CHOICEONE FINANCIAL SERVICES INC
Form 10-K
March 28, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2011

¨ **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: 000-19202

ChoiceOne Financial Services, Inc.

(Exact Name of Registrant as Specified in its Charter)

Michigan	**38-2659066**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
109 East Division Street, Sparta, Michigan	**49345**
(Address of Principal Executive Offices)	**(Zip Code)**

(616) 887-7366

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934:

Common Stock

(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 will not 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 amendment to this Form 10-K. ¨

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

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

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

As of June 30, 2011, the aggregate market value of common stock held by non-affiliates of the Registrant was $40.3 million. This amount is based on an average bid price of $12.25 per share for the Registrant s stock as of such date.

As of March 15, 2012, the Registrant had 3,293,626 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part I, Item 1, and Part II, Items 5 through 9A incorporate by reference portions of the Registrant s Annual Report to Shareholders for the year ended December 31, 2011.

Part III, Items 10 through 14 incorporate by reference portions of the Registrant s Definitive Proxy Statement for the Registrant s Annual Meeting of Shareholders to be held April 25, 2012.

FORWARD-LOOKING STATEMENTS

This report and the documents incorporated into this report contain forward-looking statements that are based on management s beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and the Registrant itself. Words such as anticipates, believes, expects, forecasts, intends, is likely, plans, predicts, projects, may, could, estimates, variat similar expressions are intended to identify such forward-looking statements. Management s determination of the provision and allowance for loan losses, the carrying value of goodwill and loan servicing rights, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other than temporary) and management s assumptions concerning pension and other postretirement benefit plans involve judgments that are inherently forward-looking. All of the information concerning interest rate sensitivity is forward-looking. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (risk factors) that are difficult to predict with regard to timing, extent, likelihood, and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed, implied or forecasted in such forward-looking statements. Furthermore, the Registrant undertakes no obligation to update, amend, or clarify forward-looking statements, whether as a result of new information, future events, or otherwise.

Risk factors include, but are not limited to, the risk factors disclosed in Item 1A of this report, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; governmental and regulatory policy changes; the outcomes of pending and future litigation and contingencies; trends in customer behavior as well as their abilities to repay loans; changes in the local and national economies; changes in market conditions; the level and timing of asset growth; local and global uncertainties such as acts of terrorism and military actions; and current uncertainties and fluctuations in the financial markets and stocks of financial services providers due to concerns about credit availability and concerns about the Michigan economy in particular. These are representative of the risk factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

PART I

Item 1. Business

General

ChoiceOne Financial Services, Inc. (the Registrant) is a one-bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Registrant was incorporated on February 24, 1986, as a Michigan corporation. The Registrant was formed to create a bank holding company for the purpose of acquiring all of the capital stock of ChoiceOne Bank (formerly Sparta State Bank), which became a wholly owned subsidiary of the Registrant on April 6, 1987. The Registrant s only subsidiary and significant asset as of December 31, 2011, was ChoiceOne Bank (the Bank). Effective January 1, 1996, the Bank acquired all of the outstanding common stock of ChoiceOne Insurance Agencies, Inc. (formerly Bradford Insurance Centre, Ltd.), an independent insurance agency headquartered in Sparta, Michigan (the Insurance Agency). Effective January 1, 2002, the Bank formed ChoiceOne Mortgage Company of Michigan (the Mortgage Company). In December 2008, the operations of the Mortgage Company were consolidated into the Bank and the Mortgage Company subsidiary was eliminated. The Bank also owns a 25% interest in a non-banking corporation, West Shore Computer Services, Inc., a data processing firm located in Scottville, Michigan. Effective November 1, 2006, the Registrant merged with Valley Ridge Financial Corp. (VRFC), a single-bank holding company for Valley Ridge Bank (VRB). In the merger, the Registrant issued shares of its common stock in exchange for all outstanding shares of VRFC. In December 2006, VRB was consolidated into the Bank.

The Registrant s business is primarily concentrated in a single industry segment banking. The Bank is a full-service banking institution that offers a variety of deposit, payment, credit and other financial services to all types of customers. These services include time, savings, and demand deposits, safe deposit services, and automated transaction machine services. Loans, both commercial and consumer, are extended primarily on a secured basis to corporations, partnerships and individuals. Commercial lending covers such categories as business, industry, agricultural, construction, inventory and real estate. The Bank s consumer loan department makes direct and indirect loans to consumers and purchasers of residential and real property. The Mortgage Company originated and sold a full line of conventional type mortgage loans for 1-4 family and multi-family residential real estate properties. No material part of the business of the Registrant or the Bank is dependent upon a single customer or very few customers, the loss of which would have a materially adverse effect on the Registrant.

The Bank s primary market area lies within portions of Kent, Muskegon, Newaygo, and Ottawa counties in Michigan in the communities where the Bank s offices are located. Currently the Bank serves these markets through thirteen full-service offices. The Registrant and the Bank have no foreign assets or income.

The principal source of revenue for the Registrant and the Bank is interest and fees on loans. On a consolidated basis, interest and fees on loans accounted for 67%, 69%, and 70% of total revenues in 2011, 2010, and 2009, respectively. Interest on securities accounted for 11%, 10%, and 11% of total revenues in 2011, 2010, and 2009, respectively.

The Consolidated Financial Statements incorporated by reference in Part II, Item 8 contain information concerning the financial position and results of operations of the Registrant.

Competition

The Bank s competition primarily comes from other financial institutions located within Kent, Muskegon, Newaygo, and Ottawa counties in western Michigan. There are a number of larger commercial banks within the Bank s primary market area. The Bank also competes with a large number of other financial institutions, such as savings and loan associations, insurance companies, consumer finance companies, credit unions and commercial finance and leasing companies for deposits, loans and service business. Money market mutual funds, brokerage houses and nonfinancial institutions provide many of the financial services offered by the Bank. Many of these competitors have substantially greater resources than the Bank. The principal methods of competition for financial services are price (the rates of interest charged for loans, the rates of interest paid for deposits and the fees charged for services) and the convenience and quality of services rendered to customers.

Supervision and Regulation

Banks and bank holding companies are extensively regulated. The Registrant is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Registrant s activities are generally limited to owning or controlling banks and engaging in such other activities as the Federal Reserve Board may determine to be closely related to banking. Prior approval of the Federal Reserve Board, and in some cases various other government agencies, is required for the Registrant to acquire control of any additional bank holding companies, banks or other operating subsidiaries.

The Bank is chartered under state law and is subject to regulation by the Michigan Office of Financial and Insurance Regulation. State banking laws place restrictions on various aspects of banking, including permitted activities, loan interest rates, branching, payment of dividends and capital and surplus requirements. The Bank is a member of the Federal Reserve System and is also subject to regulation by the Federal Reserve Board. The Bank s deposits are insured by the Federal Deposit Insurance Corporation (the FDIC) to the extent provided by law. The Bank became a member of the Federal Home Loan Bank system in March 1993. This provides certain advantages to the Bank, including favorable borrowing rates for certain funds.

The Registrant is a legal entity separate and distinct from the Bank. There are legal limitations on the extent to which the Bank can lend or otherwise supply funds to the Registrant. In addition, payment of dividends to the Registrant by the Bank is subject to various state and federal regulatory limitations.

Under Federal Reserve Board policy, the Registrant is expected to act as a source of financial strength to the Bank and to commit resources to support it. The FDIC formed the Deposit Insurance Fund (DIF) in accordance with the Federal Deposit Insurance Reform Act of 2005 (Reform Act). The FDIC will maintain the insurance reserves of the DIF by assessing depository institutions an insurance premium.

The FDIC adopted final regulations that implemented the Reform Act to create a stronger and more stable insurance system. The final regulations enable the FDIC to tie each depository institution s DIF insurance premiums both to the balance of insured deposits, as well as to the degree of risk the institution poses to the DIF. In addition, the FDIC has new flexibility to manage the DIF s reserve ratio within a range, which in turn may help prevent sharp swings in assessment rates that were possible under the design of the former system. Under the new risk-based assessment system, the FDIC will evaluate each depository institution s risk based on three primary sources of information: supervisory ratings for all insured institutions, financial ratios for most institutions, and long-term debt issuer ratings for large institutions that have them. Neither the Registrant nor the Bank has a long-term debt issuer rating. The ability to differentiate on the basis of risk will improve incentives for effective risk management and will reduce the extent to which safer banks subsidize riskier ones.

The 2008 DIF rates for nearly all depository institutions varied between five and seven cents for every $100 of deposits. The 2009 rates were approximately double those of the prior year as depository institutions classified in the FDIC s Risk Category I were assessed between 12 and 14 cents for every $100 of deposits. The rates could increase up to 50 cents for every $100 of deposits for riskier institutions. In addition, the FDIC imposed a special assessment of 5 basis points on each insured institution s assets minus its Tier 1 capital on September 30, 2009. The FDIC passed a regulation in November 2010 that changed the deposit insurance assessment base from total domestic deposits to average total assets less average tangible equity.

The Deposit Insurance Funds Act of 1996 authorized the Financing Corporation (FICO) to impose periodic assessments on all depository institutions. The purpose of these periodic assessments is to spread the cost of the interest payments on the outstanding FICO bonds issued to recapitalize the Savings Association Insurance Fund (SAIF) over a larger number of institutions. Until the change in the law, only SAIF member institutions bore the cost of funding these interest payments.

Banks are subject to a number of federal and state laws and regulations, which have a material impact on their business. These include, among others, minimum capital requirements, state usury laws, state laws relating to fiduciaries, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Expedited Funds Availability Act, the Community Reinvestment Act, the Real Estate Settlement Procedures Act, the USA PATRIOT Act, the Bank Secrecy Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, electronic funds transfer laws, redlining laws, predatory lending laws, antitrust laws, environmental laws, money laundering laws and privacy laws. The instruments of monetary policy of authorities, such as the Federal Reserve Board, may influence the growth and distribution of bank loans, investments and deposits, and may also affect interest rates on loans and deposits. These policies may have a significant effect on the operating results of banks.

Bank holding companies may acquire banks and other bank holding companies located in any state in the United States without regard to geographic restrictions or reciprocity requirements imposed by state banking law. Banks may also establish interstate branch networks through acquisitions of and mergers with 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 banking laws do not significantly restrict interstate banking. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the Office of Financial and Insurance Regulation, (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.

Effects of Compliance With Environmental Regulations

The nature of the business of the Bank is such that it holds title, on a temporary or permanent basis, to a number of parcels of real property. These include properties owned for branch offices and other business purposes as well as properties taken in or in lieu of foreclosure to satisfy loans in default. Under current state and federal laws, present and past owners of real property may be exposed to liability for the cost of clean up of environmental contamination on or originating from those properties, even if they are wholly innocent of the actions that caused the contamination. These liabilities can be material and can exceed the value of the contaminated property. Management is not presently aware of any instances where compliance with these provisions will have a material effect on the capital expenditures, earnings or competitive position of the Registrant or the Bank, or where compliance with these provisions will adversely affect a borrower s ability to comply with the terms of loan contracts.

Employees

As of February 29, 2012, the Registrant, the Bank and the Insurance Agency employed 146 employees, of which 114 were full-time employees. The Registrant, Bank, and Insurance Agency believe their relations with their employees are good.

Statistical Information

Additional statistical information describing the business of the Registrant appears on the following pages and in Management s Discussion and Analysis of Financial Condition and Results of Operations incorporated by reference in Item 7 of this report and in the Consolidated Financial Statements and the notes thereto incorporated by reference in Item 8 of this report.

The following statistical information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and notes thereto incorporated by reference in this report.

Securities Portfolio

The carrying value of securities categorized by type at December 31 was as follows:

(Dollars in thousands)

	2011	2010	2009
U.S. Government and federal agency	$ 40,413	$ 29,066	$ 18,571
State and municipal	54,499	47,620	44,599
Mortgage-backed	9,780	7,599	8,929
Corporate	6,011	2,883	
FDIC-guaranteed financial institution debt	2,038	2,053	
Equity securities	1,535	1,599	2,314
Total	$ 114,276	$ 90,820	$ 74,413

The Registrant did not hold investment securities from any one issuer at December 31, 2011, that were greater than 10% of the Registrant s shareholders equity, exclusive of U.S. Government and U.S. Government agency securities.

Presented below is the fair value of securities as of December 31, 2011 and 2010, a schedule of maturities of securities as of December 31, 2011, and the weighted average yields of securities as of December 31, 2011.

(Dollars in thousands)

	Securities maturing within:					
	Less than 1 Year	1 Year - 5 Years	5 Years - 10 Years	More than 10 Years	Fair Value at Dec. 31, 2011	Fair Value at Dec. 31, 2010
U.S. Government and federal agency	$ 11,456	$ 24,954	$ 4,003	$	$ 40,413	$ 29,066
State and municipal	9,041	26,001	18,869	588	54,499	47,620
Mortgage-backed securities	2,171	4,796	2,212	601	9,780	7,599
Corporate	305	5,706			6,011	2,883
FDIC-guaranteed financial institution debt		2,038			2,038	2,053
Total debt securities	22,973	63,495	25,084	1,189	112,741	89,221
Equity securities (1)		267		500	1,535	1,599
Total securities	$ 22,973	$ 63,762	$ 25,084	$ 1,689	$ 114,276	$ 90,820

			Weighted average yields:		
U.S. Government and federal agency	2.27%	1.63%	2.31%	%	1.88%
State and municipal (2)	5.22	4.71	4.91	5.79	4.87
Mortgage-backed securities	2.83	3.43	2.35	2.36	2.99
Corporate	1.31	1.96			1.93
FDIC-guaranteed financial institution debt		1.62			1.62
Equity securities (2)		4.30		3.75	5.17

(1) Equity securities are preferred stock that may or may not have a stated maturity.
(2) The yield is computed for tax-exempt securities on a fully tax-equivalent basis at an incremental tax rate of 34%.

Loan Portfolio

The Bank s loan portfolio categorized by loan type (excluding loans held for sale) as of December 31 is presented below.

(Dollars in thousands)

	2011	**2010**	**2009**	**2008**	**2007**
Agricultural	$ 38,929	$ 29,681	$ 31,322	$ 23,408	$ 24,765
Commercial and industrial	58,685	55,947	53,964	57,587	51,242
Consumer	18,657	16,709	16,285	16,047	15,939
Real estate commercial	106,250	116,351	121,100	123,952	125,960
Real estate construction	1,169	853	1,158	2,026	4,048
Real estate residential	96,437	97,399	98,887	102,957	106,404
Total loans, gross	$ 320,127	$ 316,940	$ 322,716	$ 325,977	$ 328,358

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following schedule presents the maturities of loans (excluding residential real estate and consumer loans) as of December 31, 2011. All loans over one year in maturity (excluding residential real estate and consumer loans) are also presented classified according to the sensitivity to changes in interest rates as of December 31, 2011.

(Dollars in thousands)

Loan Type	Less than 1 Year	1 Year 5 Years	More than 5 Years	Total
Agricultural	$ 10,748	$ 17,262	$ 10,919	$ 38,929
Commercial and industrial	21,908	28,054	8,723	58,685
Real estate commercial	24,314	76,741	5,195	106,250
Real estate construction	970	199		1,169
Totals	$ 57,940	$ 122,256	$ 24,837	$ 205,033

Loan Sensitivity to Changes in Interest Rates	Less than 1 Year	1 Year 5 Years	More than 5 Years	Total
Loans with fixed interest rates	$ 22,406	$ 91,988	$ 22,019	$ 136,413
Loans with floating or adjustable interest rates	35,534	30,268	2,818	68,620
Totals	$ 57,940	$ 122,256	$ 24,837	$ 205,033

(1) Loan maturities are classified according to the contractual maturity date or the anticipated amortization period, whichever is appropriate. The anticipated amortization period is used in the case of loans where a balloon payment is due before the end of the loan s normal amortization period. At the time the balloon payment is due, the loan can either be rewritten or payment in full can be requested. The decision regarding whether the loan will be rewritten or a payment in full will be requested will be based upon the loan s payment history, the borrower s current financial condition, and other relevant factors.

Risk Elements

The following loans were classified as nonperforming as of December 31:

(Dollars in thousands)

2011