INDEPENDENT BANK CORP /MI/
Form 10-Q
November 03, 2016

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2016

Commission file number 0-7818

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or smaller reporting company.
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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

Class	Outstanding at November 2, 2016
Common stock, no par value	21,245,536

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

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FORWARD-LOOKING STATEMENTS

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

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

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

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

	September 30, 2016 (unaudited)	December 31, 2015
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$ 38,610	$ 54,260
Interest bearing deposits	75,706	31,523
Cash and Cash Equivalents	114,316	85,783
Interest bearing deposits - time	7,233	11,866
Trading securities	152	148
Securities available for sale	603,112	585,484
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	15,507	15,471
Loans held for sale, carried at fair value	38,008	27,866
Loans		
Commercial	784,976	748,398
Mortgage	522,833	498,036
Installment	268,357	234,017
Payment plan receivables	31,188	34,599
Total Loans	1,607,354	1,515,050
Allowance for loan losses	(22,043)	(22,570)
Net Loans	1,585,311	1,492,480
Other real estate and repossessed assets	4,989	7,150
Property and equipment, net	40,375	43,103
Bank-owned life insurance	53,779	54,402
Deferred tax assets, net	32,156	39,635
Capitalized mortgage loan servicing rights	11,048	12,436
Vehicle service contract counterparty receivables, net	2,608	7,229
Other intangibles	2,019	2,280
Accrued income and other assets	27,706	23,733
Total Assets	$ 2,538,319	$ 2,409,066
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$ 725,166	$ 659,793
Savings and interest-bearing checking	1,009,354	988,174
Reciprocal	46,636	50,207
Time	425,804	387,789
Total Deposits	2,206,960	2,085,963
Other borrowings	11,527	11,954
Subordinated debentures	35,569	35,569
Vehicle service contract counterparty payables	538	797
Accrued expenses and other liabilities	32,823	23,691
Total Liabilities	2,287,417	2,157,974
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:		
21,227,974 shares at September 30, 2016 and 22,251,373 shares at December 31, 2015	323,303	339,462
Accumulated deficit	(69,386)	(82,334)
Accumulated other comprehensive loss	(3,015)	(6,036)
Total Shareholders' Equity	250,902	251,092
Total Liabilities and Shareholders' Equity	$ 2,538,319	$ 2,409,066

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
	(In thousands, except per share amounts)			
Interest Income				
Interest and fees on loans	$18,597	$17,869	$55,361	$52,859
Interest on securities				
Taxable	2,537	1,901	7,261	5,528
Tax-exempt	330	228	860	667
Other investments	281	295	884	922
Total Interest Income	21,745	20,293	64,366	59,976
Interest Expense				
Deposits	1,254	987	3,520	2,961
Other borrowings	493	465	1,455	1,382
Total Interest Expense	1,747	1,452	4,975	4,343
Net Interest Income	19,998	18,841	59,391	55,633
Provision for loan losses	(175)	(244)	(1,439)	(1,037)
Net Interest Income After Provision for Loan Losses	20,173	19,085	60,830	56,670
Non-Interest Income				
Service charges on deposit accounts	3,281	3,294	9,164	9,261
Interchange income	1,943	2,169	5,797	6,551
Net gains (losses) on assets				
Mortgage loans	3,556	1,812	7,727	5,735
Securities	(45)	45	302	97
Mortgage loan servicing, net	858	(556)	(454)	476
Title insurance fees	319	281	860	874
Net gain on branch sale	-	1,193	-	1,193
Other	1,796	1,881	5,701	5,881
Total Non-Interest Income	11,708	10,119	29,097	30,068
Non-Interest Expense				
Compensation and employee benefits	13,031	12,029	36,912	35,605
Data processing	1,971	2,001	6,008	5,958
Occupancy, net	1,919	1,940	5,982	6,399
Furniture, fixtures and equipment	990	998	2,939	2,915
Communications	670	754	2,280	2,184
Loan and collection	568	816	1,964	2,938
Advertising	455	406	1,410	1,338
Legal and professional	420	519	1,178	1,352
FDIC deposit insurance	187	350	852	1,044
Interchange expense	276	279	809	859
Credit card and bank service fees	203	197	588	602
Net (gains) losses on other real estate and repossessed assets	263	5	98	(173)
Provision for loss reimbursement on sold loans	45	(35)	30	(59)
Costs related to unfunded lending commitments	73	26	6	46
Vehicle service contract counterparty contingencies	(39)	30	(10)	89

Other	1,497	1,564	4,423	4,512
Total Non-Interest Expense	22,529	21,879	65,469	65,609
Income Before Income Tax	9,352	7,325	24,458	21,129
Income tax expense	2,979	2,278	7,547	6,682
Net Income	$6,373	$5,047	$16,911	$14,447
Net Income Per Common Share				
Basic	$0.30	$0.22	$0.79	$0.63
Diluted	$0.30	$0.22	$0.78	$0.62
Dividends Per Common Share				
Declared	$0.08	$0.06	$0.24	$0.18
Paid	$0.08	$0.06	$0.24	$0.18

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
	(In thousands)		(In thousands)	
Net income	$ 6,373	$ 5,047	$ 16,911	$ 14,447
Other comprehensive income, before tax				
Securities available for sale				
Unrealized gains arising during period	451	1,366	4,899	1,830
Change in unrealized gains for which a portion of other than temporary impairment has been recognized in earnings	(24)	10	47	-
Reclassification adjustments for gains included in earnings	(15)	-	(298)	(75)
Unrealized gains recognized in other comprehensive income on securities available for sale	412	1,376	4,648	1,755
Income tax expense	144	482	1,627	615
Unrealized gains recognized in other comprehensive income on available for sale securities, net of tax	268	894	3,021	1,140
Other comprehensive income	268	894	3,021	1,140
Comprehensive income	$ 6,641	$ 5,941	$ 19,932	$ 15,587

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Nine months ended September 30,	
	2016	2015
	(unaudited - In thousands)	
Net Income	$ 16,911	$ 14,447
Adjustments to Reconcile Net Income to Net Cash From Operating Activities		
Proceeds from sales of loans held for sale	222,610	227,381
Disbursements for loans held for sale	(225,025)	(223,446)
Provision for loan losses	(1,439)	(1,037)
Deferred federal income tax expense	8,726	7,210
Deferred loan fees	(1,634)	(1,189)
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities, loans and interest bearning deposits - time	3,831	3,345
Net gains on mortgage loans	(7,727)	(5,735)
Net gains on securities	(302)	(97)
Net (gains) losses on other real estate and repossessed assets	98	(173)
Vehicle service contract counterparty contingencies	(10)	89
Share based compensation	1,200	1,153
Gain on branch sale	-	(1,193)
Net gain on sale of fixed assets	(2)	(152)
Increase in accrued income and other assets	(5,540)	(359)
Increase (decrease) in accrued expenses and other liabilities	1,409	(684)
Total Adjustments	(3,805)	5,113
Net Cash From Operating Activities	13,106	19,560
Cash Flow Used in Investing Activities		
Proceeds from the sale of securities available for sale	56,451	11,786
Proceeds from the maturity of securities available for sale	32,590	25,458
Principal payments received on securities available for sale	117,513	94,333
Purchases of securities available for sale	(213,839)	(195,623)
Purchases of interest bearing deposits - time	-	(4,100)
Proceeds from the maturity of interest bearing deposits - time	4,613	4,576
Purchase of Federal Reserve Bank stock	(407)	(272)
Redemption of Federal Reserve Bank stock	371	391
Redemption of Federal Home Loan Bank stock	-	4,514
Net increase in portfolio loans (loans originated, net of principal payments)	(73,673)	(56,407)
Purchase of portfolio loans	(15,000)	-
Net cash paid in branch sale	-	(7,229)
Proceeds from the collection of vehicle service contract counterparty receivables	4,671	255
Proceeds from the sale of other real estate and repossessed assets	3,854	5,619
Proceeds from life insurance	2,235	-
Proceeds from the sale of property and equipment	23	490
Capital expenditures	(1,717)	(2,925)
Net Cash Used in Investing Activities	(82,315)	(119,134)
Cash Flow From Financing Activities		
Net increase in total deposits	120,997	145,313
Net increase (decrease) in other borrowings	5	(1)
Payments of Federal Home Loan Bank Advances	(432)	(399)

Net decrease in vehicle service contract counterparty payables	(259)	(27)
Dividends paid	(5,149)	(4,118)
Proceeds from issuance of common stock	61	103
Repurchase of common stock	(16,854)	(9,025)
Share based compensation withholding obligation	(627)	(1,091)
Net Cash From Financing Activities	97,742	130,755
Net Increase in Cash and Cash Equivalents	28,533	31,181
Cash and Cash Equivalents at Beginning of Period	85,783	74,016
Cash and Cash Equivalents at End of Period	$ 114,316	$ 105,197
Cash paid during the period for		
Interest	$ 4,811	$ 4,302
Income taxes	437	229
Transfers to other real estate and repossessed assets	1,791	2,843
Transfer of payment plan receivables to vehicle service contract counterparty receivables	40	431
Purchase of securities available for sale not yet settled	7,440	7,717

See notes to interim condensed consolidated financial statements (unaudited)

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

	Nine months ended September 30,	
	2016	2015
	(unaudited)	
	(In thousands)	
Balance at beginning of period	$251,092	$250,371
Cumulative effect of change in accounting principle	1,247	-
Balance at beginning of period, as adjusted	252,339	250,371
Net income	16,911	14,447
Cash dividends declared	(5,149)	(4,118)
Issuance of common stock	61	103
Share based compensation	1,200	1,153
Share based compensation withholding obligation	(627)	(1,091)
Repurchase of common stock	(16,854)	(9,025)
Net change in accumulated other comprehensive loss, net of related tax effect	3,021	1,140
Balance at end of period	$250,902	$252,980

See notes to interim condensed consolidated financial statements (unaudited)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Preparation of Financial Statements

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

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of September 30, 2016 and December 31, 2015, and the results of operations for the three and nine-month periods ended September 30, 2016 and 2015. The results of operations for the three and nine-month periods ended September 30, 2016, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the determination of the allowance for loan losses, the determination of vehicle service contract counterparty contingencies, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2015 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

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

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

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

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

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

In March 2016, the FASB issued ASU 2016-09, “Compensation – Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting”. This ASU amends existing guidance in an effort to simplify certain aspects of accounting for share-based payments. The areas for simplification in this ASU include income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This amended guidance is effective for us on January 1, 2017, with early adoption permitted. We adopted this amended guidance during the second quarter of 2016 using a modified retrospective approach. The impact of this adoption was to adjust our January 1, 2016 Condensed Consolidated Statement of Financial Position to reflect cumulative effect adjustments as follows:

	January 1, 2016 Originally Presented	Cumulative Retrospective Adjustments	January 1, 2016 Adjusted
	(Dollars in thousands)		
Deferred tax assets	$39,635	$ 1,247	$40,882
Total assets	$2,409,066	$ 1,247	$2,410,313
Common stock	$339,462	$ 62	$339,524
Accumulated deficit	$(82,334)	$ 1,185	$(81,149)
Total Shareholders’ Equity	$251,092	$ 1,247	$252,339
Total Liabilities and Shareholders’ Equity	$2,409,066	$ 1,247	$2,410,313

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

The adjustments above reflect the recording of $1.23 million of unrealized excess benefits on share based compensation and $0.06 million (impact to equity of $0.02 million after consideration of deferred taxes) for the impact of making an accounting policy election to account for forfeitures as they occur. After January 1, 2016, excess tax benefits or deficiencies resulting from share-based payments will be recognized as tax benefit or expense when they occur. Tax benefits of zero and $0.3 million were recorded during the three and nine month periods ended September 30, 2016, respectively as a result of share awards vesting during the periods. In addition, we have elected to apply the amendments related to the presentation of excess tax benefits in the statement of cash flows on a prospective basis.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments — Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments”. This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This ASU will replace today’s “incurred loss” approach with an “expected loss” model for instruments measured at amortized cost. For available-for-sale debt securities, allowances will be recorded rather than reducing the carrying amount as is done under the current other-than-temporary impairment model. This ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. This amended guidance is effective for us on January 1, 2020. We have not yet determined what the impact will be on our consolidated operating results or financial condition.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Losses	Fair Value
	(In thousands)			
September 30, 2016				
U.S. agency	$29,482	$508	$41	$29,949
U.S. agency residential mortgage-backed	168,233	1,857	132	169,958
U.S. agency commercial mortgage-backed	13,694	214	16	13,892
Private label mortgage-backed	33,482	374	278	33,578
Other asset backed	142,058	435	305	142,188
Obligations of states and political subdivisions	156,539	2,115	665	157,989
Corporate	50,787	792	124	51,455
Trust preferred	2,921	-	471	2,450
Foreign government	1,635	18	0	1,653
Total	$598,831	$6,313	$2,032	$603,112
December 31, 2015				
U.S. agency	$47,283	$309	$80	$47,512
U.S. agency residential mortgage-backed	195,055	1,584	583	196,056
U.S. agency commercial mortgage-backed	34,017	94	83	34,028
Private label mortgage-backed	5,061	161	319	4,903
Other asset backed	117,431	54	581	116,904
Obligations of states and political subdivisions	145,193	941	1,150	144,984
Corporate	38,895	9	290	38,614
Trust preferred	2,916	-	433	2,483
Total	$585,851	$3,152	$3,519	$585,484

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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, 2016						
U.S. agency	$1,604	$ 3	$ 8,147	$ 38	$9,751	$ 41
U.S. agency residential mortgage-backed	22,982	48	19,099	84	42,081	132
U.S. agency commercial mortgage-backed	3,455	14	257	2	3,712	16
Private label mortgage- backed	12,202	18	1,429	260	13,631	278
Other asset backed	22,147	96	16,998	209	39,145	305
Obligations of states and political subdivisions	17,853	91	15,203	574	33,056	665
Corporate	3,776	14	2,892	110	6,668	124
Trust preferred	-	-	2,450	471	2,450	471
Total	$84,019	$ 284	$ 66,475	$ 1,748	$150,494	$ 2,032
December 31, 2015						
U.S. agency	$12,164	$ 47	$ 6,746	$ 33	$18,910	$ 80
U.S. agency residential mortgage-backed	57,538	316	23,340	267	80,878	583
U.S. agency commercial mortgage-backed	16,747	60	2,247	23	18,994	83
Private label mortgage- backed	-	-	3,393	319	3,393	319
Other asset backed	102,660	434	5,189	147	107,849	581
Obligations of states and political subdivisions	52,493	597	12,240	553	64,733	1,150
Corporate	30,550	290	-	-	30,550	290
Trust preferred	-	-	2,483	433	2,483	433
Total	$272,152	$ 1,744	$ 55,638	$ 1,775	$327,790	$ 3,519

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

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U.S. agency, U.S. agency residential mortgage-backed securities and U.S. agency commercial mortgage backed securities — at September 30, 2016, we had 21 U.S. agency, 59 U.S. agency residential mortgage-backed and seven U.S. agency commercial mortgage-backed securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to increases in interest rates since acquisition and widening spreads to Treasury bonds. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Private label mortgage backed securities — at September 30, 2016, we had 24 of this type of security whose fair value is less than amortized cost. The unrealized losses are primarily attributed to four securities purchased prior to 2016. Two of these four securities have an impairment in excess of 10% and three of these holdings have been impaired for more than 12 months. The unrealized losses are largely attributable to credit spread widening on these four securities since their acquisition.

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

These four private label mortgage-backed securities are reviewed for other than temporary impairment (“OTTI”) utilizing a cash flow projection. The cash flow analysis forecasts cash flow from the underlying loans in each transaction and then applies these cash flows to the bonds in the securitization. Our cash flow analysis forecasts complete recovery of our cost basis for all four of these securities whose fair value is less than amortized cost.

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, 2016, we had 70 other asset backed securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening and increases in interest rates since acquisition. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Obligations of states and political subdivisions — at September 30, 2016, we had 100 municipal securities whose fair value is less than amortized cost. The unrealized losses are primarily due to increases in interest rates since acquisition. One of these securities has an impairment in excess of 10%. 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, 2016, we had seven corporate securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening and increases in interest rates since acquisition. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

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Trust preferred securities — at September 30, 2016, we had three trust preferred securities whose fair value is less than amortized cost. All of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities has suffered from credit spread widening.

One of the three securities is rated by two major rating agencies as investment grade, while one (a Bank of America issuance) is rated below investment grade by two major rating agencies and the other one is non-rated. The non-rated issue is a relatively small bank and was never rated. The issuer of this non-rated trust preferred security, which had a total amortized cost of $1.0 million and total fair value of $0.7 million as of September 30, 2016, continues to have satisfactory credit metrics and make interest payments.

The following table breaks out our trust preferred securities in further detail as of September 30, 2016 and December 31, 2015:

	September 30, 2016		December 31, 2015	
	Fair Value	Net Unrealized Loss	Fair Value	Net Unrealized Loss
	(In thousands)			
Trust preferred securities				
Rated issues	$1,735	$ (186)	$ 1,690	$ (226)
Unrated issues	715	(285)	793	(207)

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

We recorded no credit related OTTI charges in our Condensed Consolidated Statements of Operations related to securities available for sale during the three or nine month periods ended September 30, 2016 and 2015, respectively.

At September 30, 2016, three private label mortgage-backed securities had credit related OTTI and are summarized as follows:

	Senior Security	Super Senior Security	Senior Support Security	Total
	(In thousands)			
As of September 30, 2016				
Fair value	$1,346	$ 1,135	$ 75	$2,556
Amortized cost	1,303	1,064	-	2,367
Non-credit unrealized loss	-	-	-	-
Unrealized gain	43	71	75	189
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,				

2016	$-	$ -	$ -	$ -
2015	-	-	-	-
For the nine months ended September 30,				
2016	-	-	-	-
2015	-	-	-	-

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Each of these securities is receiving principal and interest payments similar to principal reductions in the underlying collateral. All three of these securities have unrealized gains at September 30, 2016. The original amortized cost for each of these securities has been permanently adjusted downward for previously recorded credit related OTTI. The unrealized loss (based on original amortized cost) for these securities is now less than previously recorded credit related OTTI amounts.

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

The amortized cost and fair value of securities available for sale at September 30, 2016, by contractual maturity, follow:

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$23,706	$23,753
Maturing after one year but within five years	86,673	87,599
Maturing after five years but within ten years	63,799	64,784
Maturing after ten years	67,186	67,360
	241,364	243,496
U.S. agency residential mortgage-backed	168,233	169,958
U.S. agency commercial mortgage-backed	13,694	13,892
Private label residential mortgage-backed	33,482	33,578
Other asset backed	142,058	142,188
Total	$598,831	$603,112

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:

	Realized	
Proceeds	Gains	Losses
(In thousands)		

2016	$56,451	$ 350	$ 52
2015	11,786	75	-

During 2016 and 2015, our trading securities consisted of various preferred stocks. During the first nine months of 2016 and 2015, we recognized gains on trading securities of $0.004 million and $0.022 million, respectively, that are included in net gains on securities in the Condensed Consolidated Statements of Operations. Both of these amounts relate to gains recognized on trading securities still held at each respective period end.

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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)					
2016						
Balance at beginning of period	$6,039	$9,956	$1,139	$52	$5,526	$22,712
Additions (deductions)						
Provision for loan losses	(153)	(247)	208	-	17	(175)
Recoveries credited to allowance	474	195	236	-	-	905
Loans charged against the allowance	(365)	(561)	(473)	-	-	(1,399)
Balance at end of period	$5,995	$9,343	$1,110	$52	$5,543	$22,043
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

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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)					
2016						
Balance at beginning of period	$5,670	$ 10,391	$ 1,181	$ 56	$ 5,272	$22,570
Additions (deductions)						
Provision for loan losses	(1,220)	(885)	399	(4)	271	(1,439)
Recoveries credited to allowance	1,944	871	808	-	-	3,623
Loans charged against the allowance	(399)	(1,034)	(1,278)	-	-	(2,711)
Balance at end of period	$5,995	$ 9,343	$ 1,110	$ 52	$ 5,543	$22,043
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

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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, 2016						
Allowance for loan losses						
Individually evaluated for impairment	$3,325	$6,717	$333	$ -	$ -	$10,375
Collectively evaluated for impairment	2,670	2,626	777	52	5,543	11,668
Total ending allowance balance	$5,995	$9,343	$1,110	$ 52	$ 5,543	$22,043
Loans						
Individually evaluated for impairment	$16,087	$60,891	$5,101	$ -		$82,079
Collectively evaluated for impairment	770,642	464,234	263,973	31,188		1,530,037
Total loans recorded investment	786,729	525,125	269,074	31,188		1,612,116
Accrued interest included in recorded investment	1,753	2,292	717	-		4,762
Total loans	$784,976	$522,833	$268,357	$ 31,188		$1,607,354
December 31, 2015						
Allowance for loan losses						
Individually evaluated for impairment	$2,708	$7,818	$457	$ -	$ -	$10,983
Collectively evaluated for impairment	2,962	2,573	724	56	5,272	11,587
Total ending allowance balance	$5,670	$10,391	$1,181	$ 56	$ 5,272	$22,570
Loans						
Individually evaluated for impairment	$16,868	$66,375	$5,888	$ -		$89,131
Collectively evaluated for impairment	733,399	433,931	228,827	34,599		1,430,756
Total loans recorded investment	750,267	500,306	234,715	34,599		1,519,887
Accrued interest included in recorded investment	1,869	2,270	698	-		4,837
Total loans	$748,398	$498,036	$234,017	$ 34,599		$1,515,050

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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, 2016			
Commercial			
Income producing - real estate	$-	$658	$ 658
Land, land development and construction - real estate	-	211	211
Commercial and industrial	-	2,517	2,517
Mortgage			
1-4 family	-	4,429	4,429
Resort lending	-	1,624	1,624
Home equity - 1st lien	-	273	273
Home equity - 2nd lien	-	353	353
Purchased loans	-	-	-
Installment			
Home equity - 1st lien	-	96	96
Home equity - 2nd lien	-	249	249
Loans not secured by real estate	-	384	384
Other	-	3	3
Payment plan receivables			
Full refund	-	-	-
Partial refund	-	4	4
Other	-	-	-
Total recorded investment	$-	$10,801	$ 10,801
Accrued interest included in recorded investment	$-	$-	$ -
December 31, 2015			
Commercial			
Income producing - real estate	$-	$1,027	$ 1,027
Land, land development and construction - real estate	49	401	450
Commercial and industrial	69	2,028	2,097
Mortgage			
1-4 family	-	4,744	4,744
Resort lending	-	1,094	1,094
Home equity - 1st lien	-	187	187
Home equity - 2nd lien	-	147	147
Purchased loans	-	2	2
Installment			
Home equity - 1st lien	-	106	106
Home equity - 2nd lien	-	443	443
Loans not secured by real estate	-	421	421
Other	-	2	2
Payment plan receivables			
Full refund	-	2	2

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

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An aging analysis of loans by class follows:

	Loans Past Due				Loans not	Total
	30-59 days	60-89 days	90+ days	Total	Past Due	Loans
	(In thousands)					
September 30, 2016						
Commercial						
Income producing - real estate	$-	$ -	$ 541	$541	$273,461	$274,002
Land, land development and construction - real estate	-	-	133	133	53,836	53,969
Commercial and industrial	105	116	457	678	458,080	458,758
Mortgage						
1-4 family	2,180	1,461	4,429	8,070	285,892	293,962
Resort lending	1,975	-	1,624	3,599	103,597	107,196
Home equity - 1st lien	107	-	273	380	27,542	27,922
Home equity - 2nd lien	226	73	353	652	52,882	53,534
Purchased loans	7	1	-	8	42,503	42,511
Installment						
Home equity - 1st lien	474	179	96	749	13,079	13,828
Home equity - 2nd lien	133	72	249	454	15,064	15,518
Loans not secured by real estate	291	114	384	789	236,376	237,165
Other	10	4	3	17	2,546	2,563
Payment plan receivables						
Full refund	258	70	-	328	10,035	10,363
Partial refund	506	313	4	823	14,041	14,864
Other	159	40	-	199	5,762	5,961
Total recorded investment	$6,431	$ 2,443	$ 8,546	$17,420	$1,594,696	$1,612,116
Accrued interest included in recorded investment	$67	$ 28	$ -	$95	$4,667	$4,762
December 31, 2015						
Commercial						
Income producing - real estate	$203	$ 209	$ 647	$1,059	$305,155	$306,214
Land, land development and construction - real estate	-	-	252	252	44,231	44,483
Commercial and industrial	785	16	151	952	398,618	399,570
Mortgage						
1-4 family	1,943	640	4,744	7,327	269,880	277,207
Resort lending	307	-	1,094	1,401	114,619	116,020
Home equity - 1st lien	50	-	187	237	22,327	22,564
Home equity - 2nd lien	439	54	147	640	50,618	51,258
Purchased loans	9	1	2	12	33,245	33,257
Installment						
Home equity - 1st lien	315	107	106	528	16,707	17,235
Home equity - 2nd lien	231	149	443	823	19,727	20,550
Loans not secured by real estate	567	83	421	1,071	193,680	194,751

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

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Impaired loans are as follows:

	September 30, 2016	December 31, 2015
Impaired loans with no allocated allowance	(In thousands)	
TDR	$541	$ 2,518
Non - TDR	133	203
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	3,472	4,810
TDR - allowance based on present value cash flow	76,701	81,002
Non - TDR - allowance based on collateral	902	260
Non - TDR - allowance based on present value cash flow	-	-
Total impaired loans	$81,749	$ 88,793
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$1,710	$ 2,436
TDR - allowance based on present value cash flow	8,361	8,471
Non - TDR - allowance based on collateral	304	76
Non - TDR - allowance based on present value cash flow	-	-
Total amount of allowance for loan losses allocated	$10,375	$ 10,983

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Impaired loans by class are as follows (1):

	September 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:	(In thousands)					
Commercial						
Income producing - real estate	$541	$787	$ -	$641	$851	$ -
Land, land development & construction-real estate	133	709	-	818	1,393	-
Commercial and industrial	-	-	-	1,245	1,241	-
Mortgage						
1-4 family	1	305	-	23	183	-
Resort lending	-	-	-	-	-	-
Home equity - 1st lien	-	-	-	-	-	-
Home equity - 2nd lien	-	-	-	-	-	-
Installment						
Home equity - 1st lien	-	67	-	-	76	-
Home equity - 2nd lien	-	-	-	-	-	-
Loans not secured by real estate	-	-	-	-	-	-
Other	-	-	-	-	-	-
	675	1,868	-	2,727	3,744	-
With an allowance recorded:						
Commercial						
Income producing - real estate	7,813	7,951	561	8,377	9,232	516
Land, land development & construction-real estate	389	391	67	1,690	1,778	296
Commercial and industrial	7,211	7,566	2,697	4,097	4,439	1,896
Mortgage						
1-4 family	43,038	44,922	4,173	47,792	49,808	5,132
Resort lending	17,295	17,327	2,488	18,148	18,319	2,662
Home equity - 1st lien	239	244	32	168	172	9
Home equity - 2nd lien	318	400	24	244	325	15
Installment						
Home equity - 1st lien	2,108	2,223	105	2,364	2,492	143
Home equity - 2nd lien	2,461	2,480	191	2,929	2,951	271
Loans not secured by real estate	530	566	37	587	658	42
Other	2	2	-	8	8	1
	81,404	84,072	10,375	86,404	90,182	10,983
Total						
Commercial						
Income producing - real estate	8,354	8,738	561	9,018	10,083	516
Land, land development & construction-real estate	522	1,100	67	2,508	3,171	296
Commercial and industrial	7,211	7,566	2,697	5,342	5,680	1,896
Mortgage						
1-4 family	43,039	45,227	4,173	47,815	49,991	5,132
Resort lending	17,295	17,327	2,488	18,148	18,319	2,662
Home equity - 1st lien	239	244	32	168	172	9

Home equity - 2nd lien	318	400	24	244	325	15
Installment						
Home equity - 1st lien	2,108	2,290	105	2,364	2,568	143
Home equity - 2nd lien	2,461	2,480	191	2,929	2,951	271
Loans not secured by real estate	530	566	37	587	658	42
Other	2	2	-	8	8	1
Total	$82,079	$85,940	$ 10,375	$89,131	$93,926	$ 10,983
Accrued interest included in recorded investment	$330			$338		

(1) There were no impaired payment plan receivables or purchased mortgage loans at September 30, 2016 or December 31, 2015

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Average recorded investment in and interest income earned on impaired loans by class for the three month periods ending September 30, follows (1):

	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$551	$ -	$5,133	$ 45
Land, land development & construction-real estate	133	-	932	14
Commercial and industrial	-	-	1,922	68
Mortgage				
1-4 family	12	3	24	3
Resort lending	-	-	-	-
Home equity - 1st lien	-	-	-	-
Home equity - 2nd lien	-	-	-	-
Installment				
Home equity - 1st lien	-	3	-	-
Home equity - 2nd lien	-	-	-	-
Loans not secured by real estate	-	-	-	-
Other	-	-	-	-
	696	6	8,011	130
With an allowance recorded:				
Commercial				
Income producing - real estate	8,000	111	14,655	154
Land, land development & construction-real estate	1,117	3	1,993	2
Commercial and industrial	7,145	69	6,431	37
Mortgage				
1-4 family	44,256	470	49,706	554
Resort lending	17,372	161	18,414	163
Home equity - 1st lien	241	2	157	2
Home equity - 2nd lien	280	6	185	-
Installment				
Home equity - 1st lien	2,140	34	2,474	47
Home equity - 2nd lien	2,585	37	2,999	47
Loans not secured by real estate	536	9	645	10
Other	4	-	10	-
	83,676	902	97,669	1,016
Total				
Commercial				
Income producing - real estate	8,551	111	19,788	199
Land, land development & construction-real estate	1,250	3	2,925	16
Commercial and industrial	7,145	69	8,353	105
Mortgage				
1-4 family	44,268	473	49,730	557
Resort lending	17,372	161	18,414	163

Home equity - 1st lien	241	2	157	2
Home equity - 2nd lien	280	6	185	-
Installment				
Home equity - 1st lien	2,140	37	2,474	47
Home equity - 2nd lien	2,585	37	2,999	47
Loans not secured by real estate	536	9	645	10
Other	4	-	10	-
Total	$84,372	$ 908	$105,680	$ 1,146

(1) There were no impaired payment plan receivables or purchased mortgage loans during the three month periods ended September 30, 2016 and 2015, respectively.

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Average recorded investment in and interest income earned on impaired loans by class for the nine month periods ending September 30, follows (1):

	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$632	$ 2	$5,490	$ 170
Land, land development & construction-real estate	405	7	986	57
Commercial and industrial	616	21	2,345	195
Mortgage				
1-4 family	12	9	18	5
Resort lending	-	-	15	-
Home equity - 1st lien	-	-	-	-
Home equity - 2nd lien	-	-	-	-
Installment				
Home equity - 1st lien	-	4	-	1
Home equity - 2nd lien	4	-	-	-
Loans not secured by real estate	-	-	-	-
Other	-	-	-	-
	1,669	43	8,854	428
With an allowance recorded:				
Commercial				
Income producing - real estate	8,153	318	13,752	452
Land, land development & construction-real estate	1,352	29	2,351	35
Commercial and industrial	5,929	151	7,304	117
Mortgage				
1-4 family	45,728	1,447	51,078	1,644
Resort lending	17,705	480	18,523	507
Home equity - 1st lien	223	6	159	6
Home equity - 2nd lien	231	11	154	6
Installment				
Home equity - 1st lien	2,233	118	2,582	141
Home equity - 2nd lien	2,723	122	3,086	147
Loans not secured by real estate	557	28	669	29
Other	5	-	11	1
	84,839	2,710	99,669	3,085
Total				
Commercial				
Income producing - real estate	8,785	320	19,242	622
Land, land development & construction-real estate	1,757	36	3,337	92
Commercial and industrial	6,545	172	9,649	312
Mortgage				
1-4 family	45,740	1,456	51,096	1,649
Resort lending	17,705	480	18,538	507

Home equity - 1st lien	223	6	159	6
Home equity - 2nd lien	231	11	154	6
Installment				
Home equity - 1st lien	2,233	122	2,582	142
Home equity - 2nd lien	2,727	122	3,086	147
Loans not secured by real estate	557	28	669	29
Other	5	-	11	1
Total	$86,508	$ 2,753	$108,523	$ 3,513

(1) There were no impaired payment plan receivables or purchased mortgage loans during the nine month periods ended September 30, 2016 and 2015, respectively.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Our average investment in impaired loans was approximately $84.4 million and $105.7 million for the three-month periods ended September 30, 2016 and 2015, respectively and $86.5 million and $108.5 million for the nine-month periods ended September 30, 2016 and 2015, respectively. Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance. Interest income recognized on impaired loans during the three months ending September 30, 2016 and 2015, was approximately $0.9 million and $1.1 million, respectively and was approximately $2.8 million and $3.5 million during the nine months ending September 30, 2016 and 2015, respectively.

Troubled debt restructurings follow:

	September 30, 2016		
	Commercial	Retail	Total
	(In thousands)		
Performing TDRs	$12,642	$62,299	$74,941
Non-performing TDRs(1)	2,352	3,421 (2)	5,773
Total	$14,994	$65,720	$80,714

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

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

We allocated $10.1 million and $10.9 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2016 and December 31, 2015, respectively.

During the nine months ended September 30, 2016 and 2015, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans generally included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

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

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Loans that have been classified as troubled debt restructurings during the three-month periods ended September 30 follow(1):

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
	(Dollars in thousands)		
2016			
Commercial			
Income producing - real estate	2	$ 180	$ 180
Land, land development & construction-real estate	-	-	-
Commercial and industrial	2	175	158
Mortgage			
1-4 family	2	204	207
Resort lending	-	-	-
Home equity - 1st lien	-	-	-
Home equity - 2nd lien	2	77	78
Installment			
Home equity - 1st lien	2	82	85
Home equity - 2nd lien	1	7	7
Loans not secured by real estate	1	34	34
Other	-	-	-
Total	12	$ 759	$ 749
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

(1) There were no payment plan receivables or purchased mortgage loans classified as troubled debt restructurings during the three month periods ended September 30, 2016 and 2015, respectively.

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(unaudited)

Loans that have been classified as troubled debt restructurings during the nine-month periods ended September 30 follow(1):

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
		(Dollars in thousands)	
2016			
Commercial			
Income producing - real estate	4	$ 290	$ 290
Land, land development & construction-real estate	-	-	-
Commercial and industrial	6	1,933	1,916
Mortgage			
1-4 family	5	396	470
Resort lending	1	116	117
Home equity - 1st lien	1	107	78
Home equity - 2nd lien	2	77	78
Installment			
Home equity - 1st lien	6	141	145
Home equity - 2nd lien	5	133	136
Loans not secured by real estate	2	46	46
Other	-	-	-
Total	32	$ 3,239	$ 3,276
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

(1) There were no payment plan receivables or purchased mortgage loans classified as troubled debt restructurings during the nine month periods ended September 30, 2016 and 2015, respectively.

The troubled debt restructurings described above for 2016 increased the allowance for loan losses by $0.34 million and resulted in charge offs of $0.02 million during the three months ended September 30, 2016, and increased the allowance by $0.69 million and resulted in charge offs of $0.02 million during the nine months ended September 30,

2016.

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.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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)	
2016		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	-	-
Resort lending	-	-
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Installment		
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Loans not secured by real estate	-	-
Other	-	-
	-	$ -
2015		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
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

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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)	
2016		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	-	-
Resort lending	-	-
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Installment		
Home equity - 1st lien	-	-
Home equity - 2nd lien	-	-
Loans not secured by real estate	-	-
Other	-	-
	-	$ -
2015		
Commercial		
Income producing - real estate	-	$ -
Land, land development & construction-real estate	-	-
Commercial and industrial	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

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

There were no troubled debt restructurings that subsequently defaulted during the three and nine months ended September 30, 2016.

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.

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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.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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, 2016					
Income producing - real estate	$268,940	$ 4,000	$ 404	$ 658	$274,002
Land, land development and construction - real estate	53,559	199	-	211	53,969
Commercial and industrial	439,036	10,727	6,478	2,517	458,758
Total	$761,535	$ 14,926	$ 6,882	$ 3,386	$786,729
Accrued interest included in total	$1,676	$ 56	$ 21	$ -	$1,753
December 31, 2015					
Income producing - real estate	$296,898	$ 6,866	$ 1,423	$ 1,027	$306,214
Land, land development and construction - real estate	40,844	2,995	243	401	44,483
Commercial and industrial	371,357	19,502	6,683	2,028	399,570
Total	$709,099	$ 29,363	$ 8,349	$ 3,456	$750,267
Accrued interest included in total	$1,729	$ 108	$ 32	$ -	$1,869

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

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The following tables summarize credit scores by loan class for our mortgage and installment loan segments:

	Mortgage (1)					
	1-4 Family	Resort Lending	Home Equity 1st Lien	Home Equity 2nd Lien	Purchased Loans	Total
	(In thousands)					
September 30, 2016						
800 and above	$32,310	$12,054	$5,590	$8,288	$4,816	$63,058
750-799	88,959	38,472	9,551	19,103	26,721	182,806
700-749	60,455	30,934	5,052	11,278	10,831	118,550
650-699	53,748	13,530	3,690	8,259	-	79,227
600-649	27,848	6,218	1,365	3,342	-	38,773
550-599	15,413	2,467	738	1,542	-	20,160
500-549	7,955	871	484	1,246	-	10,556
Under 500	5,097	596	172	244	-	6,109
Unknown	2,177	2,054	1,280	232	143	5,886
Total	$293,962	$107,196	$27,922	$53,534	$42,511	$525,125
Accrued interest included in total	$1,386	$473	$104	$210	$119	$2,292
December 31, 2015						
800 and above	$28,760	$13,943	$4,374	$7,696	$2,310	$57,083
750-799	78,802	40,888	7,137	17,405	23,283	167,515
700-749	56,519	31,980	4,341	11,022	6,940	110,802
650-699	51,813	17,433	3,203	7,691	-	80,140
600-649	27,966	4,991	1,467	3,684	-	38,108
550-599	16,714	3,070	1,027	1,918	-	22,729
500-549	10,610	1,051	572	1,295	-	13,528
Under 500	4,708	554	244	265	-	5,771
Unknown	1,315	2,110	199	282	724	4,630
Total	$277,207	$116,020	$22,564	$51,258	$33,257	$500,306
Accrued interest included in total	$1,396	$477	$87	$196	$114	$2,270

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

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	Installment(1)				
	Home Equity 1st Lien	Home Equity 2nd Lien	Loans not Secured by Real Estate	Other	Total
	(In thousands)				
September 30, 2016					
800 and above	$1,373	$1,953	$51,471	$108	$54,905
750-799	3,031	3,558	110,667	680	117,936
700-749	2,170	2,872	43,616	812	49,470
650-699	2,690	3,244	18,322	522	24,778
600-649	2,193	1,668	4,080	281	8,222
550-599	1,310	1,348	1,690	52	4,400
500-549	895	631	1,126	48	2,700
Under 500	134	233	309	25	701
Unknown	32	11	5,884	35	5,962
Total	$13,828	$15,518	$237,165	$2,563	$269,074
Accrued interest included in total	$58	$57	$582	$20	$717
December 31, 2015					
800 and above	$1,792	$1,782	$44,254	$58	$47,886
750-799	4,117	5,931	86,800	531	97,379
700-749	2,507	3,899	34,789	694	41,889
650-699	3,508	4,182	16,456	499	24,645
600-649	2,173	2,153	4,979	200	9,505
550-599	1,800	1,346	1,997	109	5,252
500-549	1,056	855	1,170	61	3,142
Under 500	223	370	385	23	1,001
Unknown	59	32	3,921	4	4,016
Total	$17,235	$20,550	$194,751	$2,179	$234,715
Accrued interest included in total	$78	$83	$520	$17	$698

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

Mepco Finance Corporation ("Mepco") is a wholly-owned subsidiary of our Bank that operates a vehicle service contract payment plan business throughout the United States. See Note #14 for more information about Mepco's business. As of September 30, 2016, approximately 33.2% 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 47.7% of Mepco's outstanding payment plan receivables as of September 30, 2016, relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the refund owing upon cancellation only with respect to the unearned portion previously funded by Mepco to the administrator (but not to the service contract seller). These receivables are shown as "Partial Refund" in the table below. The balance of Mepco's outstanding payment plan receivables relate to programs in which there is no insurer or risk retention group that has any contractual liability to Mepco for any portion of the refund amount. These receivables are shown as "Other" in the table below. For each class of our payment plan receivables we monitor financial information on the counterparties as we evaluate the credit quality of this portfolio.

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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, 2016				
AM Best rating				
A+	$-	$8	$-	$8
A	1,094	13,696	-	14,790
A-	977	1,110	3,458	5,545
B+	-	-	2,502	2,502
Not rated	8,292	50	1	8,343
Total	$10,363	$14,864	$5,961	$31,188
December 31, 2015				
AM Best rating				
A+	$-	$6	$-	$6
A	2,712	5,203	-	7,915
A-	3,418	1,177	6,265	10,860
Not rated	15,720	93	5	15,818
Total	$21,850	$6,479	$6,270	$34,599

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

Foreclosed residential real estate properties included in other real estate and repossessed assets on our Condensed Consolidated Statements of Financial Condition totaled $1.8 million and $2.8 million at September 30, 2016 and December 31, 2015, respectively. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled $0.4 million and $1.1 million at September 30, 2016 and December 31, 2015, respectively.

5. Segments

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

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

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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A summary of selected financial information for our reportable segments follows:

	IB	Mepco	Other(1)	Elimination(2)	Total
	(In thousands)				
Total assets					
September 30, 2016	$2,476,795	$50,032	$286,672	$ (275,180)	$2,538,319
December 31, 2015	2,340,566	57,208	286,936	(275,644)	2,409,066
For the three months ended September 30, 2016					
Interest income	$20,731	$1,014	$5	$ (5)	$21,745
Net interest income	19,409	880	(291)	0	19,998
Provision for loan losses	(176)	1	0	0	(175)
Income (loss) before income tax	9,811	(29)	(406)	(24)	9,352
Net income (loss)	6,665	(20)	(256)	(16)	6,373
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
For the nine months ended September 30, 2016					
Interest income	$61,190	$3,176	$22	$ (22)	$64,366
Net interest income	57,500	2,727	(836)	-	59,391
Provision for loan losses	(1,436)	(3)	-	-	(1,439)
Income (loss) before income tax	25,971	(339)	(1,103)	(71)	24,458
Net income (loss)	17,834	(225)	(652)	(46)	16,911
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

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

6. Shareholders' Equity and Earnings Per Common Share

On January 21, 2016, our Board of Directors authorized a share repurchase plan (the "Repurchase Plan") to buy back up to 5% of our outstanding common stock through December 31, 2016. On April 26, 2016 our Board of Directors authorized a $5.0 million expansion of the Repurchase Plan. We expect to accomplish the repurchases through open

market transactions, though we could affect repurchases through other means, such as privately negotiated transactions. The timing and amount of any share repurchases will depend on a variety of factors, including, among others, securities law restrictions, the trading price of our common stock, regulatory requirements, potential alternative uses for capital, and our financial performance. The Repurchase Plan does not obligate us to acquire any particular amount of common stock, and it may be modified or suspended at any time at our discretion. We expect to fund any repurchases from cash on hand. During the nine months ended September 30, 2016, we repurchased 1,153,136 shares of common stock for an aggregate purchase price of $16.9 million leaving $4.4 million to be repurchased under the Repurchase Plan.

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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. On October 25, 2016, the Board of Directors took affirmative action to not renew the Preservation Plan, which will expire on November 15, 2016.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands, except per share amounts)			
Net income	$6,373	$5,047	$16,911	$14,447
Weighted average shares outstanding (1)	21,232	22,673	21,421	22,852
Effect of stock options	149	118	150	120
Stock units for deferred compensation plan for non-employee directors	116	112	115	111
Restricted stock units	-	230	46	283
Performance share units	52	-	42	-
Weighted average shares outstanding for calculation of diluted earnings per share	21,549	23,133	21,774	23,366
Net income per common share				
Basic (1)	$0.30	$0.22	$0.79	$0.63
Diluted	$0.30	$0.22	$0.78	$0.62

(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 ended September 30, 2016 and 2015, respectively and totaled 0.03 million for both nine-month periods ended September 30, 2016 and 2015, 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.

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

	September 30, 2016		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
No hedge designation			
Rate-lock mortgage loan commitments	$31,760	0.1	$1,163
Mandatory commitments to sell mortgage loans	67,672	0.1	(283)
Pay-fixed interest rate swap agreements	48,623	8.8	(2,009)
Pay-variable interest rate swap agreements	48,623	8.8	2,009
Purchased options	3,119	4.8	216
Written options	3,119	4.8	(216)
Total	$202,916	4.4	$880

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

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

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.

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

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

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, 2016		December 31, 2015		September 30, 2016		December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)							
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	$1,163	Other assets	$550	Other liabilities	$-	Other liabilities	$-
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	69	Other liabilities	283	Other liabilities	-
Pay-fixed interest rate swap agreements	Other assets	-	Other assets	-	Other liabilities	2,009	Other liabilities	497
Pay-variable interest rate swap agreements	Other assets	2,009	Other assets	497	Other liabilities	-	Other liabilities	-
Purchased options	Other assets	216	Other assets	122	Other liabilities	-	Other liabilities	-
Written options	Other assets	-	Other assets	-	Other liabilities	216	Other liabilities	122
Total derivatives		$3,388		$1,238		$2,508		$619

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

		Gain (Loss) Recognized in Income			
		Three Month Periods Ended September 30,		Nine Month Periods Ended September 30,	
	Location of Gain (Loss) Recognized in Income	2016	2015	2016	2015
		(In thousands)			
No hedge designation					
Rate-lock mortgage loan commitments	Net gains on mortgage loans	$ 264	$ 281	$ 613	$ 386
Mandatory commitments to sell mortgage loans	Net gains on mortgage loans	94	(745)	(352)	(225)
Pay-fixed interest rate swap agreements	Interest income	196	(452)	(1,512)	(492)
Pay-variable interest rate swap agreements	Interest income	(196)	452	1,512	492
Purchased options	Interest expense	13	126	94	126
Written options	Interest expense	(13)	(126)	(94)	(126)
Total		$ 358	$ (464)	$ 261	$ 161

8. Intangible Assets

The following table summarizes intangible assets, net of amortization:

	September 30, 2016		December 31, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets - core deposits	$6,118	$ 4,099	$ 6,118	$ 3,838

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

	(In thousands)
Three months ending December 31, 2016	$ 86
2017	346
2018	346
2019	346
2020	346
2021 and thereafter	549
Total	$ 2,019

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9. Share Based Compensation

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.2 million shares of common stock as of September 30, 2016. The non-employee director stock purchase plan permits the issuance of additional share based payments for up to 0.2 million shares of common stock as of September 30, 2016. Share based awards and payments are measured at fair value at the date of grant and are expensed over the requisite service period. Common shares issued upon exercise of stock options come from currently authorized but unissued shares.

During each first quarter period of 2016 and 2015, pursuant to our long-term incentive plan, we granted 0.07 million shares of restricted stock and 0.03 million performance stock units ("PSU") to certain officers. The shares of restricted stock and PSUs cliff vest after a period of three years. The performance feature of the PSUs is based on a comparison of our total shareholder return over the three year period starting on the grant date to the total shareholder return over that period for a banking index of our peers. In addition, we issued 0.02 million PSUs and 0.01 million shares of restricted stock to certain officers and employees during the third quarter of 2016. The PSUs cliff vest after four and five year periods and the restricted stock cliff vests after one and four year periods.

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 0.006 million shares and 0.004 million shares to directors during the first nine months of 2016 and 2015, respectively and expensed their value during those same periods.

Total compensation expense recognized for grants pursuant to our long-term incentive plan was $0.3 million and $1.1 million during the three and nine month periods ended September 30, 2016, respectively, and was $0.4 million and $1.1 million during the same periods in 2015, 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, 2016, respectively and $0.1 million and $0.4 million for the same periods in 2015. Total expense recognized for non-employee director share based payments was $0.03 million and $0.09 million during the three and nine month periods ended September 30, 2016, respectively, and was $0.02 million and $0.05 million during the same periods in 2015, respectively. The corresponding tax benefit relating to this expense was $0.01 million and $0.03 million for the three and nine month periods ended September 30, 2016, respectively and $0.01 million and $0.02 million during the same respective periods in 2015.

At September 30, 2016, the total expected compensation cost related to non-vested stock options, restricted stock and PSUs not yet recognized was $2.2 million. The weighted-average period over which this amount will be recognized is 2.2 years.

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

	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregated Intrinsic Value (In thousands)
Outstanding at January 1, 2016	235,596	$ 4.94		
Granted	-			
Exercised	(16,912)	3.78		
Forfeited	(664)	6.42		
Expired	(2,300)	3.54		
Outstanding at September 30, 2016	215,720	$ 5.04	5.33	$ 2,544
Vested and expected to vest at September 30, 2016	215,720	$ 5.04	5.33	$ 2,544
Exercisable at September 30, 2016	215,720	$ 5.04	5.33	$ 2,544

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

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1, 2016	261,981	$ 11.29
Granted	121,660	15.05
Vested	(107,795)	7.92
Forfeited	(4,924)	13.24
Outstanding at September 30, 2016	270,922	$ 14.28

Certain information regarding options exercised during the periods follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Intrinsic value	$ 9	$ 71	$ 186	$ 314
Cash proceeds received	$ 5	$ 23	$ 64	$ 105
Tax benefit realized	$ 3	$ 25	$ 65	$ 110

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10. Income Tax

Income tax expense was $3.0 million and $2.3 million during the three month periods ended September 30, 2016 and 2015, respectively and $7.5 million and $6.7 million during the nine months ended September 30, 2016 and 2015, respectively. As described in note #2, we adopted ASU 2016-09, “Compensation – Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting” during the second quarter of 2016 which now requires us to recognize for book purposes either income tax expense or benefit relating to excess deficiencies/benefits relating to share-based compensation. Included in income tax expense for the three and nine month periods ended September 30, 2016 are tax benefits of zero and $0.3 million, respectively due to the vesting of certain share-based compensation grants and the exercise of stock options during the respective periods.

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, 2016 and 2015, that the realization of substantially all of our deferred tax assets continues to be more likely than not.

We did maintain a valuation allowance against our deferred tax assets of approximately $1.1 million at both September 30, 2016 and December 31, 2015. This valuation allowance on our deferred tax assets primarily relates to state income taxes at our Mepco segment. In this instance, we determined that the future realization of these particular deferred tax assets was not more likely than not. This conclusion was primarily based on the uncertainty of Mepco’s future earnings attributable to particular states (given the various apportionment criteria) and the significant reduction in the size of Mepco’s business.

At both September 30, 2016 and December 31, 2015, we had approximately $1.0 million, of gross unrecognized tax benefits. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2016.

11. Regulatory Matters

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank’s current year net profits, combined with the retained net profits of the preceding two years. Further, the Bank cannot pay a dividend at any time that it has negative undivided profits. As of September 30, 2016, the Bank had positive undivided profits of $8.7 million. We can request regulatory approval for a return of capital from the Bank to the parent company. During the first quarters of 2016 and 2015, we requested regulatory approval for returns of capital from the Bank to the parent company of $18.0 million and $18.5 million, respectively. These return of capital requests were approved by our banking regulators on February 24, 2016 and February 13, 2015, respectively and the Bank returned these amounts to the parent company on February 25, 2016 and February 17, 2015, respectively. It is not our intent to have dividends paid in amounts that would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

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We are also subject to various regulatory capital requirements. The prompt corrective action regulations establish quantitative measures to ensure capital adequacy and require minimum amounts and ratios of total, Tier 1, and common equity Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can result in certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. Under capital adequacy guidelines, we must meet specific capital requirements that involve quantitative measures as well as qualitative judgments by the regulators. The most recent regulatory filings as of September 30, 2016 and December 31, 2015, categorized our Bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent Federal Deposit Insurance Corporation ("FDIC") categorization.

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

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Our actual capital amounts and ratios follow:

	Actual		Minimum for Adequately Capitalized Institutions		Minimum for Well-Capitalized Institutions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
September 30, 2016						
Total capital to risk-weighted assets						
Consolidated	$281,310	16.05%	$ 140,243	8.00 %	NA	NA
Independent Bank	269,578	15.39	140,116	8.00	175,145	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	$259,279	14.79%	$ 105,182	6.00 %	NA	NA
Independent Bank	247,615	14.14	105,087	6.00	140,116	8.00 %
Common equity tier 1 capital to risk-weighted assets						
Consolidated	$233,631	13.33%	$ 78,886	4.50 %	NA	NA
Independent Bank	247,615	14.14	78,815	4.50	113,844	6.50 %
Tier 1 capital to average assets						
Consolidated	$259,279	10.56%	$ 98,174	4.00 %	NA	NA
Independent Bank	247,615	10.09	98,116	4.00	122,645	5.00 %
December 31, 2015						
Total capital to risk-weighted assets						
Consolidated	$278,170	16.65%	$ 133,668	8.00 %	NA	NA
Independent Bank	261,894	15.69	133,514	8.00	$166,893	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	$257,050	15.38%	$ 100,251	6.00 %	NA	NA
Independent Bank	240,867	14.43	100,136	6.00	$133,514	8.00 %
Common equity tier 1 capital to risk-weighted assets						
Consolidated	$239,271	14.32%	$ 75,188	4.50 %	NA	NA
Independent Bank	240,867	14.43	75,102	4.50	$108,480	6.50 %
Tier 1 capital to average assets						
Consolidated	$257,050	10.91%	$ 94,217	4.00 %	NA	NA
Independent Bank	240,867	10.23	94,145	4.00	$117,682	5.00 %

NA - Not applicable

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The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	September 30, 2016	December 31, 2015	September 30, 2016	December 31, 2015
	(In thousands)			
Total shareholders' equity	$250,902	$ 251,092	$263,762	$ 259,947
Add (deduct)				
Accumulated other comprehensive (income) loss for regulatory purposes	(2,783)	238	(2,782)	238
Intangible assets	(1,211)	(912)	(1,211)	(912)
Disallowed deferred tax assets	(13,277)	(11,147)	(12,154)	(18,406)
Common equity tier 1 capital	233,631	239,271	247,615	240,867
Qualifying trust preferred securities	34,500	34,500	-	-
Disallowed deferred tax assets	(8,852)	(16,721)	-	-
Tier 1 capital	259,279	257,050	247,615	240,867
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	22,031	21,120	21,963	21,027
Total risk-based capital	$281,310	$ 278,170	$269,578	$ 261,894

12. Fair Value Disclosures

FASB ASC topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 instruments include securities traded on active exchange markets, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 instruments include securities traded in less active dealer or broker markets.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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We used the following methods and significant assumptions to estimate fair value:

Securities: Where quoted market prices are available in an active market, securities (trading or available for sale) are classified as Level 1 of the valuation hierarchy. Level 1 securities include certain preferred stocks included in our trading portfolio for which there are quoted prices in active markets. If quoted market prices are not available for the specific security, then fair values are estimated by (1) using quoted market prices of securities with similar characteristics, (2) matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted prices, or (3) a discounted cash flow analysis whose significant fair value inputs can generally be verified and do not typically involve judgment by management. These securities are classified as Level 2 of the valuation hierarchy and primarily include agency securities, private label mortgage-backed securities, other asset backed securities, municipal securities, trust preferred securities, corporate securities and foreign government securities.

Loans held for sale: The fair value of mortgage loans held for sale is based on mortgage backed security pricing for comparable assets (recurring Level 2).

Impaired loans with specific loss allocations based on collateral value: From time to time, certain loans are considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. We measure our investment in an impaired loan based on one of three methods: the loan's observable market price, the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2016 and December 31, 2015, all of our impaired loans were evaluated based on either the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. When the fair value of the collateral is based on an appraised value or when an appraised value is not available we record the impaired loan as nonrecurring Level 3. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and thus will typically result in a Level 3 classification of the inputs for determining fair value.

Other real estate: At the time of acquisition, other real estate is recorded at fair value, less estimated costs to sell, which becomes the property's new basis. Subsequent write-downs to reflect declines in value since the time of acquisition may occur from time to time and are recorded in net (gains) losses on other real estate and repossessed assets in the Condensed Consolidated Statements of Operations. The fair value of the property used at and subsequent to the time of acquisition is typically determined by a third party appraisal of the property. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value.

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Appraisals for both collateral-dependent impaired loans and other real estate are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by us. Once received, an independent third party (for commercial properties over $0.25 million) or a member of our Collateral Evaluation Department (for commercial properties under $0.25 million) or a member of our Special Assets Group (for retail properties) reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. We compare the actual selling price of collateral that has been sold to the most recent appraised value of our properties to determine what additional adjustment, if any, should be made to the appraisal value to arrive at fair value. For commercial and retail properties we typically discount an appraisal to account for various factors that the appraisal excludes in its assumptions. These additional discounts generally do not result in material adjustments to the appraised value.

Capitalized mortgage loan servicing rights: The fair value of capitalized mortgage loan servicing rights is based on a valuation model used by an independent third party that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. Certain model assumptions are generally unobservable and are based upon the best information available including data relating to our own servicing portfolio, reviews of mortgage servicing assumption and valuation surveys and input from various mortgage servicers and, therefore, are recorded as nonrecurring Level 3. Management evaluates the third party valuation for reasonableness each quarter as part of our financial reporting control processes.

Derivatives: The fair value of rate-lock mortgage loan commitments and mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets (recurring Level 2). The fair value of interest rate swap agreements is based on a discounted cash flow analysis whose significant fair value inputs can generally be observed in the market place and do not typically involve judgment by management (recurring Level 2). The fair value of purchased and written options is based on prices of financial instruments with similar characteristics and do not typically involve judgment by management (recurring Level 2).

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Assets and liabilities measured at fair value, including financial assets for which we have elected the fair value option, were as follows:

	Fair Value Measurements Using		
	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)			
September 30, 2016:				
Measured at Fair Value on a Recurring Basis:				
Assets				
Trading securities	$152	$ 152	$ -	$ -
Securities available for sale				
U.S. agency	29,949	-	29,949	-
U.S. agency residential mortgage-backed	169,958	-	169,958	-
U.S. agency commercial mortgage-backed	13,892	-	13,892	-
Private label mortgage-backed	33,578	-	33,578	-
Other asset backed	142,188	-	142,188	-
Obligations of states and political subdivisions	157,989	-	157,989	-
Corporate	51,455	-	51,455	-
Trust preferred	2,450	-	2,450	-
Foreign government	1,653	-	1,653	-
Loans held for sale	38,008	-	38,008	-
Derivatives (1)	3,388	-	3,388	-
Liabilities				
Derivatives (2)	2,508	-	2,508	-
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	10,678	-	-	10,678
Impaired loans (4)				
Commercial				
Income producing - real estate	262	-	-	262
Land, land development & construction-real estate	172	-	-	172
Commercial and industrial	1,558	-	-	1,558
Mortgage				
1-4 Family	368	-	-	368
Other real estate (5)				
Commercial				
Income producing - real estate (6)	2,963	-	2,963	-

Land, land development & construction-real estate	176	-	-	176
Mortgage				
1-4 Family	25	-	-	25
Resort lending	30	-	-	30

(1) Included in accrued income and other assets
(2) Included in accrued expenses and other liabilities
(3) Only includes servicing rights that are carried at fair value due to recognition of a valuation allowance.
(4) Only includes impaired loans with specific loss allocations based on collateral value.
(5) Only includes other real estate with subsequent write downs to fair value.
(6) Level 2 valuation is based on sales price at an auction subsequent to September 30, 2016.

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	Fair Value Measurements Using		
	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)			
December 31, 2015:				
Measured at Fair Value on a Recurring Basis:				
Assets				
Trading securities	$148	$ 148	$ -	$ -
Securities available for sale				
U.S. agency	47,512	-	47,512	-
U.S. agency residential mortgage-backed	196,056	-	196,056	-
U.S. agency commercial mortgage-backed	34,028	-	34,028	-
Private label mortgage-backed	4,903	-	4,903	-
Other asset backed	116,904	-	116,904	-
Obligations of states and political subdivisions	144,984	-	144,984	-
Corporate	38,614	-	38,614	-
Trust preferred	2,483	-	2,483	-
Loans held for sale	27,866	-	27,866	-
Derivatives (1)	1,238	-	1,238	-
Liabilities				
Derivatives (2)	619	-	619	-
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	8,481	-	-	8,481
Impaired loans (4)				
Commercial				
Income producing - real estate	711	-	-	711
Land, land development & construction-real estate	40	-	-	40
Commercial and industrial	1,257	-	-	1,257
Mortgage				
1-4 Family	421	-	-	421
Resort lending	129	-	-	129
Other real estate (5)				
Commercial				
Land, land development & construction-real estate	639	-	-	639
Commercial and industrial	165	-	-	165
Mortgage				
1-4 Family	26	-	-	26

Resort lending	107	-	-	107
Home equity - 1st lien	14	-	-	14
Installment				
Home equity - 1st lien	36	-	-	36

(1) Included in accrued income and other assets
(2) Included in accrued expenses and other liabilities
(3) Only includes servicing rights that are carried at fair value due to recognition of a valuation allowance.
(4) Only includes impaired loans with specific loss allocations based on collateral value.
(5) Only includes other real estate with subsequent write downs to fair value.

There were no transfers between Level 1 and Level 2 during the nine months ended September 30, 2016 and 2015.

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Changes in fair values for financial assets which we have elected the fair value option for the periods presented were as follows:

	Changes in Fair Values for the Nine-Month Periods Ended September 30 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option					
	2016			2015		
	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period
	Securities	Loans	Earnings	Securities	Loans	Earnings
	(In thousands)					
Trading securities	$ 4	$ -	$ 4	$ 22	$ -	$ 22
Loans held for sale	-	612	612	-	311	311

For those items measured at fair value pursuant to our election of the fair value option, interest income is recorded within the Condensed Consolidated Statements of Operations based on the contractual amount of interest income earned on these financial assets and dividend income is recorded based on cash dividends received.

The following represent impairment charges recognized during the three and nine month periods ended September 30, 2016 and 2015 relating to assets measured at fair value on a non-recurring basis:

Capitalized mortgage loan servicing rights, whose individual strata are measured at fair value, had a carrying amount of $10.7 million which is net of a valuation allowance of $4.7 million at September 30, 2016 and had a carrying amount of $8.5 million which is net of a valuation allowance of $3.3 million at December 31, 2015. A recovery (charge) of $0.6 million and $(1.5) million was included in our results of operations for the three and nine month periods ending September 30, 2016, respectively and $(0.9) million and $(0.3) million during the same periods in 2015.

Loans which are measured for impairment using the fair value of collateral for collateral dependent loans, had a carrying amount of $4.4 million, with a valuation allowance of $2.0 million at September 30, 2016 and had a carrying amount of $5.1 million, with a valuation allowance of $2.5 million at December 31, 2015. The provision for loan losses included in our results of operations relating to impaired loans was a net expense of $0.1 million and $1.0 million for the three month periods ending September 30, 2016 and 2015, respectively, and a net expense of $0.3 million and $1.9 million for the nine month periods ending September 30, 2016 and 2015, respectively.

Other real estate, which is measured using the fair value of the property, had a carrying amount of $3.2 million which is net of a valuation allowance of $0.6 million at September 30, 2016 and a carrying amount of $1.0 million which is net of a valuation allowance of $1.7 million at December 31, 2015. An additional charge relating to other real estate measured at fair value of $0.37 million and $0.41 million was included in our results of operations during the three and nine month periods ended September 30, 2016, respectively and $0.03 million and $0.30 million during the same periods in 2015.

We had no assets or liabilities measured at fair value on a recurring basis that used significant unobservable inputs (Level 3) during the nine months ended September 30, 2016 and 2015.

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Quantitative information about Level 3 fair value measurements measured on a non-recurring basis follows:

	Asset Fair Value (In thousands)	Valuation Technique	Unobservable Inputs	Weighted Average	
September 30, 2016					
Capitalized mortgage loan servicing rights	$ 10,678	Present value of net servicing revenue	Discount rate	10.06	%
			Cost to service	$ 82	
			Ancillary income	24	
			Float rate	1.18	%
Impaired loans					
Commercial (1)	1,787	Sales comparison approach	Adjustment for differences between comparable sales	(2.4	)%
Mortgage	368	Sales comparison approach	Adjustment for differences between comparable sales	(10.2	)
Other real estate					
Commercial	176	Sales comparison approach	Adjustment for differences between comparable sales	(22.5	)
Mortgage and installment	55	Sales comparison approach	Adjustment for differences between comparable sales	4.6	
December 31, 2015					
Capitalized mortgage loan servicing rights	$ 8,481	Present value of net servicing revenue	Discount rate	10.04	%
			Cost to service	$ 80	
			Ancillary income	24	
			Float rate	1.73	%
Impaired loans					
Commercial (1)	1,605	Sales comparison approach	Adjustment for differences between comparable sales	(2.1	)%
		Income approach	Capitalization rate	9.3	
Mortgage	550	Sales comparison approach	Adjustment for differences between comparable sales	0.7	
Other real estate					
Commercial	804	Sales comparison approach	Adjustment for differences between comparable sales	(3.9	)
Mortgage and installment	183	Sales comparison approach	Adjustment for differences between comparable sales	75.6	

(1) In addition to the valuation techniques and unobservable inputs discussed above, at September 30, 2016 and December 31, 2015, we had an impaired collateral dependent commercial relationship that totaled $0.2 million and $0.4 million, respectively that was primarily secured by collateral other than real estate. Collateral securing this relationship primarily included machinery and equipment and inventory at September 30, 2016 and December 31, 2015. Valuation techniques at September 30, 2016 and December 31, 2015, included appraisals and discounting

restructuring firm valuations based on estimates of value recovery of each particular asset type. Discount rates used ranged from 0% to 100% of stated values.

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The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding for loans held for sale for which the fair value option has been elected for the periods presented.

	Aggregate Fair Value	Difference	Contractual Principal
	(In thousands)		
Loans held for sale			
September 30, 2016	$38,008	$ 1,326	$ 36,682
December 31, 2015	27,866	714	27,152

13. Fair Values of Financial Instruments

Most of our assets and liabilities are considered financial instruments. Many of these financial instruments lack an available trading market and it is our general practice and intent to hold the majority of our financial instruments to maturity. Significant estimates and assumptions were used to determine the fair value of financial instruments. These estimates are subjective in nature, involving uncertainties and matters of judgment, and therefore, fair values may not be a precise estimate. Changes in assumptions could significantly affect the estimates.

Estimated fair values have been determined using available data and methodologies that are considered suitable for each category of financial instrument. For instruments with adjustable interest rates which reprice frequently and without significant credit risk, it is presumed that estimated fair values approximate the recorded book balances.

Cash and due from banks and interest bearing deposits: The recorded book balance of cash and due from banks and interest bearing deposits approximate fair value and are classified as Level 1.

Interest bearing deposits - time: Interest bearing deposits - time have been valued based on a model using a benchmark yield curve plus a base spread and are classified as Level 2.

Securities: Financial instrument assets actively traded in a secondary market have been valued using quoted market prices. Trading securities are classified as Level 1 while securities available for sale are classified as Level 2 as described in Note #12.

Federal Home Loan Bank and Federal Reserve Bank Stock: It is not practicable to determine the fair value of FHLB and FRB Stock due to restrictions placed on transferability.

Net loans and loans held for sale: The fair value of loans is calculated by discounting estimated future cash flows using estimated market discount rates that reflect credit and interest-rate risk inherent in the loans and do not necessarily represent an exit price. Loans are classified as Level 3. Impaired loans are valued at the lower of cost or fair value as described in Note #12. Loans held for sale are classified as Level 2 as described in Note #12.

Accrued interest receivable and payable: The recorded book balance of accrued interest receivable and payable approximate fair value and are classified at the same Level as the asset and liability they are associated with.

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Derivative financial instruments: The fair value of rate-lock mortgage loan commitments and mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets, the fair value of interest rate swap agreements is based on a discounted cash flow analysis whose significant fair value inputs can generally be observed in the market place and do not typically involve judgment by management and the fair value of purchased and written options is based on prices of financial instruments with similar characteristics and do not typically involve judgment by management. Each of these instruments has been classified as Level 2 as described in Note #12.

Deposits: Deposits without a stated maturity, including demand deposits, savings, NOW and money market accounts, have a fair value equal to the amount payable on demand. Each of these instruments is classified as Level 1. Deposits with a stated maturity, such as certificates of deposit have generally been valued based on the discounted value of contractual cash flows using a discount rate approximating current market rates for liabilities with a similar maturity resulting in a Level 2 classification.

Other borrowings: Other borrowings have been valued based on the discounted value of contractual cash flows using a discount rate approximating current market rates for liabilities with a similar maturity resulting in a Level 2 classification.

Subordinated debentures: Subordinated debentures have generally been valued based on a quoted market price of similar instruments resulting in a Level 2 classification.

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The estimated recorded book balances and fair values follow:

	Recorded Book Balance	Fair Value	Fair Value Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)				
September 30, 2016					
Assets					
Cash and due from banks	$38,610	$38,610	$38,610	$ -	$-
Interest bearing deposits	75,706	75,706	75,706	-	-
Interest bearing deposits - time	7,233	7,272	-	7,272	-
Trading securities	152	152	152	-	-
Securities available for sale	603,112	603,112	-	603,112	-
Federal Home Loan Bank and Federal Reserve Bank Stock	15,507	NA	NA	NA	NA
Net loans and loans held for sale	1,623,319	1,601,113	-	38,008	1,563,105
Accrued interest receivable	6,973	6,973	2	2,438	4,533
Derivative financial instruments	3,388	3,388	-	3,388	-
Liabilities					
Deposits with no stated maturity (1)	$1,743,864	$1,743,864	$1,743,864	$ -	$-
Deposits with stated maturity (1)	463,096	462,297	-	462,297	-
Other borrowings	11,527	12,702	-	12,702	-
Subordinated debentures	35,569	22,223	-	22,223	-
Accrued interest payable	630	630	17	613	-
Derivative financial instruments	2,508	2,508	-	2,508	-
December 31, 2015					
Assets					
Cash and due from banks	$54,260	$54,260	$54,260	$ -	$-
Interest bearing deposits	31,523	31,523	31,523	-	-
Interest bearing deposits - time	11,866	11,858	-	11,858	-
Trading securities	148	148	148	-	-
Securities available for sale	585,484	585,484	-	585,484	-
Federal Home Loan Bank and Federal Reserve Bank Stock	15,471	NA	NA	NA	NA
Net loans and loans held for sale	1,520,346	1,472,613	-	27,866	1,444,747
Accrued interest receivable	6,565	6,565	5	1,969	4,591
Derivative financial instruments	1,238	1,238	-	1,238	-
Liabilities					

Deposits with no stated maturity (1)	$1,659,743	$1,659,743	$1,659,743	$ -	$ -
Deposits with stated maturity (1)	426,220	423,776	-	423,776	-
Other borrowings	11,954	13,448	-	13,448	-
Subordinated debentures	35,569	23,069	-	23,069	-
Accrued interest payable	466	466	21	445	-
Derivative financial instruments	619	619	-	619	-

(1) Deposits with no stated maturity include reciprocal deposits with a recorded book balance of $9.3 million and $11.8 million at September 30, 2016 and December 31, 2015, respectively. Deposits with a stated maturity include reciprocal deposits with a recorded book balance of $37.3 million and $38.4 million at September 30, 2016 and December 31, 2015, respectively.

The fair values for commitments to extend credit and standby letters of credit are estimated to approximate their aggregate book balance, which is nominal and therefore are not disclosed.

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Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale the entire holdings of a particular financial instrument.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business, the value of future earnings attributable to off-balance sheet activities and the value of assets and liabilities that are not considered financial instruments.

Fair value estimates for deposit accounts do not include the value of the core deposit intangible asset resulting from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

14. Contingent Liabilities

We are involved in various litigation matters in the ordinary course of business. At the present time, we do not believe any of these matters will have a significant impact on our consolidated financial position or results of operations. The aggregate amount we have accrued for losses we consider probable as a result of these litigation matters is immaterial. However, because of the inherent uncertainty of outcomes from any litigation matter, we believe it is reasonably possible we may incur losses in addition to the amounts we have accrued. At this time, we estimate the maximum amount of additional losses that are reasonably possible is approximately $1.0 million. However, because of a number of factors, including the fact that certain of these litigation matters are still in their early stages, this maximum amount may change in the future.

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans or vehicle service contract counterparty receivables). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, but we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote. Risks associated with the likelihood that we will not collect the full amount owed to us, net of reserves, are disclosed elsewhere in this report.

Our Mepco segment conducts its payment plan business activities across the United States. Mepco acquires the payment plans from companies (which we refer to as Mepco's "counterparties") at a discount from the face amount of the payment plan. Each payment plan (which are classified as payment plan receivables in our Condensed Consolidated Statements of Financial Condition) permits a consumer to purchase a vehicle service contract by making installment payments, generally for a term of 12 to 30 months, to the sellers of those contracts (one of the "counterparties"). Mepco thereafter collects the payments from consumers. In acquiring the payment plan, Mepco generally funds a portion of the cost to the seller of the service contract and a portion of the cost to the administrator of the service contract. The administrator, in turn, pays the necessary contractual liability insurance policy ("CLIP") premium to the insurer or risk retention group.

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Consumers are allowed to voluntarily cancel the service contract at any time and are generally entitled to receive a refund from the administrator of the unearned portion of the service contract at the time of cancellation. As a result, while Mepco does not owe any refund to the consumer, it also does not have any recourse against the consumer for nonpayment of a payment plan and therefore does not evaluate the creditworthiness of the individual consumer. If a consumer stops making payments on a payment plan or exercises the right to voluntarily cancel the service contract, the service contract seller and administrator are each obligated to refund to Mepco the amount necessary to make Mepco whole as a result of its funding of the service contract. In addition, the insurer or risk retention group that issued the CLIP for the service contract often guarantees all or a portion of the refund to Mepco. See Note #4 above for a breakdown of Mepco's payment plan receivables by the level of recourse Mepco has against various counterparties.

Upon the cancellation of a service contract and the completion of the billing process to the counterparties for amounts due to Mepco, there is a decrease in the amount of "payment plan receivables" and an increase in the amount of "vehicle service contract counterparty receivables" until such time as the amount due from the counterparty is collected. These amounts represent funds actually due to Mepco from its counterparties for cancelled service contracts. Mepco is currently in the process of working to recover these receivables, primarily through negotiated settlements with the counterparties. In some cases, Mepco requires collateral or guaranties by the principals of the counterparties to secure these refund obligations; however, this is generally only the case when no insurance company is involved to guarantee the repayment obligation of the seller and administrator counterparties. In most cases, there is no collateral to secure the counterparties' refund obligations to Mepco, but Mepco has the contractual right to offset unpaid refund obligations against amounts Mepco would otherwise be obligated to fund to the counterparties. In addition, even when collateral is involved, the refund obligations of these counterparties are not fully secured. Mepco incurs losses when it is unable to fully recover funds owed to it by counterparties upon cancellation of the underlying service contracts. The sudden failure of one of Mepco's major counterparties (an insurance company, administrator, or seller/dealer) could expose us to significant losses.

When counterparties do not honor their contractual obligations to Mepco to repay funds, we recognize estimated losses. Mepco pursues collection (including commencing legal action if necessary) of funds due to it under its various contracts with counterparties. Mepco has had to initiate litigation against certain counterparties, including third party insurers, to collect amounts owed to Mepco as a result of those parties' dispute of their contractual obligations to Mepco. During the first quarter of 2016, we settled our last significant remaining litigation matter with certain of Mepco's counterparties. This settlement resulted in our receipt of a cash payment of $4.0 million on March 31, 2016. This settlement also resulted in our receipt of an interest-bearing promissory note from one of Mepco's counterparties for $1.5 million with monthly payments scheduled over a five-year period beginning in May 2016. Due to the lack of any payment history and limited financial information on this counterparty, we established a full reserve on this promissory note as of March 31, 2016. A full reserve on the remaining balance ($1.39 million) on this note was maintained at September 30, 2016. This counterparty has made the first six required monthly payments on the note. As a longer-term payment history is developed on this note, we will continue to evaluate the need for all or any part of a reserve. Vehicle service contract counterparty receivables, net totaled $2.6 million as of September 30, 2016 compared to $7.2 million as of December 31, 2015. Expense/(credit) related to vehicle service contract counterparty contingencies included in non-interest expense totaled $(0.039) million and $0.030 million for the three month periods ended September 30, 2016 and 2015, respectively and totaled $(0.010) million and $0.089 million for the nine month periods ended September 30, 2016 and 2015, respectively. These charges (recoveries) are being classified in non-interest expense because they are associated with a default or potential default of a contractual obligation under our counterparty contracts as opposed to loss on the administration of the payment plan itself.

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Our estimate of probable incurred losses from vehicle service contract counterparty contingencies requires a significant amount of judgment because a number of factors can influence the amount of loss that we may ultimately incur. These factors include our estimate of future cancellations of vehicle service contracts, our evaluation of collateral that may be available to recover funds due from our counterparties, and our assessment of the amount that may ultimately be collected from counterparties in connection with their contractual obligations. We apply a rigorous process, based upon historical payment plan activity and past experience, to estimate probable incurred losses and quantify the necessary reserves for our vehicle service contract counterparty contingencies, but there can be no assurance that our modeling process will successfully identify all such losses.

We believe our assumptions regarding the collection of vehicle service contract counterparty receivables are reasonable, and we based them on our good faith judgments using data currently available. We also believe the current amount of reserves we have established and the vehicle service contract counterparty contingencies expense that we have recorded are appropriate given our estimate of probable incurred losses at the applicable Condensed Consolidated Statement of Financial Condition date. However, because of the uncertainty surrounding the numerous and complex assumptions made, actual losses could exceed the charges we have taken to date.

The provision for loss reimbursement on sold loans represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac and Ginnie Mae). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. The provision for loss reimbursement on sold loans was an expense (credit) of $0.05 million and $(0.04) million for the three months ended September 30, 2016 and 2015, respectively and $0.03 million and $(0.06) million for the nine month periods ended September 30, 2016 and 2015, respectively. The small expenses in 2016 are primarily due to establishing specific reserves for pending loss reimbursement claims. The small credit provisions in 2015 are due primarily to the settlements of certain loss reimbursement claims at slightly lower amounts than what had been specifically reserved for at the end of the respective previous period. The reserve for loss reimbursements on sold mortgage loans totaled $0.6 million and $0.5 million at September 30, 2016 and December 31, 2015, respectively. This reserve is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. The reserve levels at September 30, 2016 and December 31, 2015 also reflect the resolution of the mortgage loan origination years of 2000 to 2008 with Fannie Mae and Freddie Mac. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate given our analyses. However, future losses could exceed our current estimate.

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15. Accumulated Other Comprehensive Loss ("AOCL")

A summary of changes in AOCL follows:

	Unrealized Gains (Losses) on Securities Available for Sale	Disproportionate Tax Effects from Securities Available for Sale	Total
For the three months ended September 30, 2016			
Balances at beginning of period	$ 2,515	$ (5,798)	$(3,283)
Other comprehensive income before reclassifications	278	-	278
Amounts reclassified from AOCL	(10)	-	(10)
Net current period other comprehensive income	268	-	268
Balances at end of period	$ 2,783	$ (5,798)	$(3,015)
2015			
Balances at beginning of period	$ 408	$ (5,798)	$(5,390)
Other comprehensive income before reclassifications	894	-	894
Amounts reclassified from AOCL	-	-	-
Net current period other comprehensive income	894	-	894
Balances at end of period	$ 1,302	$ (5,798)	$(4,496)
For the nine months ended September 30, 2016			
Balances at beginning of period	$ (238)	$ (5,798)	$(6,036)
Other comprehensive income before reclassifications	3,215	-	3,215
Amounts reclassified from AOCL	(194)	-	(194)
Net current period other comprehensive income	3,021	-	3,021
Balances at end of period	$ 2,783	$ (5,798)	$(3,015)
2015			
Balances at beginning of period	$ 162	$ (5,798)	$(5,636)
Other comprehensive income before reclassifications	1,189	-	1,189
Amounts reclassified from AOCL	(49)	-	(49)
Net current period other comprehensive income	1,140	-	1,140
Balances at end of period	$ 1,302	$ (5,798)	$(4,496)

The disproportionate tax effects from securities available for sale arose due to tax effects of other comprehensive income ("OCI") in the presence of a valuation allowance against our deferred tax assets and a pretax loss from operations. Generally, the amount of income tax expense or benefit allocated to operations is determined without regard to the tax effects of other categories of income or loss, such as OCI. However, an exception to the general rule is provided when, in the presence of a valuation allowance against deferred tax assets, there is a pretax loss from operations and pretax income from other categories in the current period. In such instances, income from other

categories must offset the current loss from operations, the tax benefit of such offset being reflected in operations.

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A summary of reclassifications out of each component of AOCL for the three months ended September 30 follows:

AOCL Component	Amount Reclassified From AOCL (In thousands)	Affected Line Item in Condensed Consolidated Statements of Operations
2016		
Unrealized gains on securities available for sale		
	$ 15	Net gains on securities
	-	Net impairment loss recognized in earnings
	15	Total reclassifications before tax
	5	Income tax expense
	$ 10	Reclassifications, net of tax
2015		
Unrealized gains on securities available for sale		
	$ -	Net gains on securities
	-	Net impairment loss recognized in earnings
	-	Total reclassifications before tax
	-	Income tax expense
	$ -	Reclassifications, net of tax

A summary of reclassifications out of each component of AOCL for the nine months ended September 30 follows:

AOCL Component	Amount Reclassified From AOCL (In thousands)	Affected Line Item in Condensed Consolidated Statements of Operations
2016		
Unrealized gains on securities available for sale		
	$ 298	Net gains on securities
	-	Net impairment loss recognized in earnings
	298	Total reclassifications before tax
	104	Income tax expense
	$ 194	Reclassifications, net of tax
2015		
Unrealized gains on securities available for sale		
	$ 75	Net gains on securities
	-	Net impairment loss recognized in earnings
	75	Total reclassifications before tax
	26	Income tax expense
	$ 49	Reclassifications, net of tax

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ITEM 2.

Management's Discussion and Analysis
of Financial Condition and Results of Operations

Introduction. The following section presents additional information to assess the financial condition and results of operations of Independent Bank Corporation, its wholly-owned bank, Independent Bank (the "Bank"), and their subsidiaries. This section should be read in conjunction with the Condensed Consolidated Financial Statements. We also encourage you to read our 2015 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC"). That report includes a list of risk factors that you should consider in connection with any decision to buy or sell our securities.

Overview. We provide banking services to customers located primarily in Michigan's Lower Peninsula. As a result, our success depends to a great extent upon the economic conditions in Michigan's Lower Peninsula. At times, we have experienced a difficult economy in Michigan. Economic conditions in Michigan began to show signs of improvement during 2010. Generally, these improvements have continued into 2016, albeit at an uneven pace. There has been an overall decline in the unemployment rate as well as generally improving housing prices and other related statistics (such as home sales and new building permits). In addition, since early- to mid-2009, we have seen an improvement in our asset quality metrics. In particular, since early 2012, we have generally experienced a decline in non-performing assets, lower levels of new loan defaults, and reduced levels of loan net charge-offs.

Regulation. On July 2, 2013, the Federal Reserve Board (the "FRB") 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 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (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 2.5% capital conservation buffer is being phased in over a four-year period beginning in 2016 with 0.625% added to the minimum ratio for adequately capitalized institutions for 2016 and each subsequent year until being fully phased in during 2019. To avoid limits on capital distributions and certain discretionary bonus payments we must meet the minimum ratio for adequately capitalized institutions plus the phased in buffer. The rule also raises the minimum ratio of tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking organizations. As to the quality of capital, the New Capital Rules emphasize common equity tier 1 capital, the most loss-absorbing form of capital, and implements strict eligibility criteria for regulatory capital instruments. The New Capital Rules also change the methodology for calculating risk-weighted assets to enhance risk sensitivity. Under the New Capital Rules our existing trust preferred securities are grandfathered as qualifying regulatory capital. We were subject to the New Capital Rules beginning on January 1, 2015, and as of September 30, 2016 and December 31, 2015 we exceeded all of the capital ratio requirements of the New Capital Rules.

It is against this backdrop that we discuss our results of operations and financial condition in the third quarter and first nine months of 2016 as compared to 2015.

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Results of Operations

Summary. We recorded net income of $6.4 million and $5.0 million, respectively, during the three months ended September 30, 2016 and 2015. The increase in net income on a comparative quarterly basis is due primarily to increases in net interest income and non-interest income that were partially offset by increases in non-interest expense and income tax expense.

We recorded net income of $16.9 million and $14.4 million, respectively, during the nine months ended September 30, 2016 and 2015. The increase in net income on a comparative year-to-date basis is due primarily to an increase in net interest income and decreases in the provision for loan losses (a higher credit) and in non-interest expense that were partially offset by a decrease in non-interest income and an increase in income tax expense.

Key performance ratios

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net income (annualized) to				
Average assets	1.02 %	0.86 %	0.92 %	0.84 %
Average common shareholders' equity	10.20	7.84	9.19	7.59
Net income per common share				
Basic	$ 0.30	$ 0.22	$ 0.79	$ 0.63
Diluted	0.30	0.22	0.78	0.62

Net interest income. Net interest income is the most important source of our earnings and thus is critical in evaluating our results of operations. Changes in our net interest income are primarily influenced by our level of interest-earning assets and the income or yield that we earn on those assets and the manner and cost of funding our interest-earning assets. Certain macro-economic factors can also influence our net interest income such as the level and direction of interest rates, the difference between short-term and long-term interest rates (the steepness of the yield curve) and the general strength of the economies in which we are doing business. Finally, risk management plays an important role in our level of net interest income. The ineffective management of credit risk and interest-rate risk in particular can adversely impact our net interest income.

Our net interest income totaled $20.0 million during the third quarter of 2016, an increase of $1.2 million, or 6.1% from the year-ago period. The quarterly increase in net interest income in 2016 compared to 2015 primarily reflects a $182.3 million increase in average interest-earning assets that was partially offset by a seven basis point decrease in our tax equivalent net interest income as a percent of average interest-earning assets (the "net interest margin").

For the first nine months of 2016, net interest income totaled $59.4 million, an increase of $3.8 million, or 6.8% from 2015. The year-to-date increase in net interest income in 2016 compared to 2015 primarily reflects a $169.4 million increase in average interest-earning assets that was partially offset by a four basis point decrease in our net interest margin.

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The decline in our net interest margin is primarily due to the prolonged low interest rate environment that has pushed our average yield on loans lower as well as a slight increase in our cost of funds (caused primarily by a higher mix and slightly higher average interest rate on time deposits).

Interest rates have generally been at extremely low levels since 2008 due primarily to the FRB's monetary policies and its efforts to stimulate the U.S. economy. This very low interest rate environment has generally had an adverse impact on our net interest margin. Based on recent announcements by the FRB, short-term interest rates are expected to remain extremely low until at least late-2016 or 2017. Given the repricing characteristics of our interest-earning assets and interest-bearing liabilities (and our level of non-interest bearing demand deposits), we would expect that our net interest margin will generally benefit on a long-term basis from rising interest rates.

Our net interest income is also adversely impacted by our level of non-accrual loans. In the third quarter and first nine months of 2016 non-accrual loans averaged $10.7 million and $10.6 million, respectively compared to $12.9 million and $13.7 million, respectively for the same periods in 2015. In addition, in the third quarter and first nine months of 2016 we had net recoveries of $0.07 million and $0.75 million, respectively, of accrued and unpaid interest on loans placed on or taken off non-accrual or previously charged-off during each period compared to net recoveries of $0.16 million and $0.34 million, respectively, during the same periods in 2015.

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Average Balances and Tax Equivalent Rates

	Three Months Ended September 30,					
	2016			2015		
	Average Balance	Interest	Rate [3]	Average Balance	Interest	Rate [3]
	(Dollars in thousands)					
Assets [1]						
Taxable loans	$1,613,189	$18,562	4.59 %	$1,470,529	$17,834	4.83 %
Tax-exempt loans [2]	3,492	53	6.04	3,740	54	5.73
Taxable securities	534,319	2,537	1.90	520,805	1,901	1.46
Tax-exempt securities [2]	58,694	507	3.46	33,104	347	4.19
Interest bearing cash	69,603	86	0.49	68,972	70	0.40
Other investments	15,347	195	5.05	15,231	225	5.86
Interest Earning Assets	2,294,644	21,940	3.81	2,112,381	20,431	3.85
Cash and due from banks	34,565			45,477		
Other assets, net	152,793			164,253		
Total Assets	$2,482,002			$2,322,111		
Liabilities						
Savings and interest-bearing checking	$1,014,201	284	0.11	$990,229	266	0.11
Time deposits	438,504	970	0.88	371,501	721	0.77
Other borrowings	47,227	493	4.15	47,769	465	3.86
Interest Bearing Liabilities	1,499,932	1,747	0.46	1,409,499	1,452	0.41
Non-interest bearing deposits	706,282			633,305		
Other liabilities	27,110			23,844		
Shareholders' equity	248,678			255,463		
Total liabilities and shareholders' equity	$2,482,002			$2,322,111		
Net Interest Income		$20,193			$18,979	
Net Interest Income as a Percent of Average Interest Earning Assets			3.51 %			3.58 %

(1) All domestic.

(2) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 35%

(3) Annualized

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Average Balances and Tax Equivalent Rates

	Nine Months Ended September 30,					
	2016			2015		
	Average Balance	Interest	Rate [3]	Average Balance	Interest	Rate [3]
	(Dollars in thousands)					
Assets [1]						
Taxable loans	$1,577,758	$55,255	4.67 %	$1,446,857	$52,736	4.87 %
Tax-exempt loans [2]	3,564	163	6.11	4,097	189	6.17
Taxable securities	532,576	7,261	1.82	518,906	5,528	1.42
Tax-exempt securities [2]	50,286	1,320	3.50	32,790	1,021	4.15
Interest bearing cash	75,121	292	0.52	64,913	194	0.40
Other investments	15,456	592	5.12	17,772	728	5.48
Interest Earning Assets	2,254,761	64,883	3.84	2,085,335	60,396	3.87
Cash and due from banks	38,069			44,829		
Other assets, net	157,570			167,849		
Total Assets	$2,450,400			$2,298,013		
Liabilities						
Savings and interest-bearing checking	$1,018,727	831	0.11	$988,594	792	0.11
Time deposits	435,146	2,689	0.83	373,235	2,169	0.78
Other borrowings	47,405	1,455	4.10	47,930	1,382	3.86
Interest Bearing Liabilities	1,501,278	4,975	0.44	1,409,759	4,343	0.41
Non-interest bearing deposits	677,645			609,192		
Other liabilities	25,612			24,581		
Shareholders' equity	245,865			254,481		
Total liabilities and shareholders' equity	$2,450,400			$2,298,013		
Net Interest Income		$59,908			$56,053	
Net Interest Income as a Percent of Average Interest Earning Assets			3.55 %			3.59 %

(1) All domestic.

(2) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 35%

(3) Annualized

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Provision for loan losses. The provision for loan losses was a credit of approximately $0.2 million during both the three months ended September 30, 2016 and 2015. During the nine-month periods ended September 30, 2016 and 2015, the provision was a credit of $1.4 million and $1.0 million, respectively. The provision reflects our assessment of the allowance for loan losses taking into consideration factors such as loan mix, levels of non-performing and classified loans and loan net charge-offs. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors. See “Portfolio Loans and asset quality” for a discussion of the various components of the allowance for loan losses and their impact on the provision for loan losses in the third quarter and first nine months of 2016.

Non-interest income. Non-interest income is a significant element in assessing our results of operations. We regard net gains on mortgage loans as a recurring source of revenue but they are quite cyclical and thus can be volatile.

Non-interest income totaled $11.7 million during the three months ended September 30, 2016, an increase of $1.6 million from the comparable period in 2015. For the first nine months of 2016 non-interest income totaled $29.1 million, a $1.0 million decrease from the comparable period in 2015. The components of non-interest income are as follows:

Non-Interest Income

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Service charges on deposit accounts	$3,281	$3,294	$9,164	$9,261
Interchange income	1,943	2,169	5,797	6,551
Net gains (losses) on assets:				
Mortgage loans	3,556	1,812	7,727	5,735
Securities	(45)	45	302	97
Mortgage loan servicing, net	858	(556)	(454)	476
Investment and insurance commissions	427	447	1,278	1,380
Bank owned life insurance	282	304	870	979
Title insurance fees	319	281	860	874
Gain on branch sale	-	1,193	-	1,193
Other	1,087	1,130	3,553	3,522
Total non-interest income	$11,708	$10,119	$29,097	$30,068

Service charges on deposit accounts declined slightly on both a comparative quarterly and year-to-date basis in 2016 as compared to 2015. Over the last few years, such service charges have been decreasing, principally due to a decline in non-sufficient funds (“NSF”) occurrences and related NSF fees. We believe the long-term decline in NSF occurrences is due to our customers managing their finances more closely and having real-time access to deposit account information through electronic channels allowing them to reduce NSF activity and avoid the associated fees.

Interchange income decreased on both a comparative quarterly and year-to-date basis in 2016 as compared to 2015. The decrease in interchange income in 2016 as compared to 2015 primarily results from lower incentives under our Debit Brand Agreement with MasterCard. In addition, although transaction volume increased 1.8% year-over-year, interchange revenue per transaction declined by 5.3%, primarily due to a higher mix of debit (PIN-based) versus credit (signature-based) transactions.

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Net gains on mortgage loans increased on both a quarterly and a year to date basis. Mortgage loan activity is summarized as follows:

Mortgage Loan Activity

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Mortgage loans originated	$123,124	$79,648	$288,592	$260,744
Mortgage loans sold	89,349	71,063	215,494	221,957
Net gains on the sale of mortgage loans	3,556	1,812	7,727	5,735
Net gains as a percent of mortgage loans sold ("Loan Sales Margin")	3.98 %	2.55 %	3.59 %	2.58 %
Fair value adjustments included in the Loan Sales Margin	0.55	(0.05)	0.40	0.21

The increases in mortgage loan originations in 2016 as compared to 2015 are due primarily to a decrease in mortgage loan interest rates during parts of 2016 that resulted in an increase in mortgage loan refinance volumes as well as an improving housing market which has resulted in an increase in purchase money mortgage origination volume.

Net gains as a percentage of mortgage loans sold (our "Loan Sales Margin") are impacted by several factors including competition and the manner in which the loan is sold. Net gains on mortgage loans are also impacted by recording fair value accounting adjustments. Excluding the aforementioned fair value accounting adjustments, the Loan Sales Margin would have been 3.43% and 2.60% in the third quarters of 2016 and 2015, respectively and 3.19% and 2.37% for the comparative 2016 and 2015 year-to-date periods, respectively. The increase in the Loan Sales Margin (excluding fair value adjustments) in 2016 was generally due to a widening of primary-to-secondary market pricing spreads as well as a higher content of government (FHA and VA) mortgage loan sales, which generally have higher profit margins than conventional mortgage loan sales. The changes in the fair value accounting adjustments are primarily due to changes in the amount of commitments to originate mortgage loans for sale. Because of recent increases in longer-term interest rates and competitive factors, we do not expect the significant increase in the Loan Sales Margin that we have experienced in the first nine months of 2016 to continue into the last quarter of 2016 or into 2017.

The volume of loans sold is dependent upon our ability to originate mortgage loans as well as the demand for fixed-rate obligations and other loans that we choose to not put into portfolio because of our established interest-rate risk parameters. (See "Portfolio Loans and asset quality.") Net gains on mortgage loans are also dependent upon economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates and thus can often be a volatile part of our overall revenues.

Net securities (losses) gains totaled $(0.045) million and $0.302 million during the three and nine months ended September 30, 2016, respectively, and $0.045 million and $0.097 million for the respective comparable periods in 2015. The third quarter 2016 securities net losses were due primarily to a $0.06 million decrease in the fair value of trading securities. The year-to-date 2016 securities net gains were due primarily to the sale of $56.5 million of investments. The third quarter 2015 securities net gains were due to an increase in the fair value of our trading securities. The 2015 year-to-date securities net gains were due to the sale of $11.8 million of investments and an increase in the fair value of our trading securities. We recorded no net impairment losses in 2016 or 2015 for other than temporary impairment of securities available for sale. (See "Securities.")

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Mortgage loan servicing generated income of $0.9 million and a loss of $0.5 million in the third quarter and first nine months of 2016, respectively, compared to a loss of $0.6 million and income of $0.5 million in the third quarter and first nine months of 2015, respectively. These variances are primarily due to changes in the valuation allowance on and the amortization of capitalized mortgage loan servicing rights. The period end valuation allowance is based on the valuation of the mortgage loan servicing portfolio. Activity related to capitalized mortgage loan servicing rights is as follows:

Capitalized Mortgage Loan Servicing Rights

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Balance at beginning of period	$10,331	$12,535	$12,436	$12,106
Originated servicing rights capitalized	896	678	2,153	2,128
Amortization	(799)	(700)	(2,065)	(2,259)
Change in valuation allowance	620	(883)	(1,476)	(345)
Balance at end of period	$11,048	$11,630	$11,048	$11,630
Valuation allowance at end of period	$4,748	$4,118	$4,748	$4,118

At September 30, 2016 we were servicing approximately $1.64 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of 4.24% and a weighted average service fee of approximately 25.5 basis points. Remaining capitalized mortgage loan servicing rights at September 30, 2016 totaled $11.0 million, representing approximately 67 basis points on the related amount of mortgage loans serviced for others. The capitalized mortgage loan servicing had an estimated fair market value of $11.1 million at September 30, 2016.

Investment and insurance commissions represent revenues generated on the sale or management of investments and insurance for our customers. These revenues were relatively unchanged on a quarterly basis and declined slightly on a year-to-date basis in 2016 as compared to 2015, due primarily to open sales representative positions that were not filled until the second quarter of 2016.

Income from bank owned life insurance declined on both a comparative quarterly and year-to-date basis in 2016 compared to 2015 reflecting a lower average crediting rate on our cash surrender value. Our separate account is primarily invested in agency mortgage-backed securities and managed by PIMCO. The crediting rate (on which the earnings are based) reflects the performance of the separate account. The total cash surrender value of our bank owned life insurance was $53.8 million and $54.4 million at September 30, 2016 and December 31, 2015, respectively.

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Title insurance fees were slightly higher on a comparative quarterly basis and relatively unchanged on a year-to-date basis in 2016 as compared to 2015. The amount of title insurance fees is primarily a function of the level of mortgage loans that we originated.

Third quarter and year-to-date 2015 results include a net gain of $1.2 million on the sale of our Midland, Michigan branch.

Other non-interest income was relatively unchanged on both a comparative quarterly and year-to-date basis in 2016 compared to 2015.

Non-interest expense. Non-interest expense is an important component of our results of operations. We strive to efficiently manage our cost structure and management is focused on a number of initiatives to reduce and contain non-interest expenses.

Non-interest expense increased by $0.65 million to $22.5 million and decreased by $0.1 million to $65.5 million during the three- and nine-month periods ended September 30, 2016, respectively, compared to the same periods in 2015.

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The components of non-interest expense are as follows:

Non-Interest Expense

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Compensation	$8,546	$8,419	$24,948	$24,880
Performance-based compensation	2,174	1,572	5,374	4,604
Payroll taxes and employee benefits	2,311	2,038	6,590	6,121
Compensation and employee benefits	13,031	12,029	36,912	35,605
Data processing	1,971	2,001	6,008	5,958
Occupancy, net	1,919	1,940	5,982	6,399
Furniture, fixtures and equipment	990	998	2,939	2,915
Communications	670	754	2,280	2,184
Loan and collection	568	816	1,964	2,938
Advertising	455	406	1,410	1,338
Legal and professional fees	420	519	1,178	1,352
FDIC deposit insurance	187	350	852	1,044
Interchange expense	276	279	809	859
Credit card and bank service fees	203	197	588	602
Supplies	178	190	551	619
Amortization of intangible assets	86	86	260	260
Net (gains) losses on other real estate and repossessed assets	263	5	98	(173)
Provision for loss reimbursement on sold loans	45	(35)	30	(59)
Costs related to unfunded lending commitments	73	26	6	46
Vehicle service contract counterparty contingencies	(39)	30	(10)	89
Other	1,233	1,288	3,612	3,633
Total non-interest expense	$22,529	$21,879	$65,469	$65,609

Compensation and employee benefits expenses, in total, increased $1.0 million, or 8.3%, on a quarterly comparative basis and increased $1.3 million, or 3.7%, for the first nine months of 2016 compared to the same periods in 2015.

Compensation expense increased by $0.1 million, or 1.5%, and by $0.1 million, or 0.3%, in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. Average full-time equivalent employees (“FTEs”) were higher by approximately 1.4% and lower by approximately 0.7% during the third quarter and first nine months of 2016, respectively, compared to the year ago periods. On a year-to-date basis, the impact of the slight decline in the average FTE level was offset by merit raises granted in 2016.

Performance-based compensation increased by $0.6 million and by $0.8 million in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015, due primarily to a higher accrual for anticipated incentive compensation based on our estimated 2016 performance as compared to goals.

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Payroll taxes and employee benefits increased by $0.3 million and $0.5 million in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The quarterly increase is due primarily to increases in medical insurance and employee training costs as well as a higher employer 401(k) contribution. The year-to-date increase is due primarily to a higher employer 401(k) contribution and increased employee training costs. The increased employee training costs primarily relate to a new sales training program implemented in 2016.

Data processing expenses were relatively unchanged in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. A decline in software amortization expense was offset by the cost of new services added with our core data processing vendor or other outside service providers.

Occupancy, net, was relatively unchanged and decreased by $0.4 million in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The year-to-date decline is primarily due to decreases in utility costs and real estate property taxes (which reflect fewer properties owned due to sales or other dispositions) and lower lease costs for our Mepco Finance Corporation (“Mepco”) Chicago office due to relocating to smaller space in the fourth quarter of 2015.

Furniture, fixtures and equipment expenses were relatively unchanged on both a comparative quarterly and year-to-date basis.

Communications expenses declined by $0.1 million and increased by $0.1 million in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The year-to-date increase in 2016 is due primarily to mailing costs for a new checking account program.

Loan and collection expenses primarily reflect costs related to the management and collection of non-performing loans and other problem credits. These expenses have further declined in 2016, which primarily reflects the overall year-over-year decrease in non-performing assets and watch credits. (See “Portfolio Loans and asset quality.”)

Advertising expenses increased slightly on both a quarterly and year-to-date basis in 2016 as compared to 2015, due primarily to the cost of a new checking account acquisition program.

Legal and professional fees decreased on both a comparative quarterly and year-to-date basis due primarily to a decline in legal fees at Mepco because of the resolution (in the first quarter of 2016) of counterparty litigation associated with collection matters.

FDIC deposit insurance decreased on both a comparative quarterly and year-to-date basis due primarily to a decline in our premium rate during the third quarter of 2016. At June 30, 2016, the FDIC Deposit Insurance Fund reserve ratio reached 1.15%, which triggered a new assessment method and generally lower deposit insurance premiums for banks with less than $10 billion in assets.

Interchange expense primarily represents our third-party cost to process debit card transactions. This cost has declined slightly on both a comparative quarterly and year-to-date basis due primarily to the decline in debit card transaction revenue described above.

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Credit card and bank service fees were essentially unchanged on both a comparative quarterly and year-to-date basis as the number of payment plans being serviced by Mepco in 2016 compared to 2015 was relatively stable.

Supplies expenses decreased on both a comparative quarterly and year-to-date basis due primarily to declines at Mepco associated with the outsourcing of its mailroom operations.

The amortization of intangible assets primarily relates to branch acquisitions and the amortization of the deposit customer relationship value, including core deposit value, which was acquired in connection with those acquisitions. We had remaining unamortized intangible assets of $2.0 million and $2.3 million at September 30, 2016 and December 31, 2015, respectively. See Note #8 to the Condensed Consolidated Financial Statements for a schedule of future amortization of intangible assets.

Net (gains) losses on other real estate and repossessed assets primarily represent the gain or loss on the sale or additional write downs on these assets subsequent to the transfer of the asset from our loan portfolio. This transfer occurs at the time we acquire the collateral that secured the loan. At the time of acquisition, the other real estate or repossessed asset is valued at fair value, less estimated costs to sell, which becomes the new basis for the asset. Any write-downs at the time of acquisition are charged to the allowance for loan losses. In general, greater stability in real estate prices during the last few years (with several markets even experiencing price increases) has resulted in modest losses or gains on the sale of other real estate. We recorded net losses of $0.263 million and $0.098 million in the third quarter and first nine months of 2016, respectively, as compared to a net loss of $0.005 million and a net gain of $0.173 million, respectively, recorded in the same periods in 2015. The net losses in 2016 primarily reflect a $0.36 million write-down in the third quarter on a group of commercial income-producing properties that were sold at auction. We expect to close on this sale ($3.0 million balance in other real estate at September 30, 2016) in the fourth quarter of 2016.

The provision for loss reimbursement on sold loans was an expense of $0.045 million and $0.030 million in the third quarter and first nine months of 2016, respectively, compared to a credit of $0.035 million and a credit of $0.059 million in the third quarter and first nine months of 2015, respectively. This provision represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac and Ginnie Mae). The small expenses in 2016 are primarily due to establishing specific reserves for pending loss reimbursement claims. The small credit provisions in 2015 are due primarily to the settlements of certain loss reimbursement claims at slightly lower amounts than what had been specifically reserved for at the end of the respective previous period. Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. The reserve for loss reimbursements on sold mortgage loans totaled $0.560 million and $0.530 million at September 30, 2016 and December 31, 2015, respectively. This reserve is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. The reserve levels at September 30, 2016 and December 31, 2015 also reflect the resolution of the mortgage loan origination years of 2000 to 2008 with Fannie Mae and Freddie Mac. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate given our analyses. However, future losses could exceed our current estimate.

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The changes in costs related to unfunded lending commitments are primarily impacted by changes in the amounts of such commitments to originate portfolio loans as well as (for commercial loan commitments) the grade (pursuant to our loan rating system) of such commitments.

Our estimate of probable incurred losses from vehicle service contract counterparty contingencies requires a significant amount of judgment because a number of factors can influence the amount of loss that we may ultimately incur. These factors include our estimate of future cancellations of vehicle service contracts, our evaluation of collateral that may be available to recover funds due from our counterparties, and our assessment of the amount that may ultimately be collected from counterparties in connection with their contractual obligations. We apply a rigorous process, based upon historical payment plan activity and past experience, to estimate probable incurred losses and quantify the necessary reserves for our vehicle service contract counterparty contingencies, but there can be no assurance that our modeling process will successfully identify all such losses.

In particular, as noted in our Risk Factors included in Part I - Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, Mepco has had to initiate litigation against certain counterparties, including third party insurers, to collect amounts owed to Mepco as a result of those parties' dispute of their contractual obligations to Mepco. During the first quarter of 2016, we settled our last significant remaining litigation matter with certain of Mepco’s counterparties. This settlement resulted in our receipt of a cash payment of $4.0 million on March 31, 2016. This settlement also resulted in our receipt of an interest-bearing promissory note from one of Mepco’s counterparties for $1.5 million with monthly payments scheduled over a five-year period beginning in May 2016. Due to the lack of any payment history and limited financial information on this counterparty, we established a full reserve on this promissory note as of March 31, 2016. A full reserve on the remaining balance ($1.39 million) on this note was maintained at September 30, 2016. This counterparty has made the first six required monthly payments on the note. As a longer-term payment history is developed on this note, we will continue to evaluate the need for all or any part of a reserve. Vehicle service contract counterparty receivables, net totaled $2.6 million as of September 30, 2016 compared to $7.2 million as of December 31, 2015.

In addition, see Note #14 to the Condensed Consolidated Financial Statements included within this report for more information about Mepco's business, certain risks and difficulties we currently face with respect to that business, and reserves we have established (through vehicle service contract counterparty contingencies expense) for losses related to the business.

Other non-interest expenses were relatively unchanged in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015.

Income tax expense. We recorded an income tax expense of $3.0 million and $7.5 million in the third quarter and the first nine months of 2016, respectively. This compares to an income tax expense of $2.3 million and $6.7 million in the third quarter and the first nine months of 2015, respectively.

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The second quarter and first nine months of 2016 included a $0.3 million income tax benefit resulting from the adoption of Financial Accounting Standards Board Accounting Standards Update 2016-09 “Compensation – Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). See Note #2 to the Condensed Consolidated Financial Statements.

Our actual federal income tax expense is different than the amount computed by applying our statutory federal income tax rate to our pre-tax income primarily due to tax-exempt interest income and tax-exempt income from the increase in the cash surrender value on life insurance.

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, 2016 and 2015, that the realization of substantially all of our deferred tax assets continues to be more likely than not.

We did maintain a valuation allowance against our deferred tax assets of approximately $1.1 million at both September 30, 2016 and December 31, 2015. This valuation allowance on our deferred tax assets primarily relates to state income taxes at our Mepco segment. In this instance, we determined that the future realization of these particular deferred tax assets was not more likely than not. This conclusion was primarily based on the uncertainty of Mepco’s future earnings attributable to particular states (given the various apportionment criteria) and the significant reduction in the size of Mepco’s business.

Business Segments. Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent 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.

The following table presents net income (loss) by business segment.

Business Segments

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Independent Bank	$6,665	$5,455	$17,834	$15,623
Mepco	(20)	(168)	(225)	(437)
Other[1]	(256)	(224)	(652)	(693)
Elimination	(16)	(16)	(46)	(46)
Net income (loss)	$6,373	$5,047	$16,911	$14,447

[1] Includes amounts relating to our parent company.

The increase in third quarter net income at Independent Bank in 2016 compared to 2015 is primarily due to increases in net interest income and non-interest income that were partially offset by increases in non-interest expense and income tax expense. The increase in year-to-date net income at Independent Bank in 2016 compared to 2015 is primarily due to an increase in net interest income and decreases in the provision for loan losses (a higher credit) and in non-interest expense that were partially offset by a decrease in non-interest income and an increase in income tax expense. (See “Net interest income,” “Provision for loan losses,” “Non-interest income,” “Non-interest expense,” “Income tax expense,” and “Portfolio Loans and asset quality.”)

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The improvement in Mepco's results in 2016 compared to 2015 is primarily due to a decrease in non-interest expenses that was partially offset by a decrease in net interest income as a result of a decline in year-over-year average payment plan receivables. All of Mepco's funding is provided by Independent Bank through an intercompany loan (that is eliminated in consolidation). The rate on this intercompany loan is based on the Prime Rate (currently 3.50%). Mepco might not be able to obtain such favorable funding costs on its own in the open market.

Financial Condition

Summary. Our total assets increased by $129.3 million during the first nine months of 2016 due primarily to increases in cash and cash equivalents, securities available for sale and loans. Loans, excluding loans held for sale ("Portfolio Loans"), totaled $1.61 billion at September 30, 2016, an increase of $92.3 million, or 6.1%, from December 31, 2015. (See "Portfolio Loans and asset quality.")

Deposits totaled $2.21 billion at September 30, 2016, compared to $2.09 billion at December 31, 2015. The $121.0 million increase in total deposits during the period is primarily due to growth in checking, savings and time deposit account balances.

Securities. We maintain diversified securities portfolios, which include obligations of U.S. government-sponsored agencies, securities issued by states and political subdivisions, residential and commercial mortgage-backed securities, collateralized loan obligations, asset-backed securities, corporate securities and trust preferred securities. We regularly evaluate asset/liability management needs and attempt to maintain a portfolio structure that provides sufficient liquidity and cash flow. Except as discussed below, we believe that the unrealized losses on securities available for sale are temporary in nature and are expected to be recovered within a reasonable time period. We believe that we have the ability to hold securities with unrealized losses to maturity or until such time as the unrealized losses reverse. (See "Asset/liability management.")

Securities

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
Securities available for sale				
September 30, 2016	$598,831	$6,313	$2,032	$603,112
December 31, 2015	585,851	3,152	3,519	585,484

In the first quarter of 2016, we initiated the use of Pacific Investment Management Company LLC ("PIMCO") to manage an approximately $150 million segment of our securities available for sale. This segment of our securities available for sale has a similar risk-weighting and duration as our remaining portfolio.

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Securities available for sale increased by $17.6 million during the first nine months of 2016 due primarily to increases in private label mortgage-backed securities, asset-backed securities, corporate securities and municipal securities. The securities were purchased to utilize a portion of the funds generated from the increase in total deposits. (See “Deposits” and “Liquidity and capital resources.”)

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

Sales of securities were as follows (See “Non-interest income.”):

	Nine months ended September 30,	
	2016	2015
	(In thousands)	
Proceeds	$56,451	$11,786
Gross gains	$350	$75
Gross losses	(52)	-
Net impairment charges	-	-
Fair value adjustments	4	22
Net gains	$302	$97

Portfolio Loans and asset quality. In addition to the communities served by our Bank branch network, our principal lending markets also include nearby communities and metropolitan areas. Subject to established underwriting criteria, we also may participate in commercial lending transactions with certain non-affiliated banks and make whole loan purchases from other financial institutions. In August 2016, we purchased $14.8 million of single-family residential fixed rate mortgage loans from another Michigan-based financial institution. These mortgage loans were all on properties located in Michigan, had a weighted average interest rate (after a 0.25% servicing fee) of 3.65% and a weighted average remaining contractual maturity of 332 months. In December 2015, we purchased $32.6 million of single-family residential fixed rate jumbo mortgage loans from another Michigan-based financial institution. These mortgage loans were all on properties located in Michigan, had a weighted average interest rate (after a 0.25% servicing fee) of 3.94% and a weighted average remaining contractual maturity of 344 months.

The senior management and board of directors of our Bank retain authority and responsibility for credit decisions and we have adopted uniform underwriting standards. Our loan committee structure and the loan review process attempt to provide requisite controls and promote compliance with such established underwriting standards. However, there can be no assurance that our lending procedures and the use of uniform underwriting standards will prevent us from incurring significant credit losses in our lending activities.

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We generally retain loans that may be profitably funded within established risk parameters. (See “Asset/liability management.”) As a result, we may hold adjustable-rate mortgage loans as Portfolio Loans, while 15- and 30-year, fixed-rate obligations are generally sold to mitigate exposure to changes in interest rates. (See “Non-interest income.”)

Non-performing assets[1]

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Non-accrual loans	$ 10,801	$ 10,607
Loans 90 days or more past due and still accruing interest	-	116
Total non-performing loans	10,801	10,723
Other real estate and repossessed assets	4,989	7,150
Total non-performing assets	$ 15,790	$ 17,873
As a percent of Portfolio Loans		
Non-performing loans	0.67 %	0.71 %
Allowance for loan losses	1.37	1.49
Non-performing assets to total assets	0.62	0.74
Allowance for loan losses as a percent of non-performing loans	204.08	210.48

(1) Excludes loans classified as “troubled debt restructured” that are not past due and vehicle service contract counterparty receivables, net.

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Troubled debt restructurings ("TDR")

	September 30, 2016		
	Commercial	Retail	Total
	(In thousands)		
Performing TDR's	$12,642	$62,299	$74,941
Non-performing TDR's(1)	2,352	3,421 (2)	5,773
Total	$14,994	$65,720	$80,714

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

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

Non-performing loans increased by $0.08 million, or 0.7%, during the first nine months of 2016 due principally to an increase in non-performing mortgage loans that was largely offset by declines in non-performing commercial and consumer installment loans. In general, improving economic conditions in our market areas, as well as our collection and resolution efforts, have resulted in a generally stable or downward trend in non-performing loans. However, we are still experiencing some loan defaults, particularly related to commercial loans secured by income-producing property and mortgage loans secured by resort/vacation property.

Non-performing loans exclude performing loans that are classified as troubled debt restructurings (“TDRs”). Performing TDRs totaled $74.9 million, or 4.7% of total Portfolio Loans, and $81.5 million, or 5.4% of total Portfolio Loans, at September 30, 2016 and December 31, 2015, respectively. The decrease in the amount of performing TDRs in the first nine months of 2016 primarily reflects a decline in retail loan TDRs.

Other real estate and repossessed assets totaled $5.0 million at September 30, 2016, compared to $7.2 million at December 31, 2015. This decrease is primarily the result of sales of other real estate being in excess of the migration of non-performing loans secured by real estate into other real estate as the foreclosure process is completed.

We will place a loan that is 90 days or more past due on non-accrual, unless we believe the loan is both well secured and in the process of collection. Accordingly, we have determined that the collection of the accrued and unpaid interest on any loans that are 90 days or more past due and still accruing interest is probable.

The ratio of loan net charge-offs to average Portfolio Loans was a negative 0.08% (as a result of net recoveries) on an annualized basis in the first nine months of 2016 compared to 0.03% in the first nine months of 2015. The $1.3 million decline in loan net charge-offs is primarily due to declines in commercial loan and mortgage loan net charge-offs. The overall decrease in loan net charge-offs primarily reflects a year-over-year reduction in non-performing loans and improvement in collateral liquidation values.

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Allowance for loan losses

	Nine months ended September 30,			
	2016		2015	
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(Dollars in thousands)			
Balance at beginning of period	$22,570	$ 652	$25,990	$ 539
Additions (deductions)				
Provision for loan losses	(1,439)	-	(1,037)	-
Recoveries credited to allowance	3,623	-	3,418	-
Loans charged against the allowance	(2,711)	-	(3,767)	-
Additions (deductions) included in non-interest expense	-	6	-	46
Balance at end of period	$22,043	$ 658	$24,604	$ 585
Net loans charged against the allowance to average Portfolio Loans (annualized)	(0.08)%		0.03 %	

Allocation of the Allowance for Loan Losses

	September 30, 2016	December 31, 2015
	(In thousands)	
Specific allocations	$10,375	$ 10,983
Other adversely rated commercial loans	559	1,053
Historical loss allocations	5,566	5,262
Additional allocations based on subjective factors	5,543	5,272
Total	$22,043	$ 22,570

Some loans will not be repaid in full. Therefore, an allowance for loan losses (“AFLL”) is maintained at a level which represents our best estimate of losses incurred. In determining the AFLL and the related provision for loan losses, we consider four principal elements: (i) specific allocations based upon probable losses identified during the review of the loan portfolio, (ii) allocations established for other adversely rated commercial loans, (iii) allocations based principally on historical loan loss experience, and (iv) additional allowances based on subjective factors, including local and general economic business factors and trends, portfolio concentrations and changes in the size and/or the general terms of the loan portfolios.

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The first AFLL element (specific allocations) reflects our estimate of probable incurred losses based upon our systematic review of specific loans. These estimates are based upon a number of factors, such as payment history, financial condition of the borrower, discounted collateral exposure and discounted cash flow analysis. Impaired commercial, mortgage and installment loans are allocated allowance amounts using this first element. The second AFLL element (other adversely rated commercial loans) reflects the application of our commercial loan rating system. This rating system is similar to those employed by state and federal banking regulators. Commercial loans that are rated below a certain predetermined classification are assigned a loss allocation factor for each loan classification category that is based upon a historical analysis of both the probability of default and the expected loss rate ("loss given default"). The lower the rating assigned to a loan or category, the greater the allocation percentage that is applied. The third AFLL element (historical loss allocations) is determined by assigning allocations to higher rated ("non-watch credit") commercial loans using a probability of default and loss given default similar to the second AFLL element and to homogenous mortgage and installment loan groups based upon borrower credit score and portfolio segment. For homogenous mortgage and installment loans a probability of default for each homogenous pool is calculated by way of credit score migration. Historical loss data for each homogenous pool coupled with the associated probability of default is utilized to calculate an expected loss allocation rate. The fourth AFLL element (additional allocations based on subjective factors) is based on factors that cannot be associated with a specific credit or loan category and reflects our attempt to ensure that the overall allowance for loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses. We consider a number of subjective factors when determining this fourth element, including local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and the general terms of the overall loan portfolio.

Increases in the AFLL are recorded by a provision for loan losses charged to expense. Although we periodically allocate portions of the AFLL to specific loans and loan portfolios, the entire AFLL is available for incurred losses. We generally charge-off commercial, homogenous residential mortgage and installment loans and payment plan receivables when they are deemed uncollectible or reach a predetermined number of days past due based on product, industry practice and other factors. Collection efforts may continue and recoveries may occur after a loan is charged against the AFLL.

While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors.

Mepco's allowance for losses is determined in a similar manner as discussed above, and primarily takes into account historical loss experience and other subjective factors deemed relevant to Mepco's payment plan business. Estimated incurred losses associated with Mepco's outstanding vehicle service contract payment plans are included in the provision for loan losses. Mepco recorded a $0.003 million credit and a $0.005 million credit in the first nine months of 2016 and 2015, respectively, for its provision for loan losses. Mepco's allowance for loan losses totaled $0.060 million and $0.063 million at September 30, 2016 and December 31, 2015, respectively. Mepco has established procedures for vehicle service contract payment plan servicing, administration and collections, including the timely cancellation of the vehicle service contract, in order to protect our position in the event of payment default or voluntary cancellation by the customer. Mepco has also established procedures to attempt to prevent and detect fraud since the payment plan origination activities and initial customer contacts are done entirely through unrelated third parties (vehicle service contract administrators and sellers or automobile dealerships). However, there can be no assurance that the aforementioned risk management policies and procedures will prevent us from the possibility of incurring significant credit or fraud related losses in this business segment. The estimated incurred losses described in this paragraph should be distinguished from the possible losses we may incur from counterparties failing to pay their obligations to Mepco. See Note #14 to the Condensed Consolidated Financial Statements included within this report.

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The allowance for loan losses decreased $0.53 million to $22.04 million at September 30, 2016 from $22.57 million at December 31, 2015 and was equal to 1.37% of total Portfolio Loans at September 30, 2016 compared to 1.49% at December 31, 2015. Two of the four components of the allowance for loan losses outlined above declined in the first nine months of 2016. The allowance for loan losses related to specific loans decreased $0.61 million in 2016 due primarily to a $7.0 million decline in the balance of individually impaired loans as well as charge-offs. The allowance for loan losses related to other adversely rated commercial loans decreased $0.49 million in 2016 primarily due to a decrease in the balance of such loans included in this component to $13.8 million at September 30, 2016 from $27.8 million at December 31, 2015. The allowance for loan losses related to historical losses increased $0.30 million during 2016 due principally to loan growth. The allowance for loan losses related to subjective factors increased $0.27 million during 2016 also primarily due to overall growth of the loan portfolio.

Deposits and borrowings. Historically, the loyalty of our customer base has allowed us to price deposits competitively, contributing to a net interest margin that compares favorably to our peers. However, we still face a significant amount of competition for deposits within many of the markets served by our branch network, which limits our ability to materially increase deposits without adversely impacting the weighted-average cost of core deposits.

To attract new core deposits, we have implemented various account acquisition strategies as well as branch staff sales training. Account acquisition initiatives have historically generated increases in customer relationships. Over the past several years, we have also expanded our treasury management products and services for commercial businesses and municipalities or other governmental units and have also increased our sales calling efforts in order to attract additional deposit relationships from these sectors. We view long-term core deposit growth as an important objective. Core deposits generally provide a more stable and lower cost source of funds than alternative sources such as short-term borrowings. (See “Liquidity and capital resources.”)

Deposits totaled $2.21 billion and $2.09 billion at September 30, 2016 and December 31, 2015, respectively. The $121.0 million increase in deposits during the first nine months of 2016 is due to growth in checking, savings and time deposit account balances. Reciprocal deposits totaled $46.6 million and $50.2 million at September 30, 2016 and December 31, 2015, respectively. These deposits represent demand, money market and time deposits from our customers that have been placed through Promontory Interfinancial Network’s Insured Cash Sweep® service and Certificate of Deposit Account Registry Service®. These services allow our customers to access multi-million dollar FDIC deposit insurance on deposit balances greater than the standard FDIC insurance maximum.

We cannot be sure that we will be able to maintain our current level of core deposits. In particular, those deposits that are uninsured may be susceptible to outflow. At September 30, 2016, we had approximately $572.4 million of uninsured deposits. A reduction in core deposits would likely increase our need to rely on wholesale funding sources.

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We have also implemented strategies that incorporate using federal funds purchased, other borrowings and Brokered CDs to fund a portion of our interest-earning assets. The use of such alternate sources of funds supplements our core deposits and is also an integral part of our asset/liability management efforts.

Other borrowings, comprised almost entirely of advances from the Federal Home Loan Bank (the "FHLB"), totaled $11.5 million and $12.0 million at September 30, 2016 and December 31, 2015, respectively.

As described above, we utilize wholesale funding, including FHLB borrowings and Brokered CDs to augment our core deposits and fund a portion of our assets. At September 30, 2016, our use of such wholesale funding sources (including reciprocal deposits) amounted to approximately $58.2 million, or 2.6% of total funding (deposits and total borrowings, excluding subordinated debentures). Because wholesale funding sources are affected by general market conditions, the availability of such funding may be dependent on the confidence these sources have in our financial condition and operations. The continued availability to us of these funding sources is not certain. Our liquidity may be constrained if we are unable to renew our wholesale funding sources or if adequate financing is not available in the future at acceptable rates of interest or at all. Our financial performance could also be affected if we are unable to maintain our access to funding sources or if we are required to rely more heavily on more expensive funding sources. In such case, our net interest income and results of operations could be adversely affected.

We historically employed derivative financial instruments to manage our exposure to changes in interest rates. We discontinued the active use of derivative financial instruments during 2008. We began to again utilize interest-rate swaps in 2014, relating to our commercial lending activities. During the first nine months of 2016 and 2015, we entered into $23.0 million and $16.6 million (aggregate notional amounts), respectively, of interest rate swaps with commercial loan customers, which were offset with interest rate swaps that the Bank entered into with a broker-dealer. We recorded $0.4 million and $0.3 million of fee income related to these transactions during each of the first nine month periods of 2016 and 2015, respectively.

Liquidity and capital resources. Liquidity risk is the risk of being unable to timely meet obligations as they come due at a reasonable funding cost or without incurring unacceptable losses. Our liquidity management involves the measurement and monitoring of a variety of sources and uses of funds. Our Condensed Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus our liquidity management on maintaining adequate levels of liquid assets (primarily funds on deposit with the FRB and certain securities available for sale) as well as developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for purchasing securities available for sale or originating Portfolio Loans as well as to be able to respond to unforeseen liquidity needs.

Our primary sources of funds include our deposit base, secured advances from the FHLB, a federal funds purchased borrowing facility with another commercial bank, and access to the capital markets (for Brokered CDs).

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At September 30, 2016, we had $324.1 million of time deposits that mature in the next 12 months. Historically, a majority of these maturing time deposits are renewed by our customers. Additionally, $1.74 billion of our deposits at September 30, 2016, were in account types from which the customer could withdraw the funds on demand. Changes in the balances of deposits that can be withdrawn upon demand are usually predictable and the total balances of these accounts have generally grown or have been stable over time as a result of our marketing and promotional activities. However, there can be no assurance that historical patterns of renewing time deposits or overall growth or stability in deposits will continue in the future.

We have developed contingency funding plans that stress test our liquidity needs that may arise from certain events such as an adverse change in our financial metrics (for example, credit quality or regulatory capital ratios). Our liquidity management also includes periodic monitoring that measures quick assets (defined generally as short-term assets with maturities less than 30 days and loans held for sale) to total assets, short-term liability dependence and basic surplus (defined as quick assets compared to short-term liabilities). Policy limits have been established for our various liquidity measurements and are monitored on a monthly basis. In addition, we also prepare cash flow forecasts that include a variety of different scenarios.

We believe that we currently have adequate liquidity at our Bank because of our cash and cash equivalents, our portfolio of securities available for sale, our access to secured advances from the FHLB, our ability to issue Brokered CDs and our improved financial metrics.

We also believe that the available cash on hand at the parent company (including time deposits) of approximately $11.5 million as of September 30, 2016 provides sufficient liquidity resources at the parent company to meet operating expenses, to make interest payments on the subordinated debentures and to pay a cash dividend on our common stock for the foreseeable future.

Effective management of capital resources is critical to our mission to create value for our shareholders. In addition to common stock, our capital structure also currently includes cumulative trust preferred securities.

Capitalization

	September 30, 2016	December 31, 2015
	(In thousands)	
Subordinated debentures	$35,569	$ 35,569
Amount not qualifying as regulatory capital	(1,069)	(1,069)
Amount qualifying as regulatory capital	34,500	34,500
Shareholders' equity		
Common stock	323,303	339,462
Accumulated deficit	(69,386)	(82,334)
Accumulated other comprehensive loss	(3,015)	(6,036)
Total shareholders' equity	250,902	251,092
Total capitalization	$285,402	$ 285,592

We currently have three special purpose entities with $34.5 million of outstanding cumulative trust preferred securities. These special purpose entities issued common securities and provided cash to our parent company that in turn issued subordinated debentures to these special purpose entities equal to the trust preferred securities and common securities. The subordinated debentures represent the sole asset of the special purpose entities. The common securities and subordinated debentures are included in our Condensed Consolidated Statements of Financial Condition.

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The FRB has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities (and certain other capital elements) are limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital, subject to restrictions. At the parent company, all of these securities qualified as Tier 1 capital at September 30, 2016 and December 31, 2015. Although the Dodd-Frank Act further limited Tier 1 treatment for trust preferred securities, those new limits did not apply to our outstanding trust preferred securities. Further, the New Capital Rules grandfathered the treatment of our trust preferred securities as qualifying regulatory capital.

Common shareholders' equity decreased slightly to $250.9 million at September 30, 2016 from $251.1 million at December 31, 2015 due primarily to share repurchases and dividends paid that were partially offset by our net income in the first nine months of 2016 and a decline in our accumulated other comprehensive loss.

We resumed a quarterly cash dividend on our common stock of six cents per share in May 2014 and continued to pay regular quarterly dividends at that amount through August 2015. In October 2016 and 2015, our Board of Directors increased the quarterly cash dividend on our common stock to ten cents and eight cents per share, respectively.

For the past several years, the Bank had negative "undivided profits" (i.e. a retained deficit). Under Michigan banking regulations, the Bank was not permitted to pay a dividend when it had a retained deficit. We can request regulatory approval for a return of capital from the Bank to the parent company. During the first quarter of 2016, we requested regulatory approval for an $18.0 million return of capital from the Bank to the parent company. This return of capital request was approved by our banking regulators on February 24, 2016 and the Bank returned $18.0 million of capital to the parent company on February 25, 2016. In the second quarter of 2016, the Bank returned to a positive retained earnings position. At September 30, 2016, the Bank had retained earnings of $8.7 million. In October 2016, the Bank paid a $5.0 million dividend to the parent company. Also see Note #11 to the Condensed Consolidated Financial Statements included within this report.

On January 21, 2016, our Board of Directors authorized a share repurchase plan. Under the terms of the 2016 share repurchase plan, we are authorized to buy back up to 5% of our outstanding common stock. The repurchase plan is authorized to last through December 31, 2016. We intend and 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, other regulatory requirements, potential alternative uses for capital, and our financial performance. The repurchase program 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. On April 26, 2016 our Board of Directors authorized a $5.0 million expansion of this repurchase plan. Through October 31, 2016, we repurchased 1,153,136 shares of our common stock pursuant to this plan at an average price of $14.62 per share leaving $4.4 million remaining under this repurchase plan.

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As of September 30, 2016 and December 31, 2015, our Bank (and holding company) continued to meet the requirements to be considered “well-capitalized” under federal regulatory standards (also see Note #11 to the Condensed Consolidated Financial Statements included within this report).

Asset/liability management. Interest-rate risk is created by differences in the cash flow characteristics of our assets and liabilities. Options embedded in certain financial instruments, including caps on adjustable-rate loans as well as borrowers’ rights to prepay fixed-rate loans, also create interest-rate risk.

Our asset/liability management efforts identify and evaluate opportunities to structure our statement of financial condition in a manner that is consistent with our mission to maintain profitable financial leverage within established risk parameters. We evaluate various opportunities and alternate asset/liability management strategies carefully and consider the likely impact on our risk profile as well as the anticipated contribution to earnings. The marginal cost of funds is a principal consideration in the implementation of our asset/liability management strategies, but such evaluations further consider interest-rate and liquidity risk as well as other pertinent factors. We have established parameters for interest-rate risk. We regularly monitor our interest-rate risk and report at least quarterly to our board of directors.

We employ simulation analyses to monitor our interest-rate risk profile and evaluate potential changes in our net interest income and market value of portfolio equity that result from changes in interest rates. The purpose of these simulations is to identify sources of interest-rate risk. The simulations do not anticipate any actions that we might initiate in response to changes in interest rates and, accordingly, the simulations do not provide a reliable forecast of anticipated results. The simulations are predicated on immediate, permanent and parallel shifts in interest rates and generally assume that current loan and deposit pricing relationships remain constant. The simulations further incorporate assumptions relating to changes in customer behavior, including changes in prepayment rates on certain assets and liabilities.

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Changes in Market Value of Portfolio Equity and Net Interest Income

Change in Interest Rates	Market Value Of Portfolio Equity(1)	Percent Change	Net Interest Income(2)	Percent Change
	(Dollars in thousands)			
September 30, 2016				
200 basis point rise	$387,000	11.50 %	$ 85,700	7.93 %
100 basis point rise	372,400	7.29	83,000	4.53
Base-rate scenario	347,100	-	79,400	-
100 basis point decline	314,500	(9.39)	74,700	(5.92)
December 31, 2015				
200 basis point rise	$419,600	8.42 %	$ 80,700	6.32 %
100 basis point rise	407,300	5.25	78,700	3.69
Base-rate scenario	387,000	-	75,900	-
100 basis point decline	356,500	(7.88)	72,000	(5.14)

(1) Simulation analyses calculate the change in the net present value of our assets and liabilities, including debt and related financial derivative instruments, under parallel shifts in interest rates by discounting the estimated future cash flows using a market-based discount rate. Cash flow estimates incorporate anticipated changes in prepayment speeds and other embedded options.

(2) Simulation analyses calculate the change in net interest income under immediate parallel shifts in interest rates over the next twelve months, based upon a static statement of financial condition, which includes debt and related financial derivative instruments, and do not consider loan fees.

Accounting standards update. See Note #2 to the Condensed Consolidated Financial Statements included elsewhere in this report for details on recently issued accounting pronouncements and their impact on our financial statements.

Fair valuation of financial instruments. Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) topic 820 - “Fair Value Measurements and Disclosures” (“FASB ASC topic 820”) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

We utilize fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. FASB ASC topic 820 differentiates between those assets and liabilities required to be carried at fair value at every reporting period (“recurring”) and those assets and liabilities that are only required to be adjusted to fair value under certain circumstances (“nonrecurring”). Trading securities, securities available-for-sale, loans held for sale, and derivatives are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis, such as loans held for investment, capitalized mortgage loan servicing rights and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets. See Note #12 to the Condensed Consolidated Financial Statements included within this report for a complete discussion on our use of fair valuation of financial instruments and the related measurement techniques.

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Litigation Matters

We are involved in various litigation matters in the ordinary course of business. At the present time, we do not believe any of these matters will have a significant impact on our consolidated financial position or results of operations. The aggregate amount we have accrued for losses we consider probable as a result of these litigation matters is immaterial. However, because of the inherent uncertainty of outcomes from any litigation matter, we believe it is reasonably possible we may incur losses in addition to the amounts we have accrued. At this time, we estimate the maximum amount of additional losses that are reasonably possible is approximately $1.0 million. However, because of a number of factors, including the fact that certain of these litigation matters are still in their early stages, this maximum amount may change in the future.

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans or vehicle service contract counterparty receivables). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, but we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote. Risks associated with the likelihood that we will not collect the full amount owed to us, net of reserves, are disclosed elsewhere in this report.

Critical Accounting Policies

Our accounting and reporting policies are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. Accounting and reporting policies for the allowance for loan losses, capitalized mortgage loan servicing rights, vehicle service contract payment plan counterparty contingencies, and income taxes are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those that we have used could result in material changes in our consolidated financial position or results of operations. During the first quarter of 2016, we dropped the assessment of other than temporary impairment of securities available for sale as a critical accounting policy as we do not believe that this assessment will have a material impact on our consolidated financial position or results of operations. There have been no other material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

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Item 3.

Quantitative and Qualitative Disclosures about Market Risk

See applicable disclosures set forth in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2 under the caption “Asset/liability management.”

Item 4.

Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15(e) and 15d – 15(e)) for the period ended September 30, 2016, have concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in Internal Controls.

During the quarter ended September 30, 2016, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Company maintains a Deferred Compensation and Stock Purchase Plan for Non-Employee Directors (the "Plan") pursuant to which non-employee directors can elect to receive shares of the Company's common stock in lieu of fees otherwise payable to the director for his or her service as a director. A director can elect to receive shares on a current basis or to defer receipt of the shares, in which case the shares are issued to a trust to be held for the account of the director and then generally distributed to the director after his or her retirement from the Board. Pursuant to this Plan, during the third quarter of 2016, the Company issued 652 shares of common stock to non-employee directors on a current basis and 1,325 shares of common stock to the trust for distribution to directors on a deferred basis. The shares were issued on July 1, 2016, at a price of $14.51 per share, representing aggregate fees of $0.03 million. The price per share was the consolidated closing bid price per share of the Company's common stock as of the date of issuance, as determined in accordance with NASDAQ Marketplace Rules. The Company issued the shares pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the issuance of the shares was made on a private basis pursuant to the Plan.

The following table shows certain information relating to repurchases of common stock for the three-months ended September 30, 2016:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Remaining Number of Shares Authorized for Purchase Under the Plan(1)
July 2016	93,271	$ 14.41	93,271	-
August 2016	-	-	-	-
September 2016	-	-	-	-
Total	93,271	$ 14.41	93,271	-

(1) Plus an additional $4.4 million.

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Item 6. Exhibits

(a) The following exhibits (listed by number corresponding to the Exhibit Table as Item 601 in Regulation S-K) are filed with this report:

31.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

31.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

32.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

32.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

101. INS Instance Document

101. SCH XBRL Taxonomy Extension Schema Document

101. CAL XBRL Taxonomy Extension Calculation Linkbase Document

101. DEF XBRL Taxonomy Extension Definition Linkbase Document

101. LAB XBRL Taxonomy Extension Label Linkbase Document

101. PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date November 3, 2016 By /s/ Robert N. Shuster
Robert N. Shuster, Principal Financial Officer

Date November 3, 2016 By /s/ James J. Twarozynski
James J. Twarozynski, Principal Accounting Officer