CHOICEONE FINANCIAL SERVICES INC
Form 10-Q
November 14, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2011

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission File Number: 000-19202

ChoiceOne Financial Services, Inc.

(Exact Name of Registrant as Specified in its Charter)

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

(616) 887-7366

(Registrant s Telephone Number, including Area Code)

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

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

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

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

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

As of October 31, 2011, the Registrant had outstanding 3,291,837 shares of common stock.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	**September 30, 2011 (Unaudited)**	December 31, 2010 (Audited)
Assets		
Cash and due from banks	**$ 10,068**	$ 19,074
Federal funds sold		5,000
Cash and cash equivalents	**10,068**	24,074
Securities available for sale	**110,498**	90,820
Federal Home Loan Bank stock	**2,478**	2,889
Federal Reserve Bank stock	**1,271**	1,270
Loans held for sale	**1,438**	1,610
Loans	**321,756**	316,940
Allowance for loan losses	**(4,834)**	(4,729)
Loans, net	**316,922**	312,211
Premises and equipment, net	**12,227**	12,525
Other real estate owned, net	**1,427**	1,953
Cash value of life insurance policies	**9,754**	9,520
Intangible assets, net	**2,284**	2,620
Goodwill	**13,728**	13,728
Other assets	**4,940**	7,304
Total assets	**$ 487,035**	$ 480,524
Liabilities		
Deposits noninterest-bearing	**$ 70,968**	$ 66,932
Deposits interest-bearing	**326,425**	322,952
Total deposits	**397,393**	389,884
Advances from Federal Home Loan Bank	**8,454**	8,473
Securities sold under agreements to repurchase	**17,118**	22,249
Federal funds purchased	**2,400**	
Other liabilities	**4,191**	5,605
Total liabilities	**429,556**	426,211
Shareholders Equity		
Preferred stock; shares authorized: 100,000; shares outstanding: none		
Common stock and paid in capital, no par value; shares authorized: 7,000,000; shares outstanding: 3,290,915 at Sept 30, 2011 and 3,280,515 at December 31, 2010	**46,578**	46,461
Retained earnings	**8,264**	6,952
Accumulated other comprehensive income, net	**2,637**	900
Total shareholders equity	**57,479**	54,313
Total liabilities and shareholders equity	**$ 487,035**	$ 480,524

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share data)	**2011**	2010	**2011**	2010
Interest income				
Loans, including fees	**$ 4,635**	$ 4,787	**$ 13,777**	$ 14,278
Securities:				
Taxable	**449**	369	**1,313**	1,087
Tax exempt	**312**	345	**961**	1,062
Other	**3**	6	**16**	12
Total interest income	**5,399**	5,507	**16,067**	16,439
Interest expense				
Deposits	**728**	967	**2,280**	3,046
Advances from Federal Home Loan Bank	**78**	178	**230**	605
Other	**70**	73	**217**	229
Total interest expense	**876**	1,218	**2,727**	3,880
Net interest income	**4,523**	4,289	**13,340**	12,559
Provision for loan losses	**950**	900	**2,800**	2,950
Net interest income after provision for loan losses	**3,573**	3,389	**10,540**	9,609
Noninterest income				
Customer service charges	**898**	821	**2,613**	2,345
Insurance and investment commissions	**163**	156	**533**	526
Gains on sales of loans	**125**	209	**396**	383
Gains on sales of securities	**5**	91	**67**	488
Gains/(losses) on sales of other assets	**27**	(66)	**69**	(167)
Earnings on life insurance policies	**90**	90	**267**	269
Other	**198**	164	**585**	459
Total noninterest income	**1,506**	1,465	**4,530**	4,303
Noninterest expense				
Salaries and benefits	**1,842**	1,808	**5,518**	5,244
Occupancy and equipment	**592**	577	**1,724**	1,657
Data processing	**436**	402	**1,302**	1,240
Professional fees	**199**	169	**582**	518
Supplies and postage	**115**	129	**394**	400
Advertising and promotional	**26**	31	**112**	101
Loan and collection expense	**146**	193	**397**	443
FDIC insurance	**108**	156	**405**	468
Intangible amortization	**112**	112	**336**	336
Other	**342**	349	**1,082**	941
Total noninterest expense	**3,918**	3,926	**11,852**	11,348
Income before income tax	**1,161**	928	**3,218**	2,564
Income tax expense	**275**	189	**724**	512
Net income	**$ 886**	$ 739	**$ 2,494**	$ 2,052

Basic earnings per share	**$ 0.27**	$ 0.23	**$ 0.76**	$ 0.63
Diluted earnings per share	**$ 0.27**	$ 0.23	**$ 0.76**	$ 0.63
Dividends declared per share	**$ 0.12**	$ 0.12	**$ 0.36**	$ 0.36

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

(Dollars in thousands)	Number of Shares	Common Stock and Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Total
Balance, January 1, 2010	3,265,714	$ 46,326	$ 5,813	$ 787	$ 52,926
Comprehensive income					
Net income			2,052		2,052
Net change in unrealized gain on securities available for sale, net of tax of $506				983	983
Total comprehensive income					3,035
Shares issued	12,104	99			99
Shares cancelled	(4)				
Change in ESOP repurchase obligation		(14)			(14)
Effect of stock options granted		11			11
Effect of employee stock purchases		11			11
Cash dividends declared ($0.36 per share)			(1,178)		(1,178)
Balance, September 30, 2010	3,277,814	$ 46,433	$ 6,687	$ 1,770	$ 54,890
Balance, January 1, 2011	**3,280,515**	**$ 46,461**	**$ 6,952**	**$ 900**	**$ 54,313**
Comprehensive income					
Net income			**2,494**		**2,494**
Net change in unrealized gain on securities available for sale, net of tax of $895				**1,737**	**1,737**
Total comprehensive income					**4,231**
Shares issued	**9,923**	**104**			**104**
Exercise of stock options	**477**				
Change in ESOP repurchase obligation		**(2)**			**(2)**
Effect of stock options granted		**4**			**4**
Effect of employee stock purchases		**11**			**11**
Cash dividends declared ($0.36 per share)			**(1,182)**		**(1,182)**
Balance, September 30, 2011	**3,290,915**	**$ 46,578**	**$ 8,264**	**$ 2,637**	**$ 57,479**

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	**$ 2,494**	$ 2,052
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	**2,800**	2,950
Depreciation	**711**	662
Amortization	**949**	848
Expense related to employee stock options and stock purchases	**15**	22
Gains on sales of securities	**(67)**	(488)
Gains on sales of loans	**(396)**	(383)
Loans originated for sale	**(17,357)**	(16,488)
Proceeds from loan sales	**17,872**	16,429
Earnings on bank-owned life insurance	**(267)**	(269)
Losses/(gains) on sales of other real estate owned	**(230)**	166
Write-downs of other real estate owned	**164**	257
Proceeds from sales of other real estate owned	**2,866**	640
Deferred federal income tax benefit	**(138)**	(106)
Net changes in other assets	**2,300**	202
Net changes in other liabilities	**(2,171)**	(72)
Net cash from operating activities	**9,545**	6,422
Cash flows from investing activities:		
Securities available for sale:		
Sales	**3,031**	5,614
Maturities, prepayments and calls	**15,047**	19,141
Purchases	**(35,522)**	(38,955)
Sale of Federal Home Loan Bank stock	**411**	
Purchase of Federal Reserve Bank stock	**(1)**	
Loan originations and repayments, net	**(9,785)**	4,561
Additions to premises and equipment	**(413)**	(1,536)
Net cash from investing activities	**(27,232)**	(11,175)
Cash flows from financing activities:		
Net change in deposits	**7,509**	21,554
Net change in repurchase agreements	**(5,131)**	(1,256)
Net change in federal funds purchased	**2,400**	
Proceeds from Federal Home Loan Bank advances	**250**	
Payments on Federal Home Loan Bank advances	**(269)**	(6,519)
Issuance of common stock	**104**	99
Cash dividends	**(1,182)**	(1,178)
Net cash from financing activities	**3,681**	12,700
Net change in cash and cash equivalents	**(14,006)**	7,947
Beginning cash and cash equivalents	**24,074**	19,750
Ending cash and cash equivalents	**$ 10,068**	$ 27,697

Supplemental disclosures of cash flow information:

Cash paid for interest	**$ 2,776**	$ 3,997
Cash paid for income taxes	**$ 415**	$ 110
Loans transferred to other real estate	**$ 2,274**	$ 1,054
Other real estate transferred to loans	**$**	$ 85

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include ChoiceOne Financial Services, Inc. (ChoiceOne or the Registrant) and its wholly-owned subsidiary, ChoiceOne Bank (the Bank), and the Bank s wholly-owned subsidiary ChoiceOne Insurance Agencies, Inc. Intercompany transactions and balances have been eliminated in consolidation.

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information, prevailing practices within the banking industry and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The accompanying consolidated financial statements reflect all adjustments ordinary in nature which are, in the opinion of management, necessary for a fair presentation of the Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010, the Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2011 and September 30, 2010, the Consolidated Statements of Changes in Shareholders Equity for the nine-month periods ended September 30, 2011 and September 30, 2010, and the Consolidated Statements of Cash Flows for the nine-month periods ended September 30, 2011 and September 30, 2010. Operating results for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Registrant s Annual Report on Form 10-K for the year ended December 31, 2010.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses inherent in the consolidated loan portfolio. Management s evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, assessments of the impact of current economic conditions on the portfolio and historical loss experience of seasoned loan portfolios. See Note 3 to the interim consolidated financial statements for additional information.

Management believes the accounting estimate related to the allowance for loan losses is a critical accounting estimate because (1) the estimate is highly susceptible to change from period to period because of assumptions concerning the changes in the types and volumes of the portfolios and economic conditions and (2) the impact of recognizing an impairment or loan loss could have a material effect on ChoiceOne s assets reported on the balance sheet as well as its net income.

Stock Transactions

A total of 5,283 shares of common stock were issued to the Registrant s Board of Directors for a cash price of $61,000 under the terms of the Directors Stock Purchase Plan in the first nine months of 2011. A total of 4,640 shares were issued to employees for a cash price of $43,000 under the Employee Stock Purchase Plan in the first three quarters of 2011. A total of 477 shares were issued upon the exercise of stock options in the first quarter of 2011.

Reclassifications

Certain amounts presented in prior periods have been reclassified to conform to the current presentation.

New Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued ASU No. 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring,* (ASU 2011-02), which amends FASB ASC 310-40, *Receivables Troubled Debt Restructurings by Creditors* because of inconsistencies in practice and the increased volume of debt modifications. ASU 2011-02 provides additional clarifying guidance in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring qualifies as a troubled debt restructuring. The effective date of implementation is for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to restructurings that occurred after the beginning of the fiscal year of adoption, with early application allowed. As a result of applying ASU 2011-02, receivables that are newly considered impaired for which impairment was previously measured using a general allowance for credit losses may be identified. Disclosure is required of the total amount of receivables and the allowance for loan losses as of the end of the period of adoption. For purposes of measuring impairment of those receivables, ASU 2011-02 should be applied prospectively for the first interim or annual period beginning on or after June 15, 2011. ChoiceOne adopted ASU 2011-02 in the third quarter of 2011.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles Goodwill and Other: Testing Goodwill for Impairment,* (ASU 2011-08) to simplify how entities test goodwill for impairment. Prior to ASU 2011-08, an entity was required to perform a two-step test to assess goodwill for impairment. The first step compared the fair value of a reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit was less than its carrying value, the second step was used to measure the amount of the impairment loss, if any. ASU 2011-08 permits an entity to assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing appropriate events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then it is not required to perform the two-step impairment test for the reporting unit. ASU 2011-08 applies to both an entity s annual and interim goodwill impairment tests. ASU 2011-08 is effective for fiscal years beginning after December 15, 2011 and early adoption is permitted. ChoiceOne plans to adopt ASU 2011-08 as of December 31, 2011. The adoption of ASU 2011-08 is not expected to have a material impact on the Corporation s consolidated financial condition or results of operations.

NOTE 2 SECURITIES

The fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	September 30, 2011			
(Dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Government and federal agency	**$ 39,943**	**$ 692**	**$ (1)**	**$ 40,634**
State and municipal	**50,620**	**2,743**	**(193)**	**53,170**
Mortgage-backed	**6,908**	**305**		**7,213**
Corporate	**5,940**	**104**	**(5)**	**6,039**
FDIC-guaranteed financial institution debt	**2,012**	**32**		**2,044**
Equity securities	**1,500**		**(102)**	**1,398**
Total	**$ 106,923**	**$ 3,876**	**$ (301)**	**$ 110,498**

	December 31, 2010			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	$ 28,737	$ 382	$ (53)	$ 29,066
State and municipal	47,319	935	(373)	47,881
Mortgage-backed	7,307	298	(6)	7,599
Corporate	2,854	36	(7)	2,883
FDIC-guaranteed financial institution debt	2,020	33		2,053
Equity securities	1,500		(162)	1,338
Total	$ 89,737	$ 1,684	$ (601)	$ 90,820

ChoiceOne reviews its securities portfolio on a quarterly basis to determine whether unrealized losses are considered to be temporary or other-than-temporary. No other-than-temporary impairment charges were recorded in the first three quarters of 2011. One municipal security with a fair value of $330,000 was considered to be other-than-temporarily impaired as of September 30, 2011. The issuer of the security defaulted upon its maturity in September 2009. Impairment losses of $141,000 were recorded through December 2010 due to uncertainty as to when the principal payment will be received. A settlement agreement was reached with the security s issuer in March 2011. Based on the agreement, ChoiceOne believes it will receive an amount equal to or greater than its carrying value for the security.

Other than the security noted in the preceding paragraph, ChoiceOne believed that unrealized losses on securities were temporary in nature and were due to changes in interest rates and reduced market liquidity and not as a result of credit quality issues.

NOTE 3 ALLOWANCE FOR LOAN LOSSES

An analysis of changes in the allowance for loan losses follows:

(Dollars in thousands)	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Balance at beginning of period	**$ 4,802**	$ 4,857	**$ 4,729**	$ 4,322
Provision charged to expense	**950**	900	**2,800**	2,950
Recoveries credited to the allowance	**74**	74	**320**	261
Loans charged off	**(992)**	(990)	**(3,015)**	(2,692)
Balance at end of period	**$ 4,834**	$ 4,841	**$ 4,834**	$ 4,841

Activity in the allowance for loan losses and balances in the loan portfolio were as follows:

(Dollars in thousands)

	Agricultural	Commercial and Industrial	Consumer	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Unallocated	Total
Allowance for Loan Losses								
Nine Months Ended September 30, 2011								
Beginning balance	**$ 181**	**$ 641**	**$ 243**	**$ 1,729**	**$ 2**	**$ 1,554**	**$ 379**	**$ 4,729**
Charge-offs		**(159)**	**(262)**	**(1,092)**		**(1,502)**		**(3,015)**
Recoveries	**6**	**9**	**177**	**51**		**77**		**320**
Provision	**37**	**283**	**59**	**965**	**1**	**1,819**	**(364)**	**2,800**
Ending balance	**$ 224**	**$ 774**	**$ 217**	**$ 1,653**	**$ 3**	**$ 1,948**	**$ 15**	**$ 4,834**
Individually evaluated for impairment	**$**	**$ 84**	**$**	**$ 369**	**$**	**$**	**$**	**$ 453**
Collectively evaluated for impairment	**$ 224**	**$ 690**	**$ 217**	**$ 1,284**	**$ 3**	**$ 1,948**	**$ 15**	**$ 4,381**
Nine Months Ended September 30, 2010								
Beginning balance	$ 124	$ 735	$ 306	$ 1,546	$ 3	$ 1,590	$ 18	$ 4,322
Charge-offs		(272)	(328)	(1,256)		(836)		(2,692)
Recoveries		44	194	16		7		261
Provision	62	499	107	1,026	(1)	827	430	2,950
Ending balance	$ 186	$ 1,006	$ 279	$ 1,332	$ 2	$ 1,588	$ 448	$ 4,841
Individually evaluated for impairment	$	$ 200	$	$ 874	$	$	$	$ 1,074

Collectively evaluated for impairment	$ 186	$ 806	$ 279	$ 458	$ 2	$ 1,588	$ 448	$ 3,767

Loans								
September 30, 2011								
Individually evaluated for impairment	**$**	**$ 214**	**$**	**$ 3,702**	**$**	**$ 1,396**	**$**	**$ 5,312**
Collectively evaluated for impairment	**35,605**	**57,517**	**18,988**	**107,882**	**1,112**	**95,340**		**316,444**
Ending balance	**$ 35,605**	**$ 57,731**	**$ 18,988**	**$ 111,584**	**$ 1,112**	**$ 96,736**	**$**	**$ 321,756**
December 31, 2010								
Individually evaluated for impairment	$ 39	$ 272	$	$ 3,529	$	$ 2,733	$	$ 6,573
Collectively evaluated for impairment	29,642	55,675	16,709	112,822	853	94,666		310,367
Ending balance	$ 29,681	$ 55,947	$ 16,709	$ 116,351	$ 853	$ 97,399	$	$ 316,940

The process to monitor the credit quality of ChoiceOne s loan portfolio includes tracking (1) the risk ratings of business loans, (2) the level of classified business loans, and (3) delinquent and nonperforming consumer loans. Business loans are risk rated on a scale of 1 to 8. A description of the characteristics of the ratings follows:

Risk rating 1 through 3: These loans are considered pass credits. They exhibit acceptable to exceptional credit risk and demonstrate the ability to repay the loan from normal business operations.

Risk rating 4: These loans are considered watch credits. They have potential developing weaknesses that, if not corrected, may cause deterioration in the ability of the borrower to repay the loan. While a loss is possible for a loan with this rating, it is not anticipated.

Risk rating 5: These loans are considered special mention credits. Loans in this risk rating are considered to be inadequately protected by the net worth and debt service coverage of the borrower or of any pledged collateral. These loans have well defined weaknesses that may jeopardize the borrower s ability to repay the loan. If the weaknesses are not corrected, loss of principal and interest could be probable.

Risk rating 6: These loans are considered substandard credits. These loans have well defined weaknesses, the severity of which makes collection of principal and interest in full questionable. Loans in this category may be placed on nonaccrual status.

Risk rating 7: These loans are considered doubtful credits. Some loss of principal and interest has been determined to be probable. The estimate of the amount of loss could be affected by factors such as the borrower s ability to provide additional capital or collateral. Loans in this category are on nonaccrual status.

Risk rating 8: These loans are considered loss credits. They are considered uncollectible and will be charged off against the allowance for loan losses.

Information regarding the Bank s credit exposure follows:

(Dollars in thousands)

Corporate Credit Exposure Credit Risk Profile By Creditworthiness Category

	Agricultural		Commercial and Industrial		Commercial Real Estate	
	September 30, 2011	December 31, 2010	**September 30, 2011**	December 31, 2010	**September 30, 2011**	December 31, 2010
Risk rating 2	**$ 4,346**	$ 1,901	**$ 2,683**	$ 2,818	**$ 6,441**	$ 6,755
Risk rating 3	**20,261**	17,592	**28,267**	29,806	**47,490**	57,265
Risk rating 4	**7,828**	8,919	**22,631**	20,198	**36,340**	31,921
Risk rating 5	**2,845**	1,017	**3,379**	2,703	**13,428**	14,069
Risk rating 6	**276**	213	**704**	251	**6,780**	5,412
Risk rating 7	**49**	39	**67**	171	**1,105**	929
	$ 35,605	**$ 29,681**	**$ 57,731**	**$ 55,947**	**$ 111,584**	**$ 116,351**

Consumer Credit Exposure Credit Risk Profile Based On Payment Activity

	Consumer		Construction Real Estate		Residential Real Estate	
	September 30, 2011	December 31, 2010	**September 30, 2011**	December 31, 2010	**September 30, 2011**	**December 31, 2010**
Performing	**$ 18,935**	$ 16,519	**$ 1,112**	$ 853	**$ 95,322**	$ 92,885
Nonperforming	**53**	190			**1,414**	4,514
	$ 18,988	$ 16,709	**$ 1,112**	$ 853	**$ 96,736**	$ 97,399

The following schedule provides information on loans that were considered troubled debt restructurings (TDRs) as of September 30, 2011 that were modified during the three month and nine month periods ended September 30, 2011:

	Three Months Ended September 30, 2011			**Nine Months Ended September 30, 2011**		
(Dollars in thousands)	**Number of Loans**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Loans**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Residential real estate		**$**	**$**	**5**	**$ 554**	**$ 554**

The pre-modification and post-modification outstanding recorded investment represents amounts as of the date of loan modification. If a difference exists between the pre-modification and post-modification outstanding recorded investment, it represents impairment recognized through the provision for loan losses computed based on a loan s post-modification present value of expected future cash flows discounted at the loan s original effective interest rate. If no difference exists, a loss is not expected to be incurred based on an assessment of the borrower s expected cash flows.

The following schedule provides information on TDRs as of September 30, 2011 where the borrower was past due with respect to principal and/or interest for 30 days or more during the three and nine months ended September 30, 2011 that had been modified during the 12-month period prior to the default:

	With Payment Defaults During the Following Periods:			
	Three Months Ended September 30, 2011		**Nine Months Ended September 30, 2011**	
(Dollars in thousands)	**Number of Loans**	**Recorded Investment**	**Number of Loans**	**Recorded Investment**
Commercial real estate	**3**	**$ 255**	**3**	**$ 255**
Residential real estate	**5**	**475**	**7**	**780**
	8	**$ 730**	**10**	**$ 1,035**

Loans are classified as performing when they are current as to principal and interest payments or are past due on payments less than 90 days. Loans are classified as nonperforming when they are past due 90 days or more as to principal and interest payments or are considered a troubled debt restructuring.

Impaired loans by loan category follow:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2011					
With no related allowance recorded					

Agricultural	$	$	$	$ 57	$
Commercial and industrial	127	134		183	
Commercial real estate	2,399	3,594		2,680	15
Residential real estate	1,396	1,396		1,630	36
With an allowance recorded					
Agricultural					
Commercial and industrial	87	93	84	91	
Commercial real estate	1,304	1,525	369	1,454	5
Residential real estate					
Total					
Agricultural				57	
Commercial and industrial	214	227	84	274	
Commercial real estate	3,703	5,119	369	4,134	20
Residential real estate	1,396	1,396		1,630	36

December 31, 2010					
With no related allowance recorded Agricultural	$ 39	$ 44	$	$ 165	$
Commercial and industrial	222	229		211	(5)
Commercial real estate	1,914	2,385		1,951	(2)
Residential real estate	2,733	2,736		2,640	170
With an allowance recorded					
Agricultural				65	
Commercial and industrial	50	50	50	464	12
Commercial real estate	1,615	1,672	531	3,591	(3)
Residential real estate					
Total					
Agricultural	39	44		230	
Commercial and industrial	272	279	50	675	7
Commercial real estate	3,529	4,057	531	5,542	(5)
Residential real estate	2,733	2,736		2,640	170

An aging analysis of loans by loan category follows:

(Dollars in thousands)	30 to 59 Days	60 to 89 Days	Greater Than 90 Days (1)	Total	Loans Not Past Due	Total Loans	90 Days Past Due and Accruing
September 30, 2011							
Agricultural	**$ 5**	**$ 45**	**$ 56**	**$ 106**	**$ 35,499**	**$ 35,605**	**$**
Commercial and industrial	**96**	**419**	**141**	**656**	**57,075**	**57,731**	
Consumer	**121**	**53**	**52**	**226**	**18,762**	**18,988**	**15**
Commercial real estate	**1,043**	**466**	**2,939**	**4,448**	**107,136**	**111,584**	
Construction real estate					**1,112**	**1,112**	
Residential real estate	**1,757**	**236**	**521**	**2,514**	**94,222**	**96,736**	**182**
	$ 3,022	**$ 1,219**	**$ 3,709**	**$ 7,950**	**$ 313,806**	**$ 321,756**	**$ 197**
December 31, 2010							
Agricultural	$ 71	$ 7	$ 39	$ 117	$ 29,564	$ 29,681	$
Commercial and industrial	133	175	142	450	55,497	55,947	
Consumer	84	41	29	154	16,555	16,709	23
Commercial real estate	266	646	2,129	3,041	113,310	116,351	
Construction real estate					853	853	
Residential real estate	1,223	833	2,249	4,305	93,094	97,399	
	$ 1,777	$ 1,702	$ 4,588	$ 8,067	$ 308,873	$ 316,940	$ 23

(1) Includes nonaccrual loans.

Nonaccrual loans by loan category follow:

(Dollars in thousands)	**September 30, 2011**	December 31, 2010
Agricultural	**$ 289**	$ 64
Commercial and industrial	**240**	256
Consumer	**23**	5
Commercial real estate	**3,620**	3,302
Construction real estate		
Residential real estate	**1,352**	2,646

	$	**5,524**	$	6,273

NOTE 4 EARNINGS PER SHARE

Earnings per share are based on the weighted average number of shares outstanding during the period. A computation of basic earnings per share and diluted earnings per share follows:

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Basic Earnings Per Share				
Net income available to common shareholders	**$ 886**	$ 739	**$ 2,494**	$ 2,052
Weighted average common shares outstanding	**3,289,203**	3,275,801	**3,285,377**	3,271,301
Basic earnings per share	**$ 0.27**	$ 0.23	**$ 0.76**	$ 0.63
Diluted Earnings Per Share				
Net income available to common shareholders	**$ 886**	$ 739	**$ 2,494**	$ 2,052
Weighted average common shares outstanding	**3,289,203**	3,275,801	**3,285,377**	3,271,301
Plus dilutive stock options				
Weighted average common shares outstanding and potentially dilutive shares	**3,289,203**	3,275,801	**3,285,377**	3,271,301
Diluted earnings per share	**$ 0.27**	$ 0.23	**$ 0.76**	$ 0.63

There were 46,656 stock options as of September 30, 2011 and 49,232 as of September 30, 2010, that are considered to be anti-dilutive to earnings per share for the three-month and nine-month periods ended September 30, 2011 and 2010. These stock options have been excluded from the calculation above.

NOTE 5 FINANCIAL INSTRUMENTS

Financial instruments as of the dates indicated were as follows:

(Dollars in thousands)	**September 30, 2011** Carrying Amount	**September 30, 2011** Estimated Fair Value	December 31, 2010 Carrying Amount	December 31, 2010 Estimated Fair Value
Assets:				
Cash and due from banks	**$ 10,068**	**$ 10,068**	$ 19,074	$ 19,074
Federal funds sold			5,000	5,000
Securities available for sale	**110,498**	**110,498**	90,820	90,820
Federal Home Loan Bank and Federal Reserve Bank stock	**3,749**	**3,749**	4,159	4,159
Loans held for sale	**1,438**	**1,438**	1,610	1,610
Loans, net	**316,922**	**317,081**	312,211	314,781
Accrued interest receivable	**2,283**	**2,283**	2,000	2,000
Liabilities:				
Demand, savings and money market deposits	**246,970**	**246,970**	229,378	229,378
Time deposits	**150,423**	**151,792**	160,506	159,616
Repurchase agreements	**17,118**	**16,810**	22,249	22,251
Federal funds purchased	**2,400**	**2,400**		
Advances from Federal Home Loan Bank	**8,454**	**8,802**	8,473	8,947
Accrued interest payable	**182**	**182**	231	231

The estimated fair values approximate the carrying amounts for all assets and liabilities except those described later in this paragraph. The methodology for determining the estimated fair value for securities available for sale is described in Note 6. The estimated fair value for loans is based on the rates charged at September 30, 2011 for new loans with similar maturities, applied until the loan is assumed to reprice or be paid. The allowance for loan losses is considered to be a reasonable estimate of discount for credit quality concerns. The estimated fair values for time deposits and Federal Home Loan Bank advances are based on the rates paid at September 30, 2011 for new deposits or FHLB advances, applied until maturity. The estimated fair values for other financial instruments and off-balance sheet loan commitments are considered nominal.

NOTE 6 FAIR VALUE MEASUREMENTS

The following tables present information about the Bank s assets and liabilities measured at fair value on a recurring basis at September 30, 2011 and December 31, 2010, and the valuation techniques used by the Bank to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Bank has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Bank s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

There were no liabilities measured at fair value as of September 30, 2011 or December 31, 2010. Disclosures concerning assets measured at fair value are as follows:

Assets Measured at Fair Value on a Recurring Basis

(Dollars in Thousands)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at Date Indicated
Investment Securities, Available for Sale September 30, 2011				
U.S. Government and federal agency	**$ 40,241**	**$ 393**	**$**	**$ 40,634**
State and municipal		**50,859**	**2,311**	**53,170**
Mortgage-backed		**7,213**		**7,213**
Corporate		**6,039**		**6,039**
FDIC-guaranteed financial institution debt		**2,044**		**2,044**
Equity securities		**898**	**500**	**1,398**
Total	**$ 40,241**	**$ 67,446**	**$ 2,811**	**$ 110,498**
Investment Securities, Available for Sale December 31, 2010				
U.S. Government and federal agency	$ 29,066	$	$	$ 29,066
State and municipal		45,542	2,339	47,881
Mortgage-backed		7,599		7,599
Corporate	2,883			2,883
FDIC-guaranteed financial institution debt	2,053			2,053
Equity securities		838	500	1,338

Total	$ 30,358	$ 53,979	$ 2,839	$ 90,820

Changes in Level 3 Assets Measured at Fair Value on a Recurring Basis

(Dollars in Thousands)

	2011	2010
Investment Securities Available for Sale		
Balance, January 1	**$ 2,839**	$ 2,807
Total realized and unrealized gains (losses) included in income		
Total unrealized gains (losses) included in other comprehensive income	**185**	8
Net purchases, sales, calls, and maturities	**(280)**	(271)
Net transfers in/out of Level 3	**67**	269
Balance, September 30	**$ 2,811**	$ 2,813

Of the Level 3 assets that were held by the Bank at September 30, 2011, the net unrealized gain for the nine months ended September 30, 2011 was $185,000, which is recognized in other comprehensive income in the consolidated balance sheet. There were no sales or purchases of Level 3 securities in the first three quarters of 2011 or 2010.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets and liabilities. As a result, the unrealized gains and losses for these assets and liabilities presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

Available for sale investment securities categorized as Level 3 assets consist of bonds issued by local municipalities and a trust preferred security. The Bank estimates the fair value of these securities based on the present value of expected future cash flows using management s best estimate of key assumptions, including forecasted interest yield and payment rates, credit quality and a discount rate commensurate with the current market and other risks involved.

The Bank also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets are not normally measured at fair value, but can be subject to fair value adjustments in certain circumstances, such as impairment. Disclosures concerning assets measured at fair value on a non-recurring basis are as follows:

Assets Measured at Fair Value on a Non-recurring Basis

(Dollars in Thousands)

	Balance at Dates Indicated	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for the Period Ended
Impaired Loans					
September 30, 2011	**$ 5,312**	**$**	**$**	**$ 5,312**	**$ 381**
December 31, 2010	$ 6,573	$	$	$ 6,573	$ 164
Other Real Estate					
September 30, 2011	**$ 1,427**	**$**	**$**	**$ 1,427**	**$ 164**
December 31, 2010	$ 1,953	$	$	$ 1,953	$ 528

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Bank estimates the fair value of the loans based on the present value of expected future cash flows using management s best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals). The changes in fair value consisted of charge-downs of impaired loans that were posted to the allowance for loan losses and write-downs of other real estate that were posted to a valuation account. The fair value of other real estate owned was based on appraisals or other reviews of property values, adjusted for estimated costs to sell.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion is designed to provide a review of the consolidated financial condition and results of operations of ChoiceOne Financial Services, Inc. (ChoiceOne or the Registrant) and its wholly-owned subsidiary, ChoiceOne Bank (the Bank), and the Bank s wholly-owned subsidiary, ChoiceOne Insurance Agencies, Inc. This discussion should be read in conjunction with the consolidated financial statements and related notes.

FORWARD-LOOKING STATEMENTS

This discussion and other sections of 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 itself. Words such as anticipates, believes, estimates, expects, forecasts, intends, is likely, plans, predicts, projects, may, could, variations of such words and are intended to identify such forward-looking statements. Management s determination of the provision and allowance for loan losses, the carrying value of goodwill and loan servicing rights, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other than temporary) and management s assumptions concerning pension and other postretirement benefit plans involve judgments that are inherently forward-looking. All of the information concerning interest rate sensitivity is forward-looking. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (risk factors) that are difficult to predict with regard to timing, extent, likelihood, and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed, implied or forecasted in such forward-looking statements. Furthermore, ChoiceOne 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 discussed in Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2010; changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; governmental and regulatory policy changes; the outcomes of pending and future litigation and contingencies; trends in customer behavior as well as their abilities to repay loans; changes in the local and national economies; changes in market conditions; the level and timing of asset growth; various other 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 capital and 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.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses inherent in the consolidated loan portfolio. Management s evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, assessments of the impact of current economic conditions on the portfolio and historical loss experience of seasoned loan portfolios.

Management believes the accounting estimate related to the allowance for loan losses is a critical accounting estimate because (1) the estimate is highly susceptible to change from period to period because of assumptions concerning the changes in the types and volumes of the portfolios and current economic conditions and (2) the impact of recognizing an impairment or loan loss could have a material effect on the Company s assets reported on the balance sheet as well as its net income.

Goodwill

Generally accepted accounting principles require that the fair value of the assets and liabilities of an acquired entity be recorded at their fair value on the date of acquisition. The fair values are determined using both internal computations and information obtained from outside parties when deemed necessary. The net difference between the price paid for the acquired company and the net value of its balance sheet is recorded as goodwill. Accounting principles also require that goodwill be evaluated for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Management performed its annual review of goodwill as of June 30, 2011. ChoiceOne engaged an outside consulting firm to assist in the goodwill impairment analysis. The following steps were used in the valuation: determination of the reporting unit, determination of the appropriate standard of value, determination of the appropriate level of value, calculation of fair value, and comparison of the fair value computed to the equity carrying value. It was determined that the relevant reporting unit to be valued was ChoiceOne Bank. The standard of value used in the valuation was fair value as determined by generally accepted accounting principles. The appropriate level of value was determined to be the controlling interest level. The appraisal methodology used to calculate the fair value included the following valuation approaches:

Income Approach: A discounted cash flow value was calculated based on earnings capacity. The discount