(Dollars in thousands, except per share data)

	Three Months Ended			
	March 31	June 30	September 30	December 31
<b>2005</b>				
Interest income	\$ 23,198	\$ 25,357	\$ 27,752	\$ 29,087
Net Interest income	14,844	15,487	16,105	16,401
Provision for loan losses	900	1,125	855	795
Income before income tax expense	6,655	7,769	8,211	8,107
Net income	4,535	5,262	5,550	5,542
Net income per share*				
Basic	0.45	0.52	0.54	0.54
Diluted	0.44	0.50	0.53	0.53
<b>2004</b>				
Interest income	\$ 17,305	\$ 18,636	\$ 20,345	\$ 22,043
Net Interest income	11,392	12,570	13,619	14,439
Provision for loan losses	1,225	1,440	3,900	1,325
Income before income tax expense	4,208	4,948	3,047	6,569
Net income	2,866	3,346	2,116	4,448
Net income per share*				
Basic	0.28	0.33	0.21	0.44
Diluted	0.28	0.32	0.21	0.43

Net income for the third quarter of 2004 includes the impact of a \$2.3 million (\$1.5 million after-tax, or \$0.15 per share) charge against earnings related to the one borrower whose loans became impaired as described in Note 4 of the financial statements.

\*Retroactively adjusted to reflect the effect of all stock dividends.

## **Management's Discussion and Analysis of Results of Operations and Financial Condition**

Management's discussion and analysis of results of operations and financial condition contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those projected in such forward-looking statements.

The following section presents additional information to assess the results of operations and financial condition of the Company. This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this Annual Report.

### **Overview**

Macatawa Bank Corporation is a Michigan corporation and is the holding company for two wholly owned subsidiaries, Macatawa Bank and Macatawa Investment Services, Inc. and for two trusts, Macatawa Statutory Trust I and Macatawa Statutory Trust II. Macatawa Bank Corporation is a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates twenty-three 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 Investment Services is a broker/dealer providing various services including discount brokerage, personal financial planning, and consultation regarding mutual funds and annuities. 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 the Corporation's financial statements. For further information regarding consolidation, see the Notes to the Consolidated Financial Statements included herein. Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, originates and sells residential mortgage loans into the secondary market on a servicing released basis.

While maintaining asset quality and improving profitability, we have experienced rapid and substantial growth since opening Macatawa Bank in November of 1997. We first became profitable in 1999 and have increased earnings each year since then with 2005 net income reaching \$20.9 million. Since our inception in 1997, we have raised approximately \$100.6 million in capital through private and public common stock offerings and trust preferred offerings to facilitate our growth and progress over these years.

We believe that growth in core deposits is key to our long-term success and is our primary funding source for asset growth. Establishing a branching network in our markets has been of high importance in order to facilitate this core deposit growth. We have gained community awareness and acceptance in our markets through this expanding branch network and our high service quality standards.

The West Michigan markets within which we operate continue to provide significant expansion opportunities for us. We opened our tenth branch in the Kent County market on the north side of the greater Grand Rapids area during the second quarter of 2005. Because of the significance of the greater Grand Rapids market and as it represents the greatest opportunity for market share growth, we anticipate additional branch openings in this market within the next few years. We also continue to enjoy success in building new and existing relationships in the Holland/Zeeland area, and our entrance into the Grand Haven market during the third quarter of 2003 has produced excellent growth results. We anticipate that we will continue to experience growth in our balance sheet and in our earnings due to these expansion opportunities.

## RESULTS OF OPERATIONS

**Summary:** Net income totaled \$20.9 million, or \$2.00 per diluted share for 2005 as compared to \$12.8 million, or \$1.24 per diluted share for 2004, and \$11.8 million, or \$1.15 per diluted share for 2003. The results for 2004 include a charge against earnings of \$2.3 million (\$1.5 million after tax), or approximately \$0.15 per share, for a loss associated with the impaired commercial loan relationship described under Loan Portfolio and Asset Quality.

The increase in net income principally reflects strong growth in our net interest income due to our continuing growth in interest earning assets, partially offset by increases in noninterest expense.

**Net Interest Income:** Net interest income totaled \$62.8 million during 2005 compared to \$52.0 million during 2004 and \$42.1 million during 2003. The 21% growth in net interest income during 2005 compared to 2004 was driven by significant growth in average interest earning assets which increased by \$219.0 million, or 15%, to \$1.65 billion for 2005. The net interest margin increased 17 basis points to 3.81% for 2005, also contributing to the growth in net interest income. The increases in short-term interest rates that began in mid-2004 were a primary reason for the increase in the net interest margin.

The yield on earning assets increased 90 basis points to 6.37% for 2005 from 5.47% for 2004. The primary reason for this increase was the rise in the yield on our variable rate loan portfolio. The increases in short-term interest rates that began in mid-2004 continued throughout all of 2005 causing the increase in variable rate loan yields. The addition of new loans at generally higher rates during this period also contributed to the increase in asset yield. The increase in the yield on earning assets was offset by an 80 basis point increase in our overall cost of funds to 2.87% for 2005. The primary reasons for the increase can be attributed to higher rates paid on our deposit accounts, the rollover of time deposits to higher rates within the rising rate environment during 2005, and a shift to higher costing sources of funds, primarily time deposits. Part of the increase in time deposits was from the use of brokered time deposits to support the growth in assets during the year. In addition, the rates paid on retail time deposits reached levels in 2005 that had not been seen in the past few years, causing deposit customers to shift funds from transaction accounts, primarily money market accounts, into the higher rate time accounts.

The 24% growth in net interest income during 2004 compared to 2003 was also largely driven by significant growth in average interest earning assets which increased by \$273.0 million, or 24%, to \$1.43 billion for 2004. The net interest margin was relatively flat, increasing 1 basis point to 3.64% for 2004.

During a period of historically low rates that began during 2003 and remained throughout all of 2004, the decline in the yield on earning assets of eight basis points in 2004 compared to 2003 was offset by a corresponding decline of 12 basis points in the overall cost of funds. A shift to lower costing transaction accounts, primarily money market accounts, also contributed to the decline in the cost of funds during 2004.

Anticipated growth in earning assets is expected to continue to increase levels of net interest income. We do not, however, anticipate changes in short-term interest rates to have as much of an impact on our net interest margin considering our balanced sensitivity. We continue to maintain derivative instruments, as discussed in the Notes to the Consolidated Financial Statements, to help balance our interest rate risk sensitivity considering our significant variable rate loan portfolio. This is discussed in further detail under the section Sensitivity to Market Risk.

The following table shows an analysis of net interest margin for the years ended December 31, 2005, 2004 and 2003.

(Dollars in Thousands)	For the years ended December 31,								
	2005			2004			2003		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
<b>Assets:</b>									
Taxable securities	\$ 109,027	\$ 4,392	4.03%	\$ 84,151	\$ 3,528	4.19%	\$ 70,723	\$ 3,237	4.76%
Tax-exempt securities (1)	49,285	2,084	6.53%	40,491	1,727	6.62%	24,843	1,067	6.82%
Loans (2)	1,473,558	98,031	6.58%	1,295,887	72,583	5.54%	1,046,723	59,775	5.58%
Federal Home Loan Bank stock	13,299	573	4.25%	9,857	430	4.29%	6,629	338	5.03%
Federal funds sold and other short-term investments	8,976	315	3.46%	4,787	61	1.25%	1,856	18	0.98%
Total interest earning assets (1)	1,654,145	105,395	6.37%	1,435,173	78,329	5.47%	\$1,150,774	\$64,435	5.55%
Noninterest earning assets:									
Cash and due from banks	35,370			33,792			30,367		
Other	93,517			68,478			69,422		
Total assets	\$1,783,032			\$1,537,443			\$1,250,563		
<b>Liabilities and Shareholders' Equity:</b>									
Deposits:									
NOW and money market accounts	\$ 608,718	\$ 11,841	1.95%	\$ 587,834	\$ 6,916	1.18%	\$ 395,697	\$ 3,662	0.93%
Savings	40,674	183	0.45%	38,266	86	0.23%	35,172	127	0.36%
IRAs	30,536	1,092	3.58%	27,170	884	3.26%	25,618	936	3.66%
Time deposits	546,307	18,944	3.47%	407,835	11,185	2.74%	406,613	12,245	3.01%
Borrowings:									
Federal Home Loan Bank advances	171,000	6,599	3.81%	145,346	5,223	3.59%	124,825	4,676	3.75%
Long-term debt	41,238	2,603	6.23%	36,742	1,659	4.52%	12,850	507	3.95%
Federal funds borrowed and other borrowed funds	36,715	1,296	3.48%	22,837	356	1.54%	14,317	188	1.30%
Total interest bearing liabilities	1,475,188	42,558	2.87%	1,266,030	26,309	2.07%	1,015,092	22,341	2.19%
Noninterest bearing liabilities:									
Noninterest bearing demand accounts	164,184			139,510			110,670		
Other noninterest bearing liabilities	7,148			5,973			5,966		
Shareholders' equity	136,512			125,930			118,835		
Total liabilities and Shareholders' equity	\$1,783,032			\$1,537,443			\$1,250,563		
Net interest income		\$ 62,837			\$52,020			\$42,094	
Net interest spread (1)			3.50%			3.40%			3.36%
Net interest margin (1)			3.81%			3.64%			3.63%
Ratio of average interest earning assets to average interest bearing liabilities	112.13%			113.36%			113.37%		

(1) Yields are adjusted for tax-exempt interest.

(2) Loan fees included in interest income are not material. Nonaccrual loans are included in average loans outstanding.

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

(Dollars in thousands)	For The Year Ended December 31					
	2005 vs 2004			2004 vs 2003		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income						
Taxable securities	\$ 1,007	\$ (143)	\$ 864	\$ 709	\$ (418)	\$ 291
Tax-exempt securities	387	(30)	357	727	(67)	660
Loans	10,914	14,534	25,448	13,147	(339)	12,808
FHLB stock	148	(5)	143	146	(54)	92
Fed funds sold and other short-term investments	84	170	254	36	7	43
Total interest income	\$ 12,540	\$ 14,526	\$ 27,066	\$ 14,765	\$ (871)	\$ 13,894
Interest expense						
NOWs and MMDAs	\$ 254	\$ 4,671	\$ 4,925	\$ 2,506	\$ 748	\$ 3,254
Savings	6	91	97	40	(81)	(41)
IRAs	116	92	208	162	(214)	(52)
Time deposits	4,362	3,397	7,759	111	(1,171)	(1,060)
FHLB advances	970	406	1,376	856	(309)	547
Long-term debt	222	722	944	1,069	83	1,152
Fed funds purchased and other borrowings	305	635	940	127	41	168
Total interest expense	6,235	10,014	16,249	4,871	(903)	3,968
Net interest income	\$ 6,305	\$ 4,512	\$ 10,817	\$ 9,894	\$ 32	\$ 9,926

**Provision for Loan Losses:** The provision for loan losses for 2005 was \$3.7 million as compared to \$7.9 million for 2004 and \$4.1 million for 2003. For 2004, the provision for loan losses includes a \$2.3 million additional provision for the one commercial borrower described below under Portfolio Loans and Asset Quality. When excluding this specific provision, the provision for loan losses in 2005 still declined by \$1.9 million primarily due to slower loan growth in 2005 compared to 2004. The amount of the loan loss provision in all periods is a byproduct of establishing our allowance for loan losses at levels deemed necessary in our methodology for determining the adequacy of the allowance. For more information about our allowance for loan losses and our methodology for establishing its level, see the discussion under the section Allowance for Loan Losses.

**Noninterest Income:** Noninterest income totaled \$13.0 million during 2005, as compared to \$10.0 during 2004 and \$10.2 million in 2003. The \$3 million or 30% improvement over 2004 included increases in all individual components with the exception of trust fees which were unchanged. Deposit service charge income increased \$1.4 million or 46% and was the primary reason for the increase in noninterest income. An overdraft privilege service implemented at the beginning of the second quarter of 2005 continues to be well received and is largely the reason for the increase in deposit service charge income. The increase in deposit service charges of \$398,000 or 16% during 2004 reflects the continued expansion of our deposit customer account base as we have grown.

Revenues from trust services were unchanged at \$2.9 million for 2005 and 2004 compared to \$2.5 million for 2003. Trust fees are, to a great extent, based on the underlying values of trust assets managed. Although we are gaining new trust customers each year, fees remained relatively flat in 2005 due to a decline in the market valuation of securities held in the trust accounts.

Other income increased \$1.5 million in 2005 and \$564,000 in 2004. The increase in other income for both years included increases in miscellaneous fee categories associated with volume increases as we have grown. These fee categories include debit card and ATM processing income, revenues from mutual fund and annuity sales, and income from title insurance sales. The increase in 2005 also included an additional \$499,000 of income earned on bank-owned life insurance purchased during the fourth quarter of 2004. Also included in other income for 2005 was \$348,000 in gains on the sale of two commercial properties, one previously held as other real estate.

Gain on sales of loans primarily includes gains on the sale of real estate mortgage loans, and to a lesser extent, gains on the sale of the SBA guaranteed portion of certain commercial loans. We sell the majority of the fixed-rate mortgage loans we originate. We do not retain the servicing rights for the loans we sell. A summary of gain on sales of loans and related volume is as follows:

(Dollars in thousands)

**For The Year Ended December 31**

	<b>2005</b>	<b>2004</b>	<b>2003</b>
Gain on the sale of SBA guaranteed loans	\$ 100	\$ 122	\$ 109
Net gain on the sale of real estate mortgage loans	2,236	2,085	3,637
Gain on sales of loans	<u>\$ 2,336</u>	<u>\$ 2,207</u>	<u>\$ 3,746</u>
Real estate mortgage loans originated for sale	137,028	141,661	305,612
Real estate mortgage loans sold	140,083	144,772	324,030
Net gain on the sale of real estate mortgage loans as a percent of real estate mortgage loans sold ("Loan sales margin")	1.60%	1.44%	1.12%

Gain on sales of loans increased \$129,000 in 2005 compared to 2004, while 2004 decreased \$1.5 million compared to 2003. The generally higher levels of longer-term interest rates in 2005 and 2004 resulted in significantly lower levels of residential refinancing and loan originations than in 2003 when longer-term interest rates reached historic lows and related refinancing activity was at record highs. An improvement in the loan sales margin received on residential loans sold during both 2005 and 2004 slightly offset the significant decline in volume since 2003. The general improvement in our loan sales margin since 2003 reflects an improvement in our competitive position with our secondary market investors and greater discipline in our pricing practices. Since mortgage interest rate levels have generally increased from their historic lows in 2003, we expect the volume of originations going forward to be more consistent with 2005 and 2004 levels.

**Noninterest Expense:** Noninterest expense totaled \$41.4 million for 2005 as compared to \$35.4 million for 2004 and \$30.6 million for 2003. Salaries and benefits increased \$3.2 million in 2005 over 2004 and \$2.8 million in 2004 over 2003, comprising the majority of the increase in both years.

The increase in salaries and benefits for 2005 and 2004 is primarily related to additional staffing in each line of business and in support departments consistent with growth of the Bank. Increased incentives associated with strong performance also contributed to the increase in salaries and benefits during 2005. The increase in salaries and benefits for 2004 also reflects an increase in staffing for the five new full-service branches that were opened during the period since the fourth quarter of 2003 through the end of 2004. The consistent increase in salaries and benefits reflects our attention to properly managing and supporting our growth and our interest in creating a platform for strong future growth.



The increase in occupancy expense of \$586,000 in 2005 and \$311,000 in 2004 and the increase in furniture and equipment expense of \$207,000 in 2005 and \$180,000 in 2004 are consistent with our branch and facilities expansion during these periods. We would expect the level of increase in these expense categories to moderate and be commensurate with our plans for future branch expansion.

The increase in marketing and promotion expense of \$415,000 in 2005 and \$264,000 in 2004 is consistent with the growth in our company, and our interest in creating a more significant presence in the markets we serve.

Data processing fees were up \$510,000 in 2005 and \$275,000 in 2004. In September of 2004, we outsourced our item processing function which was the primary reason for the increase in 2005 and also contributed to the increase in 2004. We expect future increases to decline and be more consistent with the Company's growth.

Other expense increased \$980,000 in 2005 and \$1.1 million in 2004. The increase in both periods includes increases in various expense categories consistent with the growth of our company. These categories include expenses associated with debit card and ATM processing, customer and internal courier, outside services, travel and state taxes. The increases for both 2005 and 2004 include expenses associated with the implementation and additional ongoing costs of Section 404 of the Sarbanes-Oxley Act.

Despite the increases in noninterest expense, growth in net interest and noninterest revenues continue to outpace operating expenses. The efficiency ratio has improved over the past three years, declining from 58.52% in 2003 to 57.04% in 2004 to 54.62% in 2005.

**Federal Income Tax Expense:** Our federal income tax expense has increased generally commensurate with our increase in pre-tax earnings. Our federal income tax expense is lower than the amount computed by applying our statutory federal income tax rate to our pre-tax earnings primarily due to tax-exempt interest income. Our effective tax rate was 32.1%, 31.9% and 32.9% in 2005, 2004 and 2003, respectively.

## FINANCIAL CONDITION

**Summary:** Our total assets were \$1.87 billion at December 31, 2005, an increase of \$197.4 million from \$1.67 billion in total assets at December 31, 2004. We believe the continued strong asset growth reflects the acceptance of our full-service community banking philosophy in the growing communities we serve. Our asset growth consists primarily of growth in our loan portfolio as we continue to attract new loan customers and deepen relationships with existing customers despite the strong competition from other locally based community banks and larger regional banks. Total portfolio loans increased \$151.5 million or 11% during 2005. The growth in total assets also included growth in our cash and due from banks, investment securities portfolio, and premises and equipment.

The increase in total assets was principally funded by deposit growth. Deposits grew by \$156.3 million during 2005, a 12% growth rate. We attribute the deposit growth to our quality customer service, the desire of our customers to bank with a locally run bank, and convenient accessibility through the expansion of our branch network.

**Cash and Cash Equivalents:** Our cash and cash equivalents, which include federal funds sold and short-term investments, were \$49.1 million at December 31, 2005, as compared to \$31.7 million at December 31, 2004. The high balance at the end of 2005 was due to a large inflow of customer deposits that occurred right at the end of the year.

**Securities:** Securities increased \$20.8 million or 15% to \$160.6 million at December 31, 2005 from \$139.8 million at December 31, 2004. We maintain our security portfolio at a level to provide diversity in the nature of our assets, to support our liquidity needs and to balance our interest rate risk. Our portfolio consists primarily of high quality U.S government agency and state and local municipal bonds classified as available for sale. These securities are generally purchased at fixed rates to help offset the interest sensitivity of our variable rate loan portfolio. We expect continued growth of our securities portfolio generally consistent with the growth of our company to maintain the diversity of our assets and support our liquidity and interest rate risk management.

**Loan Portfolio and Asset Quality:** Our total loan portfolio increased to \$1.55 billion at December 31, 2005 from \$1.40 billion at December 31, 2004. The \$151.5 million increase in portfolio loans continues our consistent pattern of growth. Each of our loan portfolios, including commercial and commercial real estate, residential real estate and consumer loans grew during 2005, however, the strongest growth was in the commercial and commercial real estate portfolios, which grew by 14%. We believe the continued growth we have experienced in each of our loan portfolios is a result of our focus on providing high quality customer service and reflects the acceptance of our full-service community banking philosophy in the growing communities we serve.

The majority of loans that we retain in our portfolio are to small and mid-sized businesses in the form of commercial and commercial real estate loans. Our combined commercial loan portfolios accounted for approximately 74% and 73% of our total portfolio loans at December 31, 2005 and 2004, respectively. The \$1.15 billion in commercial and commercial real estate loans at December 31, 2005 represents an increase of \$137.9 million over the \$1.02 billion at December 31, 2004. We feel the consistent growth in commercial loans that we have been able to achieve reflects the acceptance of our lending approach by our customers and the ability of our lending team to respond to their needs effectively. Our commercial loan department is built around a well-seasoned officer team and our lending approach involves an efficient loan approval process focused around local decision-making.

The residential real estate portfolio increased from \$219.0 million at December 31, 2004 to \$223.4 million at December 31, 2005. Our residential real estate loan portfolio, which also includes residential construction loans made to individual homeowners, comprised approximately 14% of portfolio loans at the end of 2005. Our residential real estate portfolio represents only a small portion of our residential origination loan volume, as we sell the majority of our fixed-rate obligations on the secondary market with servicing released to reduce our exposure to interest rate risk. We originated for sale \$137.0 million in residential mortgages in 2005, \$141.7 million in 2004, and \$305.6 million in 2003. Loans held for sale were \$2.3 million at December 31, 2005 as compared to \$3.2 million at December 31, 2004. The generally higher levels of longer-term interest rates in 2005 and 2004 resulted in significantly lower levels of residential refinancing and loan originations as compared to 2003 when longer-term interest rates were at historic lows and related refinancing activity was at record highs.

Our consumer loan portfolio includes both loans secured by personal property, as well as home equity fixed term and line of credit loans. Our consumer loan portfolio increased to \$171.5 million at December 31, 2005 from \$162.4 million at December 31, 2004. Consumer loans comprised approximately 11% of our portfolio loans at the end of 2005.

As we continue to leverage our expansive branch network and strengthen our presence in the markets we serve, we anticipate further growth in each of our loan portfolios consistent with our historical growth patterns.

Nonperforming assets are comprised of nonperforming loans, foreclosed assets and repossessed assets. Our nonperforming loans include loans on non-accrual status, restructured loans and loans delinquent more than 90 days but still accruing. Nonperforming loans as of December 31, 2005 totaled \$4.2 million or 0.27% of total portfolio loans compared to \$4.0 million or 0.29% of total portfolio loans at December 31, 2004.

The balance of nonperforming loans at the end of 2005 consists of a number of smaller commercial loans on nonaccrual for which we are considered to be well collateralized or adequately reserved. The majority of nonperforming loans at the end of 2004 related to one commercial borrower. The loans associated with this borrower became impaired due to fraud perpetrated by the borrower. The borrower has since ceased operations. Proceeds from the liquidation of collateral, payments on outstanding receivables and additional charge-offs reduced our balances from this relationship to approximately \$229,000 at the end of 2005, from \$2.3 million at year-end 2004.

Our loan portfolio is reviewed regularly by an external loan review team, our own loan officers, and our senior management. When reasonable doubt exists concerning collectibility of interest or principal of one of our loans, that loan is placed in non-accrual status. Any interest previously accrued but not collected is reversed and charged against current earnings.

Foreclosed assets include assets acquired in settlement of loans. As of December 31, 2005 foreclosed assets totaled \$527,000 compared to \$1.9 million as of December 31, 2004. The balance at the end of 2004 related to one piece of commercial real estate for which no loss was experienced upon disposition.

Total nonperforming assets amounted to \$4.9 million or 0.26% of total assets as of December 31, 2005 compared to \$5.9 million or 0.35% of total assets as of December 31, 2004. The following table shows the composition and amount of our nonperforming assets.

(Dollars in thousands)

	<b>As of December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Nonaccrual loans	\$ 3,977	\$ 3,249	\$ 1,717
Loans 90 days or more delinquent and still accruing	227	772	2,308
Restructured loans	--	--	--
<b>Total nonperforming loans</b>	<b>\$ 4,204</b>	<b>\$ 4,021</b>	<b>\$ 4,025</b>
Foreclosed assets	527	1,850	464
Repossessed assets	165	--	4
<b>Total nonperforming assets</b>	<b>\$ 4,896</b>	<b>\$ 5,871</b>	<b>\$ 4,493</b>
Nonperforming loans to total loans	.27%	.29%	.35%
Nonperforming assets to total assets	.26%	.35%	.32%

**Allowance for Loan Losses:** Our allowance for loan losses as of December 31, 2005 was \$21.0 million, representing approximately 1.36% of total portfolio loans outstanding, compared to \$19.3 million or 1.38% of total loans at December 31, 2004.

Our allowance for loan losses is maintained at a level considered appropriate based upon our regular, quarterly assessments of the probable estimated losses inherent in the loan portfolio. Our methodology for measuring the appropriate level of allowance relies on several key elements, which include specific allowances for loans considered impaired, formula allowance for graded loans, and general allocations based on historical trends for pools of similar loan types.

Specific allowances are established in cases where senior credit management has identified significant conditions or circumstances related to an individually impaired credit that we believe indicates the probability that a loss has been incurred. This amount is determined by methods prescribed by SFAS No. 114, "Accounting by Creditors for Impairment of a Loan". The specific allowance for impaired loans was \$333,000 at December 31, 2005 and \$923,000 at December 31, 2004. The specific allowance at the end of 2004 was primarily related to the one commercial loan borrower previously described under Portfolio Loans and Asset Quality.

The formula allowance is calculated by applying loss factors to outstanding loans based on the internal risk grade of such loans. We use a loan rating method based upon an eight point system. Loans are assigned a loss allocation factor for each loan classification category. The lower the grading assigned to a loan category, the greater the allocation percentage that is applied. Changes in risk grade of both performing and nonperforming loans affect the amount of the formula allowance. Because of the relatively unseasoned nature of our loan portfolio and the rapid loan growth we have experienced since inception, our actual historical loan loss experience remains limited. Accordingly, our loss factors are primarily based upon our analysis of the banking industry's historical loan loss experience, including the historical loan loss experience within the current markets we operate. These factors are monitored against our loss experience as our portfolios' age, and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the analysis date. The formula allowance was approximately \$18.6 million at December 31, 2005 and \$16.4 million at December 31, 2004. The increase of \$1.7 million in the allowance for loan losses during 2005 was primarily related to this \$2.2 million increase in the formula allowance. The increase in the formula allowance is primarily associated with the continuing growth in the commercial loan portfolio.

Groups of homogeneous loans, such as residential real estate, open- and closed-end consumer loans, etc., receive general allowance allocations based on loss trends. In lieu of an established loan loss trend for Macatawa Bank, we use historical loss trends based on industry experience and peers in determining an adequate allowance for probable losses associated with these pools of loans. General economic and business conditions, credit quality trends, collateral values, seasoning of the portfolios and recent loss experience are conditions considered in connection with allocation factors for these similar pools of loans. The general allowance was \$2.1 million at December 31, 2005 and \$1.7 million at December 31, 2004.

The continued increase in the allowance was deemed necessary given the significant growth in loans. However, the allowance for loan losses as a percent of total loans declined from 1.38% to 1.36%. A reduction in reserves necessary for impaired loans and a general improvement in the credit quality of our commercial loan portfolio were the main reasons for the decline. Based upon our internal analysis, in our judgment, we have provided adequate allowances for loan losses, although there can be no assurance that the allowance for losses on loans will be adequate to cover all losses.

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

(Dollars in thousands)	As of December 31					
	2005		2004		2003	
	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans
Commercial and commercial real estate	\$ 18,883	74.5%	\$ 17,324	72.7%	\$ 14,371	73.4%
Residential real estate	463	14.4%	476	15.7%	360	14.9%
Consumer	1,646	11.1%	1,243	11.6%	1,074	11.7%
Unallocated	--	--	208	--	288	--
Total	\$ 20,992	100.0%	\$ 19,251	100.0%	\$ 16,093	100.0%

The above allocations are not intended to imply limitations on usage of the allowance. The entire allowance is available for any loan losses without regard to loan type. The allocated portion of the allowance amounted to \$21.0 million at December 31, 2005. Of this total, 2% related to specific allocations on impaired loans, 88% related to formula allocations and 10% related to general allocations.

Net charge-offs totaled \$1.9 million, or 0.13% of average loans for 2005 compared to \$4.7 million, or 0.37% of average loans for 2004. As previously noted under the section Loan Portfolio and Asset Quality, the increase for 2004 relates primarily to a \$2.8 million charge-off associated with the impaired loans to one commercial borrower. The following is a summary of our loan balances, changes in the allowance for loan losses and related ratios.

(Dollars in thousands)	December 31		
	2005	2004	2003
Loans:			
Average daily balance of loans for the year	\$ 1,473,558	\$ 1,295,887	\$ 1,046,723
Amount of loans outstanding at end of period	1,547,879	1,396,387	1,157,107
Allowance for loan losses:			
Balance at beginning of year	\$ 19,251	\$ 16,093	\$ 13,472
Addition to allowance charged to operations	3,675	7,890	4,105
Loans charged-off:			
Commercial	(1,842)	(4,833)	(1,308)
Residential real estate	(24)	(21)	(50)
Consumer	(371)	(91)	(187)
Recoveries:			
Commercial	261	180	26
Residential real estate	17	11	17
Consumer	25	22	18
Balance at end of year	\$ 20,992	\$ 19,251	\$ 16,093
Ratios:			
Net charge-offs to average loans outstanding	.13%	.37%	.14%
Allowance for loan losses to loans outstanding at year end	1.36%	1.38%	1.39%

**Premises and Equipment:** Premises and equipment totaled \$53.0 million at December 31, 2005, an increase of \$7.2 million from December 31, 2004. The increase included costs associated with the construction of two new branch sites, one north of Grand Rapids in Rockford and one on the east side of Zeeland. The new Zeeland office allowed us to replace a leased branch site with a full service facility in a more favorable location. In addition, we began construction in 2005 on a new regional facility in downtown Holland. The increase also included the purchase of two pieces of land for two future branch sites. One site will enhance our presence in Kent County and the other will allow us to relocate a current leased facility into a more favorable location.

**Deposits:** Total deposits increased \$156.3 million to \$1.51 billion at December 31, 2005, as compared to \$1.35 billion at December 31, 2004. The majority of growth during the year was in checking accounts and time deposits. Noninterest-bearing checking accounts increased \$39.7 million to \$188.8 million and interest-bearing checking accounts grew \$38.8 million to \$207.9 million at the end of 2005. We are experiencing consistent growth in our core balances for these types of accounts. Our continued focus on quality customer service, the desire of customers to deal with a local bank, and the convenience of our expanding and maturing branch network continues to be well received in our markets. We expect this trend of growth in checking account deposits to continue. Time deposits increased \$209.9 million to \$690.2 million at the end of 2005. An increase in brokered time deposits of \$132.4 million was a large part of the increase in this category. Because of their relatively lower cost compared to other borrowings, brokered time deposits were utilized to support the growth in assets during 2005. In addition, the rates paid on retail time deposits during 2005 reached levels that had not been seen in the past few years. This caused customers to shift funds from money market accounts into these more attractive time deposits.

Noninterest bearing demand accounts comprised approximately 12% of total deposits at December 31, 2005, as compared to approximately 11% of total deposits at the end of 2004. Interest bearing demand, including money markets, and savings accounts comprised approximately 42% of total deposits at December 31, 2005, as compared to 53% at the end of last year. Time accounts as a percentage of total deposits were approximately 46% at December 31, 2005, and were approximately 36% at December 31, 2004.

**Borrowed Funds:** Borrowed funds consist of advances from the Federal Home Loan Bank, long-term debt associated with the issuance of trust preferred securities and federal funds purchased provided by our correspondent banks. Additionally, we have a \$10.0 million credit facility available for general corporate needs including contributing capital to our subsidiary bank to enable it to maintain regulatory capital at well-capitalized levels. This credit facility was unused during all of 2005 and 2004.

Borrowed funds totaled \$212.2 million at December 31, 2005, including \$145.2 million of Federal Home Loan Bank advances, \$41.2 million in long-term debt associated with trust preferred securities and \$25.8 million in federal funds purchased. Borrowed funds totaled \$187.4 million at December 31, 2004 including \$124.0 million of Federal Home Loan Bank advances and \$41.2 million in long-term debt associated with trust preferred securities and \$22.1 million in federal funds purchased. The increase in borrowed funds in 2005 was used to support growth in assets.

## CAPITAL RESOURCES AND LIQUIDITY

**Capital Resources:** Total shareholders' equity was \$141.7 million at December 31, 2005 compared to \$129.1 million at December 31, 2004. The increase of \$12.6 million was primarily the result of retained net income (net of cash dividends paid) that was slightly offset by a reduction in accumulated other comprehensive income. Net income generated during 2005 of \$20.9 million was partially offset by cash dividends of \$6.2 million, or \$.61 per share. We began paying cash dividends at the end of 2000 and have increased the amount of the dividend each year since. It is anticipated that we will continue to pay quarterly cash dividends in the future. We have also paid a stock dividend each year beginning in 2001. A 15% stock dividend was paid in May 2005, resulting in a transfer of \$10.9 million from retained earnings to common stock.

The change in accumulated other comprehensive income was due to a decrease in both the market value of securities available for sale and the derivative instruments associated with the Company's interest rate swap arrangements due principally to the general rise in longer-term interest rates during 2005. For more information regarding our interest rate swap arrangements, see the Notes to the Consolidated Financial Statements.

The Corporation was categorized as "well capitalized" for regulatory capital purposes at December 31, 2005 and 2004. The following table shows the Company's various capital ratios for 2005 and 2004.

As of and for the year ended December 31,	2005	2004
Average equity to average assets	7.7%	8.2%
Total risk-based capital	11.1%	11.1%
Tier 1 risk-based capital	9.7%	9.3%
Tier 1 capital to average assets	8.7%	8.3%

Our total capital to risk-weighted assets was 11.1% at both December 31, 2005 and 2004. Our Tier 1 Capital as a percent of average assets was 8.7% at December 31, 2005 and 8.3% at December 31, 2004. Growth in capital from strong earnings in 2005 was consistent with the growth in assets resulting in the stable capital ratios from 2004 to 2005. On March 18, 2004, we raised additional regulatory capital by participating in a pooled trust preferred security issuance in the amount of \$20.0 million. Of the \$40.0 million of trust preferred securities outstanding at December 31, 2005, approximately \$38.0 million qualified as Tier 1 capital with the remaining qualifying as Tier 2 capital. For more information regarding the trust preferred securities, please refer to the Notes to the Consolidated Financial Statements.

We believe the additional regulatory capital provided by the trust preferred security issuances, as supplemented by our improvement in earnings, will support our growth plans in the near future. Additional capital may be necessary within the next three to four years if our growth continues at its current pace. Capital sources include additional common stock offerings, trust preferred securities offerings and subordinated debt.

**Liquidity:** The liquidity of a financial institution reflects its ability to manage a variety of sources and uses of funds. Our Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus on developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for growing our investment and loan portfolios. Our sources of liquidity include our borrowing capacity with the Federal Home Loan Bank and federal funds purchased lines with our correspondent banks, loan payments by our borrowers, maturity and sales of our securities available for sale, growth of our deposits and deposit equivalents, federal funds sold, and the various capital resources discussed above. Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds. We feel our liquidity position is sufficient to meet these needs.

In the normal course of business, we enter into certain contractual obligations including obligations which are considered in our overall liquidity management. The table below summarizes our significant contractual obligations as December 31, 2005.

(dollars in thousands)	1 year or less	1-3 years	4-5 years	After 5 years
Time deposit maturities	\$ 414,491	\$ 167,167	\$ 108,577	---
Federal funds purchased and FHLB advances	73,009	42,853	46,442	---
Long-term debt	---	---	---	41,238
Total	\$ 487,500	\$ 210,020	\$ 155,019	\$ 41,238

In addition to normal loan funding, we also maintain liquidity to meet customer financing needs through unused lines of credit, unfunded loan commitments and standby letters of credit. The level and fluctuation of these commitments is also considered in our overall liquidity management. At December 31, 2005, we had a total of \$460.8 million in unused lines of credit, \$48.3 million in unfunded loan commitments, and \$24.5 million in standby letters of credit.

#### SENSITIVITY TO MARKET RISK

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Macatawa Bank has only limited agricultural-related loan assets, and therefore has no significant exposure to changes in commodity prices. Our market risk exposure is mainly comprised of our sensitivity to interest rate risk. Our balance sheet has sensitivity, in various categories of assets and liabilities, to changes in prevailing rates in the U.S. for prime rate, mortgage rates, U.S. Treasury rates and various money market indexes. Our asset/liability management process aids us in providing liquidity while maintaining a balance between interest earning assets and interest bearing liabilities.

We use two interest rate risk measurement techniques in our interest rate risk management. We first use a static gap analysis. This measures the difference between the dollar amounts of interest sensitive assets and liabilities that may be refinanced or repriced during a given time period. A significant repricing gap could result in a negative impact to our net interest margin during periods of changing market interest rates. The following table illustrates our interest rate repricing gaps for selected maturity periods at December 31, 2005.



**Static Gap Analysis**  
(dollars in thousands)

	0 to 3 months	4 to 12 months	1 to 5 years	Over 5 Years	Total
Assets:					
Loans-fixed	\$ 33,534	\$ 82,875	\$ 390,552	\$ 61,342	\$ 568,303
Loans-variable	918,204	8,461	51,916	995	979,576
Taxable securities	2,060	---	106,502	1,000	109,562
Tax exempt securities	---	713	2,123	48,205	51,041
Other securities	13,910	---	---	---	13,910
Other assets, net	---	---	---	---	147,598
Total assets	\$ 967,708	\$ 92,049	\$ 551,093	\$ 111,542	\$ 1,869,990
Liabilities:					
Time deposits	\$ 141,035	\$ 273,456	\$ 275,744	\$ ---	\$ 690,235
Savings	40,612	---	---	---	40,612
Other interest bearing deposits	588,163	---	---	---	588,163
Other borrowings	72,247	42,000	89,295	8,666	212,208
Noninterest bearing deposits	---	---	---	---	188,762
Other liabilities & equity	---	---	---	---	150,010
Total liabilities & equity	\$ 842,057	\$ 315,456	\$ 365,039	\$ 8,666	\$ 1,869,990
Period gap	\$ 125,651	\$ (223,407)	\$ 186,054	\$ 102,876	
Cumulative gap	\$ 125,651	\$ (97,756)	\$ 88,298	\$ 191,174	
Cumulative gap/total assets	6.72%	(5.23)%	4.72%	10.22%	

The above table shows that total assets maturing or repricing within three months exceeded liabilities maturing within the same time period by \$127 million indicating that we are asset sensitive in this time horizon. The above gap analysis is limited, however, in that cash flows and repricing characteristics for various categories of assets and liabilities are subject to competitive pressures, consumer sentiments and other influences that are beyond our control and are not reflected in this static analysis. As a result, various assets and liabilities indicated as maturing or repricing within a stated period may reprice at different levels and mature or reprice in other periods or at different volumes.

The analysis also does not consider the extent of repricing for certain assets or liabilities shown as re-priceable within twelve months or reflect the magnitude of interest rate changes on net interest income, or consider certain interest rate swaps utilized to mitigate some of our interest rate risk.

Accordingly, we also utilize a simulation model to assess the direction and magnitude of variations in net interest income and the economic value of equity ("EVE") resulting from potential changes in market interest rates. Key assumptions in the model include contractual cash flows and maturities of interest-sensitive assets and interest-sensitive liabilities, prepayment speeds on certain assets, and changes in market conditions impacting loan and deposit pricing. We also assume certain levels of rate sensitivity of our non-maturing transaction deposits based upon our historical sensitivity under previous interest rate cycles, and we include pricing floors on discretionary priced liability products which limit how low various checking and savings products could go under declining interest rates. These assumptions reflect our pricing philosophy in response to changing interest rates.

The simulation analysis also considers the interest rate swaps we have entered into which have the effect of converting \$80.0 million in variable rate loans repricing immediately into fixed rate loans repricing in one to five years. The interest rate swaps are not reflected in the table above and are more fully discussed in the Notes to the Consolidated Financial Statements.

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

The following table shows the impact of changes in interest rates on net interest income over the next twelve months and EVE based on our balance sheet as of December 31, 2005 (dollars in thousands).

Interest Rate Scenario	Economic Value of Equity	Percent Change	Net Interest Income	Percent Change
<b>Change in Interest Rates</b>				
200 basis point rise	\$ 178,755	(5.7)%	\$ 71,359	6.3%
100 basis point rise	185,481	(2.1)	69,265	3.1
Base-rate scenario	189,490	---	67,156	---
100 basis point decline	194,132	2.5	65,129	(3.0)
200 basis point decline	197,408	4.2	62,690	(6.7)

If interest rates were to increase, this analysis suggests that we are well-positioned for improvements in net interest income over the next twelve months. Further, our balanced sensitivity in time horizons beyond one year results in little fluctuation in EVE under the various rate shock scenarios.

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

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

In addition to changes in interest rates, the level of future net interest income is also dependent on a number of other variables, including: the growth, composition and absolute levels of loans, deposits, and other earning assets and interest-bearing liabilities; economic and competitive conditions; potential changes in lending, investing and deposit gathering strategies; and client preferences.

#### CRITICAL ACCOUNTING AND POLICIES ESTIMATES:

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and future results could differ. The allowance for loan loss and the status of contingencies are deemed critical due to the required level of management judgment and the use of estimates, making them particularly subject to change.

Our methodology for determining the allowance for loan loss and the related provision for loan losses is described above in the "Allowance for Loan Loss" discussion. This area of accounting requires significant judgment due to the number of factors which can influence the collectibility of a loan. Unanticipated changes in these factors could significantly change the level of the allowance for loan losses and the related provision for loan losses. Although, based upon our internal analysis, and in our judgment, we have provided an adequate allowance for loan losses, there can be no assurance that our analysis has properly identified all of the probable losses in our loan portfolio.

Loss contingencies, including the legal actions involving Trade Partners as described in Note 17 of the financial statements, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. This, too, is an accounting area that involves significant judgment. Although, based upon our judgment and internal analysis we have properly accounted for loss contingencies, future changes in the status of such contingencies could result in a significant change in the level of contingent liabilities and a related impact to operating earnings.

**Forward-Looking Statements:** This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies, and expectations are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, may or similar expressions. The presentation and discussion of the provision and allowance for loan losses, statements concerning future profitability or future growth or increases, and statements about the adequacy of our capital resources are examples of inherently forward-looking statements in that they involve judgments and statements of belief as to the outcome of future events. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and future prospects include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in our market area and accounting principles, policies, and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning us and our business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission.

**Quarterly Stock Price Information:** The Company's common stock is quoted on the Nasdaq National Market under the symbol MCBC. High and low sales prices (as reported on the Nasdaq National Market) for each quarter for the years ended December 31, 2005 and 2004 are set forth in the table below. This information has been restated for the 15% stock dividend paid in May 2005 and the 5% stock dividend paid in May 2004.

Quarter	2005		2004	
	High	Low	High	Low
First Quarter	\$ 32.76	\$ 26.48	\$ 24.35	\$ 21.03
Second Quarter	\$ 36.00	\$ 26.51	\$ 24.78	\$ 20.87
Third Quarter	\$ 40.00	\$ 32.50	\$ 25.00	\$ 21.63
Fourth Quarter	\$ 39.25	\$ 31.70	\$ 28.69	\$ 22.48

Quarterly cash dividends totaling \$.35 were paid during 2003, and a 5% stock dividend was declared during the second quarter of 2003. Quarterly cash dividends totaling \$.43 were paid during 2004, and a 5% stock dividend was declared during the second quarter of 2004. Quarterly cash dividends totaling \$.61 were paid during 2005, and a 15% stock dividend was declared during the second quarter of 2005.

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**MANAGEMENT'S REPORT ON INTERNAL  
CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Company management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we believe that, as of December 31, 2005; the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent auditors have issued an audit report on our assessment of the Company's internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders  
Macatawa Bank Corporation  
Holland, Michigan

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Macatawa Bank Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Macatawa Bank Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Macatawa Bank Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Macatawa Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Macatawa Bank Corporation as of December 31, 2005 and 2004 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005 and our report dated February 10, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ Crowe Chizek and Company LLC

Grand Rapids, Michigan  
February 10, 2006

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders  
Macatawa Bank Corporation  
Holland, Michigan

We have audited the accompanying consolidated balance sheets of Macatawa Bank Corporation as of December 31, 2005 and 2004, and the related statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Macatawa Bank Corporation at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Macatawa Bank Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 10, 2006 expressed an unqualified opinion thereon.

/s/ Crowe Chizek and Company LLC

Grand Rapids, Michigan  
February 10, 2006



MACATAWA BANK CORPORATION  
CONSOLIDATED BALANCE SHEETS  
December 31, 2005 and 2004  
(Dollars in thousands)

	<b>2005</b>	<b>2004</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 49,101	\$ 31,711
Total cash and cash equivalents	49,101	31,711
Securities available for sale, at fair value	156,696	137,249
Securities held to maturity (fair value 2005 - \$3,974, 2004 - \$2,662)	3,907	2,552
Federal Home Loan Bank (FHLB) stock	13,910	12,239
Loans held for sale	2,331	3,150
Total loans	1,547,879	1,396,387
Allowance for loan losses	(20,992)	(19,251)
	1,526,887	1,377,136
Premises and equipment - net	53,028	45,784
Accrued interest receivable	8,366	6,395
Goodwill	23,915	23,915
Acquisition intangibles	1,941	2,347
Bank-owned life insurance	20,814	20,157
Other assets	9,094	9,971
Total assets	<u>\$ 1,869,990</u>	<u>\$ 1,672,606</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Noninterest-bearing	\$ 188,762	\$ 149,104
Interest-bearing	1,319,010	1,202,412
Total	1,507,772	1,351,516
Federal funds purchased	25,809	22,131
FHLB advances	145,161	123,985
Long-term debt	41,238	41,238
Accrued expenses and other liabilities	8,266	4,662
Total liabilities	1,728,246	1,543,532
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized; no shares issued and outstanding		
Common stock, no par value, 20,000,000 shares authorized; 10,227,992 and 8,823,902 shares issued and outstanding at December 31, 2005 and 2004, respectively	136,583	124,389
Retained earnings	8,040	4,277
Accumulated other comprehensive income (loss)	(2,879)	408
Total shareholders' equity	<u>141,744</u>	<u>129,074</u>
Total liabilities and shareholders' equity	<u>\$ 1,869,990</u>	<u>\$ 1,672,606</u>

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
Years ended December 31, 2005, 2004 and 2003  
(Dollars in thousands, except per share data)

	2005	2004	2003
Interest income			
Loans, including fees	\$ 98,031	\$72,583	\$59,775
Securities			
Taxable	4,392	3,528	3,237
Tax-exempt	2,084	1,727	1,067
FHLB stock	573	430	338
Federal funds sold and other short-term investments	315	61	18
Total interest income	105,395	78,329	64,435
Interest expense			
Deposits	32,060	19,071	16,970
FHLB advances	6,599	5,223	4,676
Long-term debt	2,603	1,659	507
Federal funds purchased and other borrowings	1,296	356	188
Total interest expense	42,558	26,309	22,341
<b>Net interest income</b>	62,837	52,020	42,094
Provision for loan losses	3,675	7,890	4,105
<b>Net interest income after provision for loan losses</b>	59,162	44,130	37,989
Noninterest income			
Service charges and fees	4,323	2,962	2,564
Gain on sales of loans	2,336	2,207	3,746
Trust fees	2,921	2,945	2,480
Other	3,424	1,928	1,364
Total noninterest income	13,004	10,042	10,154
Noninterest expense			
Salaries and benefits	22,388	19,206	16,371
Occupancy of premises	3,239	2,653	2,342
Furniture and equipment	2,975	2,768	2,588
Legal and professional fees	786	679	763
Marketing and promotion	1,625	1,210	946
Supplies	587	551	595
Data processing fees	1,584	1,074	799
Other	8,239	7,259	6,171
Total noninterest expenses	41,423	35,400	30,575
<b>Income before income tax expense</b>	30,743	18,772	17,568
Income tax expense	9,854	5,996	5,788
<b>Net income</b>	\$ 20,889	\$12,776	\$11,780
Basic earnings per share	\$ 2.05	\$ 1.26	\$ 1.17
Diluted earnings per share	\$ 2.00	\$ 1.24	\$ 1.15
Cash dividends per share	\$ .61	\$ .43	\$ .35

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
Years ended December 31, 2005, 2004 and 2003  
(Dollars in thousands, except per share data)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>Balance, January 1, 2003</b>	\$105,201	\$ 5,931	\$2,842	\$ 113,974
Net income		11,780		11,780
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on derivative instruments, net of tax of (\$13)			(25)	(25)
Net change in unrealized gain (loss) on securities available for sale, net of tax of (\$423)			(785)	(785)
Comprehensive income				10,970
Issued 397,664 shares in payment of 5% stock dividend	8,926	(8,940)		(14)
Issued 80,907 shares for stock option exercises	441			441
Cash dividends at \$.35 per share		(3,471)		(3,471)
<b>Balance, December 31, 2003</b>	114,568	5,300	2,032	121,900
Net income		12,776		12,776
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on derivative instruments, net of tax of (\$366)			(679)	(679)
Net change in unrealized gain (loss) on securities available for sale, net of tax of (\$509)			(945)	(945)
Comprehensive income				11,152
Issued 418,263 shares in payment of 5% stock dividend	9,330	(9,355)		(25)
Issued 35,566 shares for stock option exercises (net of 5,249 shares exchanged and including \$97 of tax benefit)	491			491
Cash dividends at \$.43 per share		(4,444)		(4,444)
<b>Balance, December 31, 2004</b>	124,389	4,277	408	129,074

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (continued)  
Years ended December 31, 2005, 2004 and 2003  
(Dollars in thousands, except per share data)

	<b>Common Stock</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total Shareholders' Equity</b>
Net income		20,889		20,889
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on derivative instruments, net of tax of (\$725)			(1,346)	(1,346)
Net change in unrealized gain (loss) on securities available for sale, net of tax of (\$1,046)			(1,941)	(1,941)
Comprehensive income				17,602
Shares Earned (5,000) under Stock Compensation Plans	176			176
Issued 1,328,409 shares in payment of 15% stock dividend	10,863	(10,898)		(35)
Issued 70,681 shares for stock option exercises (net of 6,017 shares exchanged and including \$275 of tax benefit)	1,155			1,155
Cash dividends at \$.61 per share		(6,228)		(6,228)
<b>Balance, December 31, 2005</b>	<b>\$136,583</b>	<b>\$8,040</b>	<b>\$(2,879)</b>	<b>\$ 141,744</b>

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended December 31, 2005, 2004 and 2003  
(Dollars in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Cash flows from operating activities</b>			
Net income	\$ 20,889	\$ 12,776	\$ 11,780
Adjustments to reconcile net income to net cash from operating activities			
Depreciation and amortization	3,100	2,971	2,703
Stock compensation expense	176	0	0
Stock dividends on FHLB stock	(249)	(414)	(231)
Provision for loan losses	3,675	7,890	4,105
Origination of loans for sale	(137,028)	(141,661)	(305,612)
Proceeds from sales of loans originated for sale	140,083	144,772	324,030
Gain on sales of loans	(2,336)	(2,207)	(3,746)
Net change in			
Accrued interest receivable and other assets	(487)	(3,032)	2,011
Bank-owned life insurance	(657)	(157)	0
Accrued expenses and other liabilities	5,649	1,157	(5,057)
Net cash from operating activities	32,815	22,095	29,983
<b>Cash flows from investing activities</b>			
Loan originations and payments, net	(156,004)	(245,862)	(197,553)
Purchase of FHLB stock	(1,422)	(3,446)	(3,402)
Purchases of securities available for sale	(37,770)	(68,554)	(42,687)
Purchases of securities held to maturity	(1,430)	0	0
Maturities and calls of securities available for sale	15,298	36,574	19,273
Principal paydowns on securities	133	413	2,839
Purchase of bank-owned life insurance	0	(20,000)	0
Additions to premises and equipment	(9,957)	(9,617)	(15,264)
Net cash from investing activities	(191,152)	(310,492)	(236,794)
<b>Cash flows from financing activities</b>			
Net increase in deposits	156,256	242,117	188,526
Net increase (decrease) in short-term borrowings	3,678	22,131	(20,000)
Proceeds from long-term debt and other borrowings	0	21,583	19,655
Repayments on other borrowings	0	0	(4,500)
Proceeds from FHLB advances	475,000	339,000	128,500
Repayments on FHLB advances	(453,824)	(360,695)	(90,153)
Fractional shares purchased	(35)	(25)	(14)
Cash dividends paid	(6,228)	(4,444)	(3,471)
Proceeds from exercises of stock options	880	394	441
Net cash from financing activities	175,727	260,061	218,984
Net change in cash and cash equivalents	17,390	(28,336)	12,173
Beginning cash and cash equivalents	31,711	60,047	47,874
Ending cash and cash equivalents	\$ 49,101	\$ 31,711	\$ 60,047
Supplemental cash flow information:			
Interest paid	\$ 40,806	\$ 25,816	\$ 22,915
Income taxes paid	9,000	6,525	6,400
Supplemental noncash disclosures:			
Transfers from loans to other real estate	2,677	1,850	753

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

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**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Macatawa Bank, and its wholly-owned subsidiary, Macatawa Bank Mortgage Company; and Macatawa Investment Services, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company also 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 discussed in a separate note.

Nature of Operations: Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 23 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. Macatawa Bank Mortgage Company originates and sells residential mortgage loans into the secondary market on a servicing released basis. Macatawa Investment Services is a broker/dealer providing various brokerage services including discount brokerage, personal financial planning and consultation regarding individual stocks and mutual funds. Macatawa Statutory Trust I and Macatawa Statutory Trust II are grantor trusts that were established on July 15, 2003 and March 18, 2004 through which trust preferred securities were issued.

The Company is a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. At the present time, the Company has no plans to engage in any of the expanded activities permitted under these regulations.

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

Concentration of Credit Risk: Loans are granted to, and deposits are obtained from, customers primarily in the western Michigan area as described above. Substantially all loans are secured by specific items of collateral, including residential real estate, commercial real estate, commercial assets and consumer assets. Other financial instruments, which potentially subject the Company to concentrations of credit risk, include deposit accounts in other financial institutions.

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

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

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level yield method without anticipating prepayments. Gains and losses on sales are based on the amortized cost of the security sold. Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses.

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(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans: Loans are reported at the principal balance outstanding, net of the allowance for loan losses. Loans held for sale are reported at the lower of cost or market, on an aggregate basis. Loans are sold servicing released, therefore no mortgage servicing right assets are established.

Interest income is accrued on the principal balance and includes amortization of net deferred loan fees and costs over the loan term using the level yield method without anticipating prepayments. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days (180 days for residential mortgages). Consumer loans are typically charged-off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

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

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. Management estimates the allowance balance required based on known and inherent risks in the portfolio, 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.

Loan impairment is reported when full payment under the loan terms is not expected. 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 rate or at the fair value of collateral if repayment is expected solely from the collateral. Loans are evaluated for impairment when payments are delayed, typically 90 days or more, or when the internal grading system indicates a doubtful classification. 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.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed. The Company held \$527,000 in foreclosed assets at December 31, 2005 and \$1,850,000 in foreclosed assets at December 31, 2004.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years.

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(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 5 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

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

**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.

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

**Earnings Per Share:** Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

**Stock Compensation:** Employee compensation expense under stock option plans is reported using the intrinsic value method. No compensation cost related to stock options was recognized during 2005, 2004 or 2003, as all options granted had an exercise price equal to or greater than the market price of the underlying common stock at date of grant. Had compensation cost for stock options been measured using the fair value method, net income and basic and diluted earnings per share would have been the pro forma amounts indicated below (dollars in thousands except per share data).

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income as reported	\$ 20,889	\$ 12,776	\$ 11,780
Deduct: Stock-based compensation expense using fair value method	(508)	(431)	(346)
Pro forma net income	<u>\$ 20,381</u>	<u>12,345</u>	<u>\$ 11,434</u>
Basic earnings per share as reported	\$ 2.05	\$ 1.26	\$ 1.17
Pro forma basic earnings per share	2.00	1.22	1.13
Diluted earnings per share as reported	2.00	1.24	1.15
Pro forma diluted earnings per share	1.95	1.20	1.12
Weighted-average fair value of options granted during the period	9.44	6.17	5.25

(Continued)



MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The pro forma effects are computed using option pricing models, using the following weighted-average assumptions as of grant date.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Risk-free interest rate	4.27%	3.89%	4.16%
Expected option life	6.2 years	7 years	7 years
Expected stock price volatility	23.98%	23.38%	24.08%
Dividend yield	2.01%	2.08%	1.83%

Beginning January 1, 2006, employee compensation cost for stock options will be recorded per FAS 123, Revised (FAS 123(R)). FAS 123(R) requires all public companies to record compensation cost for stock options provided to employees in return for employee service. The cost is measured at the fair value of the options when granted, and this cost is expensed over the employee service period, which is normally the vesting period of the options. This will apply to awards granted or modified beginning January 1, 2006. Compensation cost will also be recorded for prior option grants that vest after this date. The effect on results of operations will depend on the level of future option grants and the calculation of the fair value of the options granted at such future date, as well as the vesting periods provided. Existing options that will vest after the adoption date are expected to result in additional compensation expense of approximately \$570,000 in 2006 and \$356,000 in 2007.

The Company's stock compensation plan allows for the issuance of restricted stock awards. Compensation expense is based upon the market price of the Company's stock at the date of grant and is recognized over the vesting period of the awards. During 2005, 5,000 shares of common stock were awarded under the plan. These shares vested immediately upon grant. Compensation expense for stock awarded in 2005 amounted to \$176,000. There were no stock awards in 2004 and 2003.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and unrealized gains and losses on cash flow hedges which are also recognized as separate components of equity.

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

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

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

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Derivative instruments and hedging activities: All derivative instruments are recorded at their fair values. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in income currently.

Goodwill: Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

Acquisition Intangibles: Acquisition intangibles consist of core deposit and acquired customer relationship intangible assets arising from acquisitions. They are initially measured at fair value and then are amortized on an accelerated method with estimated useful lives of ten years. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

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

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 2 - CASH AND DUE FROM BANKS**

The Company was required to have \$3,592,000 and \$2,670,000 of cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at year-end 2005 and 2004. These balances do not earn interest.

**NOTE 3 - SECURITIES**

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

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<u>Available for Sale 2005</u>				
U.S. Treasury and federal agency securities	\$111,102	\$ 103	\$ (2,644)	\$108,561
State and municipal bonds	46,878	609	(345)	47,142
Other equity securities	1,000	--	(7)	993
	<u>\$158,980</u>	<u>\$ 712</u>	<u>\$ (2,996)</u>	<u>\$156,696</u>
<u>Held to Maturity 2005</u>				
State and municipal bonds	\$ 3,907	\$ 80	\$ (13)	\$ 3,974
	<u>\$ 3,907</u>	<u>\$ 80</u>	<u>\$ (13)</u>	<u>\$ 3,974</u>
<u>Available for Sale 2004</u>				
U.S. Treasury and federal agency securities	\$ 91,394	\$ 447	\$ (442)	\$ 91,399
State and municipal bonds	45,152	907	(209)	45,850
	<u>\$136,546</u>	<u>\$ 1,354</u>	<u>\$ (651)</u>	<u>\$137,249</u>
<u>Held to Maturity 2004</u>				
State and municipal bonds	\$ 2,552	\$ 110	\$ 0	\$ 2,662
	<u>\$ 2,552</u>	<u>\$ 110</u>	<u>\$ 0</u>	<u>\$ 2,662</u>

Securities with unrealized losses at year-end 2005 and 2004, 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):

<b>Description of Securities</b>	<b>Less than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	<b>Unrealized Loss</b>
December 31, 2005						
U.S. Treasury and federal agency securities	\$70,531	\$(1,299)	\$33,654	\$(1,345)	\$104,185	\$(2,644)
State and municipal bonds	16,419	(153)	5,842	(205)	22,261	(358)
Other equity securities	993	(7)	--	--	993	(7)
Total temporarily impaired	<u>\$87,943</u>	<u>\$(1,459)</u>	<u>\$39,496</u>	<u>\$(1,550)</u>	<u>\$127,439</u>	<u>\$(3,009)</u>

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 3 – SECURITIES (Continued)**

Description of Securities	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
December 31, 2004						
U.S. Treasury and federal agency securities	\$32,610	\$(389)	\$1,947	\$(53)	\$34,557	\$(442)
State and municipal bonds	10,870	(209)	0	0	10,870	(209)
Total temporarily impaired	<u>\$43,480</u>	<u>\$(598)</u>	<u>\$1,947</u>	<u>\$(53)</u>	<u>\$45,427</u>	<u>\$(651)</u>

For unrealized losses on securities, no loss has been recognized into income in either 2005 or 2004 because management has the intent and ability to hold these securities for the foreseeable future and the declines are largely due to differences in market interest rates as compared to those of the underlying securities. The declines in fair value are considered temporary and are expected to recover as the bonds approach their maturity date.

Contractual maturities of debt securities at December 31, 2005 were as follows (dollars in thousands):

	<u>Held-to-Maturity Securities</u>		<u>Available-for-Sale Securities</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 715	\$ 713	\$ 2,057	\$ 2,059
Due from one to five years	715	709	110,136	107,640
Due from five to ten years	452	446	13,392	13,738
Due after ten years	2,025	2,106	32,395	32,266
	<u>\$3,907</u>	<u>\$ 3,974</u>	<u>\$157,980</u>	<u>\$155,703</u>

There were no sales of securities for the years ended December 31, 2005, 2004 and 2003.

At December 31, 2005 and 2004, securities with a carrying value of approximately \$1,000,000 were pledged as security for public deposits and for other purposes required or permitted by law. In addition, securities totaling \$107,581,000 and \$90,392,000 at December 31, 2005 and 2004 were used as collateral for advances from the Federal Home Loan Bank.

**NOTE 4 — LOANS**

Year-end loans were as follows (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Commercial	\$ 359,036	\$ 338,398
Commercial mortgage	793,919	676,637
Residential mortgage	223,390	218,999
Consumer	171,534	162,353
	<u>\$1,547,879</u>	<u>\$1,396,387</u>

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 4 – LOANS (Continued)**

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Beginning balance	\$ 19,251	\$ 16,093	\$ 13,472
Provision for loan losses	3,675	7,890	4,105
Loans charged-off	(2,237)	(4,945)	(1,545)
Recoveries	303	213	61
Ending balance	<u>\$ 20,992</u>	<u>\$ 19,251</u>	<u>\$ 16,093</u>

Loans charged-off for 2004 included a third quarter charge of \$2,800,000 related to one borrower whose loans, totaling \$5,900,000, became impaired due to fraud perpetrated by the borrower. After this charge-off, approximately \$3,100,000 of the loan balances remained outstanding. Subsequent to this initial charge-off, proceeds from the liquidation of certain collateral, payments on outstanding receivables, and additional charge-offs of \$125,000 in 2004 and \$789,000 in 2005, reduced the balance to approximately \$2,300,000 at December 31, 2004 and \$229,000 at December 31, 2005.

Impaired loans were as follows (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Loans with no allocated allowance for loan losses	\$2,061	\$ 0
Loans with allocated allowance for loan losses	1,297	3,215
	<u>\$3,358</u>	<u>\$3,215</u>
Amount of the allowance for loan losses allocated	<u>\$ 333</u>	<u>\$ 923</u>

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Average of impaired loans during the period	\$2,833	\$3,329	\$2,583
Interest income recognized during impairment	0	0	154
Cash-basis interest income recognized	0	0	117

Nonperforming loans were as follows at year-end (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Loans past due over 90 days still on accrual	\$ 227	\$ 772
Nonaccrual loans	3,977	3,249
	<u>\$4,204</u>	<u>\$4,021</u>

Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 5 — PREMISES AND EQUIPMENT — NET**

Year-end premises and equipment were as follows (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Land	\$ 14,252	\$ 9,265
Building	32,765	27,703
Leasehold improvements	1,231	1,431
Furniture and equipment	15,571	13,320
Construction in progress	925	3,424
	<hr/>	<hr/>
	64,744	55,143
Less accumulated depreciation	(11,716)	(9,359)
	<hr/>	<hr/>
	\$ 53,028	\$ 45,784
	<hr/>	<hr/>

Depreciation expense was \$2,713,000, \$2,546,000 and \$2,301,000 for each of the years ending December 31, 2005, 2004 and 2003.

The Bank leases certain office and branch premises and equipment under operating lease agreements. Total rental expense for all operating leases aggregated \$380,000, \$452,000 and \$586,000 for each of the years ending December 31, 2005, 2004 and 2003. Future minimum rental expense under noncancelable operating leases as of December 31, 2005 is as follows (dollars in thousands):

2006	\$200
2007	55
2008	14
2009	5
2010	2
	<hr/>
	\$276
	<hr/>

**NOTE 6 – ACQUISITION INTANGIBLES**

Intangible assets recorded for the April 1, 2002 acquisition of Grand Bank Financial Corporation were as follows as of December 31 (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Core deposits	\$ 3,185	\$ 3,185
Trust relationships	478	478
	<hr/>	<hr/>
	\$ 3,663	\$ 3,663
Less accumulated amortization	(1,772)	(1,316)
	<hr/>	<hr/>
	\$ 1,891	\$ 2,347
	<hr/>	<hr/>

Both the core deposits and trust relationships intangibles are being amortized on an accelerated basis over a period of ten years. Amortization expense for the years ended December 31, 2005, 2004 and 2003 was \$406,000, \$440,000 and \$484,000. Estimated amortization expense for the next five years is as follows (dollars in thousands):

2006	\$ 378
2007	340
2008	315
2009	297
2010	281

(Continued)

MACATAWA BANK CORPORATION  
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**NOTE 7 — DEPOSITS**

Deposits at year-end were as follows (dollars in thousands):

	<u>2005</u>	<u>2004</u>
Noninterest-bearing demand	\$ 188,762	\$ 149,104
Money market	380,216	514,415
NOW and Super NOW	207,947	169,179
Savings	40,612	38,494
Certificates of deposit	690,235	480,324
	<hr/>	<hr/>
	\$1,507,772	\$1,351,516
	<hr/>	<hr/>

The following table depicts the maturity distribution of certificates of deposits at December 31, 2005 (dollars in thousands):

2006	\$414,491
2007	84,902
2008	82,265
2009	62,018
2010	46,559
Thereafter	-
	<hr/>
	\$690,235
	<hr/>

Approximately \$515,772,000 and \$331,677,000 in time certificates of deposit were in denominations of \$100,000 or more at December 31, 2005 and 2004.

Brokered deposits totaled approximately \$284,201,000 and \$151,789,000 at December 31, 2005 and 2004. At December 31, 2005 and 2004, brokered deposits had interest rates ranging from 2.70% to 4.55% and 1.50% to 5.25%, respectively, and at year-end 2005, maturities ranging from one month to fifty-six months.

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(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 8 — FEDERAL HOME LOAN BANK ADVANCES**

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

<u>Principal Terms</u>	<u>Advance Amount</u>	<u>Range of Maturities</u>	<u>Weighted Average Interest Rate</u>
December 31, 2005			
Single maturity fixed rate advances	\$104,200	January 2006 to May 2010	3.25%
		September 2009 to December 2010	
Putable advances	31,000		5.80%
Amortizable mortgage advances	9,961	February 2008 to July 2018	3.90%
	<u>\$145,161</u>		
December 31, 2004			
Single maturity fixed rate advances	\$ 72,100	January 2005 to October 2007	3.03%
Putable advances	41,000	January 2005 to December 2010	5.98%
Amortizable mortgage advances	10,885	February 2008 to July 2018	3.93%
	<u>\$123,985</u>		

Each advance is payable at its maturity date and contains a prepayment penalty. 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 securities totaling \$107,581,000 and \$90,392,000 at December 31, 2005 and 2004, and residential and commercial real estate loans totaling \$526,066,000 and \$544,472,000 under a blanket lien arrangement at December 31, 2005 and 2004.

Maturities as of December 31, 2005 were as follows (in thousands):

2006	\$ 47,200
2007	27,000
2008	15,853
2009	5,442
2010	41,000
Thereafter	8,666
	<u>\$145,161</u>

**NOTE 9 – OTHER BORROWINGS**

The Company has a \$10,000,000 credit facility to provide liquidity for the parent company and additional capital for the Bank as necessary. There were no advances outstanding on this credit facility as of December 31, 2005 and 2004.

(Continued)



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**NOTE 10 – LONG-TERM DEBT**

The Company has issued \$40.0 million of pooled trust preferred securities (“Preferred Securities”) through its wholly-owned subsidiary grantor trusts. Macatawa Statutory Trust I issued \$619,000 of common securities to the Company and \$20.0 million of Preferred Securities on July 15, 2003 at a floating interest rate of the three-month LIBOR plus 3.05%. Macatawa Statutory Trust II issued \$619,000 of common securities and \$20.0 million of Preferred Securities on March 18, 2004 at a floating interest rate of the three-month LIBOR plus 2.75%.

The Company issued subordinated debentures (“Debentures”) to each trust in exchange for the proceeds of the offerings, which Debentures represent the sole asset of each trust. The Preferred Securities represent an interest in our Company’s subordinated debentures, which have terms that are similar to the Preferred Securities. As provided in each trust’s indenture, the Preferred Securities accrue and pay distributions quarterly at a specified rate and are subject to mandatory redemption upon the maturity of the Debentures, 30 years from the date of issuance, or upon earlier redemption. The Company has the right to redeem the Debentures in whole or in part beginning five years from the date of issuance at a redemption price specified in each trust’s indenture.

At December 31, 2005 and 2004, the Debentures totaling \$41,238,000 are reported in liabilities as Long-term debt, and the common securities of \$1,238,000 and unamortized debt issuance costs are included in other assets.

At December 31, 2005, approximately \$38 million of the \$40 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes. At December 31, 2004, approximately \$32 million of the \$40 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes.

**NOTE 11 — RELATED PARTY TRANSACTIONS**

Loans to principal officers, directors, and their affiliates were as follows (dollars in thousands).

	<u><b>2005</b></u>	<u><b>2004</b></u>
Beginning balance	\$ 14,778	\$ 12,375
New loans and renewals	12,781	17,353
Repayments and renewals	(11,567)	(14,950)
	<hr/>	<hr/>
Ending balance	\$ 15,992	\$ 14,778
	<hr/>	<hr/>

Deposits from principal officers, directors, and their affiliates at December 31, 2005 and 2004 were \$6,199,000 and \$9,487,000.

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(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 12 — STOCK OPTIONS**

Options to buy stock are granted to officers and employees under the Employee Stock Option Plan (the Employees' Plan), which provides for issue of up to 659,295 options. Options are also granted to directors under the Directors' Stock Option Plan (the Directors' Plan), which provides for issuance of up to 186,185 options. The exercise price is the market price at the date of grant for all plans. The maximum option term is ten years. The vesting schedule is over a one-year period for both the Employees' Plan and the Directors' Plan for all grants through the third quarter 2005. Beginning with grants in the fourth quarter of 2005, the vesting schedule was increased to three years. The amount of options available for future grants at year-end 2005 is 52,750. A summary of the activity in the plans is as follows.

	<b><u>Options Outstanding</u></b>	<b><u>Weighted Average Exercise Price</u></b>
Balance at January 1, 2003	468,695	\$ 10.13
Granted	159,895	20.27
Exercised	(102,190)	4.31
Forfeited	(3,795)	15.23
	<hr/>	
Balance at December 31, 2003	522,605	14.34
Granted	113,908	25.00
Exercised	(48,033)	11.26
Forfeited	(3,306)	20.82
	<hr/>	
Balance at December 31, 2004	585,174	16.63
Granted	148,100	36.84
Exercised	(83,092)	13.24
Forfeited	(2,563)	25.04
	<hr/>	
Balance at December 31, 2005	647,619	\$ 21.66
	<hr/>	

There were 499,519, 471,265 and 363,343 options exercisable at year-end 2005, 2004, and 2003. Options exercisable had a weighted average exercise price of \$17.16, \$14.62 and \$11.73 at year-end 2005, 2004 and 2003.

Options outstanding at year-end 2005 were as follows.

<b><u>Range of Exercise Prices</u></b>	<b><u>Outstanding</u></b>			<b><u>Exercisable</u></b>	
	<b><u>Number</u></b>	<b><u>Weighted Average Remaining Contractual Life in Years</u></b>	<b><u>Average Exercise Price</u></b>	<b><u>Number</u></b>	<b><u>Weighted Average Exercise Price</u></b>
\$3.00-\$10.00	64,974	3.1	7.75	64,974	7.75
\$10.01-\$13.00	72,803	3.0	11.75	72,803	11.75
\$13.01-\$17.00	158,546	6.6	15.36	158,546	15.36
\$17.01-\$23.00	97,640	7.9	21.87	97,640	21.87
\$23.01-\$28.00	105,556	8.9	25.04	105,556	25.04
\$28.01-\$33.00	4,600	9.2	30.67	0	0
\$33.01-\$38.00	143,500	9.9	37.04	0	0
	<hr/>			<hr/>	
Outstanding at year end	647,619	7.2	\$21.66	499,519	\$17.16
	<hr/>			<hr/>	

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 13 – EMPLOYEE BENEFITS**

The Company sponsors a 401(k) plan which covers substantially all employees. Employees may elect to contribute to the plan from 1% to 15% of their salary subject to statutory limitations. The Company makes matching contributions equal to 100% of the first 3% of employee contributions and 50% of employee contributions in excess of 3%, up to 6%. The Company's contributions for the years ended December 31, 2005, 2004 and 2003 were approximately \$620,000, \$560,000 and \$450,000.

The Company sponsors an employee stock purchase plan which allows employees to defer after-tax payroll dollars and purchase Company stock on a quarterly basis. The Company has reserved 25,000 shares of common stock to be issued and purchased under the plan, however, the plan allows for shares to be purchased directly from the Company or on the open market.

Grand Bank had a defined benefit pension plan covering substantially all of its employees. The plan was curtailed in conjunction with the acquisition of Grand Bank effective April 1, 2002. Financial information regarding the plan was as follows, as of December 31, 2004 (dollars in thousands).

	<u><b>2004</b></u>
Benefit obligation at year-end	\$(504)
Fair value of plan assets at year-end	474
	<hr/>
Funded status	\$(30)
	<hr/>
Net benefit cost	\$ 9
Employer contributions	66
Benefits paid	133

In March of 2005, the plan was terminated and all appropriate distributions to plan participants were made. The plan was sufficiently funded at the time of termination, therefore the final distributions had no material impact on the Company's results of operations for 2005.

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MACATAWA BANK CORPORATION  
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**NOTE 14– EARNINGS PER SHARE**

A reconciliation of the numerators and denominators of basic and diluted earnings per share are as follows (dollars in thousands except per share data):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Basic earnings per share			
Net income	\$ 20,889	\$ 12,776	\$ 11,780
Weighted average common shares outstanding	10,197,207	10,126,730	10,087,677
	<hr/>	<hr/>	<hr/>
Basic earnings per share	\$ 2.05	\$ 1.26	\$ 1.17
	<hr/>	<hr/>	<hr/>
Diluted earnings per share			
Net income	\$ 20,889	\$ 12,776	\$ 11,780
Weighted average common shares outstanding	10,197,207	10,126,730	10,087,677
Add: Dilutive effects of assumed exercises of stock options	269,504	192,281	161,975
	<hr/>	<hr/>	<hr/>
Weighted average common and dilutive potential common shares outstanding	10,466,711	10,319,011	10,249,652
	<hr/>	<hr/>	<hr/>
Diluted earnings per share	\$ 2.00	\$ 1.24	\$ 1.15
	<hr/>	<hr/>	<hr/>

Stock options for 143,500, 111,608, and 111,090 shares of common stock were not considered in computing diluted earnings per share for December 31, 2005, 2004 and 2003 because they were antidilutive.

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MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 15 — FEDERAL INCOME TAXES**

The consolidated provision for income taxes was as follows (dollars in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current	\$ 10,503	\$5,919	\$ 6,363
Deferred (benefit) expense	(649)	77	(575)
	<u>\$ 9,854</u>	<u>\$5,996</u>	<u>\$ 5,788</u>

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Statutory rate	35%	35%	35%
Statutory rate applied to income before taxes	\$ 10,760	\$ 6,570	\$ 6,149
Add (deduct)			
Tax-exempt interest income	(647)	(554)	(337)
Bank-owned life insurance	(230)	(55)	0
Other, net	(29)	35	(24)
	<u>\$ 9,854</u>	<u>\$ 5,996</u>	<u>\$ 5,788</u>

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

	<u>2005</u>	<u>2004</u>
Deferred tax asset		
Allowance for loan losses	\$ 7,347	\$ 6,690
Unrealized loss on derivative instruments	751	26
Unrealized loss on securities available for sale	800	0
Other	378	304
	<u>9,276</u>	<u>7,020</u>
Deferred tax liabilities		
Depreciation	(1,966)	(1,779)
Purchase accounting adjustments	(744)	(886)
Unrealized gain on securities available for sale	0	(246)
Other	(602)	(564)
	<u>(3,312)</u>	<u>(3,475)</u>
Net deferred tax asset	<u>\$ 5,964</u>	<u>\$ 3,545</u>

A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Based on the levels of taxable income in the current and prior years which would be available to absorb the benefit, management has determined that no valuation allowance was required at December 31, 2005 or 2004.

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MACATAWA BANK CORPORATION  
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**NOTE 16 — COMMITMENTS AND OFF-BALANCE-SHEET RISK**

Some financial instruments are used to meet customer financing needs and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to varying degrees, credit and interest-rate risk in excess of the amount reported in the financial statements.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment, and generally have fixed expiration dates. Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party. Exposure to credit loss if the other party does not perform is represented by the contractual amount for commitments to extend credit and standby letters of credit. Collateral or other security is normally not obtained for these financial instruments prior to their use, and many of the commitments are expected to expire without being used.

A summary of the notional or contractual amounts of financial instruments with off-balance-sheet risk was as follows (dollars in thousands):

	<b>December 31,</b>	
	<b><u>2005</u></b>	<b><u>2004</u></b>
Commitments to make loans	\$ 48,254	\$ 25,682
Letters of credit	24,538	20,716
Unused lines of credit	460,829	409,519

At year-end 2005, approximately 43% of the Bank's commitments to make loans were at fixed rates, offered at current market rates. The majority of the variable rate commitments noted above were tied to prime and expire within 30 days. The majority of the unused lines of credit were at variable rates tied to prime.

The Bank conducts substantially all of its business operations in western Michigan.

**NOTE 17 – CONTINGENCIES**

The Company and its subsidiaries periodically become defendants in certain claims and legal actions arising in the ordinary course of business.

On July 8, 2003, the Company filed a Form 8-K (dated July 1, 2003) with the Securities and Exchange Commission reporting events related to a former trust customer, Trade Partners, Inc. ("Trade Partners"), of the former Grand Bank, which the Company acquired effective April 1, 2002. Trade Partners was involved in purchasing and selling interests in viaticals, which are interests in life insurance policies of the terminally ill or elderly. Beginning in 1996, Grand Bank served as a custodian and escrow agent with respect to viaticals purchased by Trade Partners and sold to investors. Two lawsuits were filed, one in December 2002 and another in March 2003, against Trade Partners, Grand Bank and the Company alleging that Grand Bank breached certain escrow agreements related to viatical settlement contracts. Both of these lawsuits have been dismissed although the plaintiffs reserved the right to pursue the claims in the future. A third lawsuit was filed in April 2003 by two individual investors against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The complaint seeks damages for the asserted breach of certain escrow agreements for which Grand Bank served as custodian and escrow agent. In May 2003 a purported class action complaint was filed against the Company alleging that Grand Bank breached escrow agreements and its fiduciary duties and violated the Michigan Uniform Securities Act with respect to the investments secured by the purported class in viaticals or in interests in limited partnerships which made loans to Trade Partners secured by viaticals. The Company has answered the complaint denying the material allegations and raising certain affirmative defenses. In late July 2005 another purported class action was filed against the Company by the counsel to the Trade Partners receiver making allegations similar to those in the first class action, but on behalf of a class which the suit claims comprises all persons who made any kind of investment with Trade Partners. The Company has answered the complaint denying the material allegations and raising certain affirmative defenses. Management believes the Company has strong defenses and will vigorously defend the cases.

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**NOTE 17 – CONTINGENCIES (Continued)**

Trade Partners is now in receivership. The supervising court authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank extended a \$4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. One carrier has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity.

The legal actions involving Trade Partners have not progressed to trial and the outcome of such actions is uncertain. While we are therefore unable to determine at this time whether or to what extent these actions may impact the Company, the Company believes it has strong defenses and fully intends to defend any and all such actions vigorously.

**NOTE 18 – HEDGING ACTIVITIES**

The Company has asset/liability management policies that include guidelines for measuring and monitoring interest rate risk. Within these guidelines, parameters have been established for maximum fluctuations in net interest income. Possible fluctuations are measured and monitored using simulation analysis. The policies provide for the use of derivative instruments and hedging activities to aid in managing interest rate risk to within the policy parameters.

The Company's assets are comprised of a large portion of loans on which the interest rates are variable. As such, the Company may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates. Interest rate swap arrangements may be utilized to hedge against these fluctuations in cash flows.

The Company has entered into interest rate swap arrangements, all of which are classified as cash flow hedges, that convert the variable rate cash inflows on certain of its loans to fixed rates of interest. These interest rate swaps pay interest to the Company at a fixed rate and require interest payments from the Company at a variable rate. All of these swaps were fully effective during 2005 and 2004. It is anticipated that approximately \$578,000 net of tax, of unrealized losses on these cash flow hedges will be reclassified to earnings over the next twelve months.

Summary information about interest rate swaps at year-end follows (dollars in thousands).

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Notional amounts	\$ 80,000	\$ 100,000
Weighted average pay rates	7.25%	5.25%
Weighted average receive rates	6.42%	6.54%
Weighted average maturity	3.0 years	3.2 years
Unrealized loss related to interest rate swaps	\$ (2,146)	\$ (75)

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(Continued)

MACATAWA BANK CORPORATION  
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**NOTE 19 — REGULATORY MATTERS**

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 classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If the Bank is only adequately capitalized, regulatory approval is required to accept brokered deposits; and if the Bank is undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

At December 31, 2005 and 2004, actual capital levels (dollars in thousands) and minimum required levels were:

	<u>Actual</u>		<u>Minimum Required For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2005</u>						
Total capital (to risk weighted assets)						
Consolidated	\$179,756	11.1%	\$129,959	8.0%	\$162,448	10.0%
Bank	173,481	10.7	129,733	8.0	162,167	10.0
Tier 1 capital (to risk weighted assets)						
Consolidated	157,450	9.7	64,979	4.0	97,469	6.0
Bank	153,210	9.5	64,867	4.0	97,300	6.0
Tier 1 capital (to average assets)						
Consolidated	157,450	8.7	72,799	4.0	90,999	5.0
Bank	153,210	8.4	72,677	4.0	90,846	5.0
<u>December 31, 2004</u>						
Total capital (to risk weighted assets)						
Consolidated	\$161,367	11.1%	\$116,104	8.0%	\$145,130	10.0%
Bank	147,500	10.2	115,945	8.0	144,931	10.0
Tier 1 capital (to risk weighted assets)						
Consolidated	135,226	9.3	58,052	4.0	87,078	6.0
Bank	129,384	8.9	57,972	4.0	86,959	6.0
Tier 1 capital (to average assets)						
Consolidated	135,226	8.3	65,060	4.0	81,325	5.0
Bank	129,384	8.0	64,904	4.0	81,130	5.0

The Company and Bank were categorized as well capitalized at December 31, 2005 and 2004. There are no conditions or events since that notification that management believes have changed either institution's category.

Banking regulations limit capital distributions. Generally, capital distributions are limited to undistributed net income for the current and prior two years. At December 31, 2005 and 2004, approximately \$50,126,000 and \$35,516,000 was available to pay dividends to the holding company.

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**NOTE 20 — FAIR VALUES OF FINANCIAL INSTRUMENTS**

Carrying amount and estimated fair values of financial instruments were as follows at year-end (dollars in thousands).

	<u>2005</u>		<u>2004</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets				
Cash and cash equivalents	\$ 49,101	\$ 49,101	\$ 31,711	\$ 31,711
Securities available for sale	156,696	156,696	137,249	137,249
Securities held to maturity	3,907	3,974	2,552	2,662
FHLB stock	13,910	13,910	12,239	12,239
Loans held for sale	2,331	2,331	3,150	3,150
Loans, net	1,526,887	1,515,525	1,377,136	1,374,836
Accrued interest receivable	8,366	8,366	6,395	6,395
Bank-owned life insurance	20,814	20,814	20,157	20,157
Financial liabilities				
Deposits	(1,507,772)	(1,488,120)	(1,351,516)	(1,352,905)
Federal funds purchased	(25,809)	(25,809)	(22,131)	(22,131)
FHLB advances	(145,161)	(143,372)	(123,985)	(127,415)
Long-term debt	(41,238)	(42,658)	(41,238)	(42,122)
Interest rate swaps	(2,146)	(2,146)	(75)	(75)
Accrued interest payable	(4,528)	(4,528)	(2,776)	(2,776)
Off-balance sheet credit-related items				
Loan commitments	0	0	0	0

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, Federal Home Loan Bank stock, accrued interest receivable and payable, bank-owned life insurance, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. 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. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values. Fair value of loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. The fair value of interest rate swaps is based on market prices or dealer quotes. The fair value of off-balance sheet credit-related items is not significant.

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**NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)**

Following are condensed parent company only financial statements (dollars in thousands):

CONDENSED BALANCE SHEETS

	<u>2005</u>	<u>2004</u>
ASSETS		
Cash and cash equivalents	\$ 4,550	\$ 13,351
Investment in Bank subsidiary	175,511	155,232
Investment in other subsidiaries	2,103	2,082
Other assets	1,158	32
	<hr/>	<hr/>
Total assets	\$ 183,322	\$170,697
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Long-term debt	\$ 41,238	\$ 41,238
Other liabilities	340	385
	<hr/>	<hr/>
Total liabilities	41,578	41,623
Shareholders' equity		
Common stock	136,583	124,389
Retained earnings	8,040	4,277
Accumulated other comprehensive income (loss)	(2,879)	408
	<hr/>	<hr/>
Total shareholders' equity	141,744	129,074
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 183,322	\$170,697
	<hr/>	<hr/>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)** (Continued)

CONDENSED STATEMENTS OF INCOME

	<u><b>2005</b></u>	<u><b>2004</b></u>	<u><b>2003</b></u>
Income			
Interest income	\$ 0	\$ 0	\$ 76
	<u>0</u>	<u>0</u>	<u>76</u>
Total income			
Expense			
Interest expense	2,603	1,659	514
Other expense	661	567	434
	<u>3,264</u>	<u>2,226</u>	<u>948</u>
Total expense			
Loss before income tax and equity in undistributed net income of subsidiaries	(3,264)	(2,226)	(872)
Equity in undistributed net income of subsidiaries	23,010	14,222	12,350
	<u>19,746</u>	<u>11,996</u>	<u>11,478</u>
Income before income tax			
Income tax benefit	(1,143)	(780)	(302)
	<u>\$ 20,889</u>	<u>\$ 12,776</u>	<u>\$ 11,780</u>
Net income			

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(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)** (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	<u><b>2005</b></u>	<u><b>2004</b></u>	<u><b>2003</b></u>
Cash flows from operating activities			
Net income	\$ 20,889	\$ 12,776	\$ 11,780
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Equity in undistributed earnings of subsidiaries	(23,010)	(14,222)	(12,350)
(Increase) decrease in other assets	(1,126)	119	(45)
Increase (decrease) in other liabilities	(45)	352	(5)
	<u>(3,292)</u>	<u>(975)</u>	<u>(620)</u>
Net cash from operating activities			
Cash flows from investing activities			
Loan originations and payments	0	0	4,500
Investment in subsidiaries	(126)	(11,851)	(8,232)
	<u>(126)</u>	<u>(11,851)</u>	<u>(3,732)</u>
Net cash from investing activities			
Cash flows from financing activities			
Other borrowings	0	0	(4,500)
Proceeds from issuance of long-term debt	0	20,619	20,619
Proceeds from exercises of stock options	880	394	441
Fractional shares purchased	(35)	(25)	(14)
Cash dividends paid	(6,228)	(4,444)	(3,471)
	<u>(5,383)</u>	<u>16,544</u>	<u>13,075</u>
Net cash from financing activities			
Net change in cash and cash equivalents	(8,801)	3,718	8,723
Cash and cash equivalents at beginning of year	13,351	9,633	910
	<u>\$ 4,550</u>	<u>\$ 13,351</u>	<u>\$ 9,633</u>
Cash and cash equivalents at end of year			

(Continued)

MACATAWA BANK CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2005 and 2004

**NOTE 22 — QUARTERLY FINANCIAL DATA (Unaudited)**

	<b><u>Interest Income</u></b>	<b><u>Net Interest Income</u></b>	<b><u>Net Income</u></b>	<b><u>Earnings Per Share</u></b>	
				<b><u>Basic</u></b>	<b><u>Fully Diluted</u></b>
<b>(Dollars in thousands except per share data)</b>					
<u>2005</u>					
First quarter	\$23,198	\$14,844	\$4,535	\$ 0.45	\$0.44
Second quarter	25,357	15,487	5,262	0.52	0.50
Third quarter	27,752	16,105	5,550	0.54	0.53
Fourth quarter	29,087	16,401	5,542	0.54	0.53
<u>2004</u>					
First quarter	\$17,305	\$11,392	\$2,866	\$ 0.28	\$0.28
Second quarter	18,636	12,570	3,346	0.33	0.32
Third quarter	20,345	13,619	2,116	0.21	0.21
Fourth quarter	22,043	14,439	4,448	0.44	0.43

Net income for the third quarter of 2004 includes the impact of a \$2.3 million (\$1.5 million after-tax, or \$0.15 per share) charge against earnings related to the one borrower whose loans became impaired as previously described in Note 4.

**Exhibit 21 - Subsidiaries of Registrant**

Macatawa Bank - 100% owned  
Incorporated as a Michigan Banking Corporation  
10753 Macatawa Drive  
Holland, Michigan 49424

Macatawa Investment Services, Inc. - 100% owned  
Incorporated as a Michigan corporation  
10753 Macatawa Drive  
Holland, Michigan 49424

Macatawa Statutory Trust I - 100% owned  
Statutory Trust under the laws of the State of Connecticut  
10753 Macatawa Drive  
Holland, Michigan 49424

Macatawa Statutory Trust II - 100% owned  
Statutory Trust under the laws of the State of Delaware  
10753 Macatawa Drive  
Holland, Michigan 49424

Macatawa Bank Mortgage Company  
100% owned by Macatawa Bank  
Incorporated as a Michigan corporation  
10753 Macatawa Drive  
Holland, Michigan 49424

**Exhibit 23**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the registration statements on Form S-8 (File No. 333-53593, File No. 333-53595, File No. 333-94207, File No. 333-85288, File No. 333-88572 and File No. 333-88574) of our reports dated February 10, 2006 with respect to the 2005 consolidated financial statements of Macatawa Bank Corporation, Macatawa management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which reports are included in this Annual Report on Form 10-K for the year ended December 31, 2005.

/s/Crowe Chizek and Company LLC  
Crowe Chizek and Company LLC

Grand Rapids, Michigan  
March 6, 2006

**EXHIBIT 31.1**

**Certification Pursuant to Section 302 of  
the Sarbanes-Oxley Act of 2002**

I, Benj. A Smith, III, certify that:

1. I have reviewed this annual report on Form 10-K of Macatawa Bank Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

Date: February 24, 2006

/s/ Benj. A. Smith, III

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Benj. A. Smith, III  
Chief Executive Officer



**EXHIBIT 31.2**

**Certification Pursuant to Section 302  
of the Sarbanes-Oxley Act of 2002**

I, Jon W. Swets, certify that:

1. I have reviewed this annual report on Form 10-K of Macatawa Bank Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

Date: February 24, 2006

/s/ Jon W. Swets

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Jon W. Swets  
Senior Vice President and  
Chief Financial Officer

**EXHIBIT 32-1**

Benj. A. Smith III, Chief Executive Officer of Macatawa Bank Corporation, and Jon W. Swets, Senior Vice President and Chief Financial Officer of Macatawa Bank Corporation, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Annual Report on Form 10-K for the year ended December 31, 2005 which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) the information contained in the Annual Report on Form 10-K for the year ended December 31, 2005 fairly presents, in all material respects, the financial condition and results of operations of Macatawa Bank Corporation.

Dated: February 24, 2006

/s/ Benj. A. Smith, III

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Benj. A. Smith, III  
Chief Executive Officer

/s/ Jon W. Swets

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Jon W. Swets  
Senior Vice President and Chief Financial Officer