SPIRIT REALTY CAPITAL, INC.
Form DEFA14A
June 04, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a)

of the Securities Exchange Act of 1934

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

x Definitive Additional Materials

¨ Soliciting Material Under Rule 14a-12

Spirit Realty Capital, Inc.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statements, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

SUPPLEMENT DATED June 4, 2013

(To Joint Proxy Statement/Prospectus Dated April 2, 2013)

This supplement is being mailed on or about June 4, 2013, to the stockholders of record as of March 27, 2013 of Cole Credit Property Trust II, Inc., which we refer to as CCPT II, and Spirit Realty Capital, Inc., which we refer to as Spirit. The information included herein supplements and should be read in conjunction with the definitive joint proxy statement/prospectus dated April 2, 2013 together with the supplement dated May 10, 2013, which we collectively refer to as the joint proxy statement/prospectus, relating to an agreement and plan of merger dated as of January 22, 2013, as amended, which we refer to as the merger agreement, by and among CCPT II, Cole Operating Partnership II, LP, which we refer to as the CCPT II Partnership, Spirit, and Spirit Realty, L.P., which we refer to as the Spirit Partnership. Pursuant to the merger agreement, CCPT II and Spirit will combine through a merger of Spirit with and into CCPT II, with CCPT II surviving the merger. Defined terms used but not defined herein have the meanings set forth in the joint proxy statement/prospectus.

If you are a stockholder of CCPT II and have not already submitted a proxy for use at the annual meeting, you are urged to do so promptly. No action in connection with this supplement to the joint proxy statement/prospectus is required by any stockholder who has previously delivered a proxy and who does not wish to revoke or change that proxy. For more information about how to submit a proxy, see The CCPT II Annual Meeting Manner of Submitting Proxy beginning on page 148 of the joint proxy statement/prospectus. For more information about revocation of proxies and voting instructions, see The CCPT II Annual Meeting Revocation of Proxies or Voting Instructions on page 149 of the joint proxy statement/prospectus.

If you are a stockholder of Spirit and have not already submitted a proxy for use at the special meeting, you are urged to do so promptly. No action in connection with this supplement to the joint proxy statement/prospectus is required by any stockholder who has previously delivered a proxy and who does not wish to revoke or change that proxy. For more information about how to submit a proxy, see The Spirit Special Meeting Manner of Submitting Proxy on page 156 of the joint proxy statement/prospectus. For more information about revocation of proxies and voting instructions, see The Spirit Special Meeting Revocation of Proxies or Voting Instructions on page 157 of the joint proxy statement/prospectus.

Supplemental Disclosures

As previously disclosed in the joint proxy statement/prospectus, on March 5, 2013, a putative class action and derivative lawsuit was filed in the Circuit Court for Baltimore City, Maryland against and purportedly on behalf of Spirit captioned Kendrick, et al. v. Spirit Realty Capital, Inc., et al, which we refer to as the merger litigation. The merger litigation relates to the merger agreement.

On June 4, 2013, solely to avoid the costs, risks and uncertainties inherent in litigation, Spirit and the other named defendants in the merger litigation signed a memorandum of understanding, which we refer to as the MOU, regarding a proposed settlement of all claims asserted therein. The MOU provides, among other things, that the parties will seek to enter into a stipulation of settlement which provides for the release of all asserted claims. The asserted claims will not be released until such stipulation of settlement is approved by the court. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the court will approve such settlement even if the parties were to enter into such stipulation. Additionally, as part of the MOU, Spirit has agreed to make certain additional disclosures related to the proposed merger, which are set forth below. Finally, in connection with the proposed settlement, plaintiffs intend to seek, and the defendants have agreed to pay, an award of attorneys fees and expenses in an amount to be determined by the Circuit Court for Baltimore City, Maryland. This payment will not affect the amount of consideration to be to be received by the Spirit stockholders pursuant to the terms of the merger agreement.

The additional disclosures set forth below supplement the disclosure contained in the joint proxy statement/prospectus and should be read in conjunction with the disclosure contained therein. Nothing contained in this supplement, the MOU or any stipulation of settlement shall be deemed an admission of the legal necessity or materiality of any of the disclosures set forth herein.

The following additional disclosures supplement the existing disclosures contained in the joint proxy statement/prospectus under the heading Background of the Merger beginning on page 159:

Background to the Merger

The following is added to the end of the second sentence in the sixth full paragraph on page 163:

, including the fact that such a transaction would (i) enhance the credit quality of Spirit s real estate portfolio, (ii) diversify Spirit s real estate portfolio by industry, tenant and asset class and (iii) increase Spirit s funds from operations subject to the accounting treatment of the possible acquisition.

The following is added after the first sentence in the fifth full paragraph on page 164:

The initial value implied in the indication of interest came as a result of detailed and lengthy discussions between Spirit s management and Barclays and was based on initial financial diligence and took into account the strategic rationale for, benefits of, and considerations for a possible strategic transaction with CCPT II.

The first sentence in the fourth full paragraph on page 168 is replaced with the following:

Also on December 20, 2012, in response to the prior discussions with CCPT II s financial advisors and following further discussion and analysis by Spirit s management with the assistance of Barclays, Spirit provided CCPT II with a new indication of interest for the acquisition of all of the CCPT II common stock with a common stock-for-common stock exchange ratio of 0.400 (up from 0.396 implied in its initial offer) and $450 million of newly issued preferred stock carrying a dividend rate of 6.875% (up from an implied dividend rate of 6.07% in its initial offer).

The following is added to the end of the first sentence in the seventh full paragraph on page 171:

and still retain the strategic rationale for, benefits of, and considerations for a transaction with CCPT II.

The second sentence in the seventh full paragraph on page 171 is replaced with the following:

After careful consideration of the issues raised by CCPT II with respect to Spirit s most recent indication of interest and an analysis of the available transaction structures that would allow Spirit to retain the benefits of a transaction with CCPT II, an alternative transaction structure was identified whereby Spirit would acquire CCPT II in a merger in an all common stock-for-common stock transaction, with CCPT II continuing as the surviving entity.

The following is added after the fifth sentence in the first full paragraph on page 173:

The Spirit Board discussed the proposed alternative transaction structure and concluded that the benefits of a transaction with CCPT II remained, including the potential to reduce Spirit s overall leverage, increase Spirit s public float and provide synergies and opportunities to gain efficiencies of scale. The Spirit Board instructed Spirit s management to seek to progress the negotiations with respect to a Business Combination Transaction with CCPT II on the terms discussed.

The following additional disclosures supplement the existing disclosures contained in the joint proxy statement/prospectus under the heading Opinion of Spirit s Financial Advisor beginning on page 201:

Opinion of Spirit s Financial Advisor

The following is added after the second full paragraph on page 205:

Transaction Premium Analysis

Barclays did not perform a transaction premium analysis for either Spirit or CCPT II given the structure of the merger.

The following is added after the second sentence in the final partial paragraph on page 205:

Barclays derived the range of capitalization rates by reviewing the prevailing capitalization rates for publicly traded companies similar to Spirit and CCPT II, respectively. Barclays then calculated a weighted average range for each of Spirit and CCPT II based on the mix of property types in each of their respective portfolios, factoring in the respective percentage of single tenant retail, multi-tenant retail, single tenant industrial and single tenant office space in each of their portfolios, considering rent per square foot in certain instances, and comparing such calculations against publicly traded companies similar to Spirit and CCPT II. The range for Spirit resulting from such calculations was higher than that of CCPT II due to several factors including asset mix, quality of assets, investment grade tenant composition and tenant concentration.

The following is added after the third sentence (prior to the insertion of the sentences set forth immediately above) in the final partial paragraph on page 205:

CCPT II s outstanding indebtedness was $1.8 billion, including $1.4 billion in fixed rate mortgage loans with various maturity dates ranging from September 2014 through August 2031. Barclays marked to market analyses of CCPT II s outstanding fixed rate indebtedness was based on reviewing the terms associated with CCPT II s fixed rate debt and comparing the terms available in the market for companies with similar credit profiles based on Barclays experience in the global investment banking industry.

The following is added after the third sentence in the second full paragraph on page 206:

The range of perpetuity growth rates was based on observing the growth rates in the Spirit projections and CCPT II projections, respectively, and Barclays experience in the valuation of businesses and securities in connection with mergers and acquisitions.

The following is added after the fourth sentence (prior to the insertion of the sentence set forth immediately above) in the second full paragraph on page 206:

The resulting range of discount rates for Spirit was modestly higher than the discount rates for CCPT II primarily because Spirit maintains a higher leverage profile than CCPT II and therefore would be subject to higher borrowing costs than CCPT II.

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federal agency

	$
	2,495
	$
	10,713
	$
	4,956
	$
	-
	$
	18,164
	$
	5,435
State and municipal	
	5,205
	18,822
	10,908

	846
	35,781
	28,003
Mortgage-backed securities	
	1,600
	15,240
	2,872
	-
	19,712
	7,811
Corporate	

	1,681
	573
	-
	-
	2,254
	2,382
Total debt securities	
	$
	10,981
	$
	45,348
	$
	18,736

$
846
$
75,911
$
43,631

Equity securities (1)	
	-
	-
	-
	-
	1,525
	581
Total securities	
	$
	10,981
	$
	45,348
	$
	18,736

$
846
$
77,436
$
44,212

Weighted average yields:					
U.S. Government and federal agency	5.10%	5.32%	4.90%	-%	5.18%
State and municipal (2)	6.30	6.14	6.08	6.09	6.14
Corporate	5.41	5.27	-	-	5.27
Mortgage-backed securities	6.10	4.50	4.57	-	4.64
Equity securities	-	-	-	-	5.80

(1) Equity securities are preferred and common stocks with no stated maturity.
(2) The yield is computed 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)

	2006	2005	2004	2003	2002
Agricultural	$ 18,583	$ 10,203	$ 8,686	$ 8,515	$ 8,527
Commercial and industrial	119,249	37,439	32,934	28,313	30,821
Consumer	15,589	11,820	13,250	14,532	18,565
Real estate - commercial	60,936	51,453	47,901	43,197	46,310
Real estate - construction	4,740	7,466	6,661	10,200	7,869
Real estate - residential	112,534	67,187	63,846	58,375	61,755
Total loans, gross	$ 331,631	$ 185,568	$ 173,278	$ 163,132	$ 173,847

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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, 2006. 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, 2006.

(Dollars in thousands)

Loan Type	Less than 1 Year	1 Year - 5 Years	More than 5 Years	Total
Agricultural	$ 9,009	$ 9,211	$ 363	$ 18,583
Commercial and industrial	57,864	59,060	2,325	119,249
Real estate - commercial	29,543	30,204	1,189	60,936
Real estate - construction	4,740	-	-	4,740
Totals	$ 101,156	$ 98,475	$ 3,877	$ 203,508

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	$ 56,779	$ 84,819	$ 3,287	$ 144,885
Loans with floating or adjustable interest rates	44,377	13,656	590	58,623
Totals	$ 101,156	$ 98,475	$ 3,877	$ 203,508

(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)

	2006	**2005**	**2004**	**2003**	**2002**
Loans accounted for on a non-accrual basis	$ 6,420	$ 934	$ 795	$ 1,914	$ 2,522
Accruing loans which are contractually past due 90 days or more as to principal or interest payments	278	32	11	39	210
Loans defined as "troubled debt restructurings"	24	-	16	47	48
Totals	$ 6,722	$ 966	$ 822	$ 2,000	$ 2,780

A loan is placed on nonaccrual status at the point in time at which the collectibility of principal or interest is considered doubtful. One relationship totaling $3.6 million is from various commercial real estate loans from a commercial developer in the metropolitan Grand Rapids area.

The table below illustrates interest forgone and interest recorded on nonperforming loans for the years presented.

(Dollars in thousands)

	2006	2005	2004	2003	2002
Interest on non-performing loans which would have been earned had the loans been in an accrual or performing status	$ 184	$ 33	$ 32	$ 77	$ 97
Interest on non-performing loans that was actually recorded when received	$ 47	$ 21	$ 18	$ 54	$ 48

Potential Problem Loans

At December 31, 2006, there were $8.1 million of loans not disclosed above where some concern existed as to the borrowers' abilities to comply with original loan terms. Specific loss allocations totaling $942,000 from the allowance for loan losses had been allocated for all nonperforming and potential problem loans as of December 31, 2006. However, the entire allowance for loan losses is also available for these potential problem loans.

Loan Concentrations

As of December 31, 2006, there was no concentration of loans exceeding 10% of total loans that is not otherwise disclosed as a category of loans in the loan portfolio listing in Note 4 to the Consolidated Financial Statements incorporated by reference in Item 8 of this report.

Other Interest-Bearing Assets

As of December 31, 2006, there were no other interest-bearing assets requiring disclosure.

Summary of Loan Loss Experience

The following schedule presents a summary of activity in the allowance for loan losses for the periods shown and the percentage of net charge-offs during each period to average gross loans outstanding during the period.

(Dollars in thousands)	2006	2005	2004	2003	2002
Balance at January 1	$ 1,963	$ 1,739	$ 1,974	$ 2,211	$ 2,013
Charge-offs:					
Agricultural	-	-	-	17	-
Commercial and industrial	221	72	689	343	360
Consumer	200	162	144	354	762
Real estate - commercial	-	25	66	190	90
Real estate - construction	-	20	-	-	-
Real estate - residential	92	120	41	76	45
Total charge-offs	513	399	940	980	1,257
Recoveries:					
Agricultural	-	-	-	-	-
Commercial and industrial	51	47	58	96	9
Consumer	117	81	182	242	170
Real estate - commercial	-	-	-	-	-
Real estate - construction	-	-	-	-	-
Real estate - residential	-	-	-	5	6
Total recoveries	168	128	240	343	185
Net charge-offs	345	271	700	637	1,072
Transfer of allowance from VRFC	1,751				

Additions charged to operations (1)	200	495	465	400	1,270
Balance at December 31	$ 3,569	$ 1,963	$ 1,739	$ 1,974	$ 2,211

	2006	2005	2004	2003	2002
Ratio of net charge-offs during the period to average loans outstanding during the period	0.15%	0.15%	0.41%	0.39%	0.62%

(1) Additions to the allowance for loan losses charged to operations during the periods shown were based on management's judgment after considering factors such as loan loss experience, evaluation of the loan portfolio, and prevailing and anticipated economic conditions. The evaluation of the loan portfolio is based upon various risk factors such as the financial condition of the borrower, the value of collateral and other considerations, which, in the opinion of management, deserve current recognition in estimating loan losses.

The following schedule presents an allocation of the allowance for loan losses to the various loan categories as of the years ended December 31.

(Dollars in thousands)

	2006	2005	2004	2003	2002
Agricultural	$ 314	$ 202	$ 169	$ 210	$ 220
Commercial and industrial	1,160	1,060	939	850	762
Consumer	289	195	123	325	408
Real estate - commercial	1,029	254	265	215	430
Real estate - construction	12	19	32	33	140
Real estate - residential	575	229	181	240	251
Unallocated	190	4	30	101	-
Total allowance	$ 3,569	$ 1,963	$ 1,739	$ 1,974	$ 2,211

The total increase of $1.6 million from 2005 to 2006 relates primarily to the allowance for loan losses totaling $1,751,000 acquired from VRFC in November 2006. The majority of the reserve acquired from VRFC was allocated to commercial real estate and residential real estate loans. Management increased the amount of specific losses allocated to nonperforming loans by $477,000 during 2006. Specific loss allocations totaled $942,000 at December 31, 2006 versus $465,000 at December 31, 2005. Specific loss allocations are based upon either a discounted collateral amount or the net present value of future expected cashflows from borrowers.

Management periodically reviews the assumptions, loss ratios and delinquency trends in estimating the appropriate level of its allowance for loan losses and believes the unallocated portion of the total allowance is sufficient at December 31, 2006.

The following schedule presents the stratification of the loan portfolio by category, based on the amount of loans outstanding as a percentage of total loans for the respective years ended December 31.

	2006	2005	2004	2003	2002
Agricultural	6%	6%	5%	5%	5%
Commercial and industrial	36	20	19	17	18
Consumer	5	6	7	9	11
Real estate - commercial	18	28	28	27	27
Real estate - construction	1	4	4	6	4
Real estate - residential	34	36	37	36	35
Total	100%	100%	100%	100%	100%

Deposits

The following schedule presents the average deposit balances by category and the average rates paid thereon for the respective years.

(Dollars in thousands)

	2006		2005		2004	
Noninterest-bearing demand	$ 27,611	-	$ 20,095	-	$ 17,864	-
Interest-bearing demand	56,617	2.64%	56,745	2.11%	53,339	1.53%
Savings	11,524	0.50%	9,136	0.50%	9,575	0.50%
Certificates of deposit	126,535	4.45%	87,443	3.25%	76,059	2.85%
Total	$ 222,287	3.23%	$ 173,419	2.36%	$ 156,837	1.93%

The following table illustrates the maturities of certificates of deposits issued in denominations of $100,000 or more as of December 31, 2006.

(Dollars in thousands)

Maturing in less than 3 months	$ 31,808
Maturing in 3 to 6 months	22,514
Maturing in 6 to 12 months	16,230
Maturing in more than 12 months	17,944
Total	$ 88,496

Short-Term Borrowings

Federal funds purchased by the Registrant are unsecured overnight borrowings from correspondent banks. Federal funds purchased are due the next business day. The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2006	2005	2004
Outstanding balance at December 31	$ 460	$ 4,399	$ 1,281
Average interest rate at December 31	5.37%	4.41%	2.47%
Average balance during the year	$ 2,585	$ 2,727	$ 3,094
Average interest rate during the year	4.84%	3.44%	1.56%
Maximum month end balance during the year	$ 9,987	$ 4,545	$ 6,968

Repurchase agreements are advances by Bank customers that are not covered by federal deposit insurance. These agreements are direct obligations of the Registrant and are secured by securities held in safekeeping at a correspondent bank. The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2006	2005	2004
Outstanding balance at December 31	$ 15,013	$ 7,139	$ 6,338

Average interest rate at December 31	3.58%	2.11%	1.62%
Average balance during the year	$ 6,492	$ 6,215	$ 5,051
Average interest rate during the year	2.63%	2.05%	1.45%
Maximum month end balance during the year	$ 15,013	$ 7,139	$ 6,767

Advances from the Federal Home Loan Bank ("FHLB") with original repayment terms less than one year are considered short-term borrowings for the Registrant. These advances are secured by residential real estate mortgage loans and U.S. government agency securities. The advances have maturities ranging from 3 months to 11 months from date of issue.

The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2006	2005	2004
Outstanding balance at December 31	$ -	$ 11,000	$ 9,000
Average interest rate at December 31	-%	4.19%	1.95%
Average balance during the year	$ 8,833	$ 12,542	$ 7,500
Average interest rate during the year	5.13%	3.50%	1.65%
Maximum month end balance during the year	$ 15,000	$ 15,000	$ 11,000

There were no other categories of short-term borrowings whose average balance outstanding exceeded 30% of shareholders' equity in 2006, 2005, or 2004.

Return on Equity and Assets

The following schedule presents the Registrant's ratios for the years ended December 31:

	2006	2005	2004
Return on assets (net income divided by average total assets)	0.72%	0.91%	0.83%
Return on equity (net income divided by average equity)	7.63%	10.15%	8.93%
Dividend payout ratio (dividends declared per share divided by net income per share)	66.91%	51.02%	57.44%
Equity to assets ratio (average equity divided by average total assets)	9.48%	8.97%	9.28%

Item 1A. Risk Factors

The Registrant is subject to many risks and uncertainties. Although the Registrant seeks ways to manage these risks and develop programs to control those that management can, the Registrant cannot predict the future. Actual results may differ materially from management's expectations. Some of these significant risks and uncertainties are discussed below. The risks and uncertainties described below are not the only ones that the Registrant faces. Additional risks and uncertainties of which the Registrant is unaware, or that it currently deems immaterial, also may become important factors that affect the Registrant and its business. If any of these risks were to occur, the Registrant's business, financial condition or results of operations could be materially and adversely affected.

Investments in the Registrant's common stock involve risk.

The market price of the Registrant's common stock may fluctuate significantly in response to a number of factors, including:

- Variations in quarterly or annual operating results
- Changes in interest rates
- New developments in the banking industry
- Regulatory actions
- Volatility of stock market prices and volumes
- Changes in market valuations of similar companies
- New litigation or contingencies or changes in existing litigation or contingencies

Changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies
Rumors or erroneous information

Asset quality could be less favorable than expected.

A significant source of risk for the Registrant arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most loans originated by the Registrant are secured, but some loans are unsecured depending on the nature of the loan. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of real and personal property that may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards may create the impression that a loan is adequately collateralized when in fact it is not.

General economic conditions in the state of Michigan could be less favorable than expected.

The Registrant is affected by general economic conditions in the United States, although most directly within Michigan. A further economic downturn within Michigan could negatively impact household and corporate incomes. This impact may lead to decreased demand for both loan and deposit products and increase the number of customers who fail to pay interest or principal on their loans.

If the Registrant does not adjust to changes in the financial services industry, its financial performance may suffer.

The Registrant's ability to maintain its financial performance and return on investment to shareholders will depend in part on its ability to maintain and grow its core deposit customer base and expand its financial services to its existing customers. In addition to other banks, competitors include credit unions, securities dealers, brokers, mortgage bankers, investment advisors and finance and insurance companies. The increasingly competitive environment is, in part, a result of changes in the economic environment within the state of Michigan, regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers. New competitors may emerge to increase the degree of competition for the Registrant's customers and services. Financial services and products are also constantly changing. The Registrant's financial performance will also depend in part upon customer demand for the Registrant's products and services and the Registrant's ability to develop and offer competitive financial products and services.

Changes in interest rates could reduce the Registrant's income and cash flow.

The Registrant's income and cash flow depends, to a great extent, on the difference between the interest earned on loans and securities, and the interest paid on deposits and other borrowings. Market interest rates are beyond the Registrant's control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies including, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates and interest rate relationships, will influence the origination of loans, the purchase of investments, the generation of deposits and the rate received on loans and securities and paid on deposits and other borrowings.

Additional risks and uncertainties could have a negative effect on financial performance.

Additional factors could have a negative effect on the financial performance of the Registrant and the Registrant's common stock. Some of these factors are financial market conditions, changes in financial accounting and reporting standards, new litigation or changes in existing litigation, regulatory actions and losses.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The offices of the Bank, Insurance Agency, and Mortgage Company as of February 28, 2007, were as follows:

Registrant's, Bank's, Insurance Agency's, and Mortgage Company's main office:
109 East Division, Sparta, Michigan
Office is owned by the Bank and comprises 24,000 square feet.

Bank's branch office:
416 West Division, Sparta, Michigan
Office is leased by the Bank and comprises 3,000 square feet.

Bank's branch office:
4170 - 17 Mile Road, Cedar Springs, Michigan
Office is owned by the Bank and comprises 3,000 square feet.

Bank's branch office:
6795 Courtland Drive, Rockford, Michigan
Office is owned by the Bank and comprises 2,400 square feet.

Bank's branch office:
5050 Alpine Avenue NW, Comstock Park, Michigan
Office is owned by the Bank and comprises 2,400 square feet.

Bank's branch office:
450 West Muskegon, Kent City, Michigan
Office is owned by the Bank and comprises 27,300 square feet.

Bank's branch office:
3069 Slocum Road, Ravenna, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank's branch office:
5475 East Apple Avenue, Muskegon, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank's branch office:
661 West Randall, Coopersville, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank's branch office:
10 West Main Street, Grant, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank's branch office:
246 West River Valley Drive, Newaygo, Michigan
Office is owned by the Bank and comprises 1,800 square feet.

Bank's branch office:
47 South Charles Street, White Cloud, Michigan

Office is leased by the Bank and comprises 1,800 square feet.

Bank's branch office:
1423 West Main Street, Fremont, Michigan
Office is owned by the Bank and comprises 1,600 square feet.

The Registrant operates its business at the main office of the Bank. The Registrant did not own any properties as of February 28, 2007. The Registrant, Insurance Agency, and Mortgage Company believe that their offices are suitable and adequate for their future needs and are in good condition. The Registrant's management believes all offices are adequately covered by property insurance.

Item 3. Legal Proceedings

As of December 31, 2006, there are no significant pending legal proceedings to which the Registrant or the Bank is a party or to which any of their properties are subject, except for legal proceedings arising in the ordinary course of business. In the opinion of management, pending legal proceedings will not have a material effect on the consolidated financial condition of the Registrant.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the quarter ended December 31, 2006.

PART II

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

The information under the caption "Stock Information" on pages 1 and 2 of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, is incorporated herein by reference.

On October 18, 2006, the Registrant issued 1,062 shares of common stock to its directors pursuant to the Directors' Stock Purchase Plan for an aggregate cash price of $19,000. The Registrant relied on the exemption contained in Section 4(6) of the Securities Act of 1933 in connection with this sale.

On November 22, 2006, the Registrant issued 1,002 shares of common stock to its directors pursuant to the Directors' Stock Purchase Plan for an aggregate cash price of $18,000. The Registrant relied on the exemption contained in Section 4(6) of the Securities Act of 1933 in connection with this sale.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2006 to October 31, 2006	-	-	-	38,889
November 1, 2006 to November 30, 2006	4,100	$ 18.00	4,100	34,789
December 1, 2006 to December 31, 2006	587	$ 18.00	587	34,202
Total	4,687	$ 18.00	4,687	34,202

(1) On July 21, 2004, the Board of Directors authorized the Registrant to repurchase 50,000 shares under a publicly announced repurchase plan. There is no stated expiration date. All shares purchased by the Registrant during the three months ended December 31, 2006 were made as open-market transactions.

Item 6. Selected Financial Data

The information under the caption "Selected Financial Data" on page 3 of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," including all subheadings, on pages 4 through 13, inclusive, of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information under the subheading "Liquidity and Interest Rate Risk" under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 11 through 13, inclusive, of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

The Report of Independent Registered Public Accounting Firm, Consolidated Financial Statements, and Notes to Consolidated Financial Statements on pages 15 through 40, inclusive, of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, are incorporated herein by reference.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
of ChoiceOne Financial Services, Inc., Sparta, Michigan

We have audited the accompanying consolidated balance sheets of ChoiceOne Financial Services, Inc. as of December 31, 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Corporation'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 ChoiceOne Financial Services, Inc. as of December 31, 2005, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

Crowe Chizek and Company LLC

Grand Rapids, Michigan
March 7, 2006

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

The information under the caption "Change in Independent Registered Public Accounting Firm" on page 14 of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006, is incorporated herein by reference.

Item 9A. Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Registrant's management, including the Chief Executive Officer and principal financial officer, of the effectiveness of the design and operation of the Registrant's disclosure controls and procedures. Based on and as of the time of that evaluation, the Registrant's management, including the Chief Executive Officer and principal financial officer, concluded that the Registrant's disclosure controls and procedures were effective as of the end of the period covered by this report. There was no change in the Registrant's internal control over financial reporting that occurred during the three months ended December 31, 2006 that has materially affected, or that is reasonably likely to materially affect, the Registrant's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information under the captions "ChoiceOne's Board of Directors and Executive Officers," "Related Matters - Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance" in the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held April 26, 2007, is incorporated herein by reference.

The Registrant has adopted a Code of Ethics for Executive Officers and Senior Financial Officers, which applies to the Chief Executive Officer and the Chief Financial Officer, as well as all other senior financial and accounting officers. The Code of Ethics is posted on the Registrant's website at "www.choiceone.com." The Registrant intends to satisfy the disclosure requirements under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, a provision of the Code of Ethics by posting such information on its website at "www.choiceone.com."

Item 11. Executive Compensation

The information under the captions "Executive Compensation" and "Personnel and Benefits Committee Report on Executive Compensation" in the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held April 26, 2007, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information under the caption "Ownership of ChoiceOne Common Stock" in the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held April 26, 2007, is incorporated herein by reference.

The following table presents information regarding the equity compensation plans both approved and not approved by shareholders at December 31, 2006:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	30,414	$ 17.27	117,448
Equity compensation plans not approved by security holders	-	-	42,268
Total	30,414	$ 17.27	159,716

Equity compensation plans approved by security holders include the Amended and Restated Executive Stock Incentive Plan and the Employee Stock Purchase Plan.

Shareholders at the Registrant's 2002 Annual Meeting approved the Amended and Restated Executive Stock Incentive Plan. Key employees of the Registrant and its subsidiaries, as the Personnel and Benefits Committee of the Board of Directors may select from time to time, are eligible to receive awards under this Plan. Incentive awards may be stock options, stock appreciation rights or stock awards. The Plan provides for a maximum of 106,573 shares of the Registrant's common stock, subject to adjustments for certain changes in the capital structure of the Registrant. New awards for up to 76,161 shares may be made under this Plan.

The number of shares available for issuance under the Plan is equal to the number determined by the following formula: (a) for the initial plan year, 5% of the total number of shares of common stock outstanding at the time the Plan became effective; plus (b) in each subsequent plan year, an additional number of shares of common stock not to exceed 2% of the number of shares of common stock outstanding as reported in the Registrant's Annual Report on Form 10-K for the fiscal year ending immediately before such plan year such that at the beginning of each plan year after the initial plan year there shall be available, in addition to any amount of shares remaining from the 5% authorization for the initial plan year, a minimum number of shares equal to 2% of the number of shares of common stock outstanding; plus (c) there shall be carried forward and available for additional awards certain shares that are either unused, canceled or surrendered in connection with incentive awards.

Shareholders at the 2002 Annual Meeting approved the Employee Stock Purchase Plan. This Plan allows employees to purchase the Registrant's common stock at a 15% discount from the average bid price for the Registrant's common stock. Employees who elect to participate in the plan can purchase shares of the Registrant's common stock on a quarterly basis. The Plan provides for a maximum of 55,125 shares of the Registrant's common stock, subject to adjustments for certain changes in the capital structure of the Registrant. New issuances for up to 41,287 may be made under this Plan.

Equity compensation plans not approved by security holders consist of the Directors' Stock Purchase Plan. The Plan is designed to provide directors of the Registrant the option of receiving their fees in the Registrant's stock. Directors who elect to participate in the Plan may elect to contribute to the Plan twenty-five, fifty, seventy-five or one hundred percent of their board of director fees and one hundred percent of their director committee fees earned as directors of the Registrant. Contributions to the Plan are made by the Registrant on behalf of each electing participant. Plan participants may terminate their participation in the Plan at any time by written notice of withdrawal to the Registrant. Participants will cease to be eligible to participate in the Plan when they cease to serve as directors of the Registrant. Shares are distributed to participants on a quarterly basis. The Plan provides for a maximum of 72,978 shares of the Registrant's common stock, subject to adjustments for certain changes in the capital structure of the Registrant. New issuances for up to 42,268 may be made under this Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information under the captions "Related Matters - Certain Relationships and Related Transactions" and "Corporate Governance" in the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held April 26, 2007, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information under the caption "Related Matters - Independent Certified Public Accountants" in the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held April 26, 2007, is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) (1) Financial Statements. The following financial statements and independent auditors' reports are filed as part of this report:

Consolidated Balance Sheets at December 31, 2006 and 2005.

Consolidated Statements of Income for the years ended December 31, 2006, 2005, and 2004.

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2006, 2005, and 2004.

Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004.

Notes to Consolidated Financial Statements.

Report of Independent Registered Public Accounting Firm dated March 20, 2007.

Report of Independent Registered Public Accounting Firm dated March 7, 2006.

The consolidated financial statements, notes to consolidated financial statements and independent auditors' report dated March 20, 2007 listed above are incorporated by reference in Item 8 of this report from the Registrant's Annual Report to Shareholders for the year ended December 31, 2006.

(2) Financial Statement Schedules. None.

(b) Exhibits. The following exhibits are filed as part of this report:

Exhibit	Document
2	Agreement and Plan of Merger between ChoiceOne Financial Services, Inc. and Valley Ridge Financial Corp. Previously filed as Appendix A to the Prospectus and Proxy Statement included in the Registrant's Registration Statement on Form S-4/A filed with the Commission on September 11, 2006. Here incorporated by reference.
3.1	Amended and Restated Articles of Incorporation of the Registrant. Previously filed as an exhibit to the Registrant's Form 10-K Annual Report for the year ended December 31, 2005. Here incorporated by reference.
3.2	Bylaws of the Registrant as currently in effect and any amendments thereto. Previously filed as an exhibit to the Registrant's Form 10-K Annual Report for the year ended December 31, 2003. Here incorporated by reference.

4	Advances, Pledge and Security Agreement between ChoiceOne Bank and the Federal Home Loan Bank of Indianapolis. Previously filed as an exhibit to the Registrant's Form 10-K Annual Report for the year ended December 31, 2001. Here incorporated by reference.
10.1	Employment Agreement with James A. Bosserd. (1) Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 1, 2006. Here incorporated by reference.
10.2	Amended and Restated Executive Stock Incentive Plan. (1) Previously filed as an exhibit to the Registrant's Form 10-K Annual Report for the year ended December 31, 2005. Here incorporated by reference.
10.3	Directors' Stock Purchase Plan. (1) Previously filed as an exhibit to the Registrant's Form 10-K Annual Report for the year ended December 31, 2003. Here incorporated by reference.
10.4	Consulting and Noncompetition Agreement with Richard L. Edgar. (1) Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 1, 2006. Here incorporated by reference.
10.5	Consulting and Noncompetition Agreement with Robert Karpinski. (1) Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 1, 2006. Here incorporated by reference.
10.6	Noncompetition Agreement with Ronald Hansen. (1) Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 1, 2006. Here incorporated by reference.
10.7	Retention Bonus Agreement with Michael McHugh. (1) Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 1, 2006. Here incorporated by reference.
10.8	Former Valley Ridge Executive Employee Salary Continuation Agreements. (1)
10.9	Former Valley Ridge Directors' Deferred Compensation Plan and Agreement. (1)
13	Annual Report to Shareholders for the year ended December 31, 2006
16	Letter regarding Change in Certifying Accountant. Previously filed as an exhibit to the Registrant's Form 8-K Current Report for November 25, 2005. Here incorporated by reference.
21	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm for fiscal year ended December 31, 2006.
23.2	Consent of Independent Registered Public Accounting Firm for fiscal years ended December 31, 2005 and 2004.
24	Powers of Attorney.
31.1	Certification of Chief Executive Officer.
31.2	Certification of Treasurer.
32	Certification pursuant to 18 U.S.C. § 1350.

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(1) This agreement is a management contract or compensation plan or arrangement to be filed as an exhibit to this Form 10-K.

Copies of any exhibits will be furnished to shareholders upon written request. Requests should be directed to: Thomas L. Lampen, Treasurer, ChoiceOne Financial Services, Inc., 109 East Division, Sparta, Michigan, 49345.

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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.

ChoiceOne Financial Services, Inc.

By /s/ James A. Bosserd — March 30, 2007

James A. Bosserd
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ James A. Bosserd James A. Bosserd	President and Chief Executive Officer and Director (Principal Executive Officer)	March 30, 2007
/s/ Thomas L. Lampen Thomas L. Lampen	Treasurer (Principal Financial and Accounting Officer)	March 30, 2007
*/s/ Richard L. Edgar Richard L. Edgar	Chairman of the Board and Director	March 30, 2007
*/s/ Jerome Arends Jerome Arends	Director	March 30, 2007
*/s/ Frank G. Berris Frank G. Berris	Director	March 30, 2007
*/s/ K. Timothy Bull K. Timothy Bull	Director	March 30, 2007
*/s/ William F. Cutler, Jr. William F. Cutler, Jr.	Director	March 30, 2007
*/s/ Stuart Goodfellow Stuart Goodfellow	Director	March 30, 2007
*/s/ Gary Gust Gary Gust	Director	March 30, 2007

*/s/ Robert Humphreys Robert Humphreys	Director	March 30, 2007
*/s/ Paul L. Johnson Paul L. Johnson	Director	March 30, 2007
Dennis C. Nelson	Director	March __, 2007
*/s/ Jon E. Pike Jon E. Pike	Director	March 30, 2007

*/s/ Donald VanSingel Donald VanSingel	Director	March 30, 2007
*/s/ Andrew W. Zamiara Andrew W. Zamiara	Director	March 30, 2007

*By /s/ Thomas L. Lampen

Attorney-in-Fact

EXHIBIT INDEX

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