INDEPENDENT BANK CORP /MI/
Form 10-Q
November 04, 2015

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 September 30, 2015

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	22,297,545
Class	Outstanding at November 3, 2015

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, 2014, 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

	September 30, 2015 (unaudited)	December 31, 2014
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$52,146	$48,326
Interest bearing deposits	53,051	25,690
Cash and Cash Equivalents	105,197	74,016
Interest bearing deposits - time	13,029	13,561
Trading securities	225	203
Securities available for sale	604,662	533,178
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	15,286	19,919
Loans held for sale, carried at fair value	25,462	23,662
Loans		
Commercial	726,356	690,955
Mortgage	468,578	472,628
Installment	235,627	206,378
Payment plan receivables	37,438	40,001
Total Loans	1,467,999	1,409,962
Allowance for loan losses	(24,604)	(25,990)
Net Loans	1,443,395	1,383,972
Other real estate and repossessed assets	3,851	6,454
Property and equipment, net	43,359	45,948
Bank-owned life insurance	54,098	53,625
Deferred tax assets, net	41,422	48,632
Capitalized mortgage loan servicing rights	11,630	12,106
Vehicle service contract counterparty receivables, net	7,324	7,237
Other intangibles	2,366	2,627
Accrued income and other assets	23,555	23,590
Total Assets	$2,394,861	$2,248,730
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$640,208	$576,882
Savings and interest-bearing checking	987,146	943,734
Reciprocal	47,918	53,668
Time	385,690	350,018
Total Deposits	2,060,962	1,924,302
Other borrowings	12,070	12,470
Subordinated debentures	35,569	35,569
Vehicle service contract counterparty payables	1,950	1,977
Accrued expenses and other liabilities	31,330	24,041
Total Liabilities	2,141,881	1,998,359

Shareholders' Equity		
Preferred stock, no par value, 200,000 shares authorized; none issued or outstanding	-	-
Common stock, no par value, 500,000,000 shares authorized; issued and outstanding:		
22,548,562 shares at September 30, 2015 and 22,957,323 shares at December 31, 2014	343,601	352,462
Accumulated deficit	(86,125)	(96,455)
Accumulated other comprehensive loss	(4,496)	(5,636)
Total Shareholders' Equity	252,980	250,371
Total Liabilities and Shareholders' Equity	$2,394,861	$2,248,730

See notes to interim condensed consolidated financial statements (unaudited)

Index

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(unaudited)		(unaudited)	
	(In thousands, except per share amounts)			
Interest Income				
Interest and fees on loans	$17,869	$17,818	$52,859	$54,179
Interest on securities				
Taxable	1,901	1,644	5,528	4,623
Tax-exempt	228	281	667	830
Other investments	295	325	922	1,076
Total Interest Income	20,293	20,068	59,976	60,708
Interest Expense				
Deposits	987	1,236	2,961	3,789
Other borrowings	465	649	1,382	1,720
Total Interest Expense	1,452	1,885	4,343	5,509
Net Interest Income	18,841	18,183	55,633	55,199
Provision for loan losses	(244)	(632)	(1,037)	(2,049)
Net Interest Income After Provision for Loan Losses	19,085	18,815	56,670	57,248
Non-interest Income				
Service charges on deposit accounts	3,294	3,579	9,261	10,166
Interchange income	2,169	1,984	6,551	5,992
Net gains (losses) on assets				
Mortgage loans	1,812	1,490	5,735	4,139
Securities	45	168	97	334
Other than temporary impairment loss on securities				
Total impairment loss	-	(9)	-	(9)
Loss recognized in other comprehensive income	-	-	-	-
Net impairment loss recognized in earnings	-	(9)	-	(9)
Mortgage loan servicing	(556)	932	476	1,389
Title insurance fees	281	243	874	734
Net gain on branch sale	1,193	-	1,193	-
Other	1,881	2,156	5,881	6,829
Total Non-interest Income	10,119	10,543	30,068	29,574
Non-Interest Expense				
Compensation and employee benefits	12,029	11,718	35,605	34,774
Occupancy, net	1,940	2,079	6,399	6,715
Data processing	2,001	1,790	5,958	5,653
Loan and collection	816	1,391	2,938	4,283
Furniture, fixtures and equipment	998	1,005	2,915	3,127
Communications	754	712	2,184	2,212
Legal and professional	519	559	1,352	1,380
Advertising	406	427	1,338	1,547
FDIC deposit insurance	350	396	1,044	1,235
Interchange expense	279	368	859	1,112

Credit card and bank service fees	197	226	602	734
Vehicle service contract counterparty contingencies	30	28	89	169
Costs related to unfunded lending commitments	26	12	46	27
Provision for loss reimbursement on sold loans	(35)	-	(59)	(466)
Net (gains) losses on other real estate and repossessed assets	5	(285)	(173)	(410)
Other	1,564	1,658	4,512	4,952
Total Non-interest Expense	21,879	22,084	65,609	67,044
Income Before Income Tax	7,325	7,274	21,129	19,778
Income tax expense	2,278	2,345	6,682	5,659
Net Income	$5,047	$4,929	$14,447	$14,119
Net Income Per Common Share				
Basic	$0.22	$0.21	$0.63	$0.62
Diluted	$0.22	$0.21	$0.62	$0.60
Dividends Per Common Share				
Declared	$0.06	$0.06	$0.18	$0.12
Paid	$0.06	$0.06	$0.18	$0.12

See notes to interim condensed consolidated financial statements (unaudited)

Index
INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(unaudited)		(unaudited)	
	(In thousands)			
Net income	$5,047	$4,929	$14,447	$14,119
Other comprehensive income, before tax				
Available for sale securities				
Unrealized gains arising during period	1,366	253	1,830	4,262
Change in unrealized gains for which a portion of other than temporary impairment has been recognized in earnings	10	94	-	432
Reclassification adjustment for other than temporary impairment included in earnings	-	9	-	9
Reclassification adjustments for gains included in earnings	-	(121)	(75)	(123)
Unrealized gains recognized in other comprehensive income on available for sale securities	1,376	235	1,755	4,580
Income tax expense	482	82	615	1,603
Unrealized gains recognized in other comprehensive income on available for sale securities, net of tax	894	153	1,140	2,977
Derivative instruments				
Reclassification adjustment for accretion on settled derivatives	-	95	-	285
Unrealized gains recognized in other comprehensive income on derivative instruments	-	95	-	285
Income tax expense	-	33	-	100
Unrealized gains recognized in other comprehensive income on derivative instruments, net of tax	-	62	-	185
Other comprehensive income	894	215	1,140	3,162
Comprehensive income	$5,941	$5,144	$15,587	$17,281

See notes to interim condensed consolidated financial statements (unaudited)

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

	Nine months ended September 30,	
	2015	2014
	(unaudited - In thousands)	
Net Income	$14,447	$14,119
Adjustments to Reconcile Net Income to Net Cash From Operating Activities		
Proceeds from sales of loans held for sale	227,381	160,102
Disbursements for loans held for sale	(223,446)	(158,410)
Provision for loan losses	(1,037)	(2,049)
Deferred federal income tax expense	7,210	7,218
Net deferred loan costs	(1,189)	(846)
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	3,345	1,856
Net gains on mortgage loans	(5,735)	(4,139)
Net gains on securities	(97)	(334)
Securities impairment recognized in earnings	-	9
Net gains on other real estate and repossessed assets	(173)	(410)
Vehicle service contract counterparty contingencies	89	169
Share based compensation	1,153	891
Gain on branch sale	(1,193)	-
Net gain on sale of fixed assets	(152)	-
Increase in accrued income and other assets	(359)	(6,034)
Decrease in accrued expenses and other liabilities	(684)	(5,874)
Total Adjustments	5,113	(7,851)
Net Cash From Operating Activities	19,560	6,268
Cash Flow Used in Investing Activities		
Proceeds from the sale of securities available for sale	11,786	7,630
Proceeds from the maturity of securities available for sale	25,458	48,624
Principal payments received on securities available for sale	94,333	62,400
Purchases of securities available for sale	(195,623)	(184,726)
Purchases of interest bearing deposits	(4,100)	(750)
Proceeds from the maturity of interest bearing deposits	4,576	4,050
Purchase of Federal Reserve Bank stock	(272)	(151)
Redemption of Federal Reserve Bank stock	391	226
Redemption of Federal Home Loan Bank stock	4,514	-
Net increase in portfolio loans (loans originated, net of principal payments)	(56,407)	(23,447)
Net cash paid in branch sale	(7,229)	-
Proceeds from the collection of vehicle service contract counterparty receivables	255	366
Proceeds from the sale of other real estate and repossessed assets	5,619	12,435
Proceeds from the sale of property and equipment	490	-
Capital expenditures	(2,925)	(2,660)
Net Cash Used in Investing Activities	(119,134)	(76,003)
Cash Flow From Financing Activities		
Net increase in total deposits	145,313	11,089
Net increase (decrease) in other borrowings	(1)	13,649
Payments of Federal Home Loan Bank advances	(399)	(4,609)

Net decrease in vehicle service contract counterparty payables	(27)	(1,301)
Dividends paid	(4,118)	(2,752)
Proceeds from issuance of common stock	103	66
Repurchase of common stock	(9,025)	-
Share based compensation withholding obligation	(1,091)	-
Net Cash From Financing Activities	130,755	16,142
Net Increase (Decrease) in Cash and Cash Equivalents	31,181	(53,593)
Cash and Cash Equivalents at Beginning of Period	74,016	119,081
Cash and Cash Equivalents at End of Period	$105,197	$65,488
Cash paid during the period for		
Interest	$4,302	$5,450
Income taxes	229	116
Transfers to other real estate and repossessed assets	2,843	3,118
Transfer of payment plan receivables to vehicle service contract counterparty receivables	431	105
Purchase of securities available for sale not yet settled	7,717	1,827

See notes to interim condensed consolidated financial statements (unaudited)

6

Index

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Shareholders' Equity

	Nine months ended September 30,	
	2015	2014
	(unaudited)	
	(In thousands)	
Balance at beginning of period	$250,371	$231,581
Net income	14,447	14,119
Cash dividends declared	(4,118)	(2,752)
Issuance of common stock	103	66
Share based compensation	1,153	891
Share based compensation withholding obligation	(1,091)	-
Repurchase of common stock	(9,025)	-
Net change in accumulated other comprehensive loss, net of related tax effect	1,140	3,162
Balance at end of period	$252,980	$247,067

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, 2014 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 September 30, 2015 and December 31, 2014, and the results of operations for the three and nine-month periods ended September 30, 2015 and 2014. The results of operations for the three and nine-month periods ended September 30, 2015, 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 assessment for other than temporary impairment ("OTTI") on investment securities, 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 2014 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure". The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. This amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption and retrospective or prospective application permitted. This amended guidance became effective for us on January 1, 2015, 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 fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption for fiscal years beginning after December 15, 2016, permitted. This amended guidance 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 June 2014, the FASB issued 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 is effective for us on January 1, 2016, and is not expected to have a material impact on our consolidated operating results or financial condition.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
September 30, 2015				
U.S. agency	$50,447	$344	$56	$50,735
U.S. agency residential mortgage-backed	206,387	2,116	213	208,290
U.S. agency commercial mortgage-backed	35,109	246	17	35,338
Private label residential mortgage-backed	5,295	176	342	5,129
Other asset backed	131,911	110	249	131,772
Obligations of states and political subdivisions	136,508	1,161	937	136,732
Corporate	34,088	52	34	34,106
Trust preferred	2,914	-	354	2,560
Total	$602,659	$4,205	$2,202	$604,662
December 31, 2014				
U.S. agency	$34,936	$133	$63	$35,006
U.S. agency residential mortgage-backed	256,387	1,838	667	257,558
U.S. agency commercial mortgage-backed	33,779	68	119	33,728
Private label residential mortgage-backed	6,216	187	390	6,013
Other asset backed	32,314	77	38	32,353
Obligations of states and political subdivisions	143,698	961	1,244	143,415
Corporate	22,690	53	79	22,664
Trust preferred	2,910	-	469	2,441
Total	$532,930	$3,317	$3,069	$533,178

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)					
September 30, 2015						
U.S. agency	$19,021	$ 50	$1,170	$ 6	$20,191	$ 56
U.S. agency residential mortgage-backed	26,884	94	16,024	119	42,908	213
U.S. agency commercial mortgage-backed	4,389	16	1,396	1	5,785	17
Private label residential mortgage-backed	-	-	3,542	342	3,542	342
Other asset backed	57,799	131	5,414	118	63,213	249
Obligations of states and political subdivisions	27,995	422	12,393	515	40,388	937
Corporate	11,098	34	-	-	11,098	34
Trust preferred	-	-	2,560	354	2,560	354
Total	$147,186	$ 747	$42,499	$ 1,455	$189,685	$ 2,202
December 31, 2014						
U.S. agency	$12,851	$ 58	$606	$ 5	$13,457	$ 63
U.S. agency residential mortgage-backed	89,547	531	15,793	136	105,340	667
U.S. agency commercial mortgage-backed	21,325	119	-	-	21,325	119
Private label residential mortgage-backed	208	1	4,013	389	4,221	390
Other asset backed	2,960	15	8,729	23	11,689	38
Obligations of states and political subdivisions	28,114	106	37,540	1,138	65,654	1,244
Corporate	8,660	79	-	-	8,660	79
Trust preferred	-	-	2,441	469	2,441	469
Total	$163,665	$ 909	$69,122	$ 2,160	$232,787	$ 3,069

Our portfolio of available-for-sale securities 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.

U.S. agency, U.S. agency residential mortgage-backed securities and U.S. agency commercial mortgage backed securities — at September 30, 2015, we had 29 U.S. agency, 49 U.S. agency residential mortgage-backed and 9 U.S. agency commercial mortgage-backed securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to rises in term 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 residential mortgage backed securities — at September 30, 2015, we had five of this type of security whose fair value is less than amortized cost. Two of the five issues are rated by a major rating agency as investment grade, two are rated below investment grade and one is split rated. Two of these bonds have an impairment in excess of 10% and all five of these holdings have been impaired for more than 12 months. The unrealized losses are largely attributable to credit spread widening on these securities since their acquisition.

All of these 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.

All private label residential mortgage-backed securities are reviewed for 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 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 September 30, 2015, we had 65 other asset backed securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening. 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 September 30, 2015, we had 57 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 September 30, 2015, we had eight corporate securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening. 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 September 30, 2015, 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 September 30, 2015, continues to have satisfactory credit metrics and make interest payments.

The following table breaks out our trust preferred securities in further detail as of September 30, 2015 and December 31, 2014:

	September 30, 2015		December 31, 2014	
	Fair Value	Net Unrealized Loss	Fair Value	Net Unrealized Loss
	(In thousands)			
Trust preferred securities				
Rated issues	$1,788	$ (127)	$1,643	$ (267)
Unrated issues	772	(227)	798	(202)

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.

We recorded no credit related OTTI charges in earnings on securities available for sale during the three or nine month periods ended September 30, 2015. We recorded $0.009 million of credit related OTTI charges in earnings on securities available for sale during the three and nine month periods ended September 30, 2014.

At September 30, 2015, three private label residential 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 September 30, 2015				
Fair value	$1,690	$ 1,394	$ 91	$3,175
Amortized cost	1,722	1,309	-	3,031
Non-credit unrealized loss	32	-	-	32
Unrealized gain	-	85	91	176
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 September 30,				
2015	$-	$-	$ -	$-
2014	9	-	-	9
For the nine months ended September 30,				
2015	-	-	-	-
2014	9	-	-	9

12

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

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 September 30, 2015. Prior to the second quarter of 2013, all three of these securities had an unrealized loss. 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 and nine month periods ending September 30, follows:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Balance at beginning of period	$1,844	$1,835	$1,844	$1,835
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	-	9	-	9
Balance at end of period	$1,844	$1,844	$1,844	$1,844

The amortized cost and fair value of securities available for sale at September 30, 2015, by contractual maturity, follow:

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$29,195	$29,231
Maturing after one year but within five years	69,021	69,252
Maturing after five years but within ten years	45,618	45,985
Maturing after ten years	80,123	79,665
	223,957	224,133
U.S. agency residential mortgage-backed	206,387	208,290
U.S. agency commercial mortgage-backed	35,109	35,338
Private label residential mortgage-backed	5,295	5,129
Other asset backed	131,911	131,772
Total	$602,659	$604,662

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 nine month periods ending September 30, follows:

	Proceeds	Realized	Losses

		Gains (1)	
	(In thousands)		
2015	$11,786	$ 75	$ -
2014	7,630	123	-

(1) Gains in 2014 exclude $0.179 million of unrealized gain related to a U.S. Treasury short position.

13

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

During 2015 and 2014, our trading securities consisted of various preferred stocks. During the first nine months of 2015 and 2014, we recognized gains on trading securities of $0.022 million and $0.032 million, respectively, that are included in net gains (losses) 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.

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 September 30, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Subjective Allocation	Total
	(In thousands)					
2015						
Balance at beginning of period	$6,707	$11,465	$1,461	$65	$4,888	$24,586
Additions (deductions)						
Provision for loan losses	(26)	(47)	(49)	(5)	(117)	(244)
Recoveries credited to allowance	637	286	250	-	-	1,173
Loans charged against the allowance	(190)	(379)	(342)	-	-	(911)
Balance at end of period	$7,128	$11,325	$1,320	$60	$4,771	$24,604
2014						
Balance at beginning of period	$5,175	$15,542	$1,988	$80	$5,412	$28,197
Additions (deductions)						
Provision for loan losses	(601)	(9)	32	(8)	(46)	(632)
Recoveries credited to allowance	999	197	283	-	-	1,479
Loans charged against the allowance	(385)	(729)	(422)	-	-	(1,536)
Balance at end of period	$5,188	$15,001	$1,881	$72	$5,366	$27,508

14

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

An analysis of the allowance for loan losses by portfolio segment for the nine months ended September 30, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Subjective Allocation	Total
	(In thousands)					
2015						
Balance at beginning of period	$ 5,445	$ 13,444	$ 1,814	$ 64	$ 5,223	$ 25,990
Additions (deductions)						
Provision for loan losses	479	(881)	(179)	(4)	(452)	(1,037)
Recoveries credited to allowance	1,722	843	853	-	-	3,418
Loans charged against the allowance	(518)	(2,081)	(1,168)	-	-	(3,767)
Balance at end of period	$ 7,128	$ 11,325	$ 1,320	$ 60	$ 4,771	$ 24,604
2014						
Balance at beginning of period	$ 6,827	$ 17,195	$ 2,246	$ 97	$ 5,960	$ 32,325
Additions (deductions)						
Provision for loan losses	(1,164)	(395)	132	(28)	(594)	(2,049)
Recoveries credited to allowance	3,492	1,055	886	5	-	5,438
Loans charged against the allowance	(3,967)	(2,854)	(1,383)	(2)	-	(8,206)
Balance at end of period	$ 5,188	$ 15,001	$ 1,881	$ 72	$ 5,366	$ 27,508

15

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)					
September 30, 2015						
Allowance for loan losses						
Individually evaluated for impairment	$4,048	$8,244	$484	$ -	$ -	$12,776
Collectively evaluated for impairment	3,080	3,081	836	60	4,771	11,828
Total ending allowance balance	$7,128	$11,325	$1,320	$ 60	$ 4,771	$24,604
Loans						
Individually evaluated for impairment	$30,328	$67,871	$6,005	$ -		$104,204
Collectively evaluated for impairment	697,528	402,934	230,310	37,438		1,368,210
Total loans recorded investment	727,856	470,805	236,315	37,438		1,472,414
Accrued interest included in recorded investment	1,500	2,227	688	-		4,415
Total loans	$726,356	$468,578	$235,627	$ 37,438		$1,467,999
December 31, 2014						
Allowance for loan losses						
Individually evaluated for impairment	$3,194	$9,311	$728	$ -	$ -	$13,233
Collectively evaluated for impairment	2,251	4,133	1,086	64	5,223	12,757
Total ending allowance balance	$5,445	$13,444	$1,814	$ 64	$ 5,223	$25,990
Loans						
Individually evaluated for impairment	$34,147	$72,340	$6,679	$ -		$113,166
Collectively evaluated for impairment	658,423	402,458	200,368	40,001		1,301,250
Total loans recorded investment	692,570	474,798	207,047	40,001		1,414,416
Accrued interest included in recorded investment	1,615	2,170	669	-		4,454
Total loans	$690,955	$472,628	$206,378	$ 40,001		$1,409,962

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)		
September 30, 2015			
Commercial			
Income producing - real estate	$-	$5,135	$ 5,135
Land, land development and construction - real estate	-	533	533
Commercial and industrial	-	2,318	2,318
Mortgage			
1-4 family	-	5,095	5,095
Resort lending	-	1,301	1,301
Home equity - 1st lien	-	191	191
Home equity - 2nd lien	-	189	189
Installment			
Home equity - 1st lien	-	175	175
Home equity - 2nd lien	-	445	445
Loans not secured by real estate	-	430	430
Other	-	2	2
Payment plan receivables			
Full refund	-	6	6
Partial refund	-	10	10
Other	-	4	4
Total recorded investment	$-	$15,834	$ 15,834
Accrued interest included in recorded investment	$-	$-	$ -
December 31, 2014			
Commercial			
Income producing - real estate	$-	$1,233	$ 1,233
Land, land development and construction - real estate	-	594	594
Commercial and industrial	-	2,746	2,746
Mortgage			
1-4 family	7	5,945	5,952
Resort lending	-	2,168	2,168
Home equity - 1st lien	-	331	331
Home equity - 2nd lien	-	605	605
Installment			
Home equity - 1st lien	-	576	576
Home equity - 2nd lien	-	517	517
Loans not secured by real estate	-	454	454
Other	-	48	48
Payment plan receivables			
Full refund	-	2	2
Partial refund	-	12	12
Other	-	-	-

Total recorded investment	$7	$15,231	$ 15,238
Accrued interest included in recorded investment	$-	$-	$ -

17

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

An aging analysis of loans by class follows:

	Loans Past Due					
	30-59 days	60-89 days	90+ days	Total	Loans not Past Due	Total Loans
	(In thousands)					
September 30, 2015						
Commercial						
Income producing - real estate	$183	$-	$660	$843	$274,107	$274,950
Land, land development and construction - real estate	-	119	204	323	41,899	42,222
Commercial and industrial	2,315	320	368	3,003	407,681	410,684
Mortgage						
1-4 family	2,513	662	5,095	8,270	271,130	279,400
Resort lending	309	150	1,301	1,760	116,528	118,288
Home equity - 1st lien	39	23	191	253	22,252	22,505
Home equity - 2nd lien	331	-	189	520	50,092	50,612
Installment						
Home equity - 1st lien	286	65	175	526	17,954	18,480
Home equity - 2nd lien	191	53	445	689	21,616	22,305
Loans not secured by real estate	474	132	430	1,036	192,321	193,357
Other	6	2	2	10	2,163	2,173
Payment plan receivables						
Full refund	563	115	6	684	22,848	23,532
Partial refund	710	249	10	969	7,459	8,428
Other	112	16	4	132	5,346	5,478
Total recorded investment	$8,032	$1,906	$9,080	$19,018	$1,453,396	$1,472,414
Accrued interest included in recorded investment	$113	$18	$-	$131	$4,284	$4,415
December 31, 2014						
Commercial						
Income producing - real estate	$89	$-	$214	$303	$252,763	$253,066
Land, land development and construction - real estate	131	-	223	354	33,984	34,338
Commercial and industrial	2,391	279	209	2,879	402,287	405,166
Mortgage						
1-4 family	1,877	1,638	5,952	9,467	269,719	279,186
Resort lending	226	-	2,168	2,394	126,342	128,736
Home equity - 1st lien	39	50	331	420	19,782	20,202
Home equity - 2nd lien	711	89	605	1,405	45,269	46,674
Installment						
Home equity - 1st lien	466	37	576	1,079	20,995	22,074
Home equity - 2nd lien	369	81	517	967	28,125	29,092
Loans not secured by real estate	589	231	454	1,274	152,115	153,389
Other	15	3	48	66	2,426	2,492
Payment plan receivables						
Full refund	838	214	2	1,054	26,799	27,853

Partial refund	409	123	12	544	6,550	7,094
Other	96	24	-	120	4,934	5,054
Total recorded investment	$8,246	$2,769	$11,311	$22,326	$1,392,090	$1,414,416
Accrued interest included in recorded investment	$55	$29	$-	$84	$4,370	$4,454

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

Impaired loans are as follows :

	September 30, 2015	December 31, 2014
Impaired loans with no allocated allowance	(In thousands)	
TDR	$6,416	$9,325
Non - TDR	204	299
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	3,970	5,879
TDR - allowance based on present value cash flow	86,985	94,970
Non - TDR - allowance based on collateral	6,281	2,296
Non - TDR - allowance based on present value cash flow	-	-
Total impaired loans	$103,856	$112,769
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$1,575	$2,025
TDR - allowance based on present value cash flow	8,952	10,188
Non - TDR - allowance based on collateral	2,249	1,020
Non - TDR - allowance based on present value cash flow	-	-
Total amount of allowance for loan losses allocated	$12,776	$13,233

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

Impaired loans by class are as follows (1):

	September 30, 2015			December 31, 2014		
	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	$4,778	$4,977	$ -	$5,868	$6,077	$ -
Land, land development & construction-real estate	851	1,425	-	1,051	1,606	-
Commercial and industrial	985	982	-	2,685	2,667	-
Mortgage						
1-4 family	23	166	-	-	49	-
Resort lending	-	-	-	48	397	-
Home equity - 1st lien	-	-	-	-	-	-
Home equity - 2nd lien	-	-	-	-	-	-
Installment						
Home equity - 1st lien	-	36	-	-	40	-
Home equity - 2nd lien	-	-	-	-	-	-
Loans not secured by real estate	-	-	-	-	-	-
Other	-	-	-	-	-	-
	6,637	7,586	-	9,652	10,836	-
With an allowance recorded:						
Commercial						
Income producing - real estate	16,414	17,414	1,357	12,836	13,797	689
Land, land development & construction-real estate	2,061	2,140	421	3,456	3,528	499
Commercial and industrial	5,239	5,549	2,270	8,251	8,486	2,006
Mortgage						
1-4 family	49,245	51,392	5,437	53,206	56,063	6,195
Resort lending	18,328	18,591	2,786	18,799	18,963	3,075
Home equity - 1st lien	155	172	11	162	177	14
Home equity - 2nd lien	120	201	10	125	205	27
Installment						
Home equity - 1st lien	2,434	2,610	145	2,744	2,930	219
Home equity - 2nd lien	2,931	2,942	285	3,212	3,215	419
Loans not secured by real estate	631	689	53	711	835	89
Other	9	9	1	12	12	1
	97,567	101,709	12,776	103,514	108,211	13,233
Total						
Commercial						
Income producing - real estate	21,192	22,391	1,357	18,704	19,874	689
Land, land development & construction-real estate	2,912	3,565	421	4,507	5,134	499
Commercial and industrial	6,224	6,531	2,270	10,936	11,153	2,006
Mortgage						

1-4 family	49,268	51,558	5,437	53,206	56,112	6,195
Resort lending	18,328	18,591	2,786	18,847	19,360	3,075
Home equity - 1st lien	155	172	11	162	177	14
Home equity - 2nd lien	120	201	10	125	205	27
Installment						
Home equity - 1st lien	2,434	2,646	145	2,744	2,970	219
Home equity - 2nd lien	2,931	2,942	285	3,212	3,215	419
Loans not secured by real estate	631	689	53	711	835	89
Other	9	9	1	12	12	1
Total	$104,204	$109,295	$ 12,776	$113,166	$119,047	$ 13,233
Accrued interest included in recorded investment	$348			$397		

(1) There were no impaired payment plan receivables at September 30, 2015 or December 31, 2014.

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 September 30, follows (1):

	2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$5,133	$ 45	$8,255	$ 103
Land, land development & construction-real estate	932	14	859	15
Commercial and industrial	1,922	68	3,397	63
Mortgage				
1-4 family	24	3	66	-
Resort lending	-	-	42	1
Home equity - 1st lien	-	-	-	-
Home equity - 2nd lien	-	-	-	-
Installment				
Home equity - 1st lien	-	-	-	-
Home equity - 2nd lien	-	-	-	-
Loans not secured by real estate	-	-	-	-
Other	-	-	-	-
	8,011	130	12,619	182
With an allowance recorded:				
Commercial				
Income producing - real estate	14,655	154	11,486	136
Land, land development & construction-real estate	1,993	2	4,092	38
Commercial and industrial	6,431	37	7,936	51
Mortgage				
1-4 family	49,706	554	55,633	558
Resort lending	18,414	163	19,351	195
Home equity - 1st lien	157	2	165	2
Home equity - 2nd lien	185	-	39	-
Installment				
Home equity - 1st lien	2,474	47	2,801	43
Home equity - 2nd lien	2,999	47	3,375	46
Loans not secured by real estate	645	10	699	9
Other	10	-	14	-
	97,669	1,016	105,591	1,078
Total				
Commercial				
Income producing - real estate	19,788	199	19,741	239
Land, land development & construction-real estate	2,925	16	4,951	53
Commercial and industrial	8,353	105	11,333	114
Mortgage				
1-4 family	49,730	557	55,699	558
Resort lending	18,414	163	19,393	196

Home equity - 1st lien	157	2	165	2
Home equity - 2nd lien	185	-	39	-
Installment				
Home equity - 1st lien	2,474	47	2,801	43
Home equity - 2nd lien	2,999	47	3,375	46
Loans not secured by real estate	645	10	699	9
Other	10	-	14	-
Total	$105,680	$ 1,146	$118,210	$ 1,260

(1) There were no impaired payment plan receivables during the three month periods ended September 30, 2015 and 2014, respectively.

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 nine month periods ending September 30, follows (1):

	2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$5,490	$ 170	$8,109	$ 289
Land, land development & construction-real estate	986	57	1,168	43
Commercial and industrial	2,345	195	3,517	129
Mortgage				
1-4 family	18	5	37	-
Resort lending	15	-	38	1
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	-	-	-	-
Loans not secured by real estate	-	-	-	-
Other	-	-	-	-
	8,854	428	12,869	463
With an allowance recorded:				
Commercial				
Income producing - real estate	13,752	452	12,756	417
Land, land development & construction-real estate	2,351	35	4,059	120
Commercial and industrial	7,304	117	8,562	209
Mortgage				
1-4 family	51,078	1,644	56,545	1,777
Resort lending	18,523	507	19,623	581
Home equity line of credit - 1st lien	159	6	159	5
Home equity line of credit - 2nd lien	154	6	40	1
Installment				
Home equity installment - 1st lien	2,582	141	2,860	132
Home equity installment - 2nd lien	3,086	147	3,396	143
Loans not secured by real estate	669	29	721	26
Other	11	1	15	1
	99,669	3,085	108,736	3,412
Total				
Commercial				
Income producing - real estate	19,242	622	20,865	706
Land, land development & construction-real estate	3,337	92	5,227	163
Commercial and industrial	9,649	312	12,079	338
Mortgage				
1-4 family	51,096	1,649	56,582	1,777
Resort lending	18,538	507	19,661	582

Home equity line of credit - 1st lien	159	6	159	5
Home equity line of credit - 2nd lien	154	6	40	1
Installment				
Home equity installment - 1st lien	2,582	142	2,860	133
Home equity installment - 2nd lien	3,086	147	3,396	143
Loans not secured by real estate	669	29	721	26
Other	11	1	15	1
Total	$108,523	$ 3,513	$121,605	$ 3,875

(1) There were no impaired payment plan receivables during the nine month periods ended September 30, 2015 and 2014, respectively.

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

Our average investment in impaired loans was approximately $105.7 million and $118.2 million for the three-month periods ended September 30, 2015 and 2014, respectively and $108.5 million and $121.6 million for the nine-month periods ended September 30, 2015 and 2014, 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 September 30, 2015 and 2014, was approximately $1.1 million and $1.3 million, respectively, and was approximately $3.5 million and $3.9 million during the nine months ending September 30, 2015 and 2014, respectively.

Troubled debt restructurings follow:

	September 30, 2015		
	Commercial	Retail	Total
	(In thousands)		
Performing TDRs	$22,257	$69,726	$91,983
Non-performing TDRs(1)	1,501	3,887 (2)	5,388
Total	$23,758	$73,613	$97,371

	December 31, 2014		
	Commercial	Retail	Total
	(In thousands)		
Performing TDRs	$29,475	$73,496	$102,971
Non-performing TDRs(1)	1,978	5,225 (2)	7,203
Total	$31,453	$78,721	$110,174

(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 $10.5 million and $12.2 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2015 and December 31, 2014, respectively.

During the nine months ended September 30, 2015 and 2014, 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 September 30 follow:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
	(Dollars in thousands)		
2015			
Commercial			
Income producing - real estate	-	$ -	$ -
Land, land development & construction-real estate	-	-	-
Commercial and industrial	1	48	26
Mortgage			
1-4 family	3	343	344
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	1	19	19
Other	-	-	-
Total	5	$ 410	$ 389
2014			
Commercial			
Income producing - real estate	-	$ -	$ -
Land, land development & construction-real estate	1	40	36
Commercial and industrial	5	716	693
Mortgage			
1-4 family	1	87	87
Resort lending	1	378	367
Home equity - 1st lien	-	-	-
Home equity - 2nd lien	-	-	-
Installment			
Home equity - 1st lien	3	118	96
Home equity - 2nd lien	-	-	-
Loans not secured by real estate	1	55	53
Other	-	-	-
Total	12	$ 1,394	$ 1,332

Index

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

Loans that have been classified as troubled debt restructurings during the nine-month periods ended September 30 follow:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
	(Dollars in thousands)		
2015			
Commercial			
Income producing - real estate	2	$ 229	$ 234
Land, land development & construction-real estate	-	-	-
Commercial and industrial	4	301	273
Mortgage			
1-4 family	9	1,373	1,189
Resort lending	1	313	309
Home equity - 1st lien	-	-	-
Home equity - 2nd lien	-	-	-
Installment			
Home equity - 1st lien	5	190	164
Home equity - 2nd lien	3	58	58
Loans not secured by real estate	2	19	25
Other	-	-	-
Total	26	$ 2,483	$ 2,252
2014			
Commercial			
Income producing - real estate	3	$ 354	$ 326
Land, land development & construction-real estate	2	55	50
Commercial and industrial	11	2,083	1,524
Mortgage			
1-4 family	8	1,037	1,049
Resort lending	4	1,011	997
Home equity - 1st lien	1	17	13
Home equity - 2nd lien	-	-	-
Installment			
Home equity - 1st lien	8	538	465
Home equity - 2nd lien	5	294	284
Loans not secured by real estate	3	88	80
Other	-	-	-
Total	45	$ 5,477	$ 4,788

The troubled debt restructurings described above for 2015 decreased the allowance for loan losses by $0.05 million and resulted in zero charge offs during the three months ended September 30, 2015, and increased the allowance by $0.05 million and resulted in zero charge offs during the nine months ended September 30, 2015.

The troubled debt restructurings described above for 2014 increased the allowance for loan losses by $0.2 million and resulted in zero charge offs during the three months ended September 30, 2014 and increased the allowance by $0.2

million and resulted in $0.01 million of charge offs during the nine months ended September 30, 2014.

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 September 30 follow:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
2015		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	1	54
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	$ 54
2014		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	1	66
Mortgage		
1-4 family	1	125
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	-	-
	2	$ 191

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 nine-month periods ended September 30 follow:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
2015		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	2	157
Mortgage		
1-4 family	1	54
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	1	4
Other	-	-
	4	$ 215
2014		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	2	319
Mortgage		
1-4 family	1	125
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	-	-
	3	$ 444

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

The troubled debt restructurings that subsequently defaulted described above for 2015 decreased the allowance for loan losses by $0.01 million and resulted in zero charge offs during the three months ended September 30, 2015 and had no impact on the allowance for loan losses and resulted in zero charge offs during the nine months ended September 30, 2015.

The troubled debt restructurings that subsequently defaulted described above for 2014 had no impact on the allowance for loan losses and resulted in no charge offs during the three months ended September 30, 2014 and increased the allowance for loan losses by $0.01 million and resulted in no charge offs during the nine months ended September 30, 2014.

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

The terms of certain other loans were modified during the nine months ended September 30, 2015 and 2014 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.

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)		
September 30, 2015					
Income producing - real estate	$261,676	$7,013	$1,126	$5,135	$274,950
Land, land development and construction - real estate	38,135	3,307	247	533	42,222
Commercial and industrial	371,193	29,285	7,888	2,318	410,684
Total	$671,004	$39,605	$9,261	$7,986	$727,856
Accrued interest included in total	$1,304	$189	$7	$-	$1,500
December 31, 2014					
Income producing - real estate	$241,266	$8,649	$1,918	$1,233	$253,066
Land, land development and construction - real estate	30,869	2,485	390	594	34,338
Commercial and industrial	372,947	23,475	5,998	2,746	405,166
Total	$645,082	$34,609	$8,306	$4,573	$692,570
Accrued interest included in total	$1,479	$111	$25	$-	$1,615

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	Total
	(In thousands)				
September 30, 2015					
800 and above	$27,538	$12,627	$4,859	$6,717	$51,741
750-799	77,238	42,522	6,280	16,387	142,427
700-749	50,309	33,785	4,076	11,985	100,155
650-699	52,898	16,771	3,565	8,022	81,256
600-649	28,698	5,666	1,872	3,639	39,875
550-599	16,809	2,546	647	1,957	21,959
500-549	13,983	1,253	758	1,089	17,083
Under 500	4,098	992	210	404	5,704
Unknown	7,829	2,126	238	412	10,605
Total	$279,400	$118,288	$22,505	$50,612	$470,805
Accrued interest included in total	$1,427	$508	$92	$200	$2,227
December 31, 2014					
800 and above	$27,918	$14,484	$3,863	$6,225	$52,490
750-799	72,674	45,950	6,128	14,323	139,075
700-749	52,843	32,660	3,054	9,642	98,199
650-699	51,664	20,250	3,257	8,194	83,365
600-649	27,770	6,538	1,704	3,862	39,874
550-599	21,361	3,639	994	1,721	27,715
500-549	14,575	2,156	699	1,401	18,831
Under 500	6,306	875	261	632	8,074
Unknown	4,075	2,184	242	674	7,175
Total	$279,186	$128,736	$20,202	$46,674	$474,798
Accrued interest included in total	$1,311	$562	$88	$209	$2,170

(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)				
September 30, 2015					
800 and above	$1,953	$1,840	$40,348	$59	$44,200
750-799	4,411	6,624	89,310	568	100,913
700-749	2,685	4,667	38,237	617	46,206
650-699	3,783	4,138	15,224	479	23,624
600-649	2,161	2,254	4,758	260	9,433
550-599	1,919	1,547	2,080	124	5,670
500-549	760	851	976	50	2,637
Under 500	744	280	461	11	1,496
Unknown	64	104	1,963	5	2,136
Total	$18,480	$22,305	$193,357	$2,173	$236,315
Accrued interest included in total	$70	$82	$519	$17	$688
December 31, 2014					
800 and above	$2,272	$2,835	$31,507	$60	$36,674
750-799	5,677	8,557	66,558	583	81,375
700-749	3,111	6,358	28,179	689	38,337
650-699	3,963	5,477	16,152	615	26,207
600-649	3,434	2,408	5,128	255	11,225
550-599	2,019	1,913	1,896	134	5,962
500-549	1,128	1,036	1,672	84	3,920
Under 500	393	427	455	28	1,303
Unknown	77	81	1,842	44	2,044
Total	$22,074	$29,092	$153,389	$2,492	$207,047
Accrued interest included in total	$93	$112	$445	$19	$669

(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 September 30, 2015, approximately 62.9% 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 22.5% of Mepco's outstanding payment plan receivables as of September 30, 2015, 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.

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)			
September 30, 2015				
AM Best rating				
A+	$-	$8	$-	$8
A	3,711	7,572	-	11,283
A-	3,226	753	5,470	9,449
Not rated	16,595	95	8	16,698
Total	$23,532	$8,428	$5,478	$37,438
December 31, 2014				
AM Best rating				
A+	$-	$43	$-	$43
A	10,007	6,190	-	16,197
A-	1,989	685	5,054	7,728
Not rated	15,857	176	-	16,033
Total	$27,853	$7,094	$5,054	$40,001

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 $2.8 million and $2.9 million at September 30, 2015 and December 31, 2014, respectively. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled $1.1 million and $2.5 million at September 30, 2015 and December 31, 2014, 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					
September 30, 2015	$2,323,629	$60,018	$288,708	$(277,494)	$2,394,861
December 31, 2014	2,174,536	63,378	286,158	(275,342)	2,248,730
For the three months ended September 30, 2015					
Interest income	$18,973	$1,320	$20	$(20)	$20,293
Net interest income	17,964	1,115	(238)	-	18,841
Provision for loan losses	(238)	(6)	-	-	(244)
Income (loss) before income tax	7,961	(254)	(358)	(24)	7,325
Net income (loss)	5,455	(168)	(224)	(16)	5,047
2014					
Interest income	$18,444	$1,624	$25	$(25)	$20,068
Net interest income	17,254	1,338	(409)	-	18,183
Provision for loan losses	(623)	(9)	-	-	(632)
Income (loss) before income tax	7,459	247	(408)	(24)	7,274
Net income (loss)	5,048	163	(266)	(16)	4,929
For the nine months ended September 30, 2015					
Interest income	$55,895	$4,081	$60	$(60)	$59,976
Net interest income	52,864	3,468	(699)	-	55,633
Provision for loan losses	(1,032)	(5)	-	-	(1,037)
Income (loss) before income tax	23,063	(766)	(1,097)	(71)	21,129
Net income (loss)	15,623	(437)	(693)	(46)	14,447
2014					
Interest income	$55,153	$5,555	$41	$(41)	$60,708
Net interest income	51,721	4,500	(1,022)	-	55,199
Provision for loan losses	(2,018)	(31)	-	-	(2,049)
Income (loss) before income tax	20,151	908	(1,210)	(71)	19,778
Net income (loss)	14,345	607	(665)	(168)	14,119

(1) Includes amounts relating to our parent company and certain insignificant operations.
(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, 2015, 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, 2015. We expect to accomplish the repurchases through open market transactions, though we could effect 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 nine months ended September 30, 2015, we repurchased 659,162 shares of common stock for an aggregate purchase price of $9.0 million.

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

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).

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.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands, except per share amounts)			
Net income	$5,047	$4,929	$14,447	$14,119
Weighted average shares outstanding (1)	22,673	22,940	22,852	22,919
Restricted stock units	230	306	283	305
Effect of stock options	118	123	120	126
Stock units for deferred compensation plan for non-employee directors	112	109	111	114
Weighted average shares outstanding for calculation of diluted earnings per share	23,133	23,478	23,366	23,464
Net income per common share				
Basic (1)	$0.22	$0.21	$0.63	$0.62
Diluted	$0.22	$0.21	$0.62	$0.60

(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 considered in computing diluted net income per share because they were anti-dilutive totaled 0.03 million for both three-month periods ending September 30, 2015 and 2014, respectively and totaled 0.03 million for both nine-month periods ending September 30, 2015 and 2014, respectively.

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.

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

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

	September 30, 2015		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
No hedge designation			
Rate-lock mortgage loan commitments	$24,746	0.1	$823
Mandatory commitments to sell mortgage loans	49,791	0.1	(409)
Pay-fixed interest rate swap agreements	19,616	7.3	(674)
Pay-variable interest rate swap agreements	19,616	7.3	674
Purchased options	1,681	5.9	126
Written options	1,681	5.9	(126)
Total	$117,131	2.7	$414

	December 31, 2014		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
No hedge designation			
Rate-lock mortgage loan commitments	$16,759	0.1	$437
Mandatory commitments to sell mortgage loans	38,600	0.1	(184)
Pay-fixed interest rate swap agreements	3,300	9.4	(182)
Pay-variable interest rate swap agreements	3,300	9.4	182
Total	$61,959	1.1	$253

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 earnings.

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.

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

During 2014, we began 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.

During the third quarter of 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 principle 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.

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			
	September 30, 2015		December 31, 2014		September 30, 2015		December 31, 2014	
	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	$823	Other assets	$437	Other liabilities	$-	Other liabilities	$-
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	-	Other liabilities	409	Other liabilities	184
Pay-fixed interest rate swap agreements	Other assets	-	Other assets	-	Other liabilities	674	Other liabilities	182
Pay-variable interest rate swap agreements	Other assets	674	Other assets	182	Other liabilities	-	Other liabilities	-
Purchased options	Other assets	126	Other assets	-	Other liabilities	-	Other liabilities	-
Written options	Other assets	-	Other assets	-	Other liabilities	126	Other liabilities	-
Total derivatives		$1,623		$619		$1,209		$366

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

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

Three Month Periods Ended September 30,

	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion) 2015	2014	Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion) 2015	2014	Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income 2015	2014
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements (2)	$-	$ -	Interest expense	$ -	$ (95)		$-	$-
Total	$-	$ -		$ -	$ (95)		$-	$-
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$281	$(77)
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(745)	220
Pay-fixed interest rate swap agreements						Interest income	(452)	7
Pay-variable interest rate swap agreements						Interest income	452	(7)
Purchased options						Interest expense	126	-
Written options						Interest expense	(126)	-
U.S. Treasury short position						Gain on securities	-	127
Total							$(464)	$270

(1) For cash flow hedges, this location and amount refers to the ineffective portion.
(2) Relates to a terminated pay-fixed interest rate swap whose termination fee was included in accumulated other comprehensive loss and was being amortized into earnings through December 31, 2014.

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

	Nine Month Periods Ended September 30, Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion) 2015	2014	Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion) 2015	2014	Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income 2015	2014
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements (2)	$-	$ -	Interest expense	$ -	$ (285)		$-	$-
Total	$-	$ -		$ -	$ (285)		$-	$-
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$386	$147
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(225)	(134)
Pay-fixed interest rate swap agreements						Interest income	(492)	(92)
Pay-variable interest rate swap agreements						Interest income	492	92
Purchased options						Interest expense	126	-
Written options						Interest expense	(126)	-
U.S. Treasury short position						Gain on securities	-	179
Total							$161	$192

(1) For cash flow hedges, this location and amount refers to the ineffective portion.
(2) Relates to a terminated pay-fixed interest rate swap whose termination fee was included in accumulated other comprehensive loss and was being amortized into earnings through December 31, 2014.

8. Intangible Assets

The following table summarizes intangible assets, net of amortization:

	September 30, 2015 Gross Carrying Amount	Accumulated Amortization	December 31, 2014 Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets - core deposits	$6,118	$ 3,752	$6,118	$ 3,491

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

Amortization of other intangibles has been estimated through 2020 and thereafter in the following table.

	(In thousands)
Three months ending December 31, 2015	$ 86
2016	347
2017	346
2018	346
2019	346
2020 and thereafter	895
Total	$ 2,366

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 0.3 million shares of common stock as of September 30, 2015. 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 September 30, 2015. 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 2015 and 2014, 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 issued during 2015 cliff vest after a period of three years, the shares of restricted stock issued during 2014 vest ratably over three years and the PSUs issued in both periods 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 an index of our peers in the banking industry. No long term incentive grants were made during the second or third quarters of 2015 or 2014.

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 0.004 million shares and 0.011 million shares to directors during the first nine months of 2015 and 2014, respectively and expensed their value during those same periods.

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 and $1.1 million during the three and nine month periods ended September 30, 2015, respectively, and was $0.3 million and $0.8 million during the same periods in 2014, respectively. The corresponding tax benefit relating to this expense was $0.1 million and $0.4 million for the three and nine month periods ended September 30, 2015, respectively and $0.1 million and $0.3 million for the same periods in 2014. Total expense recognized for non-employee director share based payments was $0.02 million and $0.05 million during the three and nine month periods ended September 30, 2015, respectively, and was $0.05 million and $0.14 million during the same periods in 2014, respectively. The corresponding tax benefit relating to this expense was $0.01 million and $0.02 million for the three and nine month periods ended September 30, 2015, respectively and $0.02 million and $0.05 million during the same periods in 2014.

At September 30, 2015, the total expected compensation cost related to non-vested stock options, restricted stock, PSUs and restricted stock unit awards not yet recognized was $1.8 million. The weighted-average period over which this amount will be recognized is 1.8 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, 2015	281,820	$ 4.69		
Granted	-			
Exercised	(31,450)	3.35		
Forfeited	(2,096)	4.77		
Expired	(1,924)	6.79		
Outstanding at September 30, 2015	246,350	$ 4.85	6.35	$ 2,472
Vested and expected to vest at September 30, 2015	245,298	$ 4.84	6.35	$ 2,463
Exercisable at September 30, 2015	222,742	$ 4.70	6.22	$ 2,271

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, 2015	407,130	$ 6.31
Granted	108,422	13.06
Vested	(249,526)	3.92
Forfeited	(4,384)	12.88

Outstanding at September 30, 2015	261,642	$ 11.28

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

During the third quarter of 2015, 0.23 million restricted stock units relating to a grant in 2012 vested. In addition, as permitted by our long-term incentive plan, 0.07 million shares were withheld from the shares that would otherwise have been issued to executive officers for these vesting restricted stock units in order to satisfy tax withholding obligations.

Certain information regarding options exercised during the periods follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Intrinsic value	$71	$123	$314	$231
Cash proceeds received	$23	$30	$105	$66
Tax benefit realized	$25	$44	$110	$81

10. Income Tax

Income tax expense was $2.3 million during each three month period ended September 30, 2015 and 2014 and $6.7 million and $5.7 million during the nine months ended September 30, 2015 and 2014, 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 September 30, 2015 and 2014, 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 $1.0 million at both September 30, 2015 and December 31, 2014. 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 September 30, 2015 and December 31, 2014, we had approximately $1.0 million and $1.1 million, respectively 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 2015.

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's 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 September 30, 2015, the Bank had negative undivided profits of $15.9 million. We can request regulatory approval for a return of capital from the Bank to the parent company. During the first quarter of 2014, we requested regulatory approval for a $15.0 million return of capital from the Bank to the parent company. This return of capital request was approved by our banking regulators on March 28, 2014 and the Bank returned $15.0 million of capital to the parent company on April 9, 2014. During January of 2015, we requested regulatory approval for an additional $18.5 million return of capital from the Bank to the parent company. This return of capital request was approved by our banking regulators on February 13, 2015, and the Bank returned $18.5 million of capital to the parent company on February 17, 2015. 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 (as of January 1, 2015) 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 September 30, 2015 and December 31, 2014, 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 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.

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

Our actual capital amounts and ratios follow:

Actual		Minimum for Adequately Capitalized Institutions		Minimum for Well-Capitalized Institutions
Amount	Ratio	Amount	Ratio	