INDEPENDENT BANK CORP /MI/
Form 10-Q
November 09, 2011

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, 2011

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)

230 West Main Street, P.O. Box 491, Ionia, Michigan 48846
(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 x NO o

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 x NO o

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 o Accelerated filer o Non-accelerated filer o Smaller reporting company x

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

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

Common stock, no par value	8,478,971
Class	Outstanding at November 9, 2011

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

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Discussions and statements in this report that are not statements of historical fact, including, without limitation, statements that include terms such as "will," "may," "should," "believe," "expect," "forecast," "anticipate," "estimate," "proje "likely," "optimistic" and "plan," and statements about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions and other statements that are not historical facts, 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; predictions as to our Bank's ability to maintain certain regulatory capital standards; our expectation that we will have sufficient cash on hand to meet expected obligations during 2011; and descriptions of steps we may take to improve our capital position. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals and, by their nature, are subject to assumptions, risks, and uncertainties. Although we believe that the expectations, forecasts, and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including, among others:

- our ability to successfully raise new equity capital, effect a conversion of our outstanding preferred stock held by the U.S. Treasury into our common stock, and otherwise implement our capital restoration plan;
- the failure of assumptions underlying the establishment of and provisions made to our allowance for loan losses;
- the timing and pace of an economic recovery in Michigan and the United States in general, including regional and local real estate markets;
- the ability of our Bank to remain well-capitalized;
- 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;

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- further adverse developments in the vehicle service contract industry, whose recent turmoil has increased the credit risk and reputation risk for our subsidiary, Mepco Finance Corporation;
- potential limitations on our ability to access and rely on wholesale funding sources;
- the risk that sales of our common stock could trigger a reduction in the amount of net operating loss carryforwards that we may be able to utilize for income tax purposes;
- the continued services of our management team, particularly as we work through our asset quality issues and the implementation of our capital restoration plan;
- implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act or other new legislation, which may have significant effects on us and the financial services industry, the exact nature and extent of which cannot be determined at this time; and
- the risk that our common stock may be delisted from the Nasdaq Global Select Market.

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 A of our Annual Report on Form 10-K for the year ended December 31, 2010, 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, 2011 (unaudited)	December 31, 2010
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$58,119	$ 48,933
Interest bearing deposits	297,685	336,441
Cash and Cash Equivalents	355,804	385,374
Trading securities	99	32
Securities available for sale	94,788	67,864
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	21,005	23,630
Loans held for sale, carried at fair value	28,709	50,098
Loans		
Commercial	656,268	707,530
Mortgage	609,173	658,679
Installment	227,059	245,644
Payment plan receivables	135,042	201,263
Total Loans	1,627,542	1,813,116
Allowance for loan losses	(58,820)	(67,915)
Net Loans	1,568,722	1,745,201
Other real estate and repossessed assets	34,029	39,413
Property and equipment, net	64,142	68,359
Bank-owned life insurance	49,309	47,922
Other intangibles	7,951	8,980
Capitalized mortgage loan servicing rights	11,549	14,661
Prepaid FDIC deposit insurance assessment	13,308	15,899
Vehicle service contract counterparty receivables, net	40,133	37,270
Accrued income and other assets	27,825	30,545
Total Assets	$2,317,373	$ 2,535,248
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$505,621	$ 451,856
Savings and NOW	1,010,939	995,662
Retail time	527,933	530,774
Brokered time	34,148	273,546
Total Deposits	2,078,641	2,251,838
Other borrowings	35,726	71,032
Subordinated debentures	50,175	50,175
Vehicle service contract counterparty payables	9,934	11,739
Accrued expenses and other liabilities	32,095	31,379
Total Liabilities	2,206,571	2,416,163
Shareholders' Equity		
Preferred stock, no par value, 200,000 shares authorized; 74,426 shares issued and outstanding at September 30, 2011 and December 31, 2010; per share liquidation preference: $1,075 at September 30, 2011 and $1,036 at December 31, 2010	78,802	75,700
	248,505	246,407

Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 8,413,333 shares at September 30, 2011and 7,860,483 shares at December 31, 2010		
Accumulated deficit	(204,491)	(189,902)
Accumulated other comprehensive loss	(12,014)	(13,120)
Total Shareholders' Equity	110,802	119,085
Total Liabilities and Shareholders' Equity	$2,317,373	$ 2,535,248

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,	
	2011	2010	2011	2010
	(unaudited) (In thousands, except per share amounts)			
Interest Income				
Interest and fees on loans	$27,222	$34,370	$84,808	$110,072
Interest on securities				
Taxable	297	509	1,108	2,571
Tax-exempt	301	383	931	1,594
Other investments	367	425	1,185	1,186
Total Interest Income	28,187	35,687	88,032	115,423
Interest Expense				
Deposits	3,230	6,737	12,686	22,464
Other borrowings	1,183	1,965	3,738	7,372
Total Interest Expense	4,413	8,702	16,424	29,836
Net Interest Income	23,774	26,985	71,608	85,587
Provision for loan losses	6,171	9,543	21,029	39,237
Net Interest Income After Provision for Loan Losses	17,603	17,442	50,579	46,350
Non-interest Income				
Service charges on deposit accounts	4,623	5,516	13,689	16,624
Interchange income	2,356	2,075	6,832	6,097
Net gains (losses) on assets				
Mortgage loans	2,025	3,829	5,753	8,044
Securities	(57)	(3)	271	1,625
Other than temporary loss on securities available for sale				
Total impairment loss	(4)	(316)	(146)	(434)
Loss recognized in other comprehensive income	-	-	-	-
Net impairment loss recognized in earnings	(4)	(316)	(146)	(434)
Mortgage loan servicing	(2,655)	(1,377)	(1,885)	(2,988)
Title insurance fees	299	533	1,090	1,393
Decrease in fair value of U.S. Treasury warrant	29	-	1,025	-
Gain (loss) on extinguishment of debt	-	(20)	-	18,066
Other	2,639	2,241	7,793	6,177
Total Non-interest Income	9,255	12,478	34,422	54,604
Non-interest Expense				
Compensation and employee benefits	12,654	12,806	38,032	39,449
Loan and collection	2,658	3,805	10,105	11,376
Occupancy, net	2,651	2,721	8,415	8,225
Data processing	2,502	2,248	7,227	7,187
Vehicle service contract counterparty contingencies	1,345	5,968	5,002	14,247
Furniture, fixtures and equipment	1,308	1,591	4,228	4,958
Net losses on other real estate and repossessed assets	1,931	1,296	4,114	4,879
Credit card and bank service fees	869	1,378	2,929	4,553
FDIC deposit insurance	885	1,651	2,772	5,216
Communications	863	1,054	2,700	3,142

Legal and professional	751	831	2,330	2,861
Advertising	740	692	1,964	2,145
Costs (recoveries) related to unfunded lending commitments	(172)	(807)	12	(471)
Other	2,477	2,274	7,405	6,836
Total Non-interest Expense	31,462	37,508	97,235	114,603
Loss Before Income Tax	(4,604)	(7,588)	(12,234)	(13,649)
Income tax benefit	(482)	(978)	(748)	(1,086)
Net Loss	$(4,122)	$(6,610)	$(11,486)	$(12,563)
Preferred stock dividends and discount accretion	1,043	1,109	3,102	3,299
Net Loss Applicable to Common Stock	$(5,165)	$(7,719)	$(14,588)	$(15,862)
Net Loss Per Common Share				
Basic	$(.61)	$(1.03)	$(1.78)	$(3.71)
Diluted	(.61)	(1.03)	(1.78)	(3.71)
Dividends Per Common Share				
Declared	$.00	$.00	$.00	$.00
Paid	.00	.00	.00	.00

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,	
	2011	2010
	(unaudited - In thousands)	
Net Loss	$(11,486)	$(12,563)
Adjustments to Reconcile Net Loss to Net Cash from (used in) Operating Activities		
Proceeds from sales of loans held for sale	270,796	306,563
Disbursements for loans held for sale	(243,654)	(324,004)
Provision for loan losses	21,029	39,237
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	(9,303)	(23,060)
Net gains on sales of mortgage loans	(5,753)	(8,044)
Net gains on securities	(271)	(1,625)
Securities impairment recognized in earnings	146	434
Net losses on other real estate and repossessed assets	4,114	4,879
Vehicle service contract counterparty contingencies	5,002	14,247
Gain on extinguishment of debt	-	(18,066)
Deferred loan fees	(428)	318
Share based compensation	762	415
Decrease in accrued income and other assets	6,714	309
Increase in accrued expenses and other liabilities	1,017	5,528
	50,171	(2,869)
Net Cash from (used in) Operating Activities	38,685	(15,432)
Cash Flow from Investing Activities		
Proceeds from the sale of securities available for sale	70,322	95,444
Proceeds from the maturity of securities available for sale	2,308	5,320
Principal payments received on securities available for sale	5,524	12,507
Purchases of securities available for sale	(104,052)	(53,950)
Redemption of Federal Home Loan Bank stock	2,397	-
Redemption of Federal Reserve Bank stock	228	1,411
Net decrease in portfolio loans (loans originated, net of principal payments)	150,436	271,807
Proceeds from the collection of vehicle service contract counterparty receivables	1,438	9,781
Proceeds from the sale of other real estate and repossessed assets	14,241	13,305
Capital expenditures	(2,124)	(3,075)
Net Cash from Investing Activities	140,718	352,550
Cash Flow used in Financing Activities		
Net decrease in total deposits	(173,197)	(187,268)
Net decrease in other borrowings	(3)	(1,689)
Proceeds from Federal Home Loan Bank advances	19,000	33,000
Payments of Federal Home Loan Bank advances	(54,303)	(29,280)
Net decrease in vehicle service contract counterparty payables	(1,805)	(5,200)
Extinguishment of debt, net	-	(1,005)
Proceeds from issuance of common stock	1,335	-
Net Cash used in Financing Activities	(208,973)	(191,442)
Net Increase (Decrease) in Cash and Cash Equivalents	(29,570)	145,676
Cash and Cash Equivalents at Beginning of Period	385,374	288,736

Cash and Cash Equivalents at End of Period	$355,804	$434,412
Cash paid during the period for		
Interest	$15,475	$29,975
Income taxes	26	292
Transfer of loans to other real estate and repossessed assets	12,971	31,603
Transfer of payment plan receivables to vehicle service contract counterparty receivables	9,239	63,991
Issuance of common stock in exchange for subordinated debentures	-	23,502
Subordinated debentures exchanged for common stock	-	42,713
Retirement of Series A Preferred Stock	-	69,364
Retirement of common stock warrants	-	3,579
Issuance of Series B Preferred Stock	-	72,888
Issuance of common stock warrants	-	1,704

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,	
	2011	2010
	(unaudited) (In thousands)	
Balance at beginning of period	$119,085	$109,861
Net loss	(11,486)	(12,563)
Preferred dividends	-	(1,076)
Issuance of common stock	1,335	23,502
Share based compensation	762	415
Issuance of Series B preferred stock	-	69,550
Retirement of Series A preferred stock	-	(69,364)
Issuance of common stock warrants	-	5,041
Retirement of common stock warrants	-	(3,579)
Net change in accumulated other comprehensive loss, net of related tax effect	1,106	3,308
Balance at end of period	$110,802	$125,095

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 interim 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 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, 2010 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, 2011 and December 31, 2010, and the results of operations for the three and nine-month periods ended September 30, 2011 and 2010. The results of operations for the three and nine-month periods ended September 30, 2011, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the assessment for other than temporary impairment ("OTTI") on investment securities, the determination of the allowance for loan losses, the determination of vehicle service contract counterparty contingencies, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2010 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

In April 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-02, "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring", an amendment to FASB ASC Topic 310 "Receivables". This ASU gives new guidance to improve financial reporting by creating greater consistency in the way GAAP is applied for various types of debt restructurings. This guidance clarifies which loan modifications constitute a troubled debt restructuring ("TDR"). It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a TDR, both for purposes of recording an impairment loss and for disclosure of TDRs. Although this new guidance does not amend the accounting for TDRs, it is expected that application of the clarifications contained in this guidance will result in more modifications being considered TDRs. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. The provisions of this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, this new guidance clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. In addition, the new guidance provides "a not all inclusive" list of six indicators for creditors to consider when determining if a debtor is experiencing financial difficulties which can be found in FASB ASC 310-40-15-20. This new guidance became effective for the quarter ended September 30, 2011, and applies retrospectively to restructurings occurring since January 1, 2011. See note #4 for TDR disclosures in accordance with this ASU.

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

In September, 2011 the FASB issued ASU 2011-08, "Intangibles – Goodwill and Other (Topic 350), Testing Goodwill for Impairment". This ASU provides an entity that has positive equity the option to first evaluate qualitative factors in determining whether it is more likely than not (greater than 50%) that the fair value of a reporting unit exceeds its carrying amount as a basis for determining if the two-step goodwill impairment test is necessary. This ASU is effective for annual and interim goodwill impairment testing performed for fiscal years beginning after December 15, 2011. The adoption of this standard is not expected to have a material effect on our consolidated financial statements.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
September 30, 2011				
U.S. agency residential mortgage-backed	$52,854	$978	$128	$53,704
Private label residential mortgage-backed	12,073	-	3,378	8,695
Obligations of states and political subdivisions	28,550	706	93	29,163
Trust preferred	4,696	-	1,470	3,226
Total	$98,173	$1,684	$5,069	$94,788
December 31, 2010				
U.S. agency residential mortgage-backed	$13,103	$249	$21	$13,331
Private label residential mortgage-backed	18,203	31	4,050	14,184
Obligations of states and political subdivisions	31,534	375	650	31,259
Trust preferred	9,472	116	498	9,090
Total	$72,312	$771	$5,219	$67,864

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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, 2011						
U.S. agency residential mortgage-backed	$25,290	$128	$-	$-	$25,290	$128
Private label residential mortgage-backed	266	23	8,426	3,355	8,692	3,378
Obligations of states and political political subdivisions	452	8	2,110	85	2,562	93
Trust preferred	1,189	619	2,037	851	3,226	1,470
Total	$27,197	$778	$12,573	$4,291	$39,770	$5,069
December 31, 2010						
U.S. agency residential mortgage-backed	$2,733	$21	$-	$-	$2,733	$21
Private label residential mortgage-backed	-	-	12,624	4,050	12,624	4,050
Obligations of states and political subdivisions	8,371	428	1,796	222	10,167	650
Trust preferred	-	-	2,384	498	2,384	498
Total	$11,104	$449	$16,804	$4,770	$27,908	$5,219

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

U.S. Agency residential mortgage-backed securities — at September 30, 2011 we had 12 securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to modest spread widening on certain issues. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Private label residential mortgage-backed securities — at September 30, 2011 we had eight securities whose fair value is less than amortized cost. Two of the issues are rated by a major rating agency as investment grade while four are below investment grade and two are split rated. Six of these bonds have impairment in excess of 10% and only one of these holdings has been impaired for less than 12 months. During the third quarter one security that was impaired at

June 30, 2011 with a fair value of $1.5 million and unrealized loss of $0.3 million paid off ($1.8 million in proceeds were received).

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

The unrealized losses are largely attributable to credit spread widening on these securities. The underlying loans within these securities include Jumbo (77%) and Alt A (23%) at September 30, 2011.

	September 30, 2011		December 31, 2010	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Private label residential mortgage-backed				
Jumbo	$6,702	$(2,164)	$8,429	$(2,600)
Alt-A	1,993	(1,214)	5,755	(1,419)

Seven of the private label residential mortgage-backed transactions have geographic concentrations in California, ranging from 22% to 58% of the collateral pool. Typical exposure levels to California (median exposure is 47%) are consistent with overall market collateral characteristics. Three transactions have modest exposure to Florida, ranging from 5% to 7% and one transaction has modest exposure to Nevada (5%). The underlying collateral pools do not have meaningful exposure to Arizona, Michigan or Ohio. None of the issues involve subprime mortgage collateral. Thus the impact of this market segment is only indirect, in that it has impacted liquidity and pricing in general for private label residential mortgage-backed securities. The majority of transactions are backed by fully amortizing loans. However, six transactions have concentrations in interest only loans ranging from 31% to 94% (at origination date). The structure of the residential mortgage securities portfolio provides protection to credit losses. The portfolio primarily consists of senior securities as demonstrated by the following: super senior (20%), senior (47%), senior support (24%) and mezzanine (9%). The mezzanine classes are from seasoned transactions (85 months) with a significant level of subordination (8.4%). Except for the additional discussion below relating to other than temporary impairment, each private label residential mortgage-backed security has sufficient credit enhancement via subordination to reasonably assure full realization of book value. This assertion is based on a transaction level review of the portfolio.

Individual security reviews include: external credit ratings, forecasted weighted average life, recent prepayment speeds, underwriting characteristics of the underlying collateral, the structure of the securitization and the credit performance of the underlying collateral. The review of underwriting characteristics considers: average loan size, type of loan (fixed or ARM), vintage, rate, FICO, loan-to-value, scheduled amortization, occupancy, purpose, geographic mix and loan documentation. The review of the securitization structure focuses on the priority of cash flows to the bond, the priority of the bond relative to the realization of credit losses and the level of subordination available to absorb credit losses. The review of credit performance includes: current period as well as cumulative realized losses; the level of severe payment problems, which includes other real estate (ORE), foreclosures, bankruptcy and 90 day delinquencies; and the level of less severe payment problems, which consists of 30 and 60 day delinquencies.

All of these securities are receiving some principal and interest payments. Most of these transactions are passthrough structures, receiving pro rata principal and interest payments from a dedicated collateral pool for loans that are performing. The nonreceipt of interest cash flows is not expected and thus not presently considered in our discounted cash flow methodology discussed below.

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

In addition to the review discussed above, certain private label residential mortgage-backed securities, including the four securities with a rating below investment grade are reviewed for OTTI utilizing a cash flow projection. The scope of review included securities that account for 98% of the $3.4 million in gross unrealized losses. The cash flow analysis forecasted cash flow from the underlying loans in each transaction and then applied these cash flows to the bonds in the securitization. The cash flows from the underlying loans considered contractual payment terms (scheduled amortization), prepayments, defaults and severity of loss given default. The analysis used dynamic assumptions for prepayments, defaults and loss severity. Near term prepayment assumptions were based on recently observed prepayment rates. More weight was given to longer term historic performance (12 months). In some cases, recently observed prepayment rates are lower than historic norms due to the absence of new jumbo loan issuances. This loan market is heavily dependent upon securitization for funding, and new securitization transactions have been minimal. Our model projections anticipate that prepayment rates gradually revert to historical levels. For seasoned ARM transactions, normalized prepayment rates are estimated at 15% to 25% CPR. For fixed rate collateral (one transaction), the prepayment speeds are projected to be flat.

Default assumptions are largely based on the volume of existing real-estate owned, pending foreclosures and severe delinquencies. Other considerations include the quality of loan underwriting, recent default experience, realized loss performance and the volume of less severe delinquencies. Default levels generally are projected to remain elevated or increase for a period of time sufficient to address the level of distressed loans in the transaction. Our projections expect defaults to then decline, generally beginning in year three. Current loss severity assumptions are based on recent observations when meaningful data is available. Loss severity is expected to remain elevated for the next three years as recent housing data remains weak. Severity is expected to decline beginning in year four as the back log of foreclosure and distressed sales clear the market. Except for two securities discussed in further detail below (both are currently below investment grade), our cash flow analysis forecasts complete recovery of our cost basis for each reviewed security.

At September 30, 2011 two below investment grade private label residential mortgage-backed securities with fair values of $4.0 million and $0.3 million, respectively and unrealized losses of $1.4 million and $0.02 million, respectively (amortized cost of $5.4 million and $0.3 million, respectively) had losses that were considered other than temporary.

The underlying loans in the first transaction are 30 year fixed rate jumbos with an average FICO of 744 and an average loan-to-value ratio of 72%. The loans backing this transaction were originated in 2007 and this is our only security backed by 2007 vintage loans. We believe that this vintage is a key differentiating factor between this security and the others in our portfolio that do not have unrealized losses that are considered OTTI. The bond is a senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.318 million of credit related OTTI as of September 30, 2011 and was recognized in our consolidated statements of operations ($0.056 million and $0.169 million during the first nine months of 2011 and 2010, respectively and $0.197 million and $0.065 million during the years ended December 31, 2010 and 2009, respectively). The remaining unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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The underlying loans in the second transaction are 30 year hybrid ARM jumbos with an average FICO of 738 and an average loan-to-value ratio of 57%. The loans backing this transaction were originated in 2005. The bond is a senior support security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated credit related OTTI of $0.288 million as of September 30, 2011 and was recognized in our consolidated statements of operations ($0.090 million and $0.198 million during the first nine months of 2011 and 2010, respectively). The remaining unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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.

Obligations of states and political subdivisions — at September 30, 2011 we had five municipal securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to a widening of market spreads and continued illiquidity for certain issues. The majority of the securities are not rated by a major rating agency. Approximately 59% of the non rated securities originally had a AAA credit rating by virtue of bond insurance. However, the insurance provider no longer has an investment grade rating. The remaining non rated issues are small local issues that did not receive a credit rating due to the size of the transaction. The non rated securities have a periodic internal credit review according to established procedures. 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.

Trust preferred securities — at September 30, 2011 we had four 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 over the past three to four years has suffered from significant credit spread widening fueled by uncertainty regarding potential losses of financial companies, the absence of a liquid functioning secondary market and potential supply concerns from financial companies issuing new debt to recapitalize themselves. During the first nine months of 2011 pricing for all issues decreased due to credit spread widening.

One of the four securities is rated by a major rating agency as investment grade, while one is split rated (this security is rated as investment grade by one major rating agency and below investment grade by another) and the other two are non-rated. The non-rated issues are relatively small banks and were never rated. The issuers of these non-rated trust preferred securities, which had a total amortized cost of $2.8 million and total fair value of $1.8 million as of September 30, 2011, continue to make interest payments and have satisfactory credit metrics.

An additional $0.250 million trust preferred security was written down to zero as of December 31, 2010, including a $0.067 million credit related OTTI charge in the first quarter of 2010.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The following table breaks out our trust preferred securities in further detail as of September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Trust preferred securities				
Rated issues	$1,424	$(464)	$6,290	$(375)
Unrated issues - no OTTI	1,802	(1,006)	2,800	(7)

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.

During the nine month periods ended September 30, 2011 and 2010 we recorded in earnings OTTI charges on securities available for sale of $0.1 million and $0.4 million, respectively. During the three month periods ended September 30, 2011 and 2010 we recorded in earnings OTTI charges on securities available for sale of $0.004 million and $0.3 million, respectively. These charges were incurred on two private label residential mortgage-backed securities (three and nine month periods in 2011 and 2010) and a trust preferred security (nine month period in 2010) as discussed above.

A roll forward of credit losses recognized in earnings on securities available for sale for the nine month periods ending September 30, follows:

	2011	2010
	(In thousands)	
Balance at beginning of year	$710	$248
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	146	434
Total	$856	$682

The amortized cost and fair value of securities available for sale at September 30, 2011, by contractual maturity, follow. 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.

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$1,364	$1,377
Maturing after one year but within five years	8,678	8,991
Maturing after five years but within ten years	11,065	10,862
Maturing after ten years	12,139	11,159
	33,246	32,389
U.S. agency residential mortgage-backed	52,854	53,704

Private label residential mortgage-backed	12,073	8,695
Total	$98,173	$94,788

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the nine month periods ending September 30, follows:

	Proceeds	Realized Gains	Losses(1)
		(In thousands)	
2011	$70,322	$279	$75
2010	95,444	1,878	221

(1) Losses in 2011 and 2010 exclude $0.146 million and $0.434 million, respectively of credit related OTTI recognized in earnings.

During 2011 and 2010 our trading securities consisted of various preferred stocks. During the first nine months of 2011 and 2010 we recognized gains (losses) on trading securities of $0.067 million and $(0.032) million, respectively, that are included in net gains (losses) on securities in the Condensed Consolidated Statements of Operations. Both of these amounts, relate to gains (losses) recognized on trading securities still held at each respective period end.

4. Loans

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

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

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
2011						
Balance at beginning of period	$17,697	$23,152	$6,289	$346	$13,035	$60,519
Additions (deductions)						
Provision for loan losses	3,335	2,642	693	6	(505)	6,171
Recoveries credited to allowance	229	247	421	1	-	898
Loans charged against the allowance	(4,330)	(3,254)	(1,131)	(53)	-	(8,768)
Balance at end of period	$16,931	$22,787	$6,272	$300	$12,530	$58,820
2010						
Balance at beginning of period	$31,762	$21,723	$7,242	$504	$14,375	$75,606
Additions (deductions)						
Provision for loan losses	3,829	4,187	1,672	(49)	(96)	9,543
Recoveries credited to allowance	143	276	397	1	-	817

Loans charged against the allowance	(7,632)	(4,697)	(1,881)	(12)	-	(14,222)
Balance at end of period	$28,102	$21,489	$7,430	$444	$14,279	$71,744

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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	Unallocated	Total
			(In thousands)			
2011						
Balance at beginning of period	$23,836	$22,642	$6,769	$389	$14,279	$67,915
Additions (deductions)						
Provision for loan losses	9,378	10,975	2,374	51	(1,749)	21,029
Recoveries credited to allowance	960	987	1,128	5	-	3,080
Loans charged against the allowance	(17,243)	(11,817)	(3,999)	(145)	-	(33,204)
Balance at end of period	$16,931	$22,787	$6,272	$300	$12,530	$58,820
2010						
Balance at beginning of period	$41,259	$18,434	$6,404	$754	$14,866	$81,717
Additions (deductions)						
Provision for loan losses	16,123	17,833	6,134	(266)	(587)	39,237
Recoveries credited to allowance	647	864	1,133	12	-	2,656
Loans charged against the allowance	(29,927)	(15,642)	(6,241)	(56)	-	(51,866)
Balance at end of period	$28,102	$21,489	$7,430	$444	$14,279	$71,744

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

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

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
September 30, 2011						
Allowance for loan losses:						
Individually evaluated for impairment	$7,258	$10,278	$1,783	$-	$-	$19,319
Collectively evaluated for impairment	9,673	12,509	4,489	300	12,530	39,501
Total ending allowance balance	$16,931	$22,787	$6,272	$300	$12,530	$58,820
Loans						
Individually evaluated for impairment	$45,014	$96,636	$7,933	$-		$149,583
Collectively evaluated for impairment	613,432	515,494	219,963	135,042		1,483,931
Total loans recorded investment	658,446	612,130	227,896	135,042		1,633,514
Accrued interest included in recorded investment	2,178	2,957	837	-		5,972
Total loans	$656,268	$609,173	$227,059	$135,042		$1,627,542
December 31, 2010						
Allowance for loan losses:						
Individually evaluated for impairment	$11,522	$11,567	$1,836	$-	$-	$24,925
Collectively evaluated for impairment	12,314	11,075	4,933	389	14,279	42,990
Total ending allowance balance	$23,836	$22,642	$6,769	$389	$14,279	$67,915
Loans						
Individually evaluated for impairment	$53,415	$107,026	$6,904	$-		$167,345
Collectively evaluated for impairment	656,681	554,534	239,835	201,263		1,652,313
Total loans recorded investment	710,096	661,560	246,739	201,263		1,819,658
Accrued interest included in recorded investment	2,566	2,881	1,095	-		6,542
Total loans	$707,530	$658,679	$245,644	$201,263		$1,813,116

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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, 2011			
Commercial			
Income producing - real estate	$135	$10,040	$10,175
Land, land development and construction - real estate	-	4,544	4,544
Commercial and industrial	173	7,436	7,609
Mortgage			
1-4 family	6	14,302	14,308
Resort lending	-	8,374	8,374
Home equity line of credit - 1st lien	-	471	471
Home equity line of credit - 2nd lien	-	1,033	1,033
Installment			
Home equity installment - 1st lien	-	1,640	1,640
Home equity installment - 2nd lien	-	791	791
Loans not secured by real estate	-	604	604
Other	-	8	8
Payment plan receivables			
Full refund	-	841	841
Partial refund	-	470	470
Other	-	32	32
Total recorded investment	$314	$50,586	$50,900
Accrued interest included in recorded investment	$1	$-	$1
December 31, 2010			
Commercial			
Income producing - real estate	$276	$11,925	$12,201
Land, land development and construction - real estate	-	9,672	9,672
Commercial and industrial	675	7,016	7,691
Mortgage			
1-4 family	-	19,428	19,428
Resort lending	-	9,206	9,206
Home equity line of credit - 1st lien	-	1,080	1,080
Home equity line of credit - 2nd lien	-	1,153	1,153
Installment			
Home equity installment - 1st lien	-	1,916	1,916
Home equity installment - 2nd lien	-	1,373	1,373
Loans not secured by real estate	-	923	923
Other	-	34	34
Payment plan receivables			
Full refund	-	2,470	2,470
Partial refund	-	329	329

Other	-	127	127
Total recorded investment	$951	$66,652	$67,603
Accrued interest included in recorded investment	$23	$-	$23

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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An aging analysis of loans by class follows:

	Loans Past Due					
	30-59 days	60-89 days	90+ days	Total	Loans not Past Due	Total Loans
				(In thousands)		
September 30, 2011						
Commercial						
Income producing - real estate	$1,531	$2,541	$5,890	$9,962	$269,863	$279,825
Land, land development and construction - real estate	2,234	105	1,740	4,079	53,229	57,308
Commercial and industrial	1,863	1,648	4,075	7,586	313,727	321,313
Mortgage						
1-4 family	6,292	1,688	14,308	22,288	301,986	324,274
Resort lending	952	1,643	8,374	10,969	193,468	204,437
Home equity line of credit - 1st lien	258	165	471	894	24,971	25,865
Home equity line of credit - 2nd lien	607	246	1,033	1,886	55,668	57,554
Installment						
Home equity installment - 1st lien	367	243	1,640	2,250	43,640	45,890
Home equity installment - 2nd lien	677	515	791	1,983	54,224	56,207
Loans not secured by real estate	1,160	361	604	2,125	120,470	122,595
Other	27	15	8	50	3,154	3,204
Payment plan receivables						
Full refund	4,000	1,842	841	6,683	114,552	121,235
Partial refund	479	247	470	1,196	11,766	12,962
Other	59	33	32	124	721	845
Total recorded investment	$20,506	$11,292	$40,277	$72,075	$1,561,439	$1,633,514
Accrued interest included in recorded investment	$182	$157	$1	$340	$5,632	$5,972
December 31, 2010						
Commercial						
Income producing - real estate	$3,269	$914	$8,978	$13,161	$295,948	$309,109
Land, land development and construction - real estate	1,923	147	4,919	6,989	55,693	62,682
Commercial and industrial	1,636	2,204	4,665	8,505	329,800	338,305
Mortgage						
1-4 family	4,074	2,349	19,428	25,851	319,361	345,212
Resort lending	2,667	1,003	9,206	12,876	215,398	228,274
Home equity line of credit - 1st lien	576	-	1,080	1,656	25,951	27,607
	723	464	1,153	2,340	58,127	60,467

Home equity line of credit - 2nd lien						
Installment						
Home equity installment - 1st lien	472	228	1,916	2,616	50,150	52,766
Home equity installment - 2nd lien	746	529	1,373	2,648	63,345	65,993
Loans not secured by real estate	1,302	348	923	2,573	122,066	124,639
Other	51	16	34	101	3,240	3,341
Payment plan receivables						
Full refund	6,475	3,957	2,470	12,902	148,751	161,653
Partial refund	1,134	642	329	2,105	24,170	26,275
Other	583	166	127	876	12,459	13,335
Total recorded investment	$25,631	$12,967	$56,601	$95,199	$1,724,459	$1,819,658
Accrued interest included in recorded investment	$225	$133	$23	$381	$6,161	$6,542

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Impaired loans are as follows :

	September 30, 2011	December 31, 2010
	(In thousands)	
Impaired loans with no allocated allowance		
TDR	$25,782	$ 25,754
Non - TDR	1,369	4,495
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	10,552	19,418
TDR - allowance based on present value cash flow	94,622	93,070
Non - TDR - allowance based on collateral	16,744	21,623
Non - TDR - allowance based on present value cash flow	-	2,351
Total impaired loans	$149,069	$ 166,711
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$2,436	$ 5,462
TDR - allowance based on present value cash flow	11,900	12,086
Non - TDR - allowance based on collateral	4,983	6,644
Non - TDR - allowance based on present value cash flow	-	733
Total amount of allowance for loan losses allocated	$19,319	$ 24,925

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Impaired loans by class as of and for the nine months ended September 30, 2011 are as follows (1):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In thousands)		
With no related allowance recorded:					
Commercial					
Income producing - real estate	$2,837	$2,832	$-	$2,806	$ 95
Land, land development & construction-real estate	219	219	-	712	40
Commercial and industrial	1,347	1,344	-	2,694	100
Mortgage					
1-4 family	8,569	10,699	-	8,964	296
Resort lending	8,848	8,914	-	7,900	322
Home equity line of credit - 1st lien	-	-	-	-	-
Home equity line of credit - 2nd lien	133	212	-	115	2
Installment					
Home equity installment - 1st lien	2,066	2,106	-	1,919	72
Home equity installment - 2nd lien	2,196	2,192	-	2,021	73
Loans not secured by real estate	732	783	-	588	27
Other	25	25	-	13	1
	26,972	29,326	-	27,732	1,028
With an allowance recorded:					
Commercial					
Income producing - real estate	21,426	21,380	3,137	17,820	152
Land, land development & construction-real estate	7,780	7,771	2,072	9,195	60
Commercial and industrial	11,405	11,392	2,049	10,603	92
Mortgage					
1-4 family	61,698	63,760	7,673	63,210	2,019
Resort lending	17,341	19,057	2,574	22,648	505
Home equity line of credit - 1st lien	47	47	31	24	1
Home equity line of credit - 2nd lien	-	-	-	11	-
Consumer					
Home equity installment - 1st lien	1,408	1,450	714	1,453	42
Home equity installment - 2nd lien	1,376	1,384	1,028	1,478	46
Loans not secured by real estate	130	132	41	172	3
Other	-	-	-	-	-
	122,611	126,373	19,319	126,614	2,920
Total					
Commercial					
Income producing - real estate	24,263	24,212	3,137	20,626	247
Land, land development & construction-real estate	7,999	7,990	2,072	9,907	100
Commercial and industrial	12,752	12,736	2,049	13,297	192
Mortgage					

1-4 family	70,267	74,459	7,673	72,174	2,315
Resort lending	26,189	27,971	2,574	30,548	827
Home equity line of credit - 1st lien	47	47	31	24	1
Home equity line of credit - 2nd lien	133	212	-	126	2
Consumer					
Home equity installment - 1st lien	3,474	3,556	714	3,372	114
Home equity installment - 2nd lien	3,572	3,576	1,028	3,499	119
Loans not secured by real estate	862	915	41	760	30
Other	25	25	-	13	1
Total	$149,583	$155,699	$19,319	$154,346	$ 3,948
Accrued interest included in recorded investment	$514				

(1) There were no impaired payment plan receivables at September 30, 2011.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Impaired loans by class as of December 31, 2010 are as follows (1):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:		(In thousands)	
Commercial			
Income producing - real estate	$4,545	$4,763	$-
Land, land development & construction-real estate	1,600	2,810	-
Commercial and industrial	5,830	5,873	-
Mortgage			
1-4 family	8,770	10,551	-
Resort lending	5,666	5,670	-
Home equity line of credit - 1st lien	-	-	-
Home equity line of credit - 2nd lien	93	93	-
Installment			
Home equity installment - 1st lien	1,772	1,805	-
Home equity installment - 2nd lien	1,891	1,904	-
Loans not secured by real estate	211	220	-
Other	-	-	-
	30,378	33,689	-
With an allowance recorded:			
Commercial			
Income producing - real estate	16,206	22,748	4,279
Land, land development & construction-real estate	12,735	21,017	3,922
Commercial and industrial	12,499	13,844	3,321
Mortgage			
1-4 family	64,157	66,379	8,223
Resort lending	28,315	28,874	3,319
Home equity line of credit - 1st lien	-	-	-
Home equity line of credit - 2nd lien	25	97	25
Consumer			
Home equity installment - 1st lien	1,361	1,374	620
Home equity installment - 2nd lien	1,413	1,429	1,110
Loans not secured by real estate	256	258	106
Other	-	-	-
	136,967	156,020	24,925
Total			
Commercial			
Income producing - real estate	20,751	27,511	4,279
Land, land development & construction-real estate	14,335	23,827	3,922
Commercial and industrial	18,329	19,717	3,321
Mortgage			
1-4 family	72,927	76,930	8,223
Resort lending	33,981	34,544	3,319
Home equity line of credit - 1st lien	-	-	-

Home equity line of credit - 2nd lien	118	190	25
Consumer			
Home equity installment - 1st lien	3,133	3,179	620
Home equity installment - 2nd lien	3,304	3,333	1,110
Loans not secured by real estate	467	478	106
Other	-	-	-
Total	$167,345	$189,709	$24,925
Accrued interest included in recorded investment	$634		

(1) There were no impaired payment plan receivables at December 31, 2010.

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Our average investment in impaired loans was approximately $154.3 million and $168.3 million for the nine-month periods ended September 30, 2011 and 2010, 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 first nine months of 2011 and 2010 was approximately $3.9 million and $4.3 million, respectively.

Troubled debt restructurings follow:

	September 30, 2011			
	Commercial	Retail		Total
	(In thousands)			
Performing TDR's	$22,273	$90,378		$112,651
Non-performing TDR's(1)	4,552	13,753	(2)	18,305
Total	$26,825	$104,131		$130,956

	December 31, 2010			
	Commercial	Retail		Total
	(In thousands)			
Performing TDR's	$16,957	$96,855		$113,812
Non-performing TDR's(1)	7,814	16,616	(2)	24,430
Total	$24,771	$113,471		$138,242

(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.

The Company has allocated $14.3 million and $17.5 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2011 and December 31, 2010, respectively.

During the nine months ending September 30, 2011, 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 3 months to 60 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 248 months in certain circumstances.

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

Loans that have been classified as troubled debt retructurings during the three-month period ended September 30, 2011 follows:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
Commercial			
Income producing - real estate	5	$ 6,579	$ 6,370
Land, land development & construction-real estate	1	1,900	1,804
Commercial and industrial	-	-	-
Mortgage			
1-4 family	6	1,603	1,629
Resort lending	4	1,515	1,501
Home equity line of credit - 1st lien	-	-	-
Home equity line of credit - 2nd lien	-	-	-
Installment			
Home equity installment - 1st lien	4	98	99
Home equity installment - 2nd lien	-	-	-
Loans not secured by real estate	5	67	68
Other	-	-	-
Total	25	$ 11,762	$ 11,471

Loans that have been classified as troubled debt retructurings during the nine-month period ended September 30, 2011 follows:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
		(Dollars in thousands)	
Commercial			
Income producing - real estate	16	$ 14,793	$ 13,928
Land, land development & construction-real estate	3	5,111	1,893
Commercial and industrial	10	1,129	1,111
Mortgage			
1-4 family	59	7,663	7,540
Resort lending	27	7,474	7,393
Home equity line of credit - 1st lien	1	45	47
Home equity line of credit - 2nd lien	1	23	19
Installment			
Home equity installment - 1st lien	18	475	470
Home equity installment - 2nd lien	14	464	450
Loans not secured by real estate	23	411	404
Other	-	-	-
Total	172	$ 37,588	$ 33,255

The troubled debt restructurings described above increased the allowance for loan losses by $0.7 million and resulted in charge offs of $0.3 million and $3.8 million during the three and nine months ending September 30, 2011.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Loans that have been classified as troubled debt restructured during the past twelve months and that have subsequently defaulted during the three-month period ended September 30, 2011 follows:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
Commercial		
Income producing - real estate	1	$136
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	4	607
Resort lending	1	340
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Consumer		
Home equity installment - 1st lien	-	-
Home equity installment - 2nd lien	1	46
Loans not secured by real estate	-	-
Other	-	-
	7	$1,129

Loans that have been classified as troubled debt restructured during the past twelve months and that have subsequently defaulted during the nine-month period ended September 30, 2011 follows:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
Commercial		
Income producing - real estate	3	$1,042
Land, land development & construction-real estate	1	1,222
Commercial and industrial	-	-
Mortgage		
1-4 family	8	1,024
Resort lending	5	1,128
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Consumer		
Home equity installment - 1st lien	1	19
Home equity installment - 2nd lien	4	264
Loans not secured by real estate	-	-
Other	-	-
	22	$4,699

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

The troubled debt restructurings that subsequently defaulted described above decreased the allowance for loan losses by $0.4 million and resulted in charge offs of $0.1 million and $1.5 million during the three and nine months ending September 30, 2011.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The terms of certain other loans were modified during the nine months ending September 30, 2011 that did not meet the definition of a troubled debt restructuring. The modification of these loans could have included modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

Credit Quality Indicators – As part of our ongoing 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) investment grade 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:

Ratings 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.

Ratings 7 and 8: These loans are generally referred to as our “watch” commercial credits. These ratings include 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.

Ratings 10 and 11: These loans are generally referred to as our “substandard - non-accrual” and “Doubtful” commercial credits. These ratings include 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)
(unaudited)

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

	Non-watch 1-6	Watch 7-8	Commercial Substandard Accrual 9	Non-Accrual 10-11	Total
			(In thousands)		
September 30, 2011					
Income producing - real estate	$211,598	$48,133	$10,054	$10,040	$279,825
Land, land development and construction - real estate	34,799	11,406	6,559	4,544	57,308
Commercial and industrial	267,358	32,614	13,905	7,436	321,313
Total	$513,755	$92,153	$30,518	$22,020	$658,446
Accrued interest included in total	$1,701	$350	$127	$-	$2,178
December 31, 2010					
Income producing - real estate	$225,167	$57,536	$14,482	$11,925	$309,110
Land, land development and construction - real estate	33,356	14,780	4,873	9,672	62,681
Commercial and industrial	273,138	41,738	16,413	7,016	338,305
Total	$531,661	$114,054	$35,768	$28,613	$710,096
Accrued interest included in total	$1,897	$469	$200	$-	$2,566

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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For each of our mortgage and consumer segment classes we generally monitor credit quality based on the credit scores of the borrowers. These credit scores are generally updated at least annually.

The following table summarizes credit scores by loan class for our mortgage and installment loan segments:

			Mortgage (1)		
	1-4 Family	Resort Lending	Home Equity 1st Lien	Home Equity 2nd Lien	Total
			(In thousands)		
September 30, 2011					
800 and above	$ 27,171	$ 19,581	$ 4,604	$ 6,440	$ 57,796
750-799	65,805	85,147	7,973	17,613	176,538
700-749	53,911	49,455	3,919	11,991	119,276
650-699	57,261	26,528	4,305	8,905	96,999
600-649	43,934	9,029	1,730	5,426	60,119
550-599	30,194	6,919	1,752	2,930	41,795
500-549	27,168	6,136	1,036	2,885	37,225
Under 500	13,994	1,063	490	1,152	16,699
Unknown	4,836	579	56	212	5,683
Total	$ 324,274	$ 204,437	$ 25,865	$ 57,554	$ 612,130
Accrued interest included in total	$ 1,530	$ 1,001	$ 127	$ 299	$ 2,957
December 31, 2010					
800 and above	$ 28,308	$ 21,385	$ 4,433	$ 6,386	$ 60,512
750-799	66,812	89,695	8,996	17,995	183,498
700-749	66,749	56,425	4,961	14,688	142,823
650-699	57,026	25,911	3,707	8,856	95,500
600-649	41,559	12,832	1,596	3,768	59,755
550-599	31,879	11,647	1,673	4,303	49,502
500-549	30,723	5,040	1,366	2,497	39,626
Under 500	19,005	2,941	742	1,853	24,541
Unknown	3,151	2,398	133	121	5,803
Total	$ 345,212	$ 228,274	$ 27,607	$ 60,467	$ 661,560
Accrued interest included in total	$ 1,413	$ 1,012	$ 135	$ 321	$ 2,881

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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	Home Equity 1st Lien	Home Equity 2nd Lien	Installment(1) Loans not Secured by Real Estate	Other	Total
			(In thousands)		
September 30, 2011					
800 and above	$5,704	$5,521	$17,812	$58	$29,095
750-799	12,058	17,397	44,456	586	74,497
700-749	7,212	11,553	23,319	926	43,010
650-699	7,694	8,589	15,912	534	32,729
600-649	5,002	5,381	7,905	525	18,813
550-599	3,878	3,613	4,155	199	11,845
500-549	2,863	2,663	3,340	214	9,080
Under 500	1,342	1,362	1,341	56	4,101
Unknown	137	128	4,355	106	4,726
Total	$45,890	$56,207	$122,595	$3,204	$227,896
Accrued interest included in total	$166	$202	$440	$29	$837
December 31, 2010					
800 and above	$5,626	$5,618	$13,078	$22	$24,344
750-799	14,654	19,668	46,228	554	81,104
700-749	8,994	15,015	26,714	828	51,551
650-699	8,225	10,029	15,968	779	35,001
600-649	5,878	5,677	8,520	417	20,492
550-599	4,120	4,812	5,479	255	14,666
500-549	3,350	3,248	4,398	260	11,256
Under 500	1,809	1,848	2,087	163	5,907
Unknown	110	78	2,167	63	2,418
Total	$52,766	$65,993	$124,639	$3,341	$246,739
Accrued interest included in total	$218	$264	$579	$34	$1,095

(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 #15 for more information about Mepco's business. As of September 30, 2011, approximately 89.8% 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 9.6% of Mepco’s outstanding payment plan receivables as of September 30, 2011, 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 credit ratings of the counterparties as we

evaluate the credit quality of this portfolio.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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, 2011				
AM Best rating				
A+	$ -	$ 128	$ 10	$ 138
A	32,428	139	308	32,875
A-	34,451	12,695	-	47,146
B+	2,606	-	-	2,606
B	-	-	-	-
Not rated	51,750	-	527	52,277
Total	$ 121,235	$ 12,962	$ 845	$ 135,042
December 31, 2010				
AM Best rating				
A+	$ -	$ 255	$ -	$ 255
A	40,264	497	341	41,102
A-	48,291	25,523	-	73,814
B+	19,694	-	-	19,694
B	-	-	-	-
Not rated	53,404	-	12,994	66,398
Total	$ 161,653	$ 26,275	$ 13,335	$ 201,263

Although Mepco has contractual recourse against various counterparties for refunds owing upon cancellation of vehicle service contracts, please see note #15 below regarding certain risks and difficulties associated with collecting these refunds.

5. Comprehensive Loss

Comprehensive loss for the three- and nine-month periods ended September 30 follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net loss	$(4,122)	$(6,610)	$(11,486)	$(12,563)
Net change in unrealized gain (loss) on securities available for sale, net of related tax effect	235	1,379	567	132
Change in unrealized losses on securities available for sale for which a portion of other than temporary impairment has been recognized in earnings	(143)	399	124	2,693

Net change in unrealized loss on derivative instruments, net of related tax effect	(10)	(124)	81	(51)
Reclassification adjustment for accretion on settled derivative instruments	94	256	334	534
Comprehensive loss	$(3,946)	$(4,700)	$(10,380)	$(9,255)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The net change in unrealized loss on securities available for sale reflects net gains reclassified into earnings as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net gain reclassified into earnings	$ (4)	$ (314)	$ 58	$ 1,223
Federal income tax expense as a result of the reclassification of these amounts from comprehensive income	-	-	-	-

6. 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 reimburses 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 as of or for the three-month and nine-month periods ended September 30 follows:

As of or for the three months ended September 30,

	IB	Mepco(1)	Other(2)	Elimination(3)	Total
		(In thousands)			
2011					
Total assets	$2,116,134	$202,034	$168,422	$ (169,217)	$2,317,373
Interest income	22,913	5,274	-	-	28,187
Net interest income	20,474	3,982	(682)	-	23,774
Provision for loan losses	6,165	6	-	-	6,171
Loss before income tax	(3,594)	(150)	(836)	(24)	(4,604)
Net loss	(3,164)	(96)	(838)	(24)	(4,122)
2010					
Total assets	$2,434,890	$302,329	$180,828	$ (181,275)	$2,736,772
Interest income	27,236	8,451	-	-	35,687
Net interest income	21,258	6,405	(678)	-	26,985
Provision for loan losses	9,598	(55)	-	-	9,543
Loss before income tax	(4,239)	(2,201)	(1,124)	(24)	(7,588)
Net loss	(4,078)	(1,384)	(1,124)	(24)	(6,610)

(1) Total assets include gross payment plan receivables of $0.1 million at September 30, 2010 from customers domiciled in Canada. There were no such amounts at September 30, 2011. The amount at September 30, 2010 represents less than 1% of total payment plan receivables outstanding.

(2) Includes amounts relating to our parent company and certain insignificant operations.

(3) Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

As of or for the nine months ended September 30,

	IB	Mepco(1)	Other(2)	Elimination(3)	Total
			(In thousands)		
2011					
Total assets	$2,116,134	$202,034	$168,422	$ (169,217)	$2,317,373
Interest income	71,226	16,806	-	-	88,032
Net interest income	61,078	12,556	(2,026)	-	71,608
Provision for loan losses	20,986	43	-	-	21,029
Income (loss) before income tax	(9,463)	(1,062)	(1,638)	(71)	(12,234)
Net income (loss)	(9,097)	(678)	(1,640)	(71)	(11,486)
2010					
Total assets	$2,434,890	$302,329	$180,828	$(181,275)	$2,736,772
Interest income	85,367	30,056	-	-	115,423
Net interest income	66,286	23,101	(3,800)	-	85,587
Provision for loan losses	39,529	(292)	-	-	39,237

Income (loss) before income tax	(26,143)	(377)	12,942	(71)	(13,649)
Net income (loss)	(25,196)	(238)	12,942	(71)	(12,563)

(1) Total assets include gross payment plan receivables of $0.1 million at September 30, 2010 from customers domiciled in Canada. There were no such amounts at September 30, 2011. The amount at September 30, 2010 represents less than 1% of total payment plan receivables outstanding.

(2) Includes amounts relating to our parent company and certain insignificant operations. Net income (loss) in 2010 includes parent company's $18.1 million gain on extinguishment of debt.

(3) Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

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7. Earnings Per Common Share

Basic loss per share includes weighted average common shares outstanding during the period and participating share awards. Diluted loss per share excludes the dilutive effect of additional potential common shares to be issued upon the conversion of convertible preferred stock, exercise of common stock warrants, exercise of stock options, restricted stock units and stock units for a deferred compensation plan for non-employee directors as they would be anti-dilutive.

A reconciliation of basic and diluted loss per share for the three-month and nine-month periods ended September 30 follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	(in thousands, except per share amounts)			
Net loss applicable to common stock	$(5,165)	$(7,719)	$(14,588)	$(15,862)
Weighted average shares outstanding	8,401	7,513	8,209	4,275
Effect of convertible preferred stock	42,452	48,887	42,452	30,085
Restricted stock units	140	-	116	-
Stock units for deferred compensation plan for non-employee directors	7	7	7	7
Weighted average shares outstanding for calculation of diluted loss per share(1)	51,000	56,407	50,784	34,367
Net loss per common share				
Basic	$(.61)	$(1.03)	$(1.78)	$(3.71)
Diluted(1)	(.61)	(1.03)	(1.78)	(3.71)

(1) For any period in which a loss is recorded, the assumed conversion of convertible preferred stock, assumed exercise of common stock warrants, assumed exercise of stock options, restricted stock units and stock units for a deferred compensation plan for non-employee directors would have an anti-dilutive impact on the loss per share and thus are ignored in the diluted per share calculation.

Weighted average stock options outstanding that were not considered in computing diluted loss per share because they were anti-dilutive totaled 0.2 million and 0.1 million for the three-month periods ended September 30, 2011 and 2010, respectively and 0.1 million for both nine-month periods ended September 30, 2011 and 2010, respectively. The warrant to purchase 346,154 shares of our common stock was not considered in computing the diluted loss per share in both periods in 2011 and 2010 as it was anti-dilutive.

8. 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, 2011		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
Cash Flow Hedges - Pay fixed interest-rate swap agreements	$20,000	2.0	$(1,294)
No hedge designation			
Mandatory commitments to sell mortgage loans	$75,377	0.1	$(260)
Rate-lock mortgage loan commitments	48,940	0.1	868
Amended Warrant	2,504	7.2	(286)
Total	$126,821	0.2	$322

We have established management objectives and strategies that include interest-rate risk parameters for maximum fluctuations in net interest income and market value of portfolio equity. We monitor our interest rate risk position via simulation modeling reports. The goal of our asset/liability management efforts is to maintain profitable financial leverage within established risk parameters.

We use variable-rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our balance sheet, which exposes us to variability in interest rates. To meet our objectives, we may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates ("Cash Flow Hedges"). Cash Flow Hedges currently include certain pay-fixed interest-rate swaps.

Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates. Under interest-rate cap agreements, we will receive cash if interest rates rise above a predetermined level. As a result, we effectively have variable-rate debt with an established maximum rate. We pay an upfront premium on interest rate caps which is recognized in earnings in the same period in which the hedged item affects earnings. Unrecognized premiums from interest rate caps aggregated to zero and $0.02 million at September 30, 2011 and December 31, 2010, respectively. Our last interest rate cap expired in July, 2011.

We record the fair value of Cash Flow Hedges in accrued income and other assets and accrued expenses and other liabilities. On an ongoing basis, we adjust our Condensed Consolidated Statements of Financial Condition to reflect the then current fair value of Cash Flow Hedges. The related gains or losses are reported in other comprehensive income or loss and are subsequently reclassified into earnings, as a yield adjustment in the same period in which the related interest on the hedged items (primarily variable-rate debt obligations) affect earnings. It is anticipated that approximately $0.6 million, of unrealized losses on Cash Flow Hedges at September 30, 2011 will be reclassified to earnings over the next twelve months. To the extent that the Cash Flow Hedges are not effective, the ineffective portion of the Cash Flow Hedges is immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at September 30, 2011 is 3.3 years.

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

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

During 2010, we entered into an amended and restated warrant with the U.S. Department of the Treasury ("UST") that would allow them to purchase our common stock at a fixed price (see note #16). Because of certain anti-dilution features included in the Amended Warrant (as defined in note #16), it is not considered to be indexed to our common stock and is therefore accounted for as a derivative instrument and recorded as a liability. Any change in value of the Amended Warrant is recorded in other income in our Condensed Consolidated Statements of Operations.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The following table illustrates 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, 2011		December 31, 2010		September 30, 2011		December 31, 2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)							
Derivatives designated as hedging instruments								
Pay-fixed interest rate swap agreements					Other liabilities	$1,294	Other liabilities	$1,405
Total						1,294		1,405
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	$868	Other assets	$400				
Mandatory commitments to sell mortgage loans			Other assets	1,375	Other liabilities	260		
Amended Warrant					Other liabilities	286	Other liabilities	1,311
Total		868		1,775		546		1,311
Total derivatives		$868		$1,775		$1,840		$2,716

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The effect of derivative financial instruments on the Condensed Consolidated Statements of Operations follows:

	Three Month Periods Ended September 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income(1)	
	2011	2010		2011	2010		2011	2010
				(In thousands)				
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ 477	$ 773	Interest expense	$ (345)	$ (583)	Interest expense	$ 3	$ -
Interest-rate cap agreements	-	24	Interest expense	-	(12)	Interest expense	-	-
Total	$ 477	$ 797		$ (345)	$ (595)		$ 3	$ -
No hedge designation								
Rate-lock mortgage loan commitments						Mortgage loan gains	$ 369	$ 593
Mandatory commitments to sell mortgage loans						Mortgage loan gains	(339)	195
Amended warrant						Other income	29	-
Total							$ 59	$ 788

(1) For cash flow hedges, this location and amount refers to the ineffective portion.

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	Nine Month Periods Ended September 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income(1)	
	2011	2010		2011	2010		2011	2010
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ 1,726	$ 2,744	Interest expense	$ (1,102)	$ (2,084)	Interest expense	$ -	$ -
Interest-rate cap agreements	30	164	Interest expense	(15)	(82)	Interest expense	-	2
Total	$ 1,756	$ 2,908		$ (1,117)	$ (2,166)		$ -	$ 2
No hedge designation								
Pay-fixed interest rate swap agreements						Interest expense	$ -	$ 409
Rate-lock mortgage loan commitments						Mortgage loan gains	468	1,367
Mandatory commitments to sell mortgage loans						Mortgage loan gains	(1,635)	(1,175)
Amended warrant						Other income	1,025	-
Total							$ (142)	$ 601

(1) For cash flow hedges, this location and amount refers to the ineffective portion.

9. Intangible Assets

Other intangible assets, net of amortization, were comprised of the following at September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized other intangible assets - Core deposits	$31,326	$ 23,375	$31,326	$ 22,346

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Amortization of other intangibles has been estimated through 2016 and thereafter in the following table.

	(In thousands)
Three months ended December 31, 2011	$ 342
Year ending December 31:	
2012	1,088
2013	1,078
2014	801
2015	613
2016 and thereafter	4,029
Total	$ 7,951

10. Share Based Compensation

We maintain share based payment plans that include a non-employee director stock purchase plan and a performance-based 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 0.5 million shares of common stock as of September 30, 2011. The non-employee director stock purchase plan permits the grant of additional share based payments for up to 0.2 million shares of common stock as of September 30, 2011. 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 the first quarter of 2011, pursuant to a management transition plan, our chief executive officer's annual salary was increased by $0.2 million effective January 1, 2011. This increase will be paid entirely in the form of common stock (also referred to as "salary stock"). The shares issued each pay period will vest immediately.

During the first quarter of 2011, we issued 0.14 million restricted stock units to five of our executive officers. These restricted stock units do not vest for a minimum of two years and until we repay in full our obligations related to the Troubled Asset Relief Program ("TARP").

Beginning in the second quarter of 2011 our directors elected to receive their quarterly cash retainer fees in the form of common stock. Shares equal in value to each director's quarterly cash retainer will be issued each quarter and vest immediately. We have issued 0.08 million shares to directors during 2011 and expensed their value during that same period.

During the second quarter of 2011, pursuant to our performance-based compensation plans we granted 0.1 million stock options to certain officers, none of whom is a named executive officer. The stock options have an exercise price equal to the market value on the date of grant, vest ratably over a three year period and expire 10 years from date of grant. We use the Black Scholes option pricing model to measure compensation cost for stock options. We also estimate expected forfeitures over the vesting period.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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During the first quarter of 2010, we completed a stock option exchange program under which eligible employees were able to exchange certain stock options for a lesser amount of new stock options. Pursuant to this stock option exchange program, 0.05 million stock options were exchanged for 0.01 million new stock options. The new stock options granted have an exercise price equal to the market value on the date of grant, generally vest over a one year period and have the same expiration dates as the options exchanged which ranged from 1.2 years to 7.2 years. The new options had a value substantially equal to the value of the options exchanged.

Total compensation expense recognized for stock option grants, restricted stock grants, restricted stock unit grants and salary stock was $0.3 million and $0.7 million during the three and nine month period ended September 30, 2011, and was $0.1 million and $0.4 million during the same periods in 2010. The corresponding tax benefit relating to this expense was zero for the three and nine months ended September 30, 2011 and 2010, respectively. Total expense recognized for non-employee director share based payments was $0.1 million and $0.2 million during the three and nine-month periods ended September 30, 2011, respectively. No expense was incurred for non-employee director share based payments in 2010.

At September 30, 2011, the total expected compensation cost related to non-vested stock options, restricted stock and restricted stock unit awards not yet recognized was $1.35 million. The weighted-average period over which this amount will be recognized is 2.5 years.

A summary of outstanding stock option grants and transactions follows:

	Nine-months ended September 30, 2011			
	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregated Intrinsic Value (in thousands)
Outstanding at January 1, 2011	56,252	$42.76		
Granted	138,600	1.92		
Exercised	-	-		
Exchanged	-	-		
Forfeited	(730)	10.55		
Expired	(13,260)	92.05		
Outstanding at September 30, 2011	180,862	$7.98	8.83	$0
Vested and expected to vest at September 30, 2011	163,385	$8.60	8.74	$0
Exercisable at September 30, 2011	32,553	$31.41	5.36	$0

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A summary of non-vested restricted stock and stock units and transactions follows:

	2011	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2011	26,251	$92.69
Granted	139,625	4.29
Vested	-	-
Forfeited	(831)	93.20
Outstanding at September 30, 2011	165,045	$17.90

A summary of the weighted-average assumptions used in the Black-Scholes option pricing model for grants of stock options during 2011 follows:

Expected dividend yield	1.04	%
Risk-free interest rate	1.91	
Expected life (in years)	6.00	
Expected volatility	94.72	%
Per share weighted-average fair value	$1.37	

The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life was obtained using a simplified method that, in general, averaged the vesting term and original contractual term of the stock option. This method was used as relevant historical data of actual exercise activity was not available. The expected volatility was based on historical volatility of our common stock.

There were no stock option exercises during the nine month periods ending September 30, 2011 and 2010, respectively.

11. Income Tax

At both September 30, 2011 and December 31, 2010, we had approximately $2.4 million of gross unrecognized tax benefits. If recognized, the entire amount of unrecognized tax benefits, net of $0.6 million federal tax on state benefits, would affect our effective tax rate. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2011.

As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance against the majority of our net deferred tax assets. Accordingly, we are not recognizing much income tax expense (benefit) related to any loss before income tax. The income tax expense (benefit) was $(0.48) million and $(0.98) million for the three month periods ending September 30, 2011 and 2010, respectively and $(0.75) million and $(1.09) million for the nine month periods ending September 30, 2011 and 2010, respectively. The benefit recognized during the three- and nine-month periods in 2011and 2010 was primarily the result of current period adjustments to other comprehensive income (“OCI”), net of state income tax expense and adjustments to the deferred tax asset valuation allowance. In addition, the three- and nine-month periods in 2011 included the benefit of a favorable tax

adjustment ($0.09 million) relating to an Internal Revenue Service ("IRS") review and interest ($0.13 million) relating to a refund.

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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 other comprehensive income (loss). 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. For the three month periods ending September 30, 2011 and 2010 this resulted in an income tax expense (benefit) of $(0.23) million and $(0.89) million, respectively. For the nine month periods ending September 30, 2011 and 2010 this resulted in an income tax (benefit) of $(0.49) million and $(1.00) million, respectively.

12. Regulatory Matters

Capital guidelines adopted by Federal and State regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank's current year's net profits, combined with the retained net profits of the preceding two years. It is not our intent to have dividends paid in amounts which would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

In December 2009, the Board of Directors of Independent Bank Corporation adopted resolutions (as subsequently amended) that impose the following restrictions:

- We will not pay dividends on our outstanding common stock or the outstanding preferred stock held by the UST and we will not pay distributions on our outstanding trust preferred securities without, in each case, the prior written approval of the Federal Reserve Bank ("FRB") and the Michigan Office of Financial and Insurance Regulation ("OFIR");
- We will not incur or guarantee any additional indebtedness without the prior approval of the FRB;
- We will not repurchase or redeem any of our common stock without the prior approval of the FRB; and
- We will not rescind or materially modify any of these limitations without notice to the FRB and the OFIR.

In December 2009, the Board of Directors of Independent Bank adopted resolutions (as subsequently amended) designed to enhance certain aspects of the Bank's performance and, most importantly, to improve the Bank's capital position. These resolutions require the following:

- The adoption by the Bank of a capital restoration plan designed to help the Bank achieve the minimum capital ratios established by the Bank's Board of Directors as described below;
- The enhancement of the Bank's documentation of the rationale for discounts applied to collateral valuations on impaired loans and improved support for the identification, tracking, and reporting of loans classified as TDR's;
- The adoption of certain changes and enhancements to our liquidity monitoring and contingency planning and our interest rate risk management practices;
- Additional reporting to the Bank's Board of Directors regarding initiatives and plans pursued by management to improve the Bank's risk management practices;
- Prior approval of the FRB and the OFIR for any dividends or distributions to be paid by the Bank to Independent Bank Corporation; and

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- Notice to the FRB and the OFIR of any rescission of or material modification to any of these resolutions.

The substance of all of the resolutions described above was developed in conjunction with discussions held with the FRB and the OFIR. Based on those discussions, we acted proactively to adopt the resolutions described above to address those areas of the Bank's financial condition and operations that we believe most require our focus at this time.

On October 25, 2011 the respective Boards of Directors of the Company and the Bank entered into a Memorandum of Understanding with the FRB and OFIR (the "MOU"). The MOU largely duplicates certain of the provisions in the Board resolutions described above, but also has the following specific requirements:

- Submission of a joint revised capital plan by November 30, 2011 to maintain sufficient capital at the Company on a consolidated basis and at the Bank on a stand-alone basis;
- Submission of quarterly progress reports regarding disposition plans for any assets in excess of $1.0 million that are in ORE, are 90 days or more past due, are on our "watch list", or were adversely classified in our most recent examination;
- Enhanced reporting and monitoring at Mepco regarding risk management and the internal classification of assets; and
- Enhanced interest rate risk modeling practices.

Other than the completion of the joint revised capital plan, which we are currently working to update, we believe we have already met all of the other requirements of the MOU.

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 and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can initiate 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, 2011 and December 31, 2010 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.

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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, 2011						
Total capital to risk-weighted assets						
Consolidated	$182,060	11.52 %	126,485	8.00 %	NA	NA
Independent Bank	182,998	11.57	126,549	8.00	158,186	10.00 %
Tier 1 capital to risk-weighted assets						
Consolidated	$154,069	9.74 %	63,242	4.00 %	NA	NA
Independent Bank	162,726	10.29	63,274	4.00	94,912	6.00 %
Tier 1 capital to average assets						
Consolidated	$154,069	6.70 %	92,035	4.00 %	NA	NA
Independent Bank	162,726	7.07	92,066	4.00	115,082	5.00 %
December 31, 2010						
Total capital to risk-weighted assets						
Consolidated	$193,199	10.99 %	$140,692	8.00 %	NA	NA
Independent Bank	194,524	11.06	140,760	8.00	$175,950	10.00 %
Tier 1 capital to risk-weighted assets						
Consolidated	$166,048	9.44 %	$70,346	4.00 %	NA	NA
Independent Bank	171,947	9.77	70,380	4.00	$105,570	6.00 %
Tier 1 capital to average assets						