INDEPENDENT BANK CORP /MI/
Form 10-Q
May 04, 2016

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2016

Commission file number 0-7818

INDEPENDENT BANK CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-2032782
(State or jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

4200 East Beltline, Grand Rapids, Michigan 49525
(Address of principal executive offices)

(616) 527-5820
(Registrant's telephone number, including area code)

NONE
Former name, address and fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 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 whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or smaller reporting company.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, no par value	21,262,815
Class	Outstanding at May 3, 2016

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

INDEX

Index

FORWARD-LOOKING STATEMENTS

Statements in this report that are not statements of historical fact, including statements that include terms such as "will," "may," "should," "believe," "expect," "forecast," "anticipate," "estimate," "project," "intend," "likely," "optimistic" and "plan" about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions, are forward-looking statements. Forward-looking statements include, but are not limited to, descriptions of plans and objectives for future operations, products or services; projections of our future revenue, earnings or other measures of economic performance; forecasts of credit losses and other asset quality trends; statements about our business and growth strategies; and expectations about economic and market conditions and trends. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals. They are based on assumptions, estimates, and forecasts that, although believed to be reasonable, may turn out to be incorrect. Actual results could differ materially from those discussed in the forward-looking statements for a variety of reasons, including:

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business;
- economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our bank operates;
- the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;
- the failure of assumptions underlying our estimate of probable incurred losses from vehicle service contract payment plan counterparty contingencies, including our assumptions regarding future cancellations of vehicle service contracts, the value to us of collateral that may be available to recover funds due from our counterparties, and our ability to enforce the contractual obligations of our counterparties to pay amounts owing to us;
- increased competition in the financial services industry, either nationally or regionally;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- the continued services of our management team; and
- implementation of new legislation, which may have significant effects on us and the financial services industry.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report, but the list is not intended to be all-inclusive. The risk factors disclosed in Part I – Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, as updated by any new or modified risk factors disclosed in Part II – Item 1A of any subsequently filed Quarterly Report on Form 10-Q, include all known risks our management believes could materially affect the results described by forward-looking statements in this report. However, those risks may not be the only risks we face. Our results of operations, cash flows, financial position, and prospects could also be materially and adversely affected by additional factors that are not presently known to us that we currently consider to be immaterial, or that develop after the date of this report. We cannot assure you that our future results will meet expectations. While we believe the forward-looking statements in this report are reasonable, you should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. We do not undertake, and expressly disclaim, any obligation to update or alter any statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

Index

Part I - Item 1. INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition

	March 31, 2016 (unaudited)	December 31, 2015
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$ 41,790	$ 54,260
Interest bearing deposits	102,919	31,523
Cash and Cash Equivalents	144,709	85,783
Interest bearing deposits - time	10,178	11,866
Trading securities	136	148
Securities available for sale	589,500	585,484
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	15,600	15,471
Loans held for sale, carried at fair value	28,016	27,866
Loans		
Commercial	770,886	748,398
Mortgage	504,004	500,454
Installment	231,787	231,599
Payment plan receivables	32,305	34,599
Total Loans	1,538,982	1,515,050
Allowance for loan losses	(22,495)	(22,570)
Net Loans	1,516,487	1,492,480
Other real estate and repossessed assets	6,672	7,150
Property and equipment, net	42,089	43,103
Bank-owned life insurance	54,691	54,402
Deferred tax assets, net	37,167	39,635
Capitalized mortgage loan servicing rights	10,983	12,436
Vehicle service contract counterparty receivables, net	3,173	7,229
Other intangibles	2,193	2,280
Accrued income and other assets	25,526	23,733
Total Assets	$ 2,487,120	$ 2,409,066
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$ 671,621	$ 659,793
Savings and interest-bearing checking	1,018,740	988,174
Reciprocal	50,298	50,207
Time	414,047	387,789
Total Deposits	2,154,706	2,085,963
Other borrowings	11,953	11,954
Subordinated debentures	35,569	35,569
Vehicle service contract counterparty payables	1,247	797
Accrued expenses and other liabilities	44,100	23,691
Total Liabilities	2,247,575	2,157,974
Shareholders’ Equity		
Preferred stock, no par value, 200,000 shares authorized; none issued or outstanding	-	-
	324,328	339,462

Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 21,261,830 shares at March 31, 2016 and 22,251,373 shares at December 31, 2015		
Accumulated deficit	(79,984)	(82,334)
Accumulated other comprehensive loss	(4,799)	(6,036)
Total Shareholders' Equity	239,545	251,092
Total Liabilities and Shareholders' Equity	$ 2,487,120	$ 2,409,066

See notes to interim condensed consolidated financial statements (unaudited)

Index

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

	Three months ended March 31,	
	2016	2015
	(unaudited)	
	(In thousands, except share amounts)	
Interest Income		
Interest and fees on loans	$ 18,556	$ 17,239
Interest on securities		
Taxable	2,244	1,758
Tax-exempt	248	217
Other investments	306	338
Total Interest Income	21,354	19,552
Interest Expense		
Deposits	1,114	1,007
Other borrowings	477	454
Total Interest Expense	1,591	1,461
Net Interest Income	19,763	18,091
Provision for loan losses	(530)	(659)
Net Interest Income After Provision for Loan Losses	20,293	18,750
Non-interest Income		
Service charges on deposit accounts	2,845	2,850
Interchange income	1,878	2,142
Net gains on assets		
Mortgage loans	1,642	2,139
Securities	162	85
Mortgage loan servicing, net	(978)	(420)
Title insurance fees	288	256
Other	1,972	1,910
Total Non-interest Income	7,809	8,962
Non-Interest Expense		
Compensation and employee benefits	11,881	11,785
Occupancy, net	2,207	2,419
Data processing	2,101	1,930
Furniture, fixtures and equipment	984	952
Communications	888	736
Loan and collection	825	1,155
Advertising	477	484
Legal and professional	413	380
FDIC deposit insurance	334	343
Interchange expense	266	291
Credit card and bank service fees	187	202
Vehicle service contract counterparty contingencies	30	29
Costs related to unfunded lending commitments	13	16
Net gains on other real estate and repossessed assets	(6)	(39)
Provision for loss reimbursement on sold loans	(15)	(69)
Other	1,460	1,537

Total Non-interest Expense	22,045	22,151
Income Before Income Tax	6,057	5,561
Income tax expense	1,957	1,780
Net Income	$ 4,100	$ 3,781
Net Income Per Common Share		
Basic	$ 0.19	$ 0.16
Diluted	$ 0.19	$ 0.16
Dividends Per Common Share		
Declared	$ 0.08	$ 0.06
Paid	$ 0.08	$ 0.06

See notes to interim condensed consolidated financial statements (unaudited)

Index

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

	Three months ended March 31,	
	2016	2015
	(unaudited) (In thousands)	
Net income	$ 4,100	$ 3,781
Other comprehensive income, before tax		
Securities available for sale		
Unrealized gains arising during period	2,114	2,270
Change in unrealized gains for which a portion of other than temporary impairment has been recognized in earnings	(36)	11
Reclassification adjustments for gains included in earnings	(174)	(75)
Unrealized gains recognized in other comprehensive income on securities available for sale	1,904	2,206
Income tax expense	667	772
Unrealized gains recognized in other comprehensive income on available for sale securities, net of tax	1,237	1,434
Other comprehensive income	1,237	1,434
Comprehensive income	$ 5,337	$ 5,215

See notes to interim condensed consolidated financial statements (unaudited)

Index
INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Three months ended March 31,	
	2016	2015
	(unaudited - In thousands)	
Net Income	$ 4,100	$ 3,781
Adjustments to Reconcile Net Income to Net Cash From (Used in) Operating Activities		
Proceeds from sales of loans held for sale	57,181	70,657
Disbursements for loans held for sale	(55,689)	(75,788)
Provision for loan losses	(530)	(659)
Deferred federal income tax expense	2,468	2,442
Deferred loan fees	(216)	(193)
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities, loans and interest bearning deposits - time	1,306	1,179
Net gains on mortgage loans	(1,642)	(2,139)
Net gains on securities	(162)	(85)
Net gains on other real estate and repossessed assets	(6)	(39)
Vehicle service contract counterparty contingencies	30	29
Share based compensation	410	373
(Increase) decrease in accrued income and other assets	(1,160)	517
Decrease in accrued expenses and other liabilities	(1,057)	(2,385)
Total Adjustments	933	(6,091)
Net Cash From (Used in) Operating Activities	5,033	(2,310)
Cash Flow From (Used in) Investing Activities		
Proceeds from the sale of securities available for sale	42,391	11,786
Proceeds from the maturity of securities available for sale	13,385	6,785
Principal payments received on securities available for sale	37,246	25,103
Purchases of securities available for sale	(74,259)	(77,534)
Purchases of interest bearing deposits - time	-	(246)
Proceeds from the maturity of interest bearing deposits - time	1,678	2,211
Purchase of Federal Reserve Bank stock	(129)	(132)
Net increase in portfolio loans (loans originated, net of principal payments)	(23,280)	(13,170)
Proceeds from the collection of vehicle service contract counterparty receivables	4,217	-
Proceeds from the sale of other real estate and repossessed assets	1,357	1,848
Capital expenditures	(611)	(975)
Net Cash From (Used in) Investing Activities	1,995	(44,324)
Cash Flow From Financing Activities		
Net increase in total deposits	68,743	76,171
Net decrease in other borrowings	(1)	(2)
Net increase in vehicle service contract counterparty payables	450	335
Dividends paid	(1,750)	(1,382)
Proceeds from issuance of common stock	32	16
Repurchase of common stock	(15,510)	(902)
Share based compensation withholding obligation	(66)	(66)
Net Cash From Financing Activities	51,898	74,170
Net Increase in Cash and Cash Equivalents	58,926	27,536
Cash and Cash Equivalents at Beginning of Period	85,783	74,016

Cash and Cash Equivalents at End of Period	$ 144,709	$ 101,552
Cash paid during the period for		
Interest	$ 1,495	$ 1,477
Income taxes	120	55
Transfers to other real estate and repossessed assets	873	1,017
Transfer of payment plan receivables to vehicle service contract counterparty receivables	191	21
Purchase of securities available for sale not yet settled	21,329	3,154

See notes to interim condensed consolidated financial statements (unaudited)

Index

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Shareholders' Equity

	Three months ended March 31,	
	2016	2015
	(unaudited) (In thousands)	
Balance at beginning of period	$251,092	$250,371
Net income	4,100	3,781
Cash dividends declared	(1,750)	(1,382)
Issuance of common stock	32	16
Share based compensation	410	373
Share based compensation withholding obligation	(66)	(66)
Repurchase of common stock	(15,510)	(902)
Net change in accumulated other comprehensive loss, net of related tax effect	1,237	1,434
Balance at end of period	$239,545	$253,625

See notes to interim condensed consolidated financial statements (unaudited)

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Preparation of Financial Statements

The condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2015 included in our Annual Report on Form 10-K.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of March 31, 2016 and December 31, 2015, and the results of operations for the three month periods ended March 31, 2016 and 2015. The results of operations for the three month periods ended March 31, 2016, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the determination of the allowance for loan losses, the determination of vehicle service contract counterparty contingencies, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2015 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-12, "Compensation – Stock Compensation (Topic 718) – Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period". This ASU amends existing guidance related to the accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. These amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This amended guidance became effective for us on January 1, 2016, and did not have a material impact on our consolidated operating results or financial condition.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)". This ASU supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this ASU specifies the accounting for some costs to obtain or fulfill a contract with a customer. This amended guidance is effective for us on January 1, 2018, and is not expected to have a material impact on our consolidated operating results or financial condition.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities”. This ASU amends existing guidance related to the accounting for certain financial assets and liabilities. These amendments, among other things, requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset and eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. This amended guidance is effective for us on January 1, 2018, and is not expected to have a material impact on our consolidated operating results or financial condition.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”. This ASU amends existing guidance related to the accounting for leases. These amendments, among other things, requires lessees to account for most leases on the balance sheet while recognizing expense on the income statement in a manner similar to existing guidance. For lessors the guidance modifies the classification criteria and the accounting for sales-type and direct finance leases. This amended guidance is effective for us on January 1, 2019, and is not expected to have a material impact on our consolidated operating results or financial condition.

In March 2016, the FASB issued ASU 2016-09, “Compensation – Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting”. This ASU amends existing guidance in an effort to simplify certain aspects of accounting for share-based payments. The areas for simplification in this ASU include income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This amended guidance is effective for us on January 1, 2017, with early adoption permitted, and is not expected to have a material impact on our consolidated operating results or financial condition.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
March 31, 2016				
U.S. agency	$35,016	$431	$62	$ 35,385
U.S. agency residential mortgage-backed	196,017	1,635	273	197,379
U.S. agency commercial mortgage-backed	8,382	112	2	8,492
Private label mortgage-backed	18,569	154	348	18,375
Other asset backed	128,431	124	483	128,072
Obligations of states and political subdivisions	147,411	1,644	710	148,345
Corporate	49,565	162	217	49,510
Trust preferred	2,918	-	615	2,303
Foreign government	1,654	-	15	1,639
Total	$587,963	$4,262	$2,725	$ 589,500
December 31, 2015				
U.S. agency	$47,283	$309	$80	$ 47,512
U.S. agency residential mortgage-backed	195,055	1,584	583	196,056
U.S. agency commercial mortgage-backed	34,017	94	83	34,028
Private label mortgage-backed	5,061	161	319	4,903
Other asset backed	117,431	54	581	116,904
Obligations of states and political subdivisions	145,193	941	1,150	144,984
Corporate	38,895	9	290	38,614
Trust preferred	2,916	-	433	2,483
Total	$585,851	$3,152	$3,519	$ 585,484

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Our investments' gross unrealized losses and fair values aggregated by investment type and length of time that individual securities have been at a continuous unrealized loss position follows:

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
March 31, 2016						
U.S. agency	$7,168	$ 20	$ 6,360	$ 42	$13,528	$ 62
U.S. agency residential mortgage-backed	26,856	130	16,325	143	43,181	273
U.S. agency commercial mortgage-backed	1,236	1	202	1	1,438	2
Private label mortgage- backed	5,645	17	3,093	331	8,738	348
Other asset backed	82,903	280	9,804	203	92,707	483
Obligations of states and political subdivisions	22,296	282	9,737	428	32,033	710
Corporate	28,299	208	991	9	29,290	217
Trust preferred	-	-	2,303	615	2,303	615
Foreign government	1,639	15	-	-	1,639	15
Total	$176,042	$ 953	$ 48,815	$ 1,772	$224,857	$ 2,725
December 31, 2015						
U.S. agency	$12,164	$ 47	$ 6,746	$ 33	$18,910	$ 80
U.S. agency residential mortgage-backed	57,538	316	23,340	267	80,878	583
U.S. agency commercial mortgage-backed	16,747	60	2,247	23	18,994	83
Private label mortgage- backed	-	-	3,393	319	3,393	319
Other asset backed	102,660	434	5,189	147	107,849	581
Obligations of states and political subdivisions	52,493	597	12,240	553	64,733	1,150
Corporate	30,550	290	-	-	30,550	290
Trust preferred	-	-	2,483	433	2,483	433
Total	$272,152	$ 1,744	$ 55,638	$ 1,775	$327,790	$ 3,519

Our portfolio of securities available-for-sale is reviewed quarterly for impairment in value. In performing this review management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates on the market value of the security and (4) an assessment of whether we intend to sell, or it is more likely than not that we will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. For securities that do not meet the aforementioned recovery criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income or (loss).

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

U.S. agency, U.S. agency residential mortgage-backed securities and U.S. agency commercial mortgage backed securities — at March 31, 2016, we had 30 U.S. agency, 66 U.S. agency residential mortgage-backed and five U.S. agency commercial mortgage-backed securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to increases in interest rates since acquisition and widening spreads to Treasury bonds. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Private label mortgage backed securities — at March 31, 2016, we had 11 of this type of security whose fair value is less than amortized cost. The unrealized losses are primarily attributed to five securities purchased prior to 2016. Two of these five securities have an impairment in excess of 10% and four of these holdings have been impaired for more than 12 months. The unrealized losses are largely attributable to credit spread widening on these five securities since their acquisition.

These five securities are receiving principal and interest payments. Most of these transactions are pass-through structures, receiving pro rata principal and interest payments from a dedicated collateral pool. The nonreceipt of interest cash flows is not expected and thus not presently considered in our discounted cash flow methodology discussed below.

These five private label mortgage-backed securities are reviewed for other than temporary impairment ("OTTI") utilizing a cash flow projection. The cash flow analysis forecasts cash flow from the underlying loans in each transaction and then applies these cash flows to the bonds in the securitization. Our cash flow analysis forecasts complete recovery of our cost basis for four of the five securities whose fair value is less than amortized cost while the fifth security had credit related OTTI recognized in prior years and is discussed in further detail below.

As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no other declines discussed above are deemed to be other than temporary.

Other asset backed — at March 31, 2016, we had 121 other asset backed securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening and increases in interest rates since acquisition. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Obligations of states and political subdivisions — at March 31, 2016, we had 44 municipal securities whose fair value is less than amortized cost. The unrealized losses are primarily due to increases in interest rates since acquisition. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Corporate — at March 31, 2016, we had 23 corporate securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening and increases in interest rates since acquisition. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Trust preferred securities — at March 31, 2016, we had three trust preferred securities whose fair value is less than amortized cost. All of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities has suffered from credit spread widening.

One of the three securities is rated by two major rating agencies as investment grade, while one (a Bank of America issuance) is rated below investment grade by two major rating agencies and the other one is non-rated. The non-rated issue is a relatively small bank and was never rated. The issuer of this non-rated trust preferred security, which had a total amortized cost of $1.0 million and total fair value of $0.8 million as of March 31, 2016, continues to have satisfactory credit metrics and make interest payments.

The following table breaks out our trust preferred securities in further detail as of March 31, 2016 and December 31, 2015:

	March 31, 2016		December 31, 2015	
	Fair Value	Net Unrealized Loss	Fair Value	Net Unrealized Loss
	(In thousands)			
Trust preferred securities				
Rated issues	$1,550	$ (368)	$ 1,690	$ (226)
Unrated issues	753	(247)	793	(207)

As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Foreign government — at March 31, 2016, we had one foreign government security whose fair value is less than amortized cost. The unrealized loss is primarily due to an increase in interest rates since acquisition. As management does not intend to liquidate this security and it is more likely than not that we will not be required to sell this security prior to recovery of this unrealized loss, the decline is not deemed to be other than temporary.

We recorded no credit related OTTI charges in our Condensed Consolidated Statements of Operations related to securities available for sale during the three month periods ended March 31, 2016 and 2015.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

At March 31, 2016, three private label mortgage-backed securities had credit related OTTI and are summarized as follows:

	Senior Security	Super Senior Security	Senior Support Security	Total
	(In thousands)			
As of March 31, 2016				
Fair value	$1,546	$1,250	$ 75	$2,871
Amortized cost	1,575	1,188	-	2,763
Non-credit unrealized loss	29	-	-	29
Unrealized gain	-	62	75	137
Cumulative credit related OTTI	757	457	380	1,594
Credit related OTTI recognized in our Condensed Consolidated Statements of Operations				
For the three months ended March 31,				
2016	$-	$-	$ -	$-
2015	-	-	-	-

Each of these securities is receiving principal and interest payments similar to principal reductions in the underlying collateral. Two of these securities have unrealized gains and one has an unrealized loss at March 31, 2016. The original amortized cost for each of these securities has been permanently adjusted downward for previously recorded credit related OTTI. The unrealized loss (based on original amortized cost) for two of these securities is now less than previously recorded credit related OTTI amounts. The remaining non-credit related unrealized loss in the senior security is attributed to other factors and is reflected in other comprehensive income during those same periods.

A roll forward of credit losses recognized in earnings on securities available for sale for the three month periods ending March 31, follows:

	Three months ended March 31, 2016	2015
	(In thousands)	
Balance at beginning of period	$ 1,844	$ 1,844
Additions to credit losses on securities for which no previous OTTI was recognized	-	-
Increases to credit losses on securities for which OTTI was previously recognized	-	-
Balance at end of period	$ 1,844	$ 1,844

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The amortized cost and fair value of securities available for sale at March 31, 2016, by contractual maturity, follow:

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$30,411	$30,453
Maturing after one year but within five years	74,249	74,472
Maturing after five years but within ten years	62,664	63,236
Maturing after ten years	69,240	69,021
	236,564	237,182
U.S. agency residential mortgage-backed	196,017	197,379
U.S. agency commercial mortgage-backed	8,382	8,492
Private label residential mortgage-backed	18,569	18,375
Other asset backed	128,431	128,072
Total	$587,963	$589,500

The actual maturity may differ from the contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the three month periods ending March 31, follows:

	Proceeds	Realized Gains	Losses
	(In thousands)		
2016	$42,391	$ 226	$ 52
2015	11,786	75	-

During 2016 and 2015, our trading securities consisted of various preferred stocks. During the first three months of 2016 and 2015, we recognized gains (losses) on trading securities of $(0.012) million and $0.010 million, respectively, that are included in net gains on securities in the Condensed Consolidated Statements of Operations. Both of these amounts relate to gains (losses) recognized on trading securities still held at each respective period end.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

4. Loans

Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors.

An analysis of the allowance for loan losses by portfolio segment for the three months ended March 31, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Subjective Allocation	Total
	(In thousands)					
2016						
Balance at beginning of period	$5,670	$10,391	$1,181	$56	$5,272	$22,570
Additions (deductions)						
Provision for loan losses	(404)	(279)	65	(3)	91	(530)
Recoveries credited to allowance	356	382	221	-	-	959
Loans charged against the allowance	-	(198)	(306)	-	-	(504)
Balance at end of period	$5,622	$10,296	$1,161	$53	$5,363	$22,495
2015						
Balance at beginning of period	$5,445	$13,444	$1,814	$64	$5,223	$25,990
Additions (deductions)						
Provision for loan losses	328	(733)	(85)	(2)	(167)	(659)
Recoveries credited to allowance	433	238	319	-	-	990
Loans charged against the allowance	(290)	(868)	(484)	-	-	(1,642)
Balance at end of period	$5,916	$12,081	$1,564	$62	$5,056	$24,679

16

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Allowance for loan losses and recorded investment in loans by portfolio segment follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Subjective Allocation	Total
	(In thousands)					
March 31, 2016						
Allowance for loan losses						
Individually evaluated for impairment	$2,791	$7,651	$408	$ -	$ -	$10,850
Collectively evaluated for impairment	2,831	2,645	753	53	5,363	11,645
Total ending allowance balance	$5,622	$10,296	$1,161	$ 53	$ 5,363	$22,495
Loans						
Individually evaluated for impairment	$17,585	$64,899	$5,670	$ -		$88,154
Collectively evaluated for impairment	754,908	441,354	226,789	32,305		1,455,356
Total loans recorded investment	772,493	506,253	232,459	32,305		1,543,510
Accrued interest included in recorded investment	1,607	2,249	672	-		4,528
Total loans	$770,886	$504,004	$231,787	$ 32,305		$1,538,982
December 31, 2015						
Allowance for loan losses						
Individually evaluated for impairment	$2,708	$7,818	$457	$ -	$ -	$10,983
Collectively evaluated for impairment	2,962	2,573	724	56	5,272	11,587
Total ending allowance balance	$5,670	$10,391	$1,181	$ 56	$ 5,272	$22,570
Loans						
Individually evaluated for impairment	$16,868	$66,375	$5,888	$ -		$89,131
Collectively evaluated for impairment	733,399	436,349	226,409	34,599		1,430,756
Total loans recorded investment	750,267	502,724	232,297	34,599		1,519,887
Accrued interest included in recorded investment	1,869	2,270	698	-		4,837
Total loans	$748,398	$500,454	$231,599	$ 34,599		$1,515,050

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Loans on non-accrual status and past due more than 90 days ("Non-performing Loans") follow:

	90+ and Still Accruing	Non-Accrual	Total Non-Performing Loans
	(In thousands)		
March 31, 2016			
Commercial			
Income producing - real estate	$-	$1,117	$ 1,117
Land, land development and construction - real estate	-	168	168
Commercial and industrial	147	2,304	2,451
Mortgage			
1-4 family	-	4,795	4,795
Resort lending	-	805	805
Home equity - 1st lien	-	154	154
Home equity - 2nd lien	-	268	268
Purchased loans	3	2	5
Installment			
Home equity - 1st lien	-	79	79
Home equity - 2nd lien	-	344	344
Loans not secured by real estate	-	384	384
Other	-	2	2
Payment plan receivables			
Full refund	-	2	2
Partial refund	-	-	-
Other	-	1	1
Total recorded investment	$150	$10,425	$ 10,575
Accrued interest included in recorded investment	$3	$-	$ 3
December 31, 2015			
Commercial			
Income producing - real estate	$-	$1,027	$ 1,027
Land, land development and construction - real estate	49	401	450
Commercial and industrial	69	2,028	2,097
Mortgage			
1-4 family	-	4,744	4,744
Resort lending	-	1,094	1,094
Home equity - 1st lien	-	187	187
Home equity - 2nd lien	-	147	147
Purchased loans	-	2	2
Installment			
Home equity - 1st lien	-	106	106
Home equity - 2nd lien	-	443	443
Loans not secured by real estate	-	421	421
Other	-	2	2
Payment plan receivables			
Full refund	-	2	2

Partial refund	-	2	2
Other	-	1	1
Total recorded investment	$118	$10,607	$ 10,725
Accrued interest included in recorded investment	$2	$-	$ 2

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

An aging analysis of loans by class follows:

	Loans Past Due				Loans not	Total
	30-59 days	60-89 days	90+ days	Total	Past Due	Loans
	(In thousands)					
March 31, 2016						
Commercial						
Income producing - real estate	$337	$ -	$ 776	$1,113	$310,604	$311,717
Land, land development and construction - real estate	-	-	168	168	40,795	40,963
Commercial and industrial	354	192	229	775	419,038	419,813
Mortgage						
1-4 family	2,505	662	4,795	7,962	275,295	283,257
Resort lending	677	-	805	1,482	111,434	112,916
Home equity - 1st lien	66	-	154	220	26,024	26,244
Home equity - 2nd lien	235	287	268	790	51,620	52,410
Purchased loans	12	1	5	18	31,408	31,426
Installment						
Home equity - 1st lien	529	176	79	784	15,429	16,213
Home equity - 2nd lien	215	133	344	692	18,367	19,059
Loans not secured by real estate	386	108	384	878	194,202	195,080
Other	3	11	2	16	2,091	2,107
Payment plan receivables						
Full refund	408	65	2	475	17,609	18,084
Partial refund	303	61	-	364	6,197	6,561
Other	154	3	1	158	7,502	7,660
Total recorded investment	$6,184	$ 1,699	$ 8,012	$15,895	$1,527,615	$1,543,510
Accrued interest included in recorded investment	$56	$ 21	$ 3	$80	$4,448	$4,528
December 31, 2015						
Commercial						
Income producing - real estate	$203	$ 209	$ 647	$1,059	$305,155	$306,214
Land, land development and construction - real estate	-	-	252	252	44,231	44,483
Commercial and industrial	785	16	151	952	398,618	399,570
Mortgage						
1-4 family	1,943	640	4,744	7,327	272,298	279,625
Resort lending	307	-	1,094	1,401	114,619	116,020
Home equity - 1st lien	50	-	187	237	22,327	22,564
Home equity - 2nd lien	439	54	147	640	50,618	51,258
Purchased loans	9	1	2	12	33,245	33,257
Installment						
Home equity - 1st lien	315	107	106	528	16,707	17,235
Home equity - 2nd lien	231	149	443	823	19,727	20,550
Loans not secured by real estate	567	83	421	1,071	191,262	192,333

Other	15	3	2	20	2,159	2,179
Payment plan receivables						
Full refund	492	62	2	556	21,294	21,850
Partial refund	415	228	2	645	5,834	6,479
Other	110	3	1	114	6,156	6,270
Total recorded investment	$5,881	$ 1,555	$ 8,201	$15,637	$1,504,250	$1,519,887
Accrued interest included in recorded investment	$53	$ 17	$ 2	$72	$4,765	$4,837

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Impaired loans are as follows :

	March 31, 2016	December 31, 2015
Impaired loans with no allocated allowance	(In thousands)	
TDR	$2,368	$ 2,518
Non - TDR	168	203
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	4,683	4,810
TDR - allowance based on present value cash flow	80,009	81,002
Non - TDR - allowance based on collateral	623	260
Non - TDR - allowance based on present value cash flow	-	-
Total impaired loans	$87,851	$ 88,793
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$2,531	$ 2,436
TDR - allowance based on present value cash flow	8,135	8,471
Non - TDR - allowance based on collateral	184	76
Non - TDR - allowance based on present value cash flow	-	-
Total amount of allowance for loan losses allocated	$10,850	$ 10,983

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Impaired loans by class are as follows (1):

	March 31, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:	(In thousands)					
Commercial						
Income producing - real estate	$785	$1,030	$ -	$641	$851	$ -
Land, land development & construction-real estate	537	1,112	-	818	1,393	-
Commercial and industrial	1,218	1,216	-	1,245	1,241	-
Mortgage						
1-4 family	-	140	-	23	183	-
Resort lending	-	-	-	-	-	-
Home equity - 1st lien	-	-	-	-	-	-
Home equity - 2nd lien	-	-	-	-	-	-
Installment						
Home equity - 1st lien	1	75	-	-	76	-
Home equity - 2nd lien	14	13	-	-	-	-
Loans not secured by real estate	-	-	-	-	-	-
Other	-	-	-	-	-	-
	2,555	3,586	-	2,727	3,744	-
With an allowance recorded:						
Commercial						
Income producing - real estate	8,234	9,061	548	8,377	9,232	516
Land, land development & construction-real estate	1,484	1,484	95	1,690	1,778	296
Commercial and industrial	5,327	5,592	2,148	4,097	4,439	1,896
Mortgage						
1-4 family	46,608	48,532	4,976	47,792	49,808	5,132
Resort lending	17,929	17,963	2,654	18,148	18,319	2,662
Home equity - 1st lien	243	247	12	168	172	9
Home equity - 2nd lien	119	201	9	244	325	15
Installment						
Home equity - 1st lien	2,287	2,421	130	2,364	2,492	143
Home equity - 2nd lien	2,793	2,807	239	2,929	2,951	271
Loans not secured by real estate	569	641	38	587	658	42
Other	6	6	1	8	8	1
	85,599	88,955	10,850	86,404	90,182	10,983
Total						
Commercial						
Income producing - real estate	9,019	10,091	548	9,018	10,083	516
Land, land development & construction-real estate	2,021	2,596	95	2,508	3,171	296
Commercial and industrial	6,545	6,808	2,148	5,342	5,680	1,896
Mortgage						

1-4 family	46,608	48,672	4,976	47,815	49,991	5,132
Resort lending	17,929	17,963	2,654	18,148	18,319	2,662
Home equity - 1st lien	243	247	12	168	172	9
Home equity - 2nd lien	119	201	9	244	325	15
Installment						
Home equity - 1st lien	2,288	2,496	130	2,364	2,568	143
Home equity - 2nd lien	2,807	2,820	239	2,929	2,951	271
Loans not secured by real estate	569	641	38	587	658	42
Other	6	6	1	8	8	1
Total	$88,154	$92,541	$ 10,850	$89,131	$93,926	$ 10,983
Accrued interest included in recorded investment	$303			$338		

(1) There were no impaired payment plan receivables or purchased mortgage loans at March 31, 2016 or December 31, 2015.

21

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Average recorded investment in and interest income earned on impaired loans by class for the three month periods ending March 31, follows (1):

	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$713	$ 2	$5,848	$ 53
Land, land development & construction-real estate	678	7	1,041	34
Commercial and industrial	1,232	21	2,768	37
Mortgage				
1-4 family	12	1	13	-
Resort lending	-	-	31	-
Home equity line of credit - 1st lien	-	-	-	-
Home equity line of credit - 2nd lien	-	-	-	-
Installment				
Home equity installment - 1st lien	1	1	-	-
Home equity installment - 2nd lien	7	-	-	-
Loans not secured by real estate	-	-	-	-
Other	-	-	-	-
	2,643	32	9,701	124
With an allowance recorded:				
Commercial				
Income producing - real estate	8,306	107	12,849	157
Land, land development & construction-real estate	1,587	13	2,709	14
Commercial and industrial	4,712	23	8,177	66
Mortgage				
1-4 family	47,200	502	52,451	551
Resort lending	18,039	160	18,632	171
Home equity line of credit - 1st lien	206	2	162	2
Home equity line of credit - 2nd lien	182	1	123	2
Installment				
Home equity installment - 1st lien	2,326	42	2,691	50
Home equity installment - 2nd lien	2,861	44	3,174	51
Loans not secured by real estate	578	9	694	10
Other	7	-	12	-
	86,004	903	101,674	1,074
Total				
Commercial				
Income producing - real estate	9,019	109	18,697	210
Land, land development & construction-real estate	2,265	20	3,750	48
Commercial and industrial	5,944	44	10,945	103
Mortgage				
1-4 family	47,212	503	52,464	551
Resort lending	18,039	160	18,663	171

Home equity line of credit - 1st lien	206	2	162	2
Home equity line of credit - 2nd lien	182	1	123	2
Installment				
Home equity installment - 1st lien	2,327	43	2,691	50
Home equity installment - 2nd lien	2,868	44	3,174	51
Loans not secured by real estate	578	9	694	10
Other	7	-	12	-
Total	$88,647	$ 935	$111,375	$ 1,198

(1) There were no impaired payment plan receivables or purchased mortgage loans during the three month periods ended March 31, 2016 and 2015, respectively.

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Our average investment in impaired loans was approximately $88.6 million and $111.4 million for the three-month periods ended March 31, 2016 and 2015, respectively. Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance. Interest income recognized on impaired loans during the three months ending March 31, 2016 and 2015, was approximately $0.9 million and $1.2 million, respectively.

Troubled debt restructurings follow:

	March 31, 2016		
	Commercial	Retail	Total
	(In thousands)		
Performing TDRs	$13,950	$66,619	$80,569
Non-performing TDRs(1)	2,798	3,693 (2)	6,491
Total	$16,748	$70,312	$87,060

	December 31, 2015		
	Commercial	Retail	Total
	(In thousands)		
Performing TDRs	$13,318	$68,194	$81,512
Non-performing TDRs(1)	3,041	3,777 (2)	6,818
Total	$16,359	$71,971	$88,330

(1) Included in non-performing loans table above.
(2) Also includes loans on non-accrual at the time of modification until six payments are received on a timely basis.

We allocated $10.7 million and $10.9 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of March 31, 2016 and December 31, 2015, respectively.

During the three months ended March 31, 2016 and 2015, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans generally included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan have generally been for periods ranging from 9 months to 36 months but have extended to as much as 480 months in certain circumstances. Modifications involving an extension of the maturity date have generally been for periods ranging from 1 month to 60 months but have extended to as much as 230 months in certain circumstances.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Loans that have been classified as troubled debt restructurings during the three-month periods ended March 31 follow:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
	(Dollars in thousands)		
2016			
Commercial			
Income producing - real estate	2	$ 110	$ 110
Land, land development & construction-real estate	-	-	-
Commercial and industrial	4	1,758	1,758
Mortgage			
1-4 family	2	83	153
Resort lending	1	116	117
Home equity - 1st lien	1	107	78
Home equity - 2nd lien	-	-	-
Installment			
Home equity - 1st lien	1	30	31
Home equity - 2nd lien	2	55	56
Loans not secured by real estate	-	-	-
Other	-	-	-
Total	13	$ 2,259	$ 2,303
2015			
Commercial			
Income producing - real estate	1	$ 156	$ 164
Land, land development & construction-real estate	-	-	-
Commercial and industrial	2	236	234
Mortgage			
1-4 family	5	1,005	805
Resort lending	-	-	-
Home equity - 1st lien	-	-	-
Home equity - 2nd lien	-	-	-
Installment			
Home equity - 1st lien	4	167	140
Home equity - 2nd lien	-	-	-
Loans not secured by real estate	-	-	-
Other	-	-	-
Total	12	$ 1,564	$ 1,343

The troubled debt restructurings described above for 2016 increased the allowance for loan losses by $0.06 million and resulted in zero charge offs while the troubled debt restructurings described above for 2015 increased the allowance for loan losses by $0.03 million and resulted in zero charge offs.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Loans that have been classified as troubled debt restructurings during the past twelve months and that have subsequently defaulted during the three-month periods ended March 31 follow:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
2016		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	-	-
Resort lending	-	-
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Installment		
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Loans not secured by real estate	-	-
Other	-	-
	-	$ -
2015		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	1	91
Mortgage		
1-4 family	-	-
Resort lending	-	-
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Installment		
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Loans not secured by real estate	-	-
Other	-	-
	1	$ 91

A loan is considered to be in payment default generally once it is 90 days contractually past due under the modified terms.

There were no troubled debt restructurings that subsequently defaulted in 2016 while the troubled debt restructurings that subsequently defaulted described above for 2015 had no impact on the balance of the allowance for loan losses and resulted in zero charge offs.

The terms of certain other loans were modified during the three months ended March 31, 2016 and 2015 in a manner that did not meet the definition of a troubled debt restructuring. The modification of these loans could have included modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

In order to determine whether a borrower is experiencing financial difficulty, we perform an evaluation of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under our internal underwriting policy.

Credit Quality Indicators – As part of our on on-going monitoring of the credit quality of our loan portfolios, we track certain credit quality indicators including (a) weighted-average risk grade of commercial loans, (b) the level of classified commercial loans, (c) credit scores of mortgage and installment loan borrowers, (d) financial performance of certain counterparties for payment plan receivables and (e) delinquency history and non-performing loans.

For commercial loans, we use a loan rating system that is similar to those employed by state and federal banking regulators. Loans are graded on a scale of 1 to 12. A description of the general characteristics of the ratings follows:

Rating 1 through 6: These loans are generally referred to as our “non-watch” commercial credits that include very high or exceptional credit fundamentals through acceptable credit fundamentals.

Rating 7 and 8: These loans are generally referred to as our “watch” commercial credits. This rating includes loans to borrowers that exhibit potential credit weakness or downward trends. If not checked or cured these trends could weaken our asset or credit position. While potentially weak, no loss of principal or interest is envisioned with these ratings.

Rating 9: These loans are generally referred to as our “substandard accruing” commercial credits. This rating includes loans to borrowers that exhibit a well-defined weakness where payment default is probable and loss is possible if deficiencies are not corrected. Generally, loans with this rating are considered collectible as to both principal and interest primarily due to collateral coverage.

Rating 10 and 11: These loans are generally referred to as our “substandard - non-accrual” and “doubtful” commercial credits. This rating includes loans to borrowers with weaknesses that make collection of debt in full, on the basis of current facts, conditions and values at best questionable and at worst improbable. All of these loans are placed in non-accrual.

Rating 12: These loans are generally referred to as our “loss” commercial credits. This rating includes loans to borrowers that are deemed incapable of repayment and are charged-off.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following table summarizes loan ratings by loan class for our commercial loan segment:

	Commercial				
	Non-watch 1-6	Watch 7-8	Substandard Accrual 9	Non-Accrual 10-11	Total
			(In thousands)		
March 31, 2016					
Income producing - real estate	$303,195	$6,367	$ 1,038	$1,117	$311,717
Land, land development and construction - real estate	39,120	1,675	-	168	40,963
Commercial and industrial	391,207	20,687	5,615	2,304	419,813
Total	$733,522	$28,729	$ 6,653	$3,589	$772,493
Accrued interest included in total	$1,507	$82	$ 18	$-	$1,607
December 31, 2015					
Income producing - real estate	$296,898	$6,866	$ 1,423	$1,027	$306,214
Land, land development and construction - real estate	40,844	2,995	243	401	44,483
Commercial and industrial	371,357	19,502	6,683	2,028	399,570
Total	$709,099	$29,363	$ 8,349	$3,456	$750,267
Accrued interest included in total	$1,729	$108	$ 32	$-	$1,869

For each of our mortgage and installment segment classes we generally monitor credit quality based on the credit scores of the borrowers. These credit scores are generally updated semi-annually.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following tables summarize credit scores by loan class for our mortgage and installment loan segments:

	Mortgage (1)					
	1-4 Family	Resort Lending	Home Equity 1st Lien	Home Equity 2nd Lien	Purchased Loans	Total
	(In thousands)					
March 31, 2016						
800 and above	$29,357	$13,694	$4,206	$7,409	$2,298	$56,964
750-799	84,315	39,748	10,292	18,190	20,775	173,320
700-749	54,911	31,331	4,601	11,796	6,901	109,540
650-699	51,725	16,538	3,696	7,501	-	79,460
600-649	27,962	4,934	1,447	3,720	-	38,063
550-599	16,128	3,052	1,022	1,887	-	22,089
500-549	10,348	985	561	1,261	-	13,155
Under 500	4,570	548	223	252	-	5,593
Unknown	3,941	2,086	196	394	1,452	8,069
Total	$283,257	$112,916	$26,244	$52,410	$31,426	$506,253
Accrued interest included in total	$1,368	$489	$93	$195	$104	$2,249
December 31, 2015						
800 and above	$28,760	$13,943	$4,374	$7,696	$2,310	$57,083
750-799	78,802	40,888	7,137	17,405	23,283	167,515
700-749	56,519	31,980	4,341	11,022	6,940	110,802
650-699	51,813	17,433	3,203	7,691	-	80,140
600-649	27,966	4,991	1,467	3,684	-	38,108
550-599	16,714	3,070	1,027	1,918	-	22,729
500-549	10,610	1,051	572	1,295	-	13,528
Under 500	4,708	554	244	265	-	5,771
Unknown	3,733	2,110	199	282	724	7,048
Total	$279,625	$116,020	$22,564	$51,258	$33,257	$502,724
Accrued interest included in total	$1,396	$477	$87	$196	$114	$2,270

(1) Credit scores have been updated within the last twelve months.

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

	Installment(1) Home Equity 1st Lien	Home Equity 2nd Lien	Loans not Secured by Real Estate	Other	Total
	(In thousands)				
March 31, 2016					
800 and above	$1,638	$1,678	$43,330	$91	$46,737
750-799	3,850	5,552	89,742	522	99,666
700-749	2,375	3,591	35,628	633	42,227
650-699	3,308	3,761	16,394	459	23,922
600-649	2,032	2,068	4,663	202	8,965
550-599	1,741	1,296	1,825	105	4,967
500-549	1,000	804	1,068	55	2,927
Under 500	211	280	297	23	811
Unknown	58	29	2,133	17	2,237
Total	$16,213	$19,059	$195,080	$2,107	$232,459
Accrued interest included in total	$69	$73	$514	$16	$672
December 31, 2015					
800 and above	$1,792	$1,782	$44,254	$58	$47,886
750-799	4,117	5,931	86,800	531	97,379
700-749	2,507	3,899	34,789	694	41,889
650-699	3,508	4,182	16,456	499	24,645
600-649	2,173	2,153	4,979	200	9,505
550-599	1,800	1,346	1,997	109	5,252
500-549	1,056	855	1,170	61	3,142
Under 500	223	370	385	23	1,001
Unknown	59	32	1,503	4	1,598
Total	$17,235	$20,550	$192,333	$2,179	$232,297
Accrued interest included in total	$78	$83	$520	$17	$698

(1) Credit scores have been updated within the last twelve months.

Mepco Finance Corporation (“Mepco”) is a wholly-owned subsidiary of our Bank that operates a vehicle service contract payment plan business throughout the United States. See Note #14 for more information about Mepco’s business. As of March 31, 2016, approximately 56.0% of Mepco’s outstanding payment plan receivables relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the full refund owing upon cancellation of the related service contract (including with respect to both the portion funded to the service contract seller and the portion funded to the administrator). These receivables are shown as “Full Refund” in the table below. Another approximately 20.3% of Mepco’s outstanding payment plan receivables as of March 31, 2016, relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the refund owing upon cancellation only with respect to the unearned portion previously funded by Mepco to the administrator (but not to the service contract seller). These receivables are shown as “Partial Refund” in the table below. The balance of Mepco’s outstanding payment plan receivables relate to programs in which there is no insurer or risk retention group that has any contractual liability to Mepco for any portion of the refund amount. These receivables are shown as “Other” in the table below. For each class of our payment plan receivables we monitor financial information on the counterparties as we evaluate the credit quality of this portfolio.

29

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following table summarizes credit ratings of insurer or risk retention group counterparties by class of payment plan receivable:

	Payment Plan Receivables			
	Full Refund	Partial Refund	Other	Total
	(In thousands)			
March 31, 2016				
AM Best rating				
A+	$-	$11	$-	$11
A	1,845	5,285	-	7,130
A-	2,576	1,208	7,658	11,442
Not rated	13,663	57	2	13,722
Total	$18,084	$6,561	$7,660	$32,305
December 31, 2015				
AM Best rating				
A+	$-	$6	$-	$6
A	2,712	5,203	-	7,915
A-	3,418	1,177	6,265	10,860
Not rated	15,720	93	5	15,818
Total	$21,850	$6,479	$6,270	$34,599

Although Mepco has contractual recourse against various counterparties for refunds owing upon cancellation of vehicle service contracts, see Note #14 below regarding certain risks and difficulties associated with collecting these refunds.

Foreclosed residential real estate properties included in other real estate and repossessed assets on our Condensed Consolidated Statements of Financial Condition totaled $2.5 million and $2.8 million at March 31, 2016 and December 31, 2015, respectively. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled $1.4 million and $1.1 million at March 31, 2016 and December 31, 2015, respectively.

5. Segments

Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank ("IB" or "Bank") and Mepco. These business segments are also differentiated based on the products and services provided. We evaluate performance based principally on net income (loss) of the respective reportable segments.

In the normal course of business, our IB segment provides funding to our Mepco segment through an intercompany line of credit priced at the prime rate of interest as published in the Wall Street Journal. Our IB segment also provides certain administrative services to our Mepco segment which are reimbursed at an agreed upon rate. These intercompany transactions are eliminated upon consolidation. The only other material intersegment balances and transactions are investments in subsidiaries at the parent entities and cash balances on deposit at our IB segment.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

A summary of selected financial information for our reportable segments follows:

	IB	Mepco	Other(1)	Elimination(2)	Total
	(In thousands)				
Total assets					
March 31, 2016	$2,425,152	$50,515	$275,315	$ (263,862)	$2,487,120
December 31, 2015	2,340,566	57,208	286,936	(275,644)	2,409,066
For the three months ended March 31, 2016					
Interest income	$20,243	$1,110	$5	$ (4)	$21,354
Net interest income	19,102	932	(271)	-	19,763
Provision for loan losses	(526)	(4)	-	-	(530)
Income (loss) before income tax	6,862	(359)	(423)	(23)	6,057
Net income (loss)	4,619	(237)	(267)	(15)	4,100
2015					
Interest income	$18,221	$1,331	$20	$ (20)	$19,552
Net interest income	17,183	1,135	(227)	-	18,091
Provision for loan losses	(656)	(3)	-	-	(659)
Income (loss) before income tax	6,259	(291)	(383)	(24)	5,561
Net income (loss)	4,233	(192)	(244)	(16)	3,781

(1) Includes amounts relating to our parent company.
(2) Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

6. Shareholders' Equity and Earnings Per Common Share

On January 21, 2016, our Board of Directors authorized a share repurchase plan (the "Repurchase Plan") to buy back up to 5% of our outstanding common stock through December 31, 2016. We expect to accomplish the repurchases through open market transactions, though we could affect repurchases through other means, such as privately negotiated transactions. The timing and amount of any share repurchases will depend on a variety of factors, including, among others, securities law restrictions, the trading price of our common stock, regulatory requirements, potential alternative uses for capital, and our financial performance. The Repurchase Plan does not obligate us to acquire any particular amount of common stock, and it may be modified or suspended at any time at our discretion. We expect to fund any repurchases from cash on hand. During the three months ended March 31, 2016, we repurchased 1,059,865 shares of common stock for an aggregate purchase price of $15.5 million leaving 52,703 shares to be repurchased under the Repurchase Plan. On April 26, 2016 our Board of Directors authorized a $5.0 million expansion of the Repurchase Plan.

On November 15, 2011, we entered into a Tax Benefits Preservation Plan (the "Preservation Plan") with our stock transfer agent, American Stock Transfer & Trust Company. Our Board of Directors adopted the Preservation Plan in an effort to protect the value to our shareholders of our ability to use deferred tax assets such as net operating loss carry forwards to reduce potential future federal income tax obligations. Under federal tax rules, this value could be lost in the event we experienced an "ownership change," as defined in Section 382 of the Internal Revenue Code. The Preservation Plan attempts to protect this value by reducing the likelihood that we will experience such an ownership change by discouraging any person who is not already a 5% shareholder from becoming a 5% shareholder (with certain limited exceptions).

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

On November 15, 2011, our Board of Directors declared a dividend of one preferred share purchase right (a "Right") for each outstanding share of our common stock under the terms of the Preservation Plan. The dividend is payable to the holders of common stock outstanding as of the close of business on November 15, 2011, or outstanding at any time thereafter but before the earlier of a "Distribution Date" and the date the Preservation Plan terminates. Each Right entitles the registered holder to purchase from us 1/1000 of a share of our Series C Junior Participating Preferred Stock, no par value per share ("Series C Preferred Stock"). Each 1/1000 of a share of Series C Preferred Stock has economic and voting terms similar to those of one whole share of common stock. The Rights are not exercisable and generally do not become exercisable until a person or group has acquired, subject to certain exceptions and conditions, beneficial ownership of 4.99% or more of the outstanding shares of common stock. At that time, each Right will generally entitle its holder to purchase securities of the Company at a discount of 50% to the current market price of the common stock. However, the Rights owned by the person acquiring beneficial ownership of 4.99% or more of the outstanding shares of common stock would automatically be void. The significant dilution that would result is expected to deter any person from acquiring beneficial ownership of 4.99% or more and thereby triggering the Rights.

To date, none of the Rights have been exercised or have become exercisable because no unpermitted 4.99% or more change in the beneficial ownership of the outstanding common stock has occurred. The Rights will generally expire on the earlier to occur of the close of business on November 15, 2016, and certain other events described in the Preservation Plan, including such date as our Board of Directors determines that the Preservation Plan is no longer necessary for its intended purposes. At the present time, the Board of Directors does not intend to extend the Preservation Plan.

A reconciliation of basic and diluted net income per common share follows:

	Three Months Ended March 31,	
	2016	2015
Net income	$ 4,100	$ 3,781
Weighted average shares outstanding (1)	21,751	22,997
Stock units for deferred compensation plan for non-employee directors	113	111
Effect of stock options	112	121
Restricted stock units	86	309
Weighted average shares outstanding for calculation of diluted earnings per share	22,062	23,538
Net income per common share		
Basic (1)	$ 0.19	$ 0.16
Diluted	$ 0.19	$ 0.16

(1) Basic net income per common share includes weighted average common shares outstanding during the period and participating share awards.

Weighted average stock options outstanding that were not included in weighted average shares outstanding for calculation of diluted earnings per share because they were anti-dilutive totaled 0.03 million for both the three-month periods ended March 31, 2016 and 2015.

32

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

7. Derivative Financial Instruments

We are required to record derivatives on our Condensed Consolidated Statements of Financial Condition as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the derivatives qualify for hedge accounting.

Our derivative financial instruments according to the type of hedge in which they are designated follows:

	March 31, 2016		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
No hedge designation			
Rate-lock mortgage loan commitments	$23,854	0.1	$769
Mandatory commitments to sell mortgage loans	50,127	0.1	(137)
Pay-fixed interest rate swap agreements	42,933	9.5	(1,615)
Pay-variable interest rate swap agreements	42,933	9.5	1,615
Purchased options	2,803	5.3	200
Written options	2,803	5.3	(200)
Total	$165,453	5.2	$632

	December 31, 2015		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
No hedge designation			
Rate-lock mortgage loan commitments	$20,581	0.1	$550
Mandatory commitments to sell mortgage loans	46,320	0.1	69
Pay-fixed interest rate swap agreements	27,587	8.0	(497)
Pay-variable interest rate swap agreements	27,587	8.0	497
Purchased options	2,098	5.7	122
Written options	2,098	5.7	(122)
Total	$126,271	3.7	$619

Certain financial derivative instruments have not been designated as hedges. The fair value of these derivative financial instruments has been recorded on our Condensed Consolidated Statements of Financial Condition and is adjusted on an ongoing basis to reflect their then current fair value. The changes in fair value of derivative financial instruments not designated as hedges are recognized in our Condensed Consolidated Statements of Operations.

Index

In the ordinary course of business, we enter into rate-lock mortgage loan commitments with customers ("Rate-Lock Commitments"). These commitments expose us to interest rate risk. We also enter into mandatory commitments to sell mortgage loans ("Mandatory Commitments") to reduce the impact of price fluctuations of mortgage loans held for sale and Rate-Lock Commitments. Mandatory Commitments help protect our loan sale profit margin from fluctuations in interest rates. The changes in the fair value of Rate-Lock Commitments and Mandatory Commitments are recognized currently as part of net gains on mortgage loans. We obtain market prices on Mandatory Commitments and Rate-Lock Commitments. Net gains on mortgage loans, as well as net income may be more volatile as a result of these derivative instruments, which are not designated as hedges.

During 2015, we began offering to our deposit customers an equity linked time deposit product ("Altitude CD"). The Altitude CD is a time deposit that provides the customer a guaranteed return of principal at maturity plus a potential equity return (a written option), while we receive a like stream of funds based on the equity return (a purchased option). The written and purchased options will generally move in opposite directions resulting in little or no net impact on our Condensed Consolidated Statements of Operations. All of the written and purchased options in the table above relate to this Altitude CD product.

We have a program that allows commercial loan customers to lock in a fixed rate for a longer period of time than we would normally offer for interest rate risk reasons. We will enter into a variable rate commercial loan and an interest rate swap agreement with a customer and then enter into an offsetting interest rate swap agreement with an unrelated party. The interest rate swap agreement fair values will generally move in opposite directions resulting in little or no net impact on our Condensed Consolidated Statements of Operations. All of the interest rate swap agreements in the table above relate to this program.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following tables illustrate the impact that the derivative financial instruments discussed above have on individual line items in the Condensed Consolidated Statements of Financial Condition for the periods presented:

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	March 31, 2016		December 31, 2015		March 31, 2016		December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)							
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	$769	Other assets	$550	Other liabilities	$-	Other liabilities	$-
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	69	Other liabilities	137	Other liabilities	-
Pay-fixed interest rate swap agreements	Other assets	-	Other assets	-	Other liabilities	1,615	Other liabilities	497
Pay-variable interest rateswap agreements	Other assets	1,615	Other assets	497	Other liabilities	-	Other liabilities	-
Purchased options	Other assets	200	Other assets	122	Other liabilities	-	Other liabilities	-
Written options	Other assets	-	Other assets	-	Other liabilities	200	Other liabilities	122
Total derivatives		$2,584		$1,238		$1,952		$619

The effect of derivative financial instruments on the Condensed Consolidated Statements of Operations follows:

	Three Month Periods Ended March 31,		
	Location of Gain (Loss) Recognized in Income	Gain (Loss) Recognized in Income	
		2016	2015
		(In thousands)	
No hedge designation			
Rate-lock mortgage loan commitments	Net gains on mortgage loans	$219	$388
Mandatory commitments to sell mortgage loans	Net gains on mortgage loans	(206)	(39)
Pay-fixed interest rate swap agreements	Interest income	(1,118)	(261)
Pay-variable interest rate swap agreements	Interest income	1,118	261
Purchased options	Interest expense	78	-
Written options	Interest expense	(78)	-
Total		$13	$349

35

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

8. Intangible Assets

The following table summarizes intangible assets, net of amortization:

	March 31, 2016 Gross Carrying Amount	March 31, 2016 Accumulated Amortization	December 31, 2015 Gross Carrying Amount	December 31, 2015 Accumulated Amortization
	(In thousands)			
Amortized intangible assets - core deposits	$6,118	$ 3,925	$ 6,118	$ 3,838

Amortization of other intangibles has been estimated through 2021 and thereafter in the following table.

	(In thousands)
Nine months ending December 31, 2016	$ 260
2017	346
2018	346
2019	346
2020	346
2021 and thereafter	549
Total	$ 2,193

9. Share Based Compensation

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.2 million shares of common stock as of March 31, 2016. The non-employee director stock purchase plan permits the issuance of additional share based payments for up to 0.2 million shares of common stock as of March 31, 2016. Share based awards and payments are measured at fair value at the date of grant and are expensed over the requisite service period. Common shares issued upon exercise of stock options come from currently authorized but unissued shares.

During each first quarter period of 2016 and 2015, pursuant to our long-term incentive plan, we granted 0.07 million shares of restricted stock and 0.03 million performance stock units ("PSU") to certain officers. The shares of restricted stock and PSUs cliff vest after a period of three years. The performance feature of the PSUs is based on a comparison of our total shareholder return over the three year period starting on the grant date to the total shareholder return over that period for a banking index of our peers.

Our directors may elect to receive a portion of their quarterly cash retainer fees in the form of common stock (either on a current basis or on a deferred basis pursuant to the non-employee director stock purchase plan referenced above). Shares equal in value to that portion of each director's fees that he or she has elected to receive in stock are issued each quarter and vest immediately. We issued 0.002 million shares and 0.001 million shares to directors during the first three months of 2016 and 2015, respectively and expensed their value during those same periods.

36

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Total compensation expense recognized for grants pursuant to our long-term incentive plan was $0.4 million during both three month periods ended March 31, 2016 and 2015. The corresponding tax benefit relating to this expense was $0.1 million for each period. Total expense recognized for non-employee director share based payments was $0.03 million and $0.02 million during the three months ended March 31, 2016 and 2015, respectively. The corresponding tax benefit relating to this expense was $0.01 million for each period.

At March 31, 2016, the total expected compensation cost related to non-vested stock options, restricted stock, PSUs and restricted stock unit awards not yet recognized was $2.4 million. The weighted-average period over which this amount will be recognized is 2.1 years.

A summary of outstanding stock option grants and related transactions follows:

	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregated Intrinsic Value (In thousands)
Outstanding at January 1, 2016	235,596	$ 4.94		
Granted	-			
Exercised	(10,216)	3.18		
Forfeited	(498)	6.42		
Expired	-			
Outstanding at March 31, 2016	224,882	$ 5.01	5.84	$ 2,180
Vested and expected to vest at March 31, 2016	224,631	$ 5.01	5.84	$ 2,178
Exercisable at March 31, 2016	202,938	$ 4.86	5.69	$ 2,002

A summary of outstanding non-vested restricted stock, restricted stock units and PSUs and related transactions follows:

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1, 2016	261,981	$ 11.29
Granted	96,191	14.39
Vested	(21,225)	12.78
Forfeited	(1,398)	12.70
Outstanding at March 31, 2016	335,549	$ 12.08

Index

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Certain information regarding options exercised during the periods follows:

	Three Months Ended March 31,	
	2016	2015
Intrinsic value	$ 117	$ 56
Cash proceeds received	$ 32	$ 15
Tax benefit realized	$ 41	$ 20

10. Income Tax

Income tax expense was $2.0 million and $1.8 million during the three months ended March 31, 2016 and 2015, respectively.

We assess whether a valuation allowance should be established against our deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. The ultimate realization of this asset is primarily based on generating future income. We concluded at both March 31, 2016 and 2015, that the realization of substantially all of our deferred tax assets continues to be more likely than not.

We did maintain a valuation allowance against our deferred tax assets of approximately $1.1 million at both March 31, 2016 and December 31, 2015. This valuation allowance on our deferred tax assets primarily relates to state income taxes at our Mepco segment. In this instance, we determined that the future realization of these particular deferred tax assets was not more likely than not. This conclusion was primarily based on the uncertainty of Mepco's future earnings attributable to particular states (given the various apportionment criteria) and the significant reduction in the size of Mepco's business.

At both March 31, 2016 and December 31, 2015, we had approximately $1.0 million, of gross unrecognized tax benefits. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2016.

Index
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

11. Regulatory Matters

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank's current year net profits, combined with the retained net profits of the preceding two years. Further, the Bank cannot pay a dividend at any time that it has negative undivided profits. As of March 31, 2016, the Bank had negative undivided profits of $5.7 million. We can request regulatory approval for a return of capital from the Bank to the parent company. During the first quarters of 2016 and 2015, we requested regulatory approval for returns of capital from the Bank to the parent company of $18.0 million and $18.5 million, respectively. These return of capital requests were approved by our banking regulators on February 24, 2016 and February 13, 2015, respectively and the Bank returned these amounts to the parent company on February 25, 2016 and February 17, 2015, respectively. It is not our intent to have dividends paid in amounts that would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

We are also subject to various regulatory capital requirements. The prompt corrective action regulations establish quantitative measures to ensure capital adequacy and require minimum amounts and ratios of total, Tier 1, and common equity Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can result in certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. Under capital adequacy guidelines, we must meet specific capital requirements that involve quantitative measures as well as qualitative judgments by the regulators. The most recent regulatory filings as of March 31, 2016 and December 31, 2015, categorized our Bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent Federal Deposit Insurance Corporation ("FDIC") categorization.

On July 2, 2013, the Federal Reserve approved a final rule that establishes an integrated regulatory capital framework (the "New Capital Rules"). The rule implements in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. In general, under the New Capital Rules, minimum requirements have increased for both the quantity and quality of capital held by banking organizations. Consistent with the international Basel framework, the New Capital Rules include a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets that applies to all supervised financial institutions. The capital conservation buffer began to phase in on January 1, 2016 with 0.625% added to the minimum ratio for adequately capitalized institutions for 2016. To avoid limits on capital distributions and certain discretionary bonus payments we must meet the minimum ratio for adequately capitalized institutions plus the phased in buffer. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking organizations. As to the quality of capital, the New Capital Rules emphasize common equity Tier 1 capital, the most loss-absorbing form of capital, and implement strict eligibility criteria for regulatory capital instruments. The New Capital Rules also change the methodology for calculating risk-weighted assets to enhance risk sensitivity. The New Capital Rules became effective for us on January 1, 2015.

Index