CHOICEONE FINANCIAL SERVICES INC
Form 10-K
March 13, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2014

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

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

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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

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

As of June 30, 2014, the aggregate market value of common stock held by non-affiliates of the Registrant was $55.0 million. This amount is based on an average bid price of $18.45 per share for the Registrant's stock as of such date.

As of February 28, 2015, the Registrant had 3,283,049 shares of common stock outstanding.

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ChoiceOne Financial Services, Inc.

Form 10-K ANNUAL REPORT

Contents

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 ChoiceOne Financial Services, Inc. Words such as "anticipates," "believes," "expects," "forecasts," "intends," "is likely," "plans," "predicts," "projects," "may," "could," "estimates," and variations of such words and similar ex
are intended to identify such forward-looking statements. Management's determination of the provision and allowance for loan losses, the carrying value of goodwill, loan servicing rights and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other than temporary and the amount of any impairment) 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. All statements with references to future time periods are 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, ChoiceOne Financial Services, Inc. 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, including the impact of Basel III; changes in tax laws; changes in accounting rules; 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 ability 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. ("ChoiceOne" or the "Company") is a one-bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated on February 24, 1986, as a

Michigan corporation. The Company 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 Company on April 6, 1987. The Company's only subsidiary and significant asset as of December 31, 2014, 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 Company merged with Valley Ridge Financial Corp. ("VRFC"), a single-bank holding company for Valley Ridge Bank ("VRB"). In the merger, the Company issued shares of its common stock in exchange for all outstanding shares of VRFC. In December 2006, VRB was consolidated into the Bank.

The Company'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 Company 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 Company.

The Bank's primary market area lies within 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 twelve full-service offices. The Company and the Bank have no foreign assets or income.

At December 31, 2014, the Company had consolidated total assets of $549.6 million, net loans of $341.9 million, total deposits of $434.8 million and total shareholders' equity of $66.2 million. For the year ended December 31, 2014, the Company recognized consolidated net income of $5.7 million. The principal source of revenue for the Company and the Bank is interest and fees on loans. On a consolidated basis, interest and fees on loans accounted for 61%, 63%, and 62% of total revenues in 2014, 2013, and 2012, respectively. Interest on securities accounted for 13%, 13%, and 12% of total revenues in 2014, 2013, and 2012, respectively. For more information about the Company's financial condition and results of operations, see the consolidated financial statements and related notes included in Part II, Item 8 of this report.

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 Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Company'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 Company to acquire control of any additional bank holding companies, banks or other operating subsidiaries. Under Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support it.

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 maximum extent provided by law. The Bank is a member of the Federal Home Loan Bank system, which provides certain advantages to the Bank, including favorable borrowing rates for certain funds.

The Company is a legal entity separate and distinct from the Bank. The Company's primary source of funds available to pay dividends to shareholders is dividends paid to it by the Bank. There are legal limitations on the extent to which the Bank can lend or otherwise supply funds to the Company. In addition, payment of dividends to the Company by the Bank is subject to various state and federal regulatory limitations.

The FDIC formed the Deposit Insurance Fund ("DIF") in accordance with the Federal Deposit Insurance Reform Act of 2005 ("Reform Act") to create a stronger and more stable insurance system. The FDIC maintains the insurance reserves of the DIF by assessing depository institutions an insurance premium. The DIF insures deposit accounts of the Bank up to a maximum amount of $250,000 per separately insured depositor. FDIC insured depository institutions are required to pay deposit insurance premiums based on the risk an institution poses to the DIF. In February 2011, the FDIC finalized rules, effective for assessments occurring after April 1, 2011, which redefine an institution's assessment base as average consolidated total assets minus average Tier 1 capital. The new rules also establish the general assessment rate for Risk Category 1 institutions, such as the Bank, at 5 to 9 basis points (annualized).

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.

The Company and the Bank are subject to regulatory "risk-based" capital guidelines. Failure to meet these capital guidelines could subject the Company or the Bank to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and other restrictions on its business. In addition, the Bank would generally not receive regulatory approval of any application that requires the consideration of capital adequacy, such as a branch or merger application, unless it could demonstrate a reasonable plan to meet the capital requirement within a reasonable period of time.

The Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) requires, among other things, federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. FDICIA sets forth the following five capital categories: “well-capitalized,” “adequately-capitalized,” “undercapitalized,” “significantly-undercapitalized” and “critically-undercapitalized.” A depository institution’s capital category will depend upon how its capital levels compare with various relevant capital measures as established by regulation, which include Tier 1 and total risk-based capital ratio measures and a leverage capital ratio measure. Under certain circumstances, the appropriate banking agency may treat a well-capitalized, adequately-capitalized, or undercapitalized institution as if the institution were in the next lower capital category.

Federal banking regulators are required to take specified mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Subject to a narrow exception, the banking regulator must generally appoint a receiver or conservator for an institution that is critically undercapitalized. An institution in any of the undercapitalized categories is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. An undercapitalized institution is also generally prohibited from paying any dividends, increasing its average total assets, making acquisitions, establishing any branches, accepting or renewing any brokered deposits or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval.

Basel III: On July 3, 2013, the FDIC Board of Directors approved the Regulatory Capital Interim Final Rule, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. Banks are required to transition into the new rule beginning on January 1, 2015.

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 Housing 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, Office of Foreign Assets Controls regulations, 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 Department of Insurance and Financial Services, (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 Company 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 28, 2015, the Company, the Bank and the Insurance Agency employed 151 employees, of which 120 were full-time employees. The Company, the Bank, and the Insurance Agency believe their relations with their employees are good.

Statistical Information

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

Securities Portfolio

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

(Dollars in thousands)	2014	2013	2012
U.S. Government and federal agency	$44,503	$43,722	$40,268
U.S. Treasury notes and bonds	8,058	7,224	7,398
State and municipal	69,835	64,775	64,678
Mortgage-backed securities	8,942	8,470	12,526
Corporate	7,538	8,815	6,712
Foreign debt securities	994	990	1,001
Equity securities	2,275	1,603	1,909
Asset-backed securities	376	483	—
Total	$142,521	$136,082	$134,492

The Company did not hold investment securities from any one issuer at December 31, 2014, that were greater than 10% of the Company'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, 2014 and 2013, a schedule of maturities of securities as of December 31, 2014, and the weighted average yields of securities as of December 31, 2014:

	Securities maturing within:					
	Less than	1 Year -	5 Years -	More than	Fair Value at Dec. 31	Fair Value at Dec. 31
(Dollars in thousands)	1 Year	5 Years	10 Years	10 Years	2014	2013
U.S. Government and federal agency	$9,051	$35,452	$—	$—	$44,503	$43,722
U.S. Treasury notes and bonds	—	8,058	—	—	8,058	7,224
State and municipal	9,035	29,094	30,561	1,145	69,835	64,775
Mortgage-backed securities	26	117	2,863	5,936	8,942	8,470
Corporate	507	7,031	—	—	7,538	8,815
Foreign debt securities	—	994	—	—	994	990
Asset-backed securities	376	—	—	—	376	483
Total debt securities	18,995	80,746	33,424	7,081	140,246	134,479
Equity securities (2)	—	—	—	2,275	2,275	1,603
Total	$18,995	$80,746	$33,424	$9,356	$142,521	$136,082

	Weighted average yields:				
	Less than	1 Year -	5 Years -	More than	
	1 Year	5 Years	10 Years	10 Years	Total
U.S. Government and federal agency	1.82%	1.29%	— %	— %	1.40%
U.S. Treasury notes and bonds	—	1.15	—	—	1.15
State and municipal (1)	3.42	4.04	3.94	5.27	3.93
Mortgage-backed securities	4.94	2.05	1.92	2.37	2.04
Corporate	2.20	1.66	—	—	1.69
Foreign debt securities	—	1.10	—	—	1.10
Asset-backed securities	0.50	—	—	—	0.50
Equity securities (2)	—	—	—	4.10	4.10

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

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)

	2014	2013	2012	2011	2010
Agricultural	$41,098	$37,048	$31,790	$38,929	$ 29,681
Commercial and industrial	88,062	68,530	67,365	58,685	55,947
Consumer	20,752	19,931	19,367	18,657	16,709
Real estate - commercial	99,807	96,987	93,312	106,250	116,351
Real estate - construction	2,691	890	1,056	1,169	853
Real estate - residential	93,703	92,580	98,578	96,437	97,399
Total loans, gross	$346,113	$315,966	$311,468	$320,127	$ 316,940

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, 2014. 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, 2014.

(Dollars in thousands)	Less than 1 Year	1 Year - 5 Years	More than 5 Years	Total
Loan Type				
Agricultural	$9,959	$15,484	$15,655	$41,098
Commercial and industrial	22,516	51,869	13,677	88,062
Real estate - commercial	24,700	54,982	20,125	99,807
Real estate - construction	2,691	—	—	2,691
Totals	$59,866	$122,335	$49,457	$231,658

(Dollars in thousands)	Less than 1 Year	1 Year - 5 Years	More than 5 Years	Total
Loan Sensitivity to Changes in Interest Rates				
Loans with fixed interest rates	$23,486	$119,964	$49,172	$192,622
Loans with floating or adjustable interest rates	36,380	2,371	285	39,036
Totals	$59,866	$122,335	$49,457	$231,658

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)	2014	2013	2012	2011	2010
Loans accounted for on a nonaccrual basis	$3,361	$3,123	$2,331	$4,155	$6,273

Accruing loans which are contractually past due 90 days or more as to principal or interest payments	58	11	30	70	23
Loans defined as "troubled debt restructurings"	3,175	4,523	4,405	2,448	2,141
Totals	$6,594	$7,657	$6,766	$6,673	$8,437

A loan is placed on nonaccrual status at the point in time at which the collectability of principal or interest is considered doubtful.

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

(Dollars in thousands)	2014	2013	2012	2011	2010
Interest on non-performing loans which would have been earned had the loans been in an accrual or performing status	$204	$251	$183	$373	$492
Interest on non-performing loans that was actually recorded when received	$—	$—	$—	$—	$2

<u>Potential Problem Loans</u>

At December 31, 2014, there were $7.2 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 $1.1 million from the allowance for loan losses had been allocated for all nonperforming and potential problem loans as of December 31, 2014. However, the entire allowance for loan losses is also available for these potential problem loans.

<u>Loan Concentrations</u>

As of December 31, 2014, there was no concentration of loans exceeding 10% of total loans that is not otherwise disclosed as a category of loans pursuant to Item III.A. of Industry Guide 3.

<u>Other Interest-Bearing Assets</u>

As of December 31, 2014, there were no other interest-bearing assets requiring disclosure under Item III.C.1. or 2. of Industry Guide 3 if such assets were loans.

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)	2014	2013	2012	2011	2010
Balance at January 1	$4,735	$5,852	$5,213	$4,729	$4,322
Charge-offs:					
Agricultural	—	88	—	45	—
Commercial and industrial	1	122	405	228	765
Consumer	273	351	338	361	444
Real estate - commercial	665	858	869	1,357	1,523
Real estate - construction	—	—	—	—	—
Real estate - residential	133	732	887	1,677	1,152
Total charge-offs	1,072	2,151	2,499	3,668	3,884
Recoveries:					
Agricultural	20	6	5	10	—
Commercial and industrial	119	337	61	32	68
Consumer	179	175	214	217	230
Real estate - commercial	48	84	224	89	16
Real estate - construction	—	—	—	—	—
Real estate - residential	44	132	119	104	27
Total recoveries	410	734	623	452	341
Net charge-offs	662	1,417	1,876	3,216	3,543
Additions charged to operations (1)	100	300	2,515	3,700	3,950
Balance at December 31	$4,173	$4,735	$5,852	$5,213	$4,729
Ratio of net charge-offs during the period to average loans outstanding during the period	0.20 %	0.45 %	0.61 %	1.01 %	1.12 %

(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)

	2014	2013	2012	2011	2010
Agricultural	$186	$178	$140	$55	$181
Commercial and industrial	527	562	381	609	641
Consumer	184	192	250	197	243
Real estate - commercial	1,641	1,842	2,596	2,299	1,729
Real estate - construction	9	12	15	34	2
Real estate - residential	1,193	1,626	1,923	1,847	1,554
Unallocated	433	323	547	172	379
Total allowance	$4,173	$4,735	$5,852	$5,213	$4,729

The decreases in the allowance allocations to commercial real estate loans and residential real estate loans were due to a reduction in historical charge-off levels in these loan categories.

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 was sufficient at December 31, 2014.

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:

	2014	2013	2012	2011	2010
Agricultural	12 %	12 %	10 %	12 %	9 %
Commercial and industrial	25	22	22	18	18
Consumer	6	6	6	6	5
Real estate - commercial	29	31	30	33	37
Real estate - construction	1	—	—	1	—
Real estate - residential	27	29	32	30	31
Total allowance	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)

	2014		2013		2012	
Noninterest-bearing demand	$109,556	—	$93,853	—	$83,810	—
Interest-bearing demand and money market deposits	137,924	0.16%	132,053	0.20%	136,118	0.27%
Savings	67,869	0.06	65,484	0.06	50,252	0.12
Certificates of deposit	107,388	0.73	119,072	0.86	138,805	1.20
Total	$422,737	0.25%	$410,462	0.32%	$408,985	0.51%

The following table illustrates the maturities of certificates of deposits issued in denominations of $100,000 or more as of December 31, 2014:

(Dollars in thousands)

Maturing in less than 3 months	$17,219
Maturing in 3 to 6 months	14,101
Maturing in 6 to 12 months	11,008
Maturing in more than 12 months	14,711
Total	$57,039

At December 31, 2014, the Bank had no material foreign deposits.

Short-Term Borrowings

Federal funds purchased by the Company 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)

	2014	2013	2012
Outstanding balance at December 31	$—	$—	$—
Average interest rate at December 31	— %	— %	— %
Average balance during the year	$401	$578	$97
Average interest rate during the year	0.36 %	0.36 %	0.14 %
Maximum month end balance during the year	$2,149	$5,597	$—

Repurchase agreements include advances by Bank customers that are not covered by federal deposit insurance. These agreements are direct obligations of the Company 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)

	2014	2013	2012
Outstanding balance at December 31	$26,743	$26,033	$19,572
Average interest rate at December 31	0.19 %	0.22 %	0.25 %
Average balance during the year	$22,594	$19,456	$19,289
Average interest rate during the year	0.20 %	0.23 %	0.27 %
Maximum month end balance during the year	$28,719	$26,995	$22,984

Advances from the Federal Home Loan Bank ("FHLB") with original repayment terms less than one year are considered short-term borrowings for the Company. These advances are secured by residential real estate mortgage loans and U.S. government agency securities. The advances have maturities ranging from 1 month to 12 months from the date of issue.

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

(Dollars in thousands)

	2014	2013	2012
Outstanding balance at December 31	$18,000	$6,000	$—
Average interest rate at December 31	0.41 %	0.40 %	— %
Average balance during the year	$14,556	$7,415	$—
Average interest rate during the year	0.43 %	0.60 %	— %
Maximum month end balance during the year	$25,868	$12,409	$—

There were no other categories of short-term borrowings whose average balance outstanding exceeded 30% of shareholders' equity in 2014, 2013 or 2012.

Return on Equity and Assets

The following schedule presents certain financial ratios of the Company for the years ended December 31:

	2014	2013	2012
Return on assets(net income divided by average total assets)	1.08 %	1.01 %	0.85 %
Return on equity(net income dividend by average equity)	8.88 %	8.31 %	7.17 %
Dividend payout ratio(dividends declared per share divided by net income per share)	34.15 %	34.93 %	38.67 %
Equity to assets ratio(average equity divided by average total assets)	12.18 %	12.21 %	11.87 %

Item 1A. Risk Factors

The Company is subject to many risks and uncertainties. Although the Company seeks ways to manage these risks and develop programs to control risks to the extent that management can control them, the Company 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 Company faces. Additional risks and uncertainties of which the Company is unaware, or that it currently does not consider to be material, also may become important factors that affect the Company and its business. If any of these risks were to occur, the Company's business, financial condition or results of operations could be materially and adversely affected.

Investments in the Company's common stock involve risk.

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

- Variations in quarterly or annual operating results
- Changes in dividends per share
- Changes in interest rates
- New developments in the banking industry
- Acquisitions or business combinations involving the Company or its competition
- Regulatory actions, including changes to regulatory capital levels, the components of regulatory capital and how regulatory capital is calculated
-

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
- Credit and capital availability
- Issuance of additional shares of common stock or other debt or equity securities of the Company

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Asset quality could be less favorable than expected.

A significant source of risk for the Company 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 Company 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.

The Company's 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 of loans may have a material adverse effect on the Company's earnings and overall financial condition, and the value of its common stock. The Company makes various assumptions and judgments about the collectability of its loan portfolio and provides an allowance for potential losses based on a number of factors. If its assumptions are wrong, the allowance for loan losses may not be sufficient to cover losses, which could have an adverse effect on the Company's operating results, and may cause it 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 for loan losses. Federal and state banking regulators, as an integral part of their supervisory function, periodically review the allowance for loan losses. These regulatory agencies may require the Company to increase its provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from the Company's. Any increase in the allowance for loan losses could have a negative effect on the Company's regulatory capital ratios, net income, financial condition and results of operations.

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

The Company is affected by general economic conditions in the United States, although most directly within Michigan. An 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.

The Company could be adversely affected by the soundness of other financial institutions, including defaults by larger financial institutions.

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of credit, trading, clearing, counterparty or other relationships between financial institutions. The Company has exposure to multiple counterparties, and it routinely executes transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by the Company or by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the Company interacts on a daily basis, and therefore could adversely affect the Company.

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

The Company'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 Company's customers and services. Financial services and products are also constantly changing. The Company's financial performance will also depend in part upon customer demand for the Company's products and services and the Company's ability to develop and offer competitive financial products and services.

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

The Company'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 Company'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.

The Company is subject to liquidity risk in its operations, which could adversely affect its ability to fund various obligations.

Liquidity risk is the possibility of being unable to meet obligations as they come due or capitalize on growth opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, loan originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses and capital expenditures. Liquidity is derived primarily from retail deposit growth and earnings retention, principal and interest payments on loans and investment securities, net cash provided from operations and access to other funding. If the Company is unable to maintain adequate liquidity, then its business, financial condition and results of operations would be negatively affected.

The Dodd-Frank Act may have a significant impact on the Company and results of its operations.

The Dodd-Frank Act was signed into law by President Obama on July 21, 2010. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, established the new federal Consumer Financial Protection Bureau (CFPB), and requires the CFPB and other federal agencies to implement many new and significant rules and regulations. The CFPB has issued significant new regulations that impact consumer mortgage lending and servicing. Those regulations became effective in January 2014. In addition, the CFPB has issued regulations that will change the disclosure requirements and forms used under the Truth in Lending Act and the Real Estate Settlement Procedures Act. Compliance with these new laws and regulations and other regulations under consideration by the CFPB will likely result in additional costs and could change the products and/or services that are currently being offered, which could be significant and could adversely impact the Company’s results of operations, financial condition or liquidity.

The Company relies heavily on its management and other key personnel, and the loss of any of them may adversely affect its operations.

The Company is and will continue to be dependent upon the services of its management team and other key personnel. Losing the services of one or more key members of the Company’s management team could adversely affect its operations.

The Company may be a defendant in a variety of litigation and other actions, which may have a material adverse effect on the Company’s financial condition and results of operations.

The Company and the Bank are regularly involved in a variety of litigation arising out of the normal course of business. The Company's insurance may not cover all claims that may be asserted against it, and any claims asserted against it, regardless of merit or eventual outcome, may harm its reputation or cause the Company to incur unexpected expenses, which could be material in amount. Should the ultimate expenses, judgments or settlements in any litigation exceed the Company's insurance coverage, they could have a material adverse effect on the Company's financial condition and results of operations. In addition, the Company may not be able to obtain appropriate types or levels of insurance in the future, nor may it be able to obtain adequate replacement policies with acceptable terms, if at all.

If the Company cannot raise additional capital when needed, its ability to further expand its operations through organic growth or acquisitions could be materially impaired.

The Company is required by federal and state regulatory authorities to maintain specified levels of capital to support its operations. The Company may need to raise additional capital to support its current level of assets or its growth. The Company's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. The Company cannot assure that it will be able to raise additional capital in the future on terms acceptable to it or at all. If the Company cannot raise additional capital when needed, its ability to maintain its current level of assets or to expand its operations through organic growth or acquisitions could be materially limited.

Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of computer systems or otherwise, could severely harm the Company's business.

As part of its business, the Company collects, processes and retains sensitive and confidential client and customer information on behalf of itself and other third parties. Despite the security measures the Company has in place for its facilities and systems, and the security measures of its third party service providers, the Company may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors or other similar events. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by the Company or by its vendors, could severely damage the Company's reputation, expose it to the risks of litigation and liability, disrupt the Company's operations and have a material adverse effect on the Company's business.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business and deliver its products. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches of the Company's information systems or its customers' information or computer systems would not damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company's business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses.

The Company relies on dividends from the Bank for most of its revenue.

The Company is a separate and distinct legal entity from the Bank. It receives substantially all of its revenue from dividends from the Bank. These dividends are the principal source of funds to pay cash dividends on the Company's common stock. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay to the Company. If the Bank is unable to pay dividends to the Company, the Company may not be able to pay cash dividends on its common stock. The earnings of the Bank have been the principal source of funds to pay cash dividends to shareholders. Over the long-term, cash dividends to shareholders are dependent upon earnings, as well as capital requirements, regulatory restraints and other factors affecting the Company and the Bank.

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 Company and the Company'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 and Insurance Agency as of February 28, 2015, were as follows:

Company's, Bank's and Insurance Agency'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 2,700 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 2,600 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 Company, Bank and Insurance Agency believe that their offices are suitable and adequate for their future needs and are in good condition. The Company's management believes all offices are adequately covered by property insurance.

Item 3. Legal Proceedings

As of December 31, 2014, there are no significant pending legal proceedings to which the Company 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 adverse effect on the consolidated financial condition of the Company.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

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

Stock Information

Several brokers trade ChoiceOne's common shares in the over-the-counter bulletin board market. There is no well-established public trading market for the shares and trading activity is infrequent. ChoiceOne's trading volume and recent share price information can be viewed under the symbol '**COFS.OB**' on certain financial websites.

The range of high and low bid prices for shares of common stock for each quarterly period during the past two years is as follows:

	2014		2013	
	Low	High	Low	High
First Quarter	$16.50	$18.00	$14.21	$16.47
Second Quarter	17.21	18.80	15.00	17.00
Third Quarter	18.25	22.00	16.40	17.09
Fourth Quarter	20.01	23.00	16.25	17.10

The prices listed above are over-the-counter market quotations reported to ChoiceOne by its market makers. The over-the-counter market quotations reflect inter-dealer prices without retail markup, markdown or commission and may not necessarily represent actual transactions. As of February 28, 2015, the average bid price for shares of ChoiceOne common stock was $22.77.

As of February 28, 2015, there were 757 shareholders of record of ChoiceOne Financial Services, Inc. common stock.

The following table summarizes the quarterly cash dividends declared per share of common stock during 2014 and 2013:

	2014	2013
First Quarter	$0.14	$0.13
Second Quarter	0.15	0.13
Third Quarter	0.15	0.14
Fourth Quarter	0.15	0.14
Total	$0.59	$0.54

ChoiceOne’s principal source of funds to pay cash dividends is the earnings and dividends paid by ChoiceOne Bank. ChoiceOne Bank is restricted in its ability to pay cash dividends under current banking regulations. See Note 20 to the consolidated financial statements for a description of these restrictions. Based on information presently available, management expects ChoiceOne to declare and pay regular quarterly cash dividends in 2015, although the amount of the quarterly dividends will be dependent on market conditions and ChoiceOne’s requirements for cash and capital, among other things.

On October 7, 2014, the Company issued 417 shares of common stock to its directors pursuant to the Directors' Stock Purchase Plan for an aggregate cash price of $9,000. On December 10, 2014, the Company issued 196 shares of common stock to its directors pursuant to the Directors' Stock Purchase Plan for an aggregate cash price of $4,000. The Company relied on the exemption contained in Section 4(6) of the Securities Act of 1933 in connection with these sales.