

2020  
Annual Report



# LETTER FROM THE PRESIDENT & CEO

## ***Fellow Shareholder:***

*It is my honor and pleasure to provide you with an update on Independent Bank Corporation (IBC). This past year has been an extraordinary period for all of us. Prior to the onset of the pandemic the US economy was in the midst of the longest post-war economic expansion, with historically low levels of unemployment. The coronavirus pandemic brought on a public health and economic crisis. As a result, too many lives have been lost and too many livelihoods have been negatively impacted. With the pandemic we have also been reminded of the racial, ethnic and social injustices that still exist within our communities. While we cannot guarantee equal outcomes, we must continue to do all we can to ensure respect for each individual and equal opportunity. At IBC, we continue to strive to be a part of the solution serving our clients, investing in our communities, and building shareholder value. I am very proud of our team and the job they are doing as we work our way through to the other side of the pandemic.*

The following paragraphs report on our response to the pandemic; summarize our 2020 financial results; review our Environmental, Social and Governance (ESG) initiatives; and provide an assessment of the current landscape of our industry. Also included are our thoughts on what we need to do to continue our success. At the center of all our efforts is the creation and maintenance of a high performance and inclusive culture with talented individuals working together as a team to serve and help our customers.

## **COVID-19 RESPONSE - TO OUR COMMUNITIES, CUSTOMERS, AND OUR ASSOCIATES**

The COVID-19 pandemic officially began in late 2019, but it was really early March 2020 when the first cases were reported in our markets and we began to feel the effects of the virus. Immediately we enacted our business continuity plan to help prevent the spread of the coronavirus, taking action to protect the health and well-being of our customers and our associates. This resulted in the development of the IB Safe Work Playbook and the rapid development of nearly all our non-branch associates to remote work status or work from home. During 2020, service to our customers went uninterrupted, although we did modify our branches to drive-thru service with lobby by appointment only for two extended periods of time.

Over the course of the year, we offered loan payment relief where needed to our customers; we provided Small Business Administration (SBA) Payroll Protection Program loans to businesses in our markets; we followed the Government Sponsored Entities (GSEs) directives for moratoriums on foreclosures; and we processed a record volume of mortgage loan requests for new home purchases and refinances.

For our associates, listening to their needs and concerns has been critical. In doing so we have worked hard to have consistent, frequent and open communication; we have paid service bonuses to our “front-line” associates; we have made adjustments to paid time off policies; and we have implemented extensive health and safety protocols throughout our facilities. As the vaccination process continues throughout our

markets, we are hopeful for a “return to normal” in the very near future. In the interim, we will continue to adjust as appropriate to the changing circumstances always with the intent to protect the health and well-being of our customers, our associates, and our communities.

## **FINANCIAL RESULTS FOR 2020**

### **Impressive Growth in Earnings**

In 2020, we generated impressive growth in our earnings and earnings per share. For the year ended December 31, 2020, the Company reported net income of \$56.2 million, or \$2.53 per diluted share, compared to net income of \$46.4 million, or \$2.00 per diluted share, in 2019. This represents increases of \$9.7 million, or 20.9 percent, and 53 cents, or 26.5 percent, in net income and diluted earnings per share, respectively. For 2020, our pre-tax, pre-provision earnings increased by \$23.4 million or 39.9 percent to \$81.9 million, from \$58.6 million in 2019. Over this same period our tangible book value per share increased by \$2.25 or 16.0 percent, to \$16.33 per share. Our growth in earnings was largely driven by net gains on mortgage loans of \$62.6 million in 2020 compared to \$20.0 million in 2019, combined with an increase in net interest income.

### **Our Balance Sheet Fundamentals Remain Strong**

As reflected in our balance sheet, our fundamentals continue to be strong. Loans, excluding loans held for sale, totaled \$2.734 billion at December 31, 2020, an increase of 0.3 percent from \$2.725 billion at December 31, 2019. For the year, our commercial loan portfolio increased by \$75.7 million or 6.5 percent, and our consumer installment loan portfolio increased by \$15.9 million or 3.5 percent. Our mortgage loan portfolio declined by \$83.0 million or 7.6 percent as a result of payoffs and refinances out of the portfolio into the secondary market. For the year, we originated \$1.8 billion in mortgage loans, \$262 million in paycheck protection program loans, \$225 million in new commercial commitments, and \$219 million in consumer loans.

On the funding side, deposits totaled \$3.637 billion at December 31, 2020, compared to \$3.037 billion at December 31, 2019. The \$600.6 million or 19.8 percent increase in total deposits during 2020 reflects growth in business, retail, and municipal deposits. At year-end 2020, our loan to deposit ratio was a healthy 75 percent, a 15 percent decrease from 90 percent at the prior year end, allowing capacity for additional growth prospectively. Our balance sheet continues to be slightly asset sensitive, where generally we benefit from rising interest rates.

On the credit quality front, our loan portfolio continues to perform well with past due loans continuing near historic lows. Non-performing loans at December 31, 2020, decreased to \$7.9 million from \$9.5 million at the prior year end. Other real estate and repossessed assets totaled just \$0.8 million at December 31, 2020 compared to \$1.9 million at December 31, 2019. Our ratio of our non-performing assets to total assets decreased to 21 basis points at year-end 2020 compared to 32 basis points at year-end 2019. We recorded loan net charge-offs to average loans of 11 basis points in 2020 as compared to loan net recoveries to average loans of two basis points in 2019. Despite the strong credit metrics, we did record a \$12.5 million provision for loan losses in 2020; \$11.2 million of this provision relates to an increase in the qualitative or subjective portion of the reserve. Excluding PPP loans and the remaining Traverse City State Bank acquired loan balances, the allowance for loan losses was equal to 1.43 percent of portfolio loans at December 31, 2020.

Our capital levels continue to be strong, which supports our growth initiatives and provides us with flexibility to address changes in market and business conditions. Common shareholders' equity increased to \$389.5 million at December 31, 2020, from \$350.2 million at December 31, 2019, due primarily to our net income that was partially offset by share repurchases and dividends. Our ratio of tangible common equity to tangible assets was 8.56 percent as of the end of 2020 compared to 8.96 percent at the end of 2019. In May of 2020, with the onset of the pandemic and significant uncertainty on its impact on the global, national and local economies, we issued \$40.0 million of fixed to floating subordinated notes with a ten year maturity and a five year call option. These notes qualify as Tier two capital and provide additional cushion for our regulatory capital ratios as well as additional liquidity at the bank holding company level. In 2020, we increased our total annual cash dividends by 11 percent, to \$0.80 per share from \$0.72 cents per

share in 2019. In January of 2021, your Board of Directors further increased the quarterly cash dividend by 5 percent, to \$0.21 per share from \$0.20 per share. This represents the seventh consecutive year we have increased our common stock cash dividend. For the full year 2020, we repurchased 708,956 shares of our common stock at a weighted average cost of \$20.07 per share. During 2020, through a combination of dividends and share repurchases we returned 57 percent of our 2020 earnings to our shareholders.

## **ESG INITIATIVES**

Independent Bank is currently the third largest bank headquartered in the state of Michigan. We operate 62 bank branches in Michigan's Lower Peninsula, as well as 11 loan production offices (LPOs) in Akron (Ohio), Ann Arbor, Brighton, Cadillac, Columbus (Ohio), Dearborn, Gross Pointe Woods, Kalamazoo, Midland, Saginaw, and Troy. Established in 1864, we continue to work towards our mission of making a positive difference in the lives of those we serve: our customers, communities and shareholders, as well as our all our key stakeholders, including our associates and strategic partners. Over the last two years we invested over \$1.25 million in sponsorships and donations to organizations in our communities. Our associates were recognized by the American Bankers Association for volunteerism in 2020, through their outreach programs, mentoring, and other partnerships. This includes the capstone initiative, our annual Making a Difference Day (MADD). This year, we created a section on our website, IndependentBank.com, to communicate the numerous efforts made by our Company to achieve sustainable long-term investment and growth. Below is a sample of some of the key initiatives and/or progress we have made as it pertains to protecting our environment, social responsibility, and sound governance.

### **Environmental**

We all have a responsibility to take care of our planet as the effects of global warming are more apparent than ever. Our efforts are focused both internally and externally. Internally this past year, our team completed a multi-year project upgrade to LED lighting in all of our facilities. In addition, in 2020 we began a new multi-year investment in new heating and cooling systems that will significantly reduce our energy usage throughout our footprint. We also continue to materially reduce our paper and print usage through integrated tracking and reporting, with reminders encouraging digital usage where possible. Externally, our lenders continue to support local businesses and industries working towards reducing carbon emissions with financing of windfarms, solar farms, and the electric vehicle (EV) market.

### **Social**

Home ownership is an important vehicle for individuals to generate wealth, as it puts individuals and their neighborhoods on a path to stability and prosperity. Yet, in many of our markets, the growth rate in home prices continues to outpace the growth rate in personal income, making home ownership more difficult, particularly for those borrowers in the lower to moderate income levels. That is why we invested in multiple initiatives in 2020 to promote affordable housing. These include a \$2 million investment to support affordable housing in partnership with Cinnaire, specifically the development and rehabilitation of nine apartment communities across Michigan; a \$500,000 Affordable Housing Program (AHP) grant through the FHLB for a rehabilitation project in Traverse City, MI; and a \$1 million dollar pledge for our new My Home Reward Program which enables applicants to purchase or refinance homes in low-income neighborhoods throughout our markets with no closing costs. In addition to promoting home ownership, we also promote financial literacy throughout our communities. Over the years, we have been recognized regularly by the Michigan Bankers Association for our efforts to promote financial literacy.

### **Governance**

Our corporate governance committee continues to be a strength for our Company. In addition to monitoring our corporate governance standards, this Committee has been active in evaluating and recommending new directors with diverse skill sets and perspectives to our board. This effort led to the appointments of

Ms. Keller in 2016, Mr. Cok in 2017, Mr. Beia in 2018, Ms. Kruse in 2019, and most recently Mr. Dennis Archer Jr. in October of 2020. Our most recent addition, Mr. Archer, is the CEO of Ignition Media Group, a leading integrated marketing agency, and President and founding partner of Archer Corporate Services, one of the nation's leading marketing fulfillment service firms. In addition, Mr. Archer's hospitality holding company, Congress Hospitality, is creator and managing partner of Central Kitchen, one of Detroit's top restaurants.

## **BANKING INDUSTRY**

I would characterize the banking industry today to be in strong condition, yet operating in an environment of significant uncertainty. This position of strength is a result of higher levels of capital and the surge in deposit balances as a result of over three trillion dollars of government stimulus. While loan growth outside of PPP lending in many instances is soft, we are seeing an increase in loan demand. There is also strength in loan loss reserves. During 2020, many banks increased their provisioning for loan losses. Up to this point, however, the level of charge-offs has been benign. The Fed's accommodative policy continues to drive record volumes of mortgage refinancing; however, the low level of interest rates and lack of significant slope in the yield curve continues to compress net interest margins. This has pushed bank earnings down from recent record levels.

Significant uncertainty remains in our industry due to not knowing how effective we will be in overcoming the virus including the rolling out the COVID-19 vaccine, both across the United States as well as globally. In addition, we do not know how quickly the segments of the economy that have been hit hardest by the pandemic, such as travel, hospitality, restaurants, retail Commercial Real Estate (CRE), and office CRE, will rebound and return to pre-COVID levels. A second significant uncertainty involves that of Fintech. Fintech companies continue to capture greater market share of payments, debit cards, consumer balances, residential mortgage financings and small business financing. How effective bankers are in defending this turf and or partnering will determine their relevancy.

Finally, it is likely with the leadership change in Washington, we can expect another round of stimulus as well as more legislation and tighter regulation and an increase in taxation. And while M&A activity slowed in 2020, we can expect to see continued consolidation within our industry.

## **FUTURE DIRECTION**

As we look to 2021 and beyond, the key to our success is our ability to continue to execute on our operating plan, which is built around relationship banking. This plan has four major objectives: Growing our client base; enhancing the client experience and improving productivity; sound risk management practices; and fielding a highly engaged and talented team to serve our clients. Over the years, we have been successful in the execution of our operating plan. This has enabled us to consistently achieve our performance targets. Our current targets are unchanged, 1.30 percent or better return on average assets and a 13.0 percent or better return on average equity.

### **Grow Our Client Base**

The first objective of our operating plan is organic growth. We will continue to work to grow net interest income through balanced loan growth, disciplined risk-adjusted loan pricing, and the active management of our funding costs. Our plans include adding new clients through outbound calling efforts. We also will continue to use innovative and targeted client acquisition, retention and cross-sales strategies, leveraging predictive analytics, inside sales staff, and intra-company referrals with strategic business unit partners. Finally, we will target new clients and grow revenue through the continued addition of talented sales professionals.

In addition to these organic growth initiatives, we intend to supplement our organic growth through selective and opportunistic bank and branch acquisitions with disciplined pricing. I think the important point here is your Board and management team is very conscious of creating and protecting shareholder value.

## **Enhance the Client Experience and Improve Productivity**

Our second objective is to increase productivity while continuously improving the client experience. For eight consecutive years, we have continued to improve upon our efficiency ratio, currently at 59.2 percent. As I reported this time last year, we signed a new core data processing agreement with a new partner and will be converting at the end of our current agreement in April of 2021 (Day 1.) The benefits of this change include moving to a modern core platform with flexible application processing interfaces (APIs). This will allow faster integration with new technology; real-time processing capabilities; and better access to our data and decision management using our data. This investment includes ONE Wallet, our new mobile and online platform for consumer and business clients, providing them the ability to open new accounts and apply for loans online along with, enhanced transfer, bill pay, and self-service capabilities. In addition, ONE Wallet+ enables our clients to monitor all their finances in one location as well as provides budgeting and spending analytical tools. This change will also serve as the foundation to create a unified customer experience through all channels (AKA Omni-channel), from the mobile channel, the electronic banking channel, our branch channel and back office support, which we call "The Hub." We achieved cost savings with the agreement itself and anticipate additional savings as the new enterprise solution is fully operational. Before leaving this topic, I would be remiss if I did not mention our continued leveraging of numerous cloud based solutions throughout our organization, as well as the investment in additional cybersecurity tools and a new customer relationship management (CRM) solution planned for later in 2021 (Day 2.)

Our on-going branch optimization efforts will further improve productivity. This includes: assessing existing locations; exploring new locations; reviewing service hours, staffing levels, and more. During 2020, based on changes in customer trends and market opportunities, we closed eight locations and opened one new location, bringing our branch count to 62 locations as of December 31, 2020. Over the last eight years we have more than doubled the average deposits per branch to the current level of \$58 million per branch. We are optimistic that our successful execution of these major initiatives will enable us to materially improve our productivity and the overall client experience.

## **Sound Risk Management**

Our third objective is a strong on-going enterprise-wide risk management framework. This framework encompasses credit risk, market risk (economic, capital, interest rate and liquidity), operating risk (including cyber) and reputational and regulatory risk. Included within this objective is being a good steward of our capital. We continue to target a tangible common equity to tangible assets ratio of 8.5 percent to 9.5 percent. Our capital priorities include: organic growth; a consistent dividend, paying out one-third to one-half of our earnings; consistent share repurchases and/or acquired growth, provided each meets our internal business objectives and financial metrics.

## **Retain, Develop, and Attract a Highly Engaged Talent Base**

Our fourth objective is to continue to attract, retain, and develop our service team. We recognize the path to our organization's success is through the success of each and every one of our team members. Over the last few years, we have benefited by adding to an already talented team new talented team members, often capitalizing on the market disruptions caused by M&A activity. At the same time, we continue to execute on several key initiatives aimed at raising the engagement level of our workforce. In 2020, our turnover level remained low, and the engagement rate of our associates is high as measured by our annual employee engagement survey. We encourage and support the professional development of all our colleagues through our leadership programs, mentoring, and other initiatives. We are passionate about our desire to ensure that our team members are empowered and supported in a way that will best position them to serve our customers. Finally, we believe that if we are committed to the well-being of our team members, and recognize and reward their contributions, they will promote our success.

## CLOSING

In closing, I encourage you to attend the 2021 Annual Meeting of Shareholders of Independent Bank Corporation at 3:00 p.m. Eastern Time, on Tuesday, April 20, 2021. We will be conducting our annual Meeting of Shareholders by means of remote communication via the Internet. To attend the meeting, please visit [www.virtualshareholdermeeting.com/IBCP2021](http://www.virtualshareholdermeeting.com/IBCP2021). From this site you will be able to vote electronically and submit questions during the meeting.

I would like to thank you, our shareholders, for investing in IBC, and I would like to acknowledge the commitment and ongoing effort of your Board of Directors, our Bank officers, and all of our Bank associates. Their dedication and service is exemplary, and each is truly making a positive difference in the lives of our customers, our shareholders, and the communities we serve.

Sincerely,



William B. (Brad) Kessel  
President and CEO

# FINANCIAL HIGHLIGHTS

Dollars in thousands, except per share data

	2020	2019	CHANGE AMOUNT	CHANGE PERCENT
<b>FOR THE YEAR</b>				
Interest income	\$ 139,829	\$ 148,928	\$ (9,099)	(6.11) %
Interest expense	16,217	26,347	(10,130)	(38.45)
Net interest income	123,612	122,581	1,031	0.84
Provision for loan losses	12,463	824	11,639	1412.50
Net gains on securities	267	307	(40)	(13.03)
Other non-interest income	80,478	47,429	33,049	69.68
Non-interest expense	122,413	111,733	10,680	9.56
Income before income tax	69,481	57,760	11,721	20.29
Income tax expense	13,329	11,325	2,004	17.70
Net income	\$ 56,152	\$ 46,435	\$ 9,717	20.93 %
<b>PER COMMON SHARE DATA</b>				
<b>Net income per common share</b>				
Basic	\$ 2.56	\$ 2.03	\$ 0.53	26.11 %
Diluted	2.53	2.00	0.53	26.50
Cash dividends declared and paid	0.80	0.72	0.08	11.11
<b>AT YEAR END</b>				
Assets	\$ 4,204,013	\$ 3,564,694	\$ 639,319	17.93 %
Loans	2,733,678	2,725,023	8,655	0.32
Deposits	3,637,355	3,036,727	600,628	19.78
Interest-earning assets	3,979,397	3,343,941	635,456	19.00
Shareholders' equity	389,522	350,169	39,353	11.24
Book value per common share	17.82	15.58	2.24	14.38
Tangible book value per common share	16.33	14.08	2.25	15.98
<b>RATIOS</b>				
<b>Net income to</b>				
Average common equity	15.68 %	13.63 %	2.05 %	15.04 %
Average assets	1.43	1.35	0.08	5.93
<b>As a percent of average interest-earning assets</b>				
Interest income	3.78 %	4.61 %	(0.83) %	(18.00) %
Interest expense	0.44	0.81	(0.37)	(45.68)
Net interest income	3.34	3.80	(0.46)	(12.11)

# INDEPENDENT BANK CORPORATION

## SENIOR OFFICERS

William B. Kessel

Gavin A. Mohr

James J. Twarozynski

## BOARD OF DIRECTORS<sup>1</sup>

Michael M. Magee, Jr., Chairman

Joan A. Budden

William B. Kessel

Dennis W. Archer, Jr.

Michael J. Cok

Ronia F. Kruse

Terance L. Beia

Stephen L. Gulis, Jr.

Matthew J. Missad

William J. Boer, Lead Director

Christina L. Keller

# INDEPENDENT BANK

## SENIOR OFFICERS

William B. Kessel

Jamie L. Macumber

Tricia L. Schabel

Cheryl A. Bartholic

Cheryl L. McKellar

Raymond P. Stecko

Martha A. Blandford

Christopher S. Michaels

Michael J. Stodolak

Tami E. Coates

Gavin A. Mohr

James J. Twarozynski

Larry R. Daniel

Dean M. Morse

Joane E. VanLuven

Patrick J. Ervin

Kevin D. Pierce

Linda K. Winters

Susan M. Johnson

Joel F. Rahn

Stefanie M. Kimball

Vern S. Rowley

Keith J. Lightbody

Edward W. Ryan

<sup>1</sup>Individuals listed also serve on the Board of Directors for Independent Bank.

### STOCK

Independent Bank Corporation's common stock trades on the NASDAQ Global Select Market System under the symbol IBCP.

### TRANSFER AGENT AND REGISTRAR

Broadridge Corporate Issuer Solutions, Inc., P.O. Box 1342, Brentwood, New York 11717, [shareholder.broadridge.com](mailto:shareholder.broadridge.com), (telephone 866.741.7930), serves as transfer agent and registrar of our common stock. Inquiries related to shareholder records and change of name, address or ownership of stock should be directed to our transfer agent and registrar.

### INVESTOR RELATIONS ON THE INTERNET

Go to our website at [IndependentBank.com](http://IndependentBank.com) to find the latest investor relations information about Independent Bank Corporation, including stock quotes, news releases and financial data.

### DIVIDEND REINVESTMENT AND DIRECT STOCK PURCHASES OR SALES

Our Dividend Reinvestment & Direct Stock Purchase and Sale Plan is sponsored and administered by Broadridge Corporate Issuer Solutions, Inc., the transfer agent for Independent Bank Corporation. The plan materials are available at [Stockplans.broadridge.com](http://Stockplans.broadridge.com).

### FORM 10-K

Shareholders may obtain, without charge, a copy of Form 10-K, the 2020 Annual Report to the Securities and Exchange Commission, through our website at [IndependentBank.com](http://IndependentBank.com) or by writing to the Chief Financial Officer, Independent Bank Corporation, 4200 East Beltline, Grand Rapids, Michigan 49525 or by email at [info@ibcp.com](mailto:info@ibcp.com).

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K**

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2019 or  
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-7818

**INDEPENDENT BANK CORPORATION**

(Exact name of Registrant as specified in its charter)

MICHIGAN

(State or other jurisdiction of incorporation)

38-2032782

(I.R.S. employer identification no.)

4200 East Beltline, Grand Rapids, Michigan

(Address of principal executive offices)

49525

(Zip Code)

Registrant's telephone number, including area code

(616) 527-5820

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, No Par Value

(Title of class)

IBCP

(Trading Symbol(s))

NASDAQ

(Name of Exchange)

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Yes  No

Indicate by check mark whether the registrant has submitted electronically 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 such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b of the Act).

Yes  No

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2019, was \$479,616,359.

The number of shares outstanding of the registrant's common stock as of March 4, 2020 was 22,109,669.

Documents incorporated by reference: Portions of our definitive proxy statement and annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, are incorporated by reference into Part I, Part II, Part III, and Part IV of this Form 10-K.

The Exhibit Index appears on Pages 35

## FORWARD-LOOKING STATEMENTS

Statements in this Annual Report on Form 10-K that are not statements of historical fact, including statements that include terms such as “will,” “may,” “should,” “believe,” “expect,” “forecast,” “anticipate,” “estimate,” “project,” “intend,” “likely,” “optimistic” and “plan” and statements about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions, are forward-looking statements. Forward-looking statements include, but are not limited to, descriptions of plans and objectives for future operations, products or services; projections of our future revenue, earnings or other measures of economic performance; forecasts of credit losses and other asset quality trends; statements about our business and growth strategies; and expectations about economic and market conditions and trends. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals. They are based on assumptions, estimates, and forecasts that, although believed to be reasonable, may turn out to be incorrect. Actual results could differ materially from those discussed in the forward-looking statements for a variety of reasons, including:

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business;
- economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our bank operates;
- the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;
- increased competition in the financial services industry, either nationally or regionally;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- challenges we may face in acquiring or integrating other businesses;
- the continued services of our management team; and
- implementation of new legislation, which may have significant effects on us and the financial services industry.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this Annual Report on Form 10-K, but the list is not intended to be all-inclusive. The risk factors disclosed in Part I – Item 1A below 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.

PART I

ITEM 1. BUSINESS

Independent Bank Corporation was incorporated under the laws of the State of Michigan on September 17, 1973, for the purpose of becoming a bank holding company. We are registered under the Bank Holding Company Act of 1956, as amended, and own all of the outstanding stock of Independent Bank (the “bank”), which is also organized under the laws of the State of Michigan.

Aside from the stock of our bank, we have no other substantial assets. We conduct no business except for the collection of dividends or returns of capital from our bank and the payment of dividends to our shareholders and the payment of interest on subordinated debentures. We have established certain employee retirement plans, including an employee stock ownership plan (ESOP) and deferred compensation plans, as well as health and other insurance programs, the cost of which is borne by our subsidiaries. We have no material patents, trademarks, licenses or franchises except the corporate charter of our bank, which permits it to engage in commercial banking pursuant to Michigan law.

Our bank transacts business in the single industry of commercial banking. It offers a broad range of banking services to individuals and businesses, including checking and savings accounts, commercial lending, direct and indirect consumer financing, mortgage lending, and safe deposit box services. Our bank does not offer trust services. Our principal markets are the rural and suburban communities across Lower Michigan, which are served by the bank’s main office in Grand Rapids, Michigan, and a total of 66 branches, two drive-thru facilities, and nine Michigan based loan production offices. We also have opened two loan production offices in Ohio (Columbus and Fairlawn). A third Ohio loan production office is being opened in Toledo in March 2020. Most of our bank’s branches provide full-service lobby and drive-thru services, as well as automatic teller machines (ATMs). In addition, we provide internet and mobile banking capabilities to our customers. We continue to see customer transaction volume declining at our bank offices and increasing through our electronic channels.

Our bank competes with other commercial banks, savings banks, credit unions, mortgage banking companies, securities brokerage companies, insurance companies, and money market mutual funds. Many of these competitors have substantially greater resources than we do and offer certain services that we do not currently provide. Such competitors may also have greater lending limits than our bank. In addition, non-bank competitors are generally not subject to the extensive regulations applicable to us. Price (the interest charged on loans and paid on deposits) remains a principal means of competition within the financial services industry. Our bank also competes on the basis of service and convenience in providing financial services.

As of December 31, 2019, our bank had total loans (excluding loans held for sale) of \$2.725 billion and total deposits of \$3.037 billion. As of December 31, 2019, we had 848 full-time employees and 146 part-time employees.

In addition to general banking services, we also offer title insurance services and insurance brokerage services through separate subsidiaries and investment services through a third party agreement with Cetera Investment Services LLC.

On a consolidated basis, our principal sources of revenue are interest and fees on loans, other interest income, and non-interest income. The sources of revenue for the three most recent years are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Interest and fees on loans	68.1%	66.6%	59.8%
Other interest income	7.7	7.9	10.0
Non-interest income	24.2	25.5	30.2
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

ITEM 1.    BUSINESS (continued)

Supervision and Regulation

The following is a summary of certain statutes and regulations affecting us. This summary is qualified in its entirety by reference to the particular statutes and regulations. A change in applicable laws or regulations may have a material effect on us and our bank.

*General*

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Federal Reserve, the Federal Deposit Insurance Corporation (“FDIC”), the Michigan Department of Insurance and Financial Services (“Michigan DIFS”), the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies and any changes thereto can be significant and cannot necessarily be predicted.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to us establishes a comprehensive framework for our operations and is intended primarily for the protection of the FDIC’s deposit insurance fund, our depositors, and the public, rather than our shareholders.

*Independent Bank Corporation*

We are a bank holding company and, as such, are registered with, and subject to regulation by, the Federal Reserve under the Bank Holding Company Act, as amended (the “BHCA”). Under the BHCA, we are subject to periodic examination by the Federal Reserve and are required to file periodic reports of operations and such additional information as the Federal Reserve may require.

Federal law requires bank holding companies to act as a source of strength to their bank subsidiaries and to commit capital and financial resources to support those subsidiaries. Such support may be required by the Federal Reserve at times when we might otherwise determine not to provide it.

In addition, if the Michigan DIFS deems a bank’s capital to be impaired, it may require a bank to restore its capital by special assessment upon the bank holding company, as the bank’s sole shareholder. If the bank holding company failed to pay such assessment, the directors of that bank would be required, under Michigan law, to sell the shares of bank stock owned by the bank holding company to the highest bidder at either public or private auction and use the proceeds of the sale to restore the bank’s capital.

Any capital loans by a bank holding company to a subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

*Investments and Activities.* Federal law places restrictions on the ability of our holding company to engage in certain transactions, make investments, and participate (directly or indirectly through a subsidiary) in various activities.

In general, any direct or indirect acquisition by a bank holding company of any voting shares of any bank which would result in the bank holding company’s direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation of the bank holding company with another bank holding company, will require the prior written approval of the Federal Reserve under the BHCA. In acting on such applications, the Federal Reserve must consider various statutory factors including the effect of the proposed transaction on competition in relevant geographic and product markets and each party’s financial condition, managerial resources, and record of performance under the Community Reinvestment Act.

ITEM 1.     BUSINESS (continued)

The merger or consolidation of an existing bank subsidiary of a bank holding company with another bank, or the acquisition by such a subsidiary of the assets of another bank, or the assumption of the deposit and other liabilities by such a subsidiary requires the prior written approval of the responsible federal regulatory agency under the Bank Merger Act, based upon a consideration of statutory factors similar to those outlined above with respect to the BHCA. In addition, in certain cases, an application to, and the prior approval of, the Federal Reserve under the BHCA and/or Michigan DIFS under Michigan banking laws, may be required.

With certain limited exceptions, the BHCA prohibits any bank holding company from engaging, either directly or indirectly through a subsidiary, in any activity other than managing or controlling banks unless the proposed non-banking activity is one the Federal Reserve has determined to be so closely related to banking as to be a proper incident thereto. Under current Federal Reserve regulations, such permissible non-banking activities include such things as mortgage banking, equipment leasing, securities brokerage, and consumer and commercial finance company operations. Well-capitalized and well-managed bank holding companies may, however, engage *de novo* in certain types of non-banking activities without prior notice to, or approval of, the Federal Reserve, provided that written notice of the new activity is given to the Federal Reserve within 10 business days after the activity is commenced. If a bank holding company wishes to engage in a non-banking activity by acquiring a going concern, prior notice and/or prior approval will be required, depending upon the activities in which the company to be acquired is engaged, the size of the company to be acquired and the financial and managerial condition of the acquiring bank holding company.

Eligible bank holding companies that elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of non-banking activities, including securities and insurance activities and any other activity the Federal Reserve, in consultation with the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank or financial holding companies. We have not applied for approval to operate as a financial holding company and have no current intention of doing so.

Capital Requirements. The Federal Reserve uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other things, be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a leverage capital requirement expressed as a percentage of total assets, and (ii) a risk-based requirement expressed as a percentage of total risk-weighted assets. The leverage capital requirement consists of a minimum ratio of Tier 1 capital (which consists principally of shareholders' equity) to total assets of 3% for the most highly-rated companies with minimum requirements of 4% to 5% for all others. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital. The risk-based and leverage standards presently used by the Federal Reserve are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. The federal bank regulatory agencies are required biennially to review risk-based capital standards to ensure that they adequately address interest rate risk, concentration of credit risk and risks from non-traditional activities.

Our Tier 1 capital as of December 31, 2019, includes \$38.2 million of trust preferred securities (classified on our Consolidated Statements of Financial Condition as "Subordinated debentures"). The Federal Reserve has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities and certain other capital elements is limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit could be included in the Tier 2 capital, subject to restrictions. The provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act adopted in 2010 (the "Dodd-Frank Act") imposed additional limitations on the ability to include trust preferred securities as Tier 1 capital; however, these additional limitations do not apply to our outstanding trust preferred securities.

ITEM 1.    BUSINESS (continued)

On January 1, 2015, we became subject to new regulatory capital rules issued by the Federal Reserve in 2013. In general, these new capital rules increase the minimum requirements for both the quantity and quality of capital we maintain. The rules include a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. This 2.5% capital conservation buffer was phased in beginning in 2016 and ending with full implementation of the 2.5% buffer in January 2019. The rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4%. As to the quality of capital, the new rules emphasize common equity Tier 1 capital, the most loss-absorbing form of capital, and implements strict eligibility criteria for regulatory capital instruments. The rules also change the methodology for calculating risk-weighted assets to enhance risk sensitivity. The application of the new capital rules to our organization is described below. Under these new capital rules, our existing trust preferred securities are grandfathered as qualifying regulatory capital. We believe we currently exceed all of the capital ratio requirements of these new capital rules.

Dividends. Historically, most of our revenues have been received in the form of dividends paid by our bank. We can also make requests for returns of capital from our bank; however, such requests require the approval of the Michigan DIFS. Thus, our ability to pay dividends to our shareholders is indirectly limited by restrictions on the ability of our bank to pay dividends or return capital to us, as described below. Further, in a policy statement, the Federal Reserve has expressed its view that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or that can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. The Federal Reserve possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. The "prompt corrective action" provisions of federal law and regulation authorize the Federal Reserve to restrict the amount of dividends that can be paid by an insured bank that fails to meet specified capital levels.

In addition to the restrictions on dividends imposed by the Federal Reserve, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if, after the distribution, the corporation can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution.

Change in Control Limitations. Subject to certain exceptions, the Change in the Bank Control Act ("Control Act") and regulations promulgated thereunder by the Federal Reserve, require any person acting directly or indirectly, or through or in concert with one or more persons, to give the Federal Reserve 60 days' written notice before acquiring control of a bank holding company. Pursuant to the Control Act, the Federal Reserve has the authority to prevent any such acquisition. Transactions that are presumed to constitute the acquisition of control include the acquisition of any voting securities of a bank holding company having securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, if, after the transaction, the acquiring person (or persons acting in concert) owns, controls or holds with power to vote 10% or more of any class of voting securities of the institution.

Federal Securities Regulation. Our common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We are therefore subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

*Independent Bank*

Independent Bank is a Michigan banking corporation and a member of the Federal Reserve System, and its deposit accounts are insured by the FDIC's Deposit Insurance Fund ("DIF"). As a member of the Federal Reserve System and a Michigan-chartered bank, our bank is subject to the examination, supervision, reporting and enforcement requirements of the Federal Reserve as its primary federal regulator and the Michigan DIFS as the chartering authority for Michigan banks. These agencies and the federal and state laws applicable to our bank and its operations extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of non-interest bearing reserves on deposit accounts, and the safety and soundness of banking practices.

*Deposit Insurance.* As an FDIC-insured institution, our bank is required to pay deposit insurance premium assessments to the FDIC. Under the FDIC's risk-based assessment system for deposit insurance premiums, all insured depository institutions are placed into one of four categories (Risk Categories I, II, III, and IV), based primarily on their level of capital and supervisory evaluations, for purposes of determining the institution's assessment rate. Deposit insurance premium assessments are generally based on an institution's total assets minus its tangible equity.

*FICO Assessments.* Our bank, as a member of the Deposit Insurance Fund ("DIF"), was subject to assessments to cover the payments on outstanding obligations of the Financing Corporation ("FICO"). FICO was created to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC's Savings Association Insurance Fund, which was created to insure the deposits of thrift institutions and was merged with the Bank Insurance Fund into the newly formed DIF in 2006. The FDIC made its final collection of the assessment for these bonds in March 2019. FDIC-insured institutions accordingly are no longer required to pay the FICO bond assessment.

*Michigan DIFS Assessments.* Michigan banks are required to pay supervisory fees to the Michigan DIFS to fund their operations. The amount of supervisory fees paid by a bank is based upon the bank's total assets.

*Capital Requirements.* The Federal Reserve has established the following minimum capital standards for state-chartered, FDIC-insured member banks, such as our bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders' equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, Federal Reserve regulations provide that higher capital may be required to take adequate account of, among other things, interest rate risk and the risks posed by concentrations of credit, nontraditional activities, or securities trading activities.

On January 1, 2015, we became subject to new regulatory capital rules issued by the Federal Reserve in 2013. In general, these new capital rules increase the minimum requirements for both the quantity and quality of capital we maintain. The rules include a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. This 2.5% capital conservation buffer was phased in beginning in 2016 and ending with full implementation of the 2.5% buffer in January 2019. The rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4%. As to the quality of capital, the new rules emphasize common equity Tier 1 capital, the most loss-absorbing form of capital, and implements strict eligibility criteria for regulatory capital instruments. The rules also change the methodology for calculating risk-weighted assets to enhance risk sensitivity. The application of the new capital rules to our organization is described below. We believe we currently exceed all of the capital ratio requirements of these new capital rules.

**ITEM 1. BUSINESS** (continued)

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." Federal regulations define these capital categories as follows:

	<b>Total Risk-Based Capital Ratio</b>	<b>Tier 1 Risk-Based Capital Ratio</b>	<b>Common Equity Tier 1 Risk-Based Capital Ratio</b>	<b>Leverage Ratio</b>
Well capitalized	10% or above	8% or above	6.5% or above	5% or above
Adequately capitalized	8% or above	6% or above	4.5% or above	4% or above
Undercapitalized	Less than 8%	Less than 6%	Less than 4.5%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 4%	Less than 3%	Less than 3%
Critically undercapitalized	Tangible equity to total assets of 2% or less			

At December 31, 2019, our bank's ratios exceeded minimum requirements for the well-capitalized category.

Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rates the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution to correct the deficiency following receipt of a less-than-satisfactory rating on its most recent examination report.

*Dividends.* Under Michigan law, banks are restricted as to the maximum amount of dividends they may pay on their common stock. Our bank may not pay dividends except out of its net income after deducting its losses and bad debts. In addition, a Michigan bank may not declare or pay a dividend unless the bank will have a surplus amounting to at least 20 percent of its capital after the payment of the dividend.

In addition, as a member of the Federal Reserve System, our bank is required to obtain the prior approval of the Federal Reserve for the declaration or payment of a dividend if the total of all dividends declared in any year will exceed the total of (a) the bank's retained net income (as defined by federal regulation) for that year, plus (b) the bank's retained net income for the preceding two years.

Federal law also generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. In addition, the Federal Reserve may prohibit the payment of dividends by a bank if such payment is determined, by reason of the financial condition of the bank, to be an unsafe and unsound banking practice or if the bank is in default of payment of any assessment due to the FDIC.

ITEM 1. BUSINESS (continued)

Insider Transactions. Our bank is subject to certain restrictions imposed by the Federal Reserve Act on “covered transactions” with us or our subsidiaries, which include investments in our stock or other securities issued by us or our subsidiaries, the acceptance of our stock or other securities issued by us or our subsidiaries as collateral for loans, and extensions of credit to us or our subsidiaries. Certain limitations and reporting requirements are also placed on extensions of credit by our bank to the directors and officers of the holding company, the bank, and the subsidiaries of the bank; to the principal shareholders of the holding company; and to “related interests” of such directors, officers, and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming one of our directors or officers or a principal shareholder may obtain credit from banks with which our bank maintains a correspondent relationship.

Safety and Soundness Standards. Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), the FDIC adopted guidelines to establish operational and managerial standards to promote the safety and soundness of federally-insured depository institutions. The guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality, and earnings.

Investment and Other Activities. Under federal law and regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. FDICIA, as implemented by FDIC regulations, also prohibits FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as a principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the bank’s primary federal regulator determines the activity would not pose a significant risk to the DIF. Impermissible investments and activities must be otherwise divested or discontinued within certain time frames set by the bank’s primary federal regulator in accordance with federal law. These restrictions are not currently expected to have a material impact on the operations of our bank.

Consumer Banking. Our bank’s business includes making a variety of types of loans to individuals. In making these loans, our bank is subject to state usury and other consumer protection laws and to various federal statutes, including provisions of the Gramm Leach-Bliley Act aimed at protecting the privacy of consumer financial information, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), the Home Mortgage Disclosure Act, and the regulations promulgated under these statutes, which (among other things) prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of our bank, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing. In receiving deposits, our bank is subject to extensive regulation under state and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon our bank and its directors and officers.

Anti-Money Laundering and the USA PATRIOT Act. The bank is subject to a number of financial recordkeeping and anti-money laundering laws and regulations including the Bank Secrecy Act and the USA PATRIOT Act, as well as similar rules and guidelines implemented and enforced by the Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”) and the Federal Financial Institutions Council (“FFIEC”). These laws and regulations require the bank to take certain steps to prevent the use of the bank or its systems from facilitating the flow of illegal or illicit money or terrorist funds. As of May 11, 2018, the bank is required to comply with FinCEN’s new Customer Due Diligence Requirements for Financial Institutions, which is designed to identify and verify the identity of natural persons (known as beneficial owners) of legal entity customers who own, control and profit from companies when those companies open accounts.

ITEM 1.    BUSINESS (continued)

A number of new consumer protection laws were implemented following the 2008 recession, including:

- The Homeowner Affordability and Stability Plan (HASP) was implemented in 2009 to support a recovery in the housing market and ensure that borrowers can continue to pay off their mortgages through initiatives such as access to low-cost refinancing for responsible homeowners suffering from falling home prices; a \$75 billion homeowner stability plan to prevent foreclosure, and support of low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.
- The Dodd-Frank Act, adopted in 2010, included the creation of the Consumer Financial Protection Bureau (CFPB), which was given the power to issue and enforce certain consumer protection laws. The CFPB has issued several new consumer protection regulations, including regulations that impact residential mortgage lending and servicing.
- The Dodd-Frank Act also implemented new restrictions on how mortgage brokers and loan originators may be compensated.

We have experienced, and expect to continue to experience, increased costs and expenses related to compliance with these and other new consumer protection regulations.

2018 Regulatory Reform. In May 2018 the Economic Growth, Regulatory Relief and Consumer Protection Act (the “2018 Act”), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While the 2018 Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion and for large banks with assets of more than \$50 billion.

Among other changes, the 2018 Act expanded the definition of qualified mortgages that may be held by a financial institution and simplified the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than \$10 billion by instructing the federal banking regulators to establish a single “Community Bank Leverage Ratio” of between 8% and 10% to replace the leverage and risk-based regulatory capital ratios. Effective January 1, 2020, qualifying community banking organizations may elect to comply with a greater than 9% community bank leverage ratio (the “CBLR”) requirement in lieu of the currently applicable requirements for calculating and reporting risk-based capital ratios. The CBLR is equal to Tier 1 capital divided by average total consolidated assets. In order to qualify for the CBLR election, a community bank must (1) have a leverage capital ratio greater than 9 percent, (2) have less than \$10 billion in average total consolidated assets, (3) not exceed certain levels of off-balance sheet exposure and trading assets plus trading liabilities, and (4) not be an advanced approaches banking organization. A community bank that meets the above qualifications and elects to utilize the CBLR is considered to have satisfied the risk-based and leverage capital requirements in the generally applicable capital rules and is also considered to be “well capitalized” under the prompt corrective action rules.

The 2018 Act also includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, and risk weights for certain high-risk commercial real estate loans. It is difficult to predict at this time when or how any additional new standards under the 2018 Act will ultimately be applied to us or what specific impact the 2018 Act and the yet-to-be-written implementing rules and regulations will have on community banks.

Branching Authority. Michigan banks, such as our bank, have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of *de novo* interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

ITEM 1.    BUSINESS (continued)

Michigan permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the Michigan DIFS (1) the acquisition of Michigan banks by FDIC-insured banks or savings banks located in other states, (2) the sale by a Michigan bank of branches to an FDIC-insured bank or savings bank located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) the consolidation of Michigan banks and FDIC-insured banks or savings banks located in other states having laws permitting such consolidation, (4) the establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) the establishment by foreign banks of branches located in Michigan.

Current Expected Credit Loss (“CECL”). The Financial Accounting Standards Board (“FASB”) has adopted a new accounting standard that will be effective for the Bank for our calendar year beginning on January 1, 2020. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable and may require us to increase our allowance for loan losses. It may also greatly increase the data we will need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses, or expenses incurred to determine the appropriate level of the allowance for loan losses, may have a material adverse effect on our financial condition and results of operations.

London Interbank Offered Rate (“LIBOR”). In 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calibration of LIBOR after 2021. The Federal Reserve and the Alternative Reference Rates Committee (“ARRC”), a steering committee comprised primarily of large U.S. financial institutions, have identified the Secured Overnight Financing Rate (“SOFR”), a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as a potential alternative to LIBOR, and the Federal Reserve announced final plans for the production of SOFR. However, whether SOFR will become a LIBOR replacement and the ultimate future of LIBOR remain uncertain. The language in our LIBOR-based contracts and financial instruments has developed over time and may specify various events that will trigger when a successor rate would be selected. Some contracts and financial instruments may give the calculation agent discretion over the substitute index or indices for the calculation of interest rates. Furthermore, implementation of successor indices may lead to additional documentation requirements, compliance measures, and financial impacts, as well as potential disputes or litigation with customers and creditors.

Future Legislation

Various other legislative and regulatory initiatives, including proposals to overhaul the bank regulatory system, are from time to time introduced in Congress and state legislatures, as well as regulatory agencies. Such future legislation regarding financial institutions may change banking statutes and our operating environment in substantial and unpredictable ways and could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among organizations within the industry. The nature and extent of future legislative and regulatory changes affecting financial institutions is very unpredictable. We cannot determine the ultimate effect that any such potential legislation, if enacted, would have upon our financial condition or results of operations.

Available Information

Our annual reports on Forms 10-K, quarterly reports on Forms 10-Q, current reports on Forms 8-K, and all amendments to those reports are available free of charge through our website at [www.IndependentBank.com](http://www.IndependentBank.com) as soon as reasonably practicable after filing with the Securities and Exchange Commission (SEC).

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE

I. (A) DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY:

(B) INTEREST RATES AND INTEREST DIFFERENTIAL

(C) INTEREST RATES AND DIFFERENTIAL

The information set forth in the tables captioned "Average Balances and Rates" and "Change in Net Interest Income" of our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

II. INVESTMENT PORTFOLIO

(A) The following table sets forth the fair value of securities at December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
		(in thousands)	
Equity securities at fair value	\$ -	\$ 393	\$ -
Trading securities	\$ -	\$ -	\$ 455
Available for sale			
U.S. agency residential mortgage-backed	\$ 227,762	\$ 123,751	\$ 137,918
Obligations of states and political subdivisions	96,102	127,555	172,945
Other asset backed	93,886	83,319	93,898
Private label mortgage-backed	39,693	29,419	29,109
Corporate	33,195	34,309	47,853
U.S. agency	14,661	20,014	25,682
U.S. agency commercial mortgage-backed	10,756	5,726	9,760
Trust preferred	1,843	1,819	2,802
Foreign government	502	2,014	2,060
U.S. Treasury	-	-	898
Total	<u>\$ 518,400</u>	<u>\$ 427,926</u>	<u>\$ 522,925</u>

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

(B) The following table sets forth contractual maturities of securities at December 31, 2019 and the weighted average yield of such securities:

	Maturing Within One Year		Maturing After One But Within Five Years		Maturing After Five But Within Ten Years		Maturing After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
(dollars in thousands)								
<u>Available for sale</u>								
Obligations of states and political subdivisions	\$ 8,843	2.59%	\$ 23,610	2.44%	\$ 29,859	3.49%	\$ 33,790	3.44%
U.S. agency residential mortgage-backed	464	1.20	62,950	1.91	13,480	2.12	150,868	2.99
Other asset backed	42,723	2.98	28,891	2.50	17,726	1.69	4,546	3.08
Corporate	1,608	2.45	18,472	3.22	13,115	4.16	-	-
Private label mortgage -backed	227	2.66	23,384	2.90	13,490	2.97	2,592	3.94
U.S. agency	310	0.81	8,255	1.53	6,096	2.60	-	-
U.S. agency commercial mortgage-backed	233	2.16	3,311	2.37	1,009	2.52	6,203	3.30
Trust preferred	-	-	-	-	-	-	1,843	3.22
Foreign government	-	-	502	2.07	-	-	-	-
Total	<u>\$ 54,408</u>	<u>2.87%</u>	<u>\$ 169,375</u>	<u>2.36%</u>	<u>\$ 94,775</u>	<u>2.91%</u>	<u>\$ 199,842</u>	<u>3.09%</u>
Tax equivalent adjustment for calculation of yield	<u>\$ 40</u>		<u>\$ 96</u>		<u>\$ 116</u>		<u>\$ 89</u>	

The rates set forth in the tables above for those obligations of state and political subdivisions that are tax exempt have been restated on a tax equivalent basis assuming a marginal tax rate of 21%. The amount of the adjustment is as follows.

<u>Available for sale</u>	Tax-Exempt Rate	Adjustment	Rate on Tax Equivalent Basis (1)
Under 1 year	2.15%	0.57%	2.72%
1-5 years	2.10	0.56	2.66
5-10 years	2.85	0.76	3.61
After 10 years	3.80	1.02	4.82

(1) The rates in this table are different from the rates in the table above due to obligations of states and political subdivisions in the table above include both taxable and tax exempt securities.

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

III. LOAN PORTFOLIO

(A) The following table sets forth total loans outstanding at December 31:

	2019	2018	2017	2016	2015
	(in thousands)				
Loans held for sale(a)	\$ 69,800	\$ 86,224	\$ 39,436	\$ 67,380	\$ 27,866
Mortgage	1,098,911	1,042,890	849,530	538,615	498,036
Commercial	1,166,695	1,144,481	853,260	804,017	748,398
Installment	459,417	395,149	316,027	265,616	234,017
Payment plan receivables	-	-	-	-	34,599
Total Loans	<u>\$ 2,794,823</u>	<u>\$ 2,668,744</u>	<u>\$ 2,058,253</u>	<u>\$ 1,675,628</u>	<u>\$ 1,542,916</u>

(a) 2016 includes \$30.6 million of payment plan receivables and \$0.8 million commercial loans related to the then pending sale of Mepco and \$35.9 million of 1-4 family residential mortgages.

The loan portfolio is periodically and systematically reviewed, and the results of these reviews are reported to the Board of Directors of our bank. The purpose of these reviews is to assist in assuring proper loan documentation, to facilitate compliance with applicable laws and regulations, to provide for the early identification of potential problem loans (which enhances collection prospects) and to evaluate the adequacy of the allowance for loan losses.

(B) The following table sets forth scheduled loan repayments (excluding 1-4 family residential mortgages and installment loans) at December 31, 2019:

	Due Within One Year	Due After One But Within Five Years	Due After Five Years	Total
	(in thousands)			
Mortgage	\$ -	\$ 183	\$ 161,739	\$ 161,922
Commercial	104,844	334,870	726,981	1,166,695
Total	<u>\$ 104,844</u>	<u>\$ 335,053</u>	<u>\$ 888,720</u>	<u>\$ 1,328,617</u>

The following table sets forth loans due after one year which have predetermined (fixed) interest rates and/or adjustable (variable) interest rates at December 31, 2019:

	Fixed Rate	Variable Rate	Total
	(in thousands)		
Due after one but within five years	\$ 147,236	\$ 187,817	\$ 335,053
Due after five years	541,326	347,394	888,720
Total	<u>\$ 688,562</u>	<u>\$ 535,211</u>	<u>\$ 1,223,773</u>

**ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)**

(C) The following table sets forth loans on non-accrual, loans ninety days or more past due and troubled debt restructured loans at December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
			(in thousands)		
(a) Loans accounted for on a non-accrual basis (1, 2)	\$ 10,178	\$ 9,029	\$ 8,184	\$ 13,364	\$ 10,607
(b) Aggregate amount of loans ninety days or more past due (excludes loans in (a) above)	-	5	-	-	116
(c) Loans not included above which are “troubled debt restructurings” as defined by accounting guidance	<u>47,575</u>	<u>53,087</u>	<u>60,115</u>	<u>70,286</u>	<u>81,512</u>
Total	<u>\$ 57,753</u>	<u>\$ 62,121</u>	<u>\$ 68,299</u>	<u>\$ 83,650</u>	<u>\$ 92,235</u>

(1) The accrual of interest income is discontinued when a loan becomes 90 days past due and the borrower’s capacity to repay the loan and collateral values appear insufficient. Non-accrual loans may be restored to accrual status when interest and principal payments are current and the loan appears otherwise collectible.

(2) Interest in the amount of \$3.65 million would have been earned in 2019 had loans in categories (a) and (c) remained at their original terms; however, only \$3.23 million was included in interest income for the year with respect to these loans.

Potential problem loans identified by the loan review department which are not included as non-performing in the table above were zero at December 31, 2019.

At December 31, 2019, there was no concentration of loans exceeding 10% of total loans which is not already disclosed as a category of loans in this section “Loan Portfolio” (Item III(A)).

There were no other interest-bearing assets at December 31, 2019, that would be required to be disclosed above (Item III(C)), if such assets were loans.

There were no foreign loans at December 31, 2019, 2018, 2017, 2016 and 2015.

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

IV. SUMMARY OF LOAN LOSS EXPERIENCE

(A) The following table sets forth loan balances and summarizes the changes in the allowance for loan losses for each of the years ended December 31:

	2019		2018		2017	
	(dollars in thousands)					
Total loans outstanding at the end of the year (net of unearned fees)	\$ 2,794,823		\$ 2,668,744		\$ 2,058,253	
Average total loans outstanding for the year (net of unearned fees)	\$ 2,721,627		\$ 2,424,539		\$ 1,848,860	
	Allowance for Loan Losses	Unfunded Commit- ments	Allowance for Loan Losses	Unfunded Commit- ments	Allowance for Loan Losses	Unfunded Commit- ments
Balance at beginning of year	\$ 24,888	\$ 1,296	\$ 22,587	\$ 1,125	\$ 20,234	\$ 650
Loans charged-off						
Mortgage	1,221		1,946		1,122	
Commercial	682		448		455	
Installment	1,622		1,430		1,474	
Total loans charged-off	3,525		3,824		3,051	
Recoveries of loans previously charged-off						
Mortgage	933		734		1,741	
Commercial	2,165		2,889		1,497	
Installment	863		999		967	
Total recoveries	3,961		4,622		4,205	
Net loans charged-off (recovered)	(436)		(798)		(1,154)	
Additions (deductions) included in operations	824	246	1,503	171	1,199	475
Balance at end of year	\$ 26,148	\$ 1,542	\$ 24,888	\$ 1,296	\$ 22,587	\$ 1,125
Net loans charged-off (recovered) as a percent of average loans outstanding (includes loans held for sale) for the year	(0.02) %		(0.03) %		(0.06) %	
Allowance for loan losses as a percent of loans outstanding (includes loans held for sale) at the end of the year	0.94		0.93		1.10	

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

	2016		2015	
	(dollars in thousands)			
Total loans outstanding at the end of the year (net of unearned fees)	<u>\$ 1,675,628</u>		<u>\$ 1,542,916</u>	
Average total loans outstanding for the year (net of unearned fees)	<u>\$ 1,599,899</u>		<u>\$ 1,461,480</u>	
	Allowance for Loan Losses	Unfunded Commit- ments	Allowance for Loan Losses	Unfunded Commit- ments
Balance at beginning of year	\$ 22,570	\$ 652	\$ 25,990	\$ 539
Loans charged-off				
Mortgage	2,599		2,567	
Commercial	1,317		1,694	
Installment	1,671		1,467	
Total loans charged-off	<u>5,587</u>		<u>5,728</u>	
Recoveries of loans previously charged-off				
Mortgage	1,047		1,258	
Commercial	2,472		2,656	
Installment	1,100		1,108	
Total recoveries	<u>4,619</u>		<u>5,022</u>	
Net loans charged-off	968		706	
Reclassification to loans held for sale	59		-	
Additions (deductions) included in operations	(1,309)	(2)	(2,714)	113
Balance at end of year	<u>\$ 20,234</u>	<u>\$ 650</u>	<u>\$ 22,570</u>	<u>\$ 652</u>
Net loans charged-off as a percent of average loans outstanding (includes loans held for sale) for the year	0.06	%	0.05	%
Allowance for loan losses as a percent of loans outstanding (includes loans held for sale) at the end of the year	1.21		1.46	

The allowance for loan losses reflected above is a valuation allowance in its entirety and the only allowance available to absorb probable incurred loan losses.

Further discussion of the provision and allowance for loan losses (a critical accounting policy) as well as non-performing loans, is presented in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference.

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

IV. SUMMARY OF LOAN LOSS EXPERIENCE (Continued)

(B) We have allocated the allowance for loan losses to provide for probable incurred losses within the categories of loans set forth in the table below. The amount of the allowance for loan losses that is allocated and the ratio of loans within each category to total loans at December 31 follow:

	2019		2018		2017	
	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans
	(dollars in thousands)					
Commercial	\$ 7,922	41.7%	\$ 7,090	42.9%	\$ 5,595	41.5%
Mortgage	8,216	41.8	7,978	42.3	8,733	43.2
Installment	1,283	16.5	895	14.8	864	15.3
Payment plan receivables	-	-	-	-	-	-
Subjective allocation	8,727	-	8,925	-	7,395	-
Total	<u>\$ 26,148</u>	<u>100.0%</u>	<u>\$ 24,888</u>	<u>100.0%</u>	<u>\$ 22,587</u>	<u>100.0%</u>

	2016		2015	
	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans
	(dollars in thousands)			
Commercial	\$ 4,880	48.0%	\$ 5,670	48.5%
Mortgage	8,681	34.3	10,391	34.1
Installment	1,011	15.9	1,181	15.2
Payment plan receivables(a)	-	1.8	56	2.2
Subjective allocation	5,662	-	5,272	-
Total	<u>\$ 20,234</u>	<u>100.0%</u>	<u>\$ 22,570</u>	<u>100.0%</u>

(a) Allowance for loan losses of \$0.06 million related to payment plan receivables was reclassified to loans held for sale at December 31, 2016.

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE (Continued)

V. DEPOSITS

The following table sets forth average deposit balances and the weighted-average rates paid thereon for the years ended December 31:

	2019		2018		2017	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
	(dollars in thousands)					
Non-interest bearing deposits	\$ 867,314		\$ 846,718		\$ 728,208	
Savings and interest-bearing checking	1,453,061	0.70%	1,218,243	0.39%	1,052,215	0.15%
Time deposits	655,718	2.01	632,330	1.55	502,284	1.04
Total	<u>\$ 2,976,093</u>	0.79%	<u>\$ 2,697,291</u>	0.54%	<u>\$ 2,282,707</u>	0.30%

The following table summarizes time deposits in amounts of 0.10 million or more by time remaining until maturity at December 31, 2019:

	(in thousands)	
Three months or less	\$	59,787
Over three through six months		59,823
Over six months through one year		46,192
Over one year		46,981
Total	<u>\$</u>	<u>212,783</u>

VI. RETURN ON EQUITY AND ASSETS

The ratio of net income to average shareholders' equity and to average assets, and certain other ratios, for the years ended December 31 follow:

	2019	2018	2017	2016	2015
Net income as a percent of					
Average shareholders' equity	13.63%	12.38%	7.82%	9.21%	7.89%
Average assets	1.35	1.27	0.77	0.92	0.86
Dividends declared per share as a percent of diluted net income per share	36.00	35.71	44.21	32.38	30.23
Average shareholders' equity as a percent of average assets	9.90	10.27	9.88	9.98	10.93

Additional performance ratios are set forth in Selected Consolidated Financial Data in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference. Any significant changes in the current trend of the above ratios are reviewed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference.

VII. SHORT-TERM BORROWINGS

Short-term borrowings are discussed in note 9 to the consolidated financial statements incorporated herein by reference to Part II, Item 8 of this report.

## ITEM 1A. RISK FACTORS

Investing in our common stock involves risks, including (among others) the following factors:

**Downturns in general political, economic or industry conditions, either domestically or internationally, would have an adverse effect on our financial condition and performance.**

Local, domestic, and international economic, political and industry-specific conditions affect the financial services industry, directly and indirectly. Conditions such as or related to inflation, recession, unemployment, volatile interest rates, international conflicts and other factors outside of our control, such as real estate values, energy costs, fuel prices, state and local municipal budget deficits, and government spending and the U.S. national debt, may, directly and indirectly, adversely affect us. Economic downturns could result in the delinquency of outstanding loans, which could have a material adverse impact on our earnings.

**Governmental monetary and fiscal policies may adversely affect the financial services industry and therefore impact our financial condition and results of operations.**

Monetary and fiscal policies of various governmental and regulatory agencies, particularly the Federal Reserve, affect the financial services industry, directly and indirectly. The Federal Reserve regulates the supply of money and credit in the U.S., and its monetary and fiscal policies determine in a large part our cost of funds for lending and investing and the return that can be earned on such loans and investments. Changes in such policies, including changes in interest rates, will influence the origination of loans, the value of investments, the value of capitalized mortgage loan servicing rights, the generation of deposits and the rates received on loans and investment securities and paid on deposits. Changes in monetary and fiscal policies are beyond our control and difficult to predict. Our financial condition and results of operations could be materially adversely impacted by changes in governmental monetary and fiscal policies.

**Volatility and disruptions in global capital and credit markets may adversely impact our business, financial condition and results of operations.**

Even though we operate in a distinct geographic region in the U.S., we are impacted by global capital and credit markets, which are sometimes subject to periods of extreme volatility and disruption. Disruptions, uncertainty or volatility in the capital and credit markets may limit our ability to access capital and manage liquidity, which may adversely affect our business, financial condition and results of operations. Further, our customers may be adversely impacted by such conditions, which could have a negative impact on our business, financial condition and results of operations.

**The soundness of other financial institutions could adversely affect us.**

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, can lead to market-wide liquidity problems and losses or defaults by us or by other institutions. Many of these transactions could expose us to credit risk in the event of default by a counterparty. In addition, our credit risk may be impacted when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due to us. There is no assurance that any such losses would not adversely affect us and possibly be material in nature.

**Changes in regulation or oversight may have a material adverse impact on our operations.**

We are subject to extensive regulation, supervision and examination by the Federal Reserve, the FDIC, the Michigan DIFS, the SEC and other regulatory bodies. Such regulation and supervision governs the activities in which we may engage. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, investigations and limitations related to our securities, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material adverse impact on our business, financial condition or results of operations.

**ITEM 1A. RISK FACTORS** (continued)

Additional regulatory focus on the financial services industry is common in connection with an economic downturn, as the industry experienced following the most recent financial crisis. As a result, the adverse effects on our business relating to a future economic downturn could be exacerbated by additional regulations and regulatory scrutiny that accompanied or followed any such downturn. We can neither predict when or whether future regulatory or legislative reforms will be enacted nor what their contents will be. The impact of any future legislation or regulatory actions on our businesses or operations cannot be determined at this time, and such impact may adversely affect us.

**We have credit risk inherent in our loan portfolios, and our allowance for loan losses may not be sufficient to cover actual loan losses.**

Our loan customers may not repay their loans according to their respective terms, and the collateral securing the payment of these loans may be insufficient to cover any losses we may incur. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. Non-performing loans amounted to \$9.5 million and \$8.6 million at December 31, 2019 and December 31, 2018, respectively. Our allowance for loan losses coverage ratio of non-performing loans was 274.32% and 290.27% at December 31, 2019 and December 31, 2018, respectively. In determining the size of the allowance for loan losses, we rely on our experience and our evaluation of current economic conditions. If our assumptions or judgments prove to be incorrect, our current allowance for loan losses may not be sufficient to cover certain loan losses inherent in our loan portfolio, and adjustments may be necessary to account for different economic conditions or adverse developments in our loan portfolio. Material additions to our allowance for loan losses would adversely impact our operating results.

In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize additional loan charge-offs, notwithstanding any internal analysis that has been performed. Any increase in our allowance for loan losses or loan charge-offs required by these regulatory agencies could have a material adverse effect on our results of operations and financial condition.

**We have credit risk in our securities portfolio.**

We maintain diversified securities portfolios, which include obligations of the Treasury and government-sponsored agencies as well as securities issued by states and political subdivisions, mortgage-backed securities, corporate securities and asset-backed securities. We seek to limit credit losses in our securities portfolios by principally purchasing highly rated securities (generally rated “AA” or higher by a major debt rating agency) and by conducting due diligence on the issuer. However, gross unrealized losses on securities available for sale in our portfolio totaled approximately \$1.1 million as of December 31, 2019 (compared to approximately \$6.8 million as of December 31, 2018). We believe these unrealized losses are temporary in nature and are expected to be recovered within a reasonable time period as we believe we have the ability to hold the securities to maturity or until such time as the unrealized losses reverse. However, we evaluate securities available for sale for other than temporary impairment (OTTI) at least quarterly and more frequently when economic or market concerns warrant such evaluation. Those evaluations may result in OTTI charges to our earnings. In addition to these impairment charges, we may, in the future, experience additional losses in our securities portfolio which may result in charges that could materially adversely affect our results of operations.

**Our mortgage-banking revenues are susceptible to substantial variations, due in part to factors we do not control, such as market interest rates.**

A portion of our revenues are derived from net gains on mortgage loans. These net gains primarily depend on the volume of loans we sell, which in turn depends on our ability to originate real estate mortgage loans and the demand for fixed-rate obligations and other loans that are outside of our established interest-rate risk parameters. Net gains on mortgage loans are also dependent upon economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates. Consequently, they can often be a volatile part of our overall revenues. We realized net gains of \$20.0 million on mortgage loans during 2019 compared to \$10.6 million during 2018 and \$11.8 million during 2017.

**We are subject to liquidity risk in our operations, which could adversely impact our ability to fund various obligations.**

Liquidity risk is the possibility of being unable to meet obligations as they come due or capitalize on growth opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, loan originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses and capital expenditures. Liquidity is derived primarily from retail deposit growth and earnings retention, principal and interest payments on loans and investment securities, net cash provided from operations and access to other funding. If we are unable to maintain adequate liquidity, then our business, financial condition and results of operations could be negatively impacted.

**Our parent company must rely on dividends or returns of capital from our bank for most of its cash flow.**

Our parent company is a separate and distinct legal entity from our bank. Generally, our parent company receives substantially all of its cash flow from dividends or returns of capital from our subsidiary bank. These dividends or returns of capital are the principal source of funds to pay our parent company's operating expenses and for cash dividends on our common stock. Various federal and/or state laws and regulations limit the amount of dividends that the bank may pay to the parent company.

**Any future strategic acquisitions or divestitures may present certain risks to our business and operations.**

Difficulties in capitalizing on the opportunities presented by a future acquisition may prevent us from fully achieving the expected benefits from the acquisition, or may cause the achievement of such expectations to take longer to realize than expected. Further, the assimilation of the acquired entity's customers and markets could result in higher than expected deposit attrition, loss of key employees, disruption of our businesses or the businesses of the acquired entity or otherwise adversely affect our ability to maintain relationships with customers and employees or achieve the anticipated benefits of the acquisition. These matters could have an adverse effect on us for an undetermined period. We will be subject to similar risks and difficulties in connection with any future decisions to downsize, sell or close units or otherwise change our business mix.

**Compliance with new capital requirements may adversely affect us.**

The capital requirements applicable to us as a bank holding company as well as to our subsidiary bank have been substantially revised in connection with Basel III and the requirements of the Financial Reform Act. These more stringent capital requirements, and any other new regulations, could adversely affect our ability to pay dividends in the future, or could require us to reduce business levels or to raise capital, including in ways that may adversely affect our results of operations or financial condition and/or existing shareholders. Maintaining higher levels of capital may reduce our profitability and otherwise adversely affect our business, financial condition, or results of operations.

**Declines in the businesses or industries of our customers could cause increased credit losses, which could adversely affect us.**

Our business customer base consists, in part, of customers in volatile businesses and industries such as the automotive production industry and the real estate business. These industries are sensitive to global economic conditions and supply chain factors. Any decline in one of those customers' businesses or industries could cause increased credit losses, which in turn could adversely affect us.

**The introduction, implementation, withdrawal, success and timing of business initiatives and strategies may be less successful or may be different than anticipated, which could adversely affect our business.**

We make certain projections and develop plans and strategies for our banking and financial products. If we do not accurately determine demand for or changes in our banking and financial product needs, it could result in us incurring significant expenses without the anticipated increases in revenue, which could result in a material adverse effect on our business.

**We may not be able to utilize technology to efficiently and effectively develop, market, and deliver new products and services to our customers.**

The financial services industry experiences rapid technological change with regular introductions of new technology-driven products and services. The efficient and effective utilization of technology enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to market and deliver products and services that will satisfy customer demands, meet regulatory requirements, and create additional efficiencies in our operations. We may not be able to effectively develop new technology-driven products and services or be successful in marketing or supporting these products and services to our customers, which could have a material adverse impact on our financial condition and results of operations.

**Operational difficulties, failure of technology infrastructure or information security incidents could adversely affect our business and operations.**

We are exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, failure of our controls and procedures and unauthorized transactions by employees or operational errors, including clerical or recordkeeping errors or those resulting from computer or telecommunications systems malfunctions. Given the high volume of transactions we process, certain errors may be repeated or compounded before they are identified and resolved. In particular, our operations rely on the secure processing, storage and transmission of confidential and other information on our technology systems and networks. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems.

We also face the risk of operational disruption, failure or capacity constraints due to our dependency on third party vendors for components of our business infrastructure, including our core data processing systems which are largely outsourced. While we have selected these third party vendors carefully, we do not control their operations. As such, any failure on the part of these business partners to perform their various responsibilities could also adversely affect our business and operations.

We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control, which may include, for example, computer viruses, cyber attacks, spikes in transaction volume and/or customer activity, electrical or telecommunications outages, or natural disasters. Although we have programs in place related to business continuity, disaster recovery and information security to maintain the confidentiality, integrity, and availability of our systems, business applications and customer information, such disruptions may give rise to interruptions in service to customers and loss or liability to us.

**ITEM 1A. RISK FACTORS** (continued)

The occurrence of any failure or interruption in our operations or information systems, or any security breach, could cause reputational damage, jeopardize the confidentiality of customer information, result in a loss of customer business, subject us to regulatory intervention or expose us to civil litigation and financial loss or liability, any of which could have a material adverse effect on us.

**Changes in the financial markets, including fluctuations in interest rates and their impact on deposit pricing, could adversely affect our net interest income and financial condition.**

The operations of financial institutions such as us are dependent to a large degree on net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. Prevailing economic conditions, the trade, fiscal and monetary policies of the federal government and the policies of various regulatory agencies all affect market rates of interest and the availability and cost of credit, which in turn significantly affect financial institutions' net interest income. Volatility in interest rates can also result in disintermediation, which is the flow of funds away from financial institutions into direct investments, such as federal government and corporate securities and other investment vehicles, which, because of the absence of federal insurance premiums and reserve requirements, generally pay higher rates of return than financial institutions. Our financial results could be materially adversely impacted by changes in financial market conditions.

**Competitive product and pricing pressures among financial institutions within our markets may change.**

We operate in a very competitive environment, which is characterized by competition from a number of other financial institutions in each market in which we operate. We compete with large national and regional financial institutions and with smaller financial institutions in terms of products and pricing. If we are unable to compete effectively in products and pricing in our markets, business could decline, which could have a material adverse effect on our business, financial condition or results of operations.

**Changes in customer behavior may adversely impact our business, financial condition and results of operations.**

We use a variety of methods to anticipate customer behavior as a part of our strategic planning and to meet certain regulatory requirements. Individual, economic, political, industry-specific conditions and other factors outside of our control, such as fuel prices, energy costs, real estate values or other factors that affect customer income levels, could alter predicted customer borrowing, repayment, investment and deposit practices. Such a change in these practices could materially adversely affect our ability to anticipate business needs and meet regulatory requirements.

Further, difficult economic conditions may negatively affect consumer confidence levels. A decrease in consumer confidence levels would likely aggravate the adverse effects of these difficult market conditions on us, our customers and others in the financial institutions industry.

**Our ability to maintain and expand customer relationships may differ from expectations.**

The financial services industry is very competitive. We not only vie for business opportunities with new customers, but also compete to maintain and expand the relationships we have with our existing customers. While we believe that we can continue to grow many of these relationships, we will continue to experience pressures to maintain these relationships as our competitors attempt to capture our customers. Failure to create new customer relationships and to maintain and expand existing customer relationships to the extent anticipated may adversely impact our earnings.

**Our ability to retain key officers and employees may change.**

Our future operating results depend substantially upon the continued service of our executive officers and key personnel. Our future operating results also depend in significant part upon our ability to attract and retain qualified management, financial, technical, marketing, sales and support personnel. Competition for qualified personnel is intense, and we cannot ensure success in attracting or retaining qualified personnel. There may be only a limited number of persons with the requisite skills to serve in these positions, and it may be increasingly difficult for us to hire personnel over time.

ITEM 1A. RISK FACTORS (continued)

Further, our ability to retain key officers and employees may be impacted by legislation and regulation affecting the financial services industry. Our business, financial condition or results of operations could be materially adversely affected by the loss of any key employees, or our inability to attract and retain skilled employees.

**Legal and regulatory proceedings and related matters with respect to the financial services industry, including those directly involving us, could adversely affect us or the financial services industry in general.**

We have been, and may in the future be, subject to various legal and regulatory proceedings. It is inherently difficult to assess the outcome of these matters, and there can be no assurance that we will prevail in any proceeding or litigation. Any such matter could result in substantial cost and diversion of our efforts, which by itself could have a material adverse effect on our financial condition and operating results. Further, adverse determinations in such matters could result in actions by our regulators that could materially adversely affect our business, financial condition or results of operations.

**Methods of reducing risk exposures might not be effective.**

Instruments, systems and strategies used to hedge or otherwise manage exposure to various types of credit, market and liquidity, operational, compliance, business risks and enterprise-wide risk could be less effective than anticipated. As a result, we may not be able to effectively mitigate our risk exposures in particular market environments or against particular types of risk, which could have a material adverse impact on our business, financial condition or results of operations.

**Terrorist activities or other hostilities may adversely affect the general economy, financial and capital markets, specific industries, and us.**

Terrorist attacks or other hostilities may disrupt our operations or those of our customers. In addition, these events have had and may continue to have an adverse impact on the U.S. and world economies in general and consumer confidence and spending in particular, which could harm our operations. Any of these events could increase volatility in the U.S. and world financial markets, which could harm our stock price and may limit the capital resources available to us and our customers. This could have a material adverse impact on our operating results, revenues and costs and may result in increased volatility in the market price of our common stock.

**Catastrophic events, including, but not limited to, hurricanes, tornadoes, earthquakes, fires, floods and pandemic outbreaks, may adversely affect the general economy, financial and capital markets, specific industries, and us.**

We have significant operations and a significant customer base in Michigan where natural and other disasters may occur, such as tornadoes and floods. These types of natural catastrophic events at times have disrupted the local economy, our business, and our customers and have posed physical risks to our property. In addition, catastrophic events occurring in other regions of the world may have an impact on our customers and in turn, on us. A significant catastrophic event could materially adversely affect our operating results.

**Changes in accounting standards could materially impact our consolidated financial statements.**

From time to time, changes are made to the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can be difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings (accumulated deficit).

ITEM 1A. RISK FACTORS (continued)

**Our failure to appropriately apply certain critical accounting policies could result in our misstatement of our financial results and condition.**

Accounting policies and processes are fundamental to how we record and report our financial condition and results of operations. We must exercise judgment in selecting and applying many of these accounting policies and processes so they comply with U.S. GAAP. In some cases, we must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet may result in our reporting materially different results than would have been reported under a different alternative.

We have identified certain accounting policies as being critical because they require us to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. We have established detailed policies and control procedures that are intended to ensure these critical accounting estimates and judgments are subject to internal controls and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding management's judgments and the estimates pertaining to these matters, we cannot guarantee that we will not be required to adjust accounting policies or restate prior period financial statements. See note #1, "Accounting Policies" in the Notes to Consolidated Financial Statements in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K).

**The trading price of our common stock may be subject to significant fluctuations and volatility.**

The market price of our common stock could be subject to significant fluctuations due to, among other things:

- variations in quarterly or annual results of operations;
- changes in dividends per share;
- deterioration in asset quality, including declining real estate values;
- changes in interest rates;
- significant acquisitions or business combinations, strategic partnerships, joint ventures, or capital commitments by or involving us or our competitors;
- regulatory actions, including changes to regulatory capital levels, the components of regulatory capital and how regulatory capital is calculated;
- new regulations that limit or significantly change our ability to continue to offer products or services;
- volatility of stock market prices and volumes;
- issuance of additional shares of common stock or other debt or equity securities;
- changes in market valuations of similar companies;
- changes in securities analysts' estimates of financial performance or recommendations;
- perceptions in the marketplace regarding the financial services industry, us and/or our competitors; and/or
- the occurrence of any one or more of the risk factors described above.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We and our bank operate a total of 87 facilities in Michigan and two leased facilities in Ohio. We own 64 and lease 23 of the facilities in Michigan.

With the exception of the potential remodeling of certain facilities to provide for the efficient use of work space or to maintain an appropriate appearance, each property is considered reasonably adequate for current and anticipated needs.

ITEM 3. LEGAL PROCEEDINGS

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

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, but we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ADDITIONAL ITEM - EXECUTIVE OFFICERS

Our executive officers are appointed annually by our Board of Directors at the meeting of directors preceding the Annual Meeting of Shareholders. There are no family relationships among these officers and/or our directors nor any arrangement or understanding between any officer and any other person pursuant to which the officer was elected.

The following sets forth certain information with respect to our executive officers at February 21, 2020.

<u>Name (Age)</u>	<u>Position</u>	<u>First elected as an executive officer</u>
William B. Kessel (55)	President, Chief Executive Officer and Director	2004
Stephen A. Erickson (50)	Executive Vice President and Chief Financial Officer(1)	2020
Stefanie M. Kimball (60)	Executive Vice President and Chief Risk Officer	2007
Dennis J. Mack (58)	Executive Vice President and Chief Lending Officer	2012
Larry R. Daniel (56)	Executive Vice President, Operations and Digital Banking (2)	2017
Patrick J. Ervin (54)	Executive Vice President, Mortgage Banking (3)	2017
James J. Twarozynski (54)	Senior Vice President, Controller	2002

- (1) Mr. Erickson joined Independent Bank in September 2019, as Executive Vice President and Treasurer. He was promoted to Executive Vice President and Chief Financial Officer effective February 1, 2020. Prior to joining Independent Bank, Mr. Erickson served as the Chief Financial Officer of Midland States Bancorp, Inc. (“Midland”), a nearly \$6.0 billion bank holding company, located in Effingham, Illinois. Prior to becoming the Chief Financial Officer, Mr. Erickson served as Midland’s Director of Mergers and Acquisitions from 2015 to 2018, and as President of Midland’s Merchant Services division from 2012 to 2015.
- (2) Mr. Daniel joined Independent Bank over 19 years ago as a commercial lender. Prior to being named Executive Vice President – Operations and Digital Banking in November 2017, he served as Senior Vice President of Retail and Mortgage Lending at Independent Bank, a position he held since 2012.
- (3) Mr. Ervin joined Independent Bank in August 2016, as Senior Vice President – Mortgage Banking. He was promoted to Executive Vice President – Mortgage Banking in November 2017. Prior to joining Independent Bank, Mr. Ervin served as Executive Managing Director Mortgage Banking and Servicing at Talmer Bank and Trust, a position he held since 2009.

## PART II

### ITEM 5. MARKET FOR OUR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The information set forth under the caption “Quarterly Summary” in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

We maintain a Deferred Compensation and Stock Purchase Plan for Non-Employee Directors (the “Plan”) pursuant to which non-employee directors can elect to receive shares of our common stock in lieu of fees otherwise payable to the director for his or her service as a director. A director can elect to receive shares on a current basis or to defer receipt of the shares, in which case the shares are issued to a trust to be held for the account of the director and then generally distributed to the director after his or her retirement from the Board. Pursuant to this Plan, during the fourth quarter of 2019, we issued 737 shares of common stock to non-employee directors on a current basis and 2,863 shares of common stock to the trust for distribution to directors on a deferred basis. These shares were issued on October 1, 2019 and October 24, 2019 representing aggregate fees of \$0.08 million. The shares on a current basis were issued at a price of \$21.32 per share and the shares on a deferred basis were issued at a price of \$19.38 per share, representing 90% of the fair value of the shares on the credit date. The price per share was the consolidated closing bid price per share of our common stock as of the date of issuance, as determined in accordance with NASDAQ Marketplace Rules. We issued the shares pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the issuance of the shares was made on a private basis pursuant to the Plan.

#### ISSUER PURCHASES OF EQUITY SECURITIES

The following table shows certain information relating to purchases of common stock for the three-months ended December 31, 2019:

Period	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Remaining Number of Shares Authorized for Purchase Under the Plan
October 2019	-	-	-	274,298
November 2019	-	-	-	274,298
December 2019	263	22.46	-	-
Total	263	\$ 22.46	-	-

(1) Represents shares withheld from the shares that would otherwise have been issued to certain officers in order to satisfy tax withholding obligations and the stock option exercise price resulting from the exercise of stock options.

The share repurchase plan we had in place for 2019 expired on December 31, 2019. On December 17, 2019, we announced the adoption by our Board of Directors of a 2020 share repurchase plan that authorizes the repurchase during 2020 of up to 1,120,000 shares of our outstanding common stock.

### ITEM 6. SELECTED FINANCIAL DATA

The information set forth under the caption “Selected Consolidated Financial Data” in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Asset/liability management" in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements and the independent auditor's report are set forth in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and are incorporated herein by reference.

Management's Annual Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition at December 31, 2019 and 2018

Consolidated Statements of Operations for the years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Comprehensive Income for the years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Cash Flows for the years ended December 31, 2019, 2018 and 2017

Notes to Consolidated Financial Statements

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (continued)

The supplementary data required by this item set forth under the caption "Quarterly Financial Data (Unaudited)" in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

The portions of our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), which are not specifically incorporated by reference as part of this Form 10-K are not deemed to be a part of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

1. Evaluation of Disclosure Controls and Procedures. With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15e and 15d – 15e) as of the year ended December 31, 2019 (the “Evaluation Date”), have concluded that, as of such date, our disclosure controls and procedures were effective.
2. Internal Control Over Financial Reporting. “Management’s Annual Report on Internal Control Over Financial Reporting” and our independent registered public accounting firm’s audit of internal control over financial reporting as of December 31, 2019 included within the “Report of Independent Registered Public Accounting Firm,” each as set forth in our annual report, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K) are incorporated herein by reference.

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

DIRECTORS - The information with respect to our directors set forth under the caption “Proposal I Submitted for Your Vote -- Election of Directors” in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

BENEFICIAL OWNERSHIP REPORTING – The information set forth under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

EXECUTIVE OFFICERS - Reference is made to the additional item under Part I of this report on Form 10-K.

CODE OF ETHICS - We have adopted a “Code of Ethics for Chief Executive Officer and Senior Financial Officers” that applies to our Chief Executive Officer, Chief Financial Officer, and Controller. A copy of our Code of Ethics is posted on our website at [www.IndependentBank.com](http://www.IndependentBank.com), under Investor Relations, and a printed copy is available upon request by writing to our Chief Financial Officer, Independent Bank Corporation, 4200 East Beltline, Grand Rapids, Michigan 49525.

CORPORATE GOVERNANCE – Information relating to our audit committee, set forth under the caption “Board Committees and Functions” in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information set forth under the captions “Executive Compensation,” “Director Compensation,” “Compensation Committee Interlocks and Insider Participation,” and “Compensation Committee Report” in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information set forth under the captions “Voting Securities and Record Date”, “Proposal I Submitted for Your Vote -- Election of Directors” and “Securities Ownership of Management” in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

We maintain certain equity compensation plans under which our common stock is authorized for issuance to employees and directors, including our Deferred Compensation and Stock Purchase Plan for Non-employee Directors and our Long-Term Incentive Plan.

The following sets forth certain information regarding our equity compensation plans as of December 31, 2019.

<u>Plan Category</u>	<u>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>(b) Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
Equity compensation plans approved by security holders	<u>138,506</u>	<u>\$ 4.62</u>	<u>452,996</u>
Equity compensation plan not approved by security holders	None	N/A	<u>177,519</u>

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS  
(continued)

The equity compensation plan not approved by security holders referenced above is our Deferred Compensation and Stock Purchase Plan for Non-employee Directors. This plan allows our non-employee directors to defer payment of all or a part of their director fees and to receive shares of common stock in lieu of cash for these fees. Under the plan, each non-employee director may elect to participate in a Current Stock Purchase Account, a Deferred Cash Investment Account, or a Deferred Stock Account. A Current Stock Purchase Account is credited with shares of our common stock having a fair market value equal to the fees otherwise payable. A Deferred Cash Investment Account is credited with an amount equal to the fees deferred and on each quarterly credit date with an appreciation factor that may not exceed the prime rate of interest charged by our bank. A Deferred Stock Account is credited with the amount of fees deferred and converted into stock units based on 90% of the fair market value of our common stock at the time of the deferral. Amounts in the Deferred Stock Account are credited with cash dividends and other distributions on our common stock. Fees credited to a Deferred Cash Investment Account or a Deferred Stock Account are deferred for income tax purposes. This plan does not provide for distributions of amounts deferred prior to a participant's termination as a non-employee director. Participants may generally elect either a lump sum or installment distribution.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth under the captions "Transactions Involving Management" and "Determination of Independence of Board Members" in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information set forth under the caption "Disclosure of Fees Paid to our Independent Auditors" in our definitive proxy statement, to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders, is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a) 1. Financial Statements  
All of our financial statements are incorporated herein by reference as set forth in the annual report to be delivered to shareholders in connection with the April 21, 2020 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K.)
2. Exhibits (Numbered in accordance with Item 601 of Regulation S-K)  
The Exhibit Index is located on the final three pages of this report on Form 10-K.

ITEM 16. FORM 10-K SUMMARY

Not applicable.



## EXHIBIT INDEX

### Exhibit number and description

#### EXHIBITS FILED HEREWITH

<a href="#">4</a>	Description of Registrant's Common Stock
<a href="#">13</a>	Annual report, relating to the April 21, 2020 Annual Meeting of Shareholders. This annual report will be delivered to our shareholders in compliance with Rule 14(a)-3 of the Securities Exchange Act of 1934, as amended.
<a href="#">21</a>	List of Subsidiaries.
<a href="#">23</a>	Consent of Independent Registered Public Accounting Firm (Crowe LLP).
<a href="#">24</a>	Power of Attorney (included on page 34).
<a href="#">31.1</a>	Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<a href="#">31.2</a>	Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<a href="#">32.1</a>	Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
<a href="#">32.2</a>	Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

#### EXHIBITS INCORPORATED BY REFERENCE

<a href="#">3.1</a>	Restated Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to our quarterly report on Form 10-Q filed November 3, 2017).
<a href="#">3.2</a>	Amended and Restated Bylaws (incorporated here by reference to Exhibit 3.2 to our annual report on Form 10-K filed March 7, 2017).
<a href="#">10.1*</a>	The form of Indemnity Agreement, as executed with all of the directors of the registrant (incorporated herein by reference to Exhibit 10.3 to the Form S-4 we filed on December 29, 2017).
<a href="#">10.2*</a>	The form of Management Continuity Agreement as executed with executive officers and certain senior managers (incorporated herein by reference to Exhibit 10.4 to the Form S-4 we filed on December 29, 2017).
<a href="#">10.3*</a>	Long-Term Incentive Plan, as amended through January 24, 2017 (incorporated herein by reference to Appendix A to our proxy statement filed on Schedule 14A on March 7, 2017).
<a href="#">10.4*</a>	Amended and Restated Deferred Compensation and Stock Purchase Plan for Nonemployee Directors, as amended through March 19, 2019 (incorporated herein by reference to Exhibit 10.1 to our quarterly report on Form 10-Q filed May 3, 2019).
<a href="#">10.5*</a>	Form of Restricted Stock Unit Grant Agreement as executed with certain executive officers (incorporated herein by reference to Exhibit 10.2 to our quarterly report on Form 10-Q filed May 9, 2011).
<a href="#">10.6*</a>	Form of TSR Performance Share Award Agreement as executed with certain executive officers (incorporated herein by reference to Exhibit 10.12 to our annual report on Form 10-K filed March 7, 2014).
<a href="#">10.7*</a>	Summary of Independent Bank Corporation Management Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.10 to our annual report on Form 10-K filed March 6, 2015).

\* Represents a compensation plan.

**DESCRIPTION OF THE REGISTRANT'S SECURITIES  
REGISTERED PURSUANT TO SECTION 12 OF  
THE SECURITIES EXCHANGE ACT OF 1934**

The following is a brief description of the common stock of Independent Bank Corporation (the “Company”). This summary does not purport to be complete in all respects and is subject to and qualified in its entirety by reference to the Company’s Restated Articles of Incorporation and Amended and Restated Bylaws, each of which are filed as exhibits to the Annual Report on Form 10-K of which this Exhibit 4 is a part.

**Authorized Capital Stock**

The Company’s authorized capital stock consists of 500,000,000 shares of common stock and 200,000 shares of preferred stock. As of December 31, 2019, there were 22,481,643 shares of common stock outstanding and no shares of preferred stock outstanding.

**Dividend and Liquidation Rights**

Subject to the prior rights of the holders of shares of preferred stock that may be issued and outstanding, if any, the holders of common stock are entitled to receive:

- dividends when, as, and if declared by the Company’s Board of Directors out of funds legally available for the payment of dividends; and
- in the event of dissolution of the Company, to share ratably in all assets remaining after payment of liabilities and satisfaction of the liquidation preferences, if any, of then outstanding shares of preferred stock, as provided in the Restated Articles of Incorporation.

**Voting Rights**

Each holder of common stock is entitled to one vote for each share held of record on all matters presented to a vote at a shareholders meeting, including the election of directors. Holders of common stock have no cumulative voting rights.

The Company’s Restated Articles of Incorporation provide that the Company’s Board of Directors be divided into three classes of nearly equal size, with the classes to hold office for staggered terms of three years each.

The vote required for the election of a director shall, except in a contested election, be the affirmative vote of a majority of the votes cast in the election of a nominee. For this purpose, a “majority of the votes cast” means that the number of votes cast “for” a director’s election exceeds the number of votes cast “against” that director’s election. Abstentions and broker non-votes are not counted as votes cast either “for” or “against” a director’s election. In a contested election, directors are elected by a plurality of the votes cast at the meeting of shareholders. An election is considered contested if there are more nominees for election than positions on the Board of Directors to be filled by election at that meeting.

**Listing**

The Company’s common stock is currently traded on the Nasdaq Global Select Market under the symbol “IBCP.”

**Applicable Anti-Takeover Provisions**

As a bank holding company, the acquisition of large interests in the Company’s common stock is subject to certain limitations. The federal Change in Bank Control Act prohibits a person or group of persons from acquiring “control” of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of the Company’s common stock would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company. In addition, a company is required to obtain the approval of the Federal Reserve Board under the federal Bank Holding Company Act before acquiring 25% (5% in the case of an acquiror that is a bank holding company) or more of any class of outstanding voting stock of a bank holding company, or otherwise obtaining control or a “controlling influence” over that bank holding company. These limitations may have an anti-takeover effect and could prevent or delay mergers, business combination transactions, and other large investments in the Company’s common stock that may otherwise be in the best interests of the Company.

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In addition to the foregoing limitations, the Restated Articles of Incorporation and Amended and Restated Bylaws of the Company contain provisions that could also have an anti-takeover effect. Some of the provisions also may make it difficult for shareholders to replace incumbent directors with new directors who may be willing to entertain changes that shareholders may believe will lead to improvements in the combined company's business.

**Other**

All of the outstanding shares of the Company's common stock are fully paid and non-assessable. Holders of common stock have no preemptive rights to purchase or subscribe for any additional shares of common stock or other securities, and there are no conversion rights or redemption or sinking fund provisions with respect to the Company's common stock.

The transfer agent for the Company's common stock is Broadridge Corporate Issuer Solutions, Inc., P.O. Box 1342, Brentwood, NY 11717.

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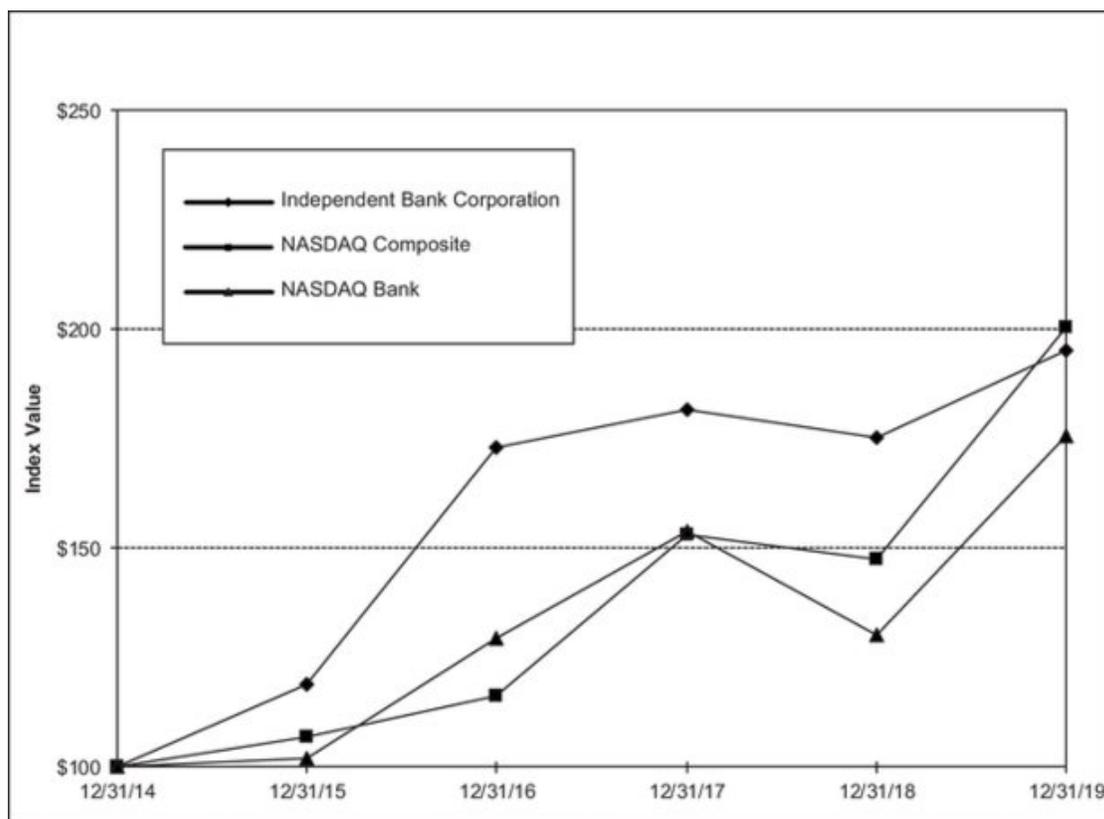
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**PERFORMANCE GRAPH**

The graph below compares the total returns (assuming reinvestment of dividends) of Independent Bank Corporation common stock, the NASDAQ Composite Index and the NASDAQ Bank Stock Index. The graph assumes \$100 invested in Independent Bank Corporation common stock (returns based on stock prices per the NASDAQ) and each of the indices on December 31, 2014, and the reinvestment of all dividends during the periods presented. The performance shown on the graph is not necessarily indicative of future performance.

***Independent Bank Corporation***



<i>Index</i>	<i>Period Ending</i>					
	<u>12/31/14</u>	<u>12/31/15</u>	<u>12/31/16</u>	<u>12/31/17</u>	<u>12/31/18</u>	<u>12/31/19</u>
Independent Bank Corporation	100.00	118.93	173.20	181.85	175.46	195.41
NASDAQ Composite	100.00	106.96	116.45	153.23	147.35	200.49
NASDAQ Bank	100.00	102.21	129.34	154.02	130.28	175.61

[TABLE OF CONTENTS](#)**SELECTED CONSOLIDATED FINANCIAL DATA**

	Year Ended December 31,				
	2019	2018	2017	2016	2015
<b>SUMMARY OF OPERATIONS</b>					
Interest income	\$ 148,928	\$ 130,773	\$ 98,309	\$ 86,523	\$ 80,842
Interest expense	26,347	17,491	9,123	6,882	5,856
Net interest income	122,581	113,282	89,186	79,641	74,986
Provision for loan losses	824	1,503	1,199	(1,309)	(2,714)
Net gains on securities	307	138	260	563	20
Net gain on branch sale	—	—	—	—	1,193
Other non-interest income	47,429	44,677	42,273	41,735	38,917
Non-interest expenses	111,733	107,461	92,082	90,347	88,450
Income before income tax	57,760	49,133	38,438	32,901	29,380
Income tax expense	11,325	9,294	17,963	10,135	9,363
Net income	<u>\$ 46,435</u>	<u>\$ 39,839</u>	<u>\$ 20,475</u>	<u>\$ 22,766</u>	<u>\$ 20,017</u>
<b>PER COMMON SHARE DATA</b>					
Net income per common share					
Basic	\$ 2.03	\$ 1.70	\$ 0.96	\$ 1.06	\$ 0.88
Diluted	2.00	1.68	0.95	1.05	0.86
Cash dividends declared and paid	0.72	0.60	0.42	0.34	0.26
Book value	15.58	14.38	12.42	11.71	11.28
<b>SELECTED BALANCES</b>					
Assets	\$ 3,564,694	\$ 3,353,281	\$ 2,789,355	\$ 2,548,950	\$ 2,409,066
Loans	2,725,023	2,582,520	2,018,817	1,608,248	1,515,050
Allowance for loan losses	26,148	24,888	22,587	20,234	22,570
Deposits	3,036,727	2,913,428	2,400,534	2,225,719	2,085,963
Shareholders' equity	350,169	338,994	264,933	248,980	251,092
Other borrowings	88,646	25,700	54,600	9,433	11,954
Subordinated debentures	39,456	39,388	35,569	35,569	35,569
<b>SELECTED RATIOS</b>					
Net interest income to average interest earning assets	3.80%	3.88%	3.65%	3.52%	3.58%
Net income to					
Average shareholders' equity	13.63	12.38	7.82	9.21	7.89
Average assets	1.35	1.27	0.77	0.92	0.86
Average shareholders' equity to average assets	9.90	10.27	9.88	9.98	10.93
Tier 1 capital to average assets	10.11	10.47	10.57	10.50	10.91
Non-performing loans to Portfolio Loans	0.35	0.33	0.39	0.75	0.70

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### **MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business;
- economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our bank operates;
- the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;
- increased competition in the financial services industry, either nationally or regionally;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- the continued services of our management team; and
- implementation of new legislation, which may have significant effects on us and the financial services industry.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report, but the list is not intended to be all-inclusive. The risk factors disclosed in Part I – Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019, 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 the 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.

*Introduction.* The following section presents additional information to assess the financial condition and results of operations of Independent Bank Corporation (“IBCP”), its wholly-owned bank, Independent Bank (the “Bank”), and their subsidiaries. This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this annual report. We also encourage you to read our Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (“SEC”). That report includes a list of risk factors that you should consider in connection with any decision to buy or sell our securities.

*Overview.* We provide banking services to customers located primarily in Michigan’s Lower Peninsula and have also opened two loan production offices in Ohio (Columbus and Fairlawn). A third Ohio loan production office is being opened in Toledo in March 2020. As a result, our success depends to a great extent upon the economic conditions in Michigan’s Lower Peninsula.

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*Significant Developments.* On December 22, 2017, “H.R. 1”, also known as the “Tax Cuts and Jobs Act” was signed into law. H.R.1, among other things, reduced the federal corporate income tax rate to 21%, effective January 1, 2018. As a result, we concluded that our deferred tax assets, net (“DTA”) had to be remeasured. Our DTA represents expected corporate tax benefits anticipated to be realized in the future. The reduction in the federal corporate income tax rate reduced these anticipated future benefits. The remeasurement of our DTA at December 31, 2017 resulted in a reduction of these net assets and a corresponding increase in income tax expense of \$6.0 million that was recorded in the fourth quarter of 2017.

On December 4, 2017, we entered into an Agreement and Plan of Merger with TCSB Bancorp, Inc. (“TCSB”) (the “Merger Agreement”) providing for a business combination of IBCP and TCSB. On April 1, 2018, TCSB was merged with and into IBCP, with IBCP as the surviving corporation (the “Merger”). In connection with the Merger, on April 1, 2018, IBCP consolidated Traverse City State Bank, TCSB’s wholly-owned subsidiary bank, with and into Independent Bank (with Independent Bank as the surviving institution). See note #26.

It is against this backdrop that we discuss our results of operations and financial condition in 2019 as compared to earlier periods.

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### RESULTS OF OPERATIONS

*Summary.* We recorded net income of \$46.4 million, or \$2.00 per diluted share, in 2019, net income of \$39.8 million, or \$1.68 per diluted share, in 2018, and net income of \$20.5 million, or \$0.95 per diluted share, in 2017. The 2019 and 2018 results include the benefit of a reduced federal income tax rate pursuant to H.R. 1 and the impact of the Merger and 2017 results include an additional \$6.0 million (\$0.28 per diluted share) of income tax expense related to the remeasurement of our DTA, both as described earlier under “Significant Developments.”

#### KEY PERFORMANCE RATIOS

	Year Ended December 31,		
	2019	2018	2017
Net income to			
Average shareholders' equity	13.63%	12.38%	7.82%
Average assets	1.35	1.27	0.77
Net income per common share			
Basic	\$ 2.03	\$ 1.70	\$ 0.96
Diluted	2.00	1.68	0.95

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

Net interest income totaled \$122.6 million during 2019, compared to \$113.3 million and \$89.2 million during 2018 and 2017, respectively. The increase in net interest income in 2019 compared to 2018 primarily reflects a \$302.1 million increase in average interest-earning assets that was partially offset by an eight basis point decrease in our tax equivalent net interest income as a percent of average interest-earning assets (the “net interest margin”).

The increase in net interest income in 2018 compared to 2017 reflects a \$462.0 million increase in average interest-earning assets and a 23 basis point increase in our net interest margin.

The increase in average interest-earning assets during 2019 and 2018 primarily reflects the impact of the Merger as well as loan growth utilizing funds from increases in deposits. The decrease in the net interest margin during 2019 as compared to 2018 primarily reflects reductions in short-term interest rates during that year as well as a flattening of the yield curve. The increase in the net interest margin during 2018 as compared to 2017 primarily reflects increases in short-term interest rates during that year as well as the impact of the Merger.

2019 and 2018 interest income on loans includes \$1.5 million and \$1.7 million, respectively, of accretion of the discount recorded on the TCSB loans acquired in the Merger.

Our net interest income is also impacted by our level of non-accrual loans. Average non-accrual loans totaled \$8.1 million, \$8.4 million and \$9.5 million in 2019, 2018 and 2017, respectively.

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**AVERAGE BALANCES AND RATES**

	2019			2018			2017		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
(Dollars in thousands)									
<b>ASSETS</b>									
Taxable loans	\$ 2,713,690	\$ 133,574	4.92%	\$ 2,418,421	\$ 116,634	4.82%	\$ 1,845,661	\$ 84,169	4.56%
Tax-exempt loans <sup>(1)</sup>	7,937	391	4.93	6,118	292	4.77	3,199	172	5.38
Taxable securities	397,598	11,842	2.98	394,160	10,874	2.76	485,343	10,928	2.25
Tax-exempt securities <sup>(1)</sup>	52,324	1,683	3.22	67,574	2,192	3.24	86,902	3,063	3.52
Interest bearing cash	48,023	818	1.70	32,593	371	1.14	37,119	264	0.71
Other investments	18,359	1,043	5.68	16,936	920	5.43	15,543	836	5.38
Interest earning assets	3,237,931	149,351	4.61	2,935,802	131,283	4.48	2,473,767	99,432	4.02
Cash and due from banks	37,575			33,384			31,980		
Other assets, net	164,726			162,750			144,442		
Total assets	<u>\$ 3,440,232</u>			<u>\$ 3,131,936</u>			<u>\$ 2,650,189</u>		
<b>LIABILITIES</b>									
Savings and interest-bearing checking	\$ 1,453,061	10,228	0.70	\$ 1,218,243	4,696	0.39	\$ 1,052,215	1,530	0.15
Time deposits	655,718	13,197	2.01	632,330	9,782	1.55	502,284	5,245	1.04
Other borrowings	77,254	2,922	3.78	79,519	3,013	3.79	74,876	2,348	3.14
Interest bearing liabilities	2,186,033	26,347	1.21	1,930,092	17,491	0.91	1,629,375	9,123	0.56
Non-interest bearing deposits	867,314			846,718			728,208		
Other liabilities	46,153			33,354			30,838		
Shareholders' equity	340,732			321,772			261,768		
Total liabilities and shareholders' equity	<u>\$ 3,440,232</u>			<u>\$ 3,131,936</u>			<u>\$ 2,650,189</u>		
Net interest income		<u>\$ 123,004</u>			<u>\$ 113,792</u>			<u>\$ 90,309</u>	
Net interest income as a percent of average interest earning assets			<u>3.80%</u>			<u>3.88%</u>			<u>3.65%</u>

(1) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 21% in 2019 and 2018 and 35% in 2017.

**RECONCILIATION OF NET INTEREST MARGIN, FULLY TAXABLE EQUIVALENT ("FTE")**

	Year Ended December 31,		
	2019	2018	2017
(Dollars in thousands)			
Net interest income	\$ 122,581	\$ 113,282	\$ 89,186
Add: taxable equivalent adjustment	423	510	1,123
Net interest income - taxable equivalent	<u>\$ 123,004</u>	<u>\$ 113,792</u>	<u>\$ 90,309</u>
Net interest margin (GAAP)	<u>3.79%</u>	<u>3.85%</u>	<u>3.61%</u>
Net interest margin (FTE)	<u>3.80%</u>	<u>3.88%</u>	<u>3.65%</u>

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**CHANGE IN NET INTEREST INCOME**

	<u>2019 compared to 2018</u>			<u>2018 compared to 2017</u>		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
	(In thousands)					
Increase (decrease) in interest income <sup>(1)</sup>						
Taxable loans	\$ 14,491	\$ 2,449	\$ 16,940	\$ 27,388	\$ 5,077	\$ 32,465
Tax-exempt loans <sup>(2)</sup>	89	10	99	141	(21)	120
Taxable securities	96	872	968	(2,263)	2,209	(54)
Tax-exempt securities <sup>(2)</sup>	(491)	(18)	(509)	(641)	(230)	(871)
Interest bearing cash	218	229	447	(35)	142	107
Other investments	80	43	123	76	8	84
Total interest income	<u>14,483</u>	<u>3,585</u>	<u>18,068</u>	<u>24,666</u>	<u>7,185</u>	<u>31,851</u>
Increase (decrease) in interest expense <sup>(1)</sup>						
Savings and interest bearing checking	1,047	4,485	5,532	276	2,890	3,166
Time deposits	374	3,041	3,415	1,587	2,950	4,537
Other borrowings	(86)	(5)	(91)	153	512	665
Total interest expense	<u>1,335</u>	<u>7,521</u>	<u>8,856</u>	<u>2,016</u>	<u>6,352</u>	<u>8,368</u>
Net interest income	<u>\$ 13,148</u>	<u>\$ (3,936)</u>	<u>\$ 9,212</u>	<u>\$ 22,650</u>	<u>\$ 833</u>	<u>\$ 23,483</u>

- (1) The change in interest due to changes in both balance and rate has been allocated to change due to balance and change due to rate in proportion to the relationship of the absolute dollar amounts of change in each.
- (2) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 21% in 2019 and 2018 and 35% in 2017.

**COMPOSITION OF AVERAGE INTEREST EARNING ASSETS AND INTEREST BEARING LIABILITIES**

	<u>Year Ended December 31,</u>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
As a percent of average interest earning assets			
Loans	84.1%	82.6%	74.7%
Other interest earning assets	15.9	17.4	25.3
Average interest earning assets	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Savings and interest-bearing checking	44.9%	41.5%	42.5%
Time deposits	20.3	21.5	20.3
Other borrowings	2.3	2.7	3.1
Average interest bearing liabilities	<u>67.5%</u>	<u>65.7%</u>	<u>65.9%</u>
Earning asset ratio	94.1%	93.7%	93.3%
Free-funds ratio <sup>(1)</sup>	32.5	34.3	34.1

- (1) Average interest earning assets less average interest bearing liabilities divided by average interest earning assets.

*Provision for loan losses.* The provision for loan losses was an expense of \$0.8 million, \$1.5 million and \$1.2 million in 2019, 2018 and 2017, respectively. The provision reflects our assessment of the allowance for loan losses taking into consideration factors such as loan mix, levels of non-performing and classified loans and loan net charge-offs. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors. See “Portfolio Loans and asset quality” for a discussion of the various components of the allowance for loan losses and their impact on the provision for loan losses.

*Non-interest income.* Non-interest income is a significant element in assessing our results of operations. Non-interest income totaled \$47.7 million during 2019 compared to \$44.8 million and \$42.5 million during 2018 and

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2017, respectively. We adopted Financial Accounting Standards Board Accounting Standards Update 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) on January 1, 2018, using the modified retrospective method. Although ASU 2014-09 did not have any impact on our January 1, 2018 shareholders’ equity or 2019 or 2018 net income, it did result in a classification change in non-interest income and non-interest expense as compared to 2017. Specifically, in 2019, interchange income and interchange expense each increased by \$1.9 million and in 2018, interchange income and interchange expense each increased by \$1.5 million, due to classification changes under ASU 2014-09 (also see note #25 to our Consolidated Financial Statements).

## NON-INTEREST INCOME

	Year Ended December 31,		
	2019	2018	2017
	(In thousands)		
Service charges on deposit accounts	\$ 11,208	\$ 12,258	\$ 12,673
Interchange income	10,297	9,905	8,023
Net gains on assets			
Mortgage loans	19,978	10,597	11,762
Securities	307	138	260
Mortgage loan servicing, net	(3,336)	3,157	1,647
Investment and insurance commissions	1,658	1,971	1,968
Bank owned life insurance	1,111	970	1,061
Other	6,513	5,819	5,139
Total non-interest income	<u>\$ 47,736</u>	<u>\$ 44,815</u>	<u>\$ 42,533</u>

Service charges on deposit accounts totaled \$11.2 million in 2019, as compared to \$12.3 million in 2018 and \$12.7 million during 2017. These yearly variations primarily reflect declines in non-sufficient funds fees.

Interchange income totaled \$10.3 million in 2019 compared to \$9.9 million in 2018 and \$8.0 million in 2017. The increases in 2019 and 2018 as compared to 2017, are primarily due to the aforementioned impact of ASU 2014-09 as well as increased transaction volume.

We realized net gains of \$20.0 million on mortgage loans during 2019, compared to \$10.6 million and \$11.8 million during 2018 and 2017 respectively. Mortgage loan activity is summarized as follows:

## MORTGAGE LOAN ACTIVITY

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Mortgage loans originated	\$ 1,011,141	\$ 807,408	\$ 871,222
Mortgage loans sold <sup>(1)</sup>	738,910	491,798	423,327
Net gains on mortgage loans	19,978	10,597	11,762
Net gains as a percent of mortgage loans sold (“Loan Sales Margin”)	2.70%	2.15%	2.78%
Fair value adjustments included in the Loan Sales Margin	0.22	(0.02)	(0.07)

(1) 2019 includes the sale of \$50.5 million of portfolio residential fixed and adjustable mortgage loans to other institutions and securitization of \$65.1 million of portfolio residential fixed rate loans. 2018 includes the sale of \$27.6 million of portfolio residential fixed and adjustable rate portfolio mortgage loans to another financial institution and securitization of \$10.9 million of portfolio residential fixed rate loans.

The increase in mortgage loan originations, sales and net gains in 2019 as compared to 2018 and 2017 is due primarily to lower interest rates that resulted in increased mortgage loan refinance activity. In addition, a solid housing market has resulted in strong purchase money mortgage origination volume. However, higher interest rates during 2018, reduced mortgage loan refinance volume during that year on an industry-wide basis.

The volume of loans sold is dependent upon our ability to originate mortgage loans as well as the demand for fixed-rate obligations and other loans that we choose to not put into portfolio because of our established interest-rate risk parameters. (See “Portfolio Loans and asset quality.”) Net gains on mortgage loans are also dependent upon

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economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates and thus can often be a volatile part of our overall revenues.

Net gains as a percentage of mortgage loans sold (our “Loan Sales Margin”) are impacted by several factors including competition and the manner in which the loan is sold. Net gains on mortgage loans are also impacted by recording fair value accounting adjustments. Excluding these fair value accounting adjustments, the Loan Sales Margin would have been 2.48% in 2019, 2.17% in 2018 and 2.85% in 2017. The higher Loan Sales Margin in 2019 and 2017, as compared to 2018, was principally due to more favorable competitive conditions including wider primary-to-secondary market pricing spreads for much of each of those years. In 2018, our Loan Sales Margin contracted due to competitive factors. In general, as overall industry-wide mortgage loan origination levels drop, pricing becomes more competitive. The changes in the fair value accounting adjustments are primarily due to changes in the amount of commitments to originate mortgage loans for sale during each period. In addition, in 2018, we recorded a loss on mortgage loans of \$0.25 million in the fourth quarter on the pending sale of approximately \$41.5 million of portfolio mortgage loans. These loans were classified as held for sale at December 31, 2018, and carried at the lower of cost or fair value. This sale closed on January 30, 2019.

We generated net gains on securities of \$0.31 million, \$0.14 million and \$0.26 million in 2019, 2018 and 2017, respectively. These net gains were due to the sales of securities and changes in the fair value of equity/trading securities as outlined in the table below. We recorded no net impairment losses in 2019, 2018 or 2017 for other than temporary impairment of securities available for sale.

## GAINS AND LOSSES ON SECURITIES

	Year Ended December 31,			
	Proceeds	Gains <sup>(1)</sup>	Losses <sup>(2)</sup>	Net
	(In thousands)			
2019	\$ 68,716	\$ 415	\$ 108	\$ 307
2018	48,736	336	198	138
2017	17,308	263	3	260

(1) Gains in 2019 and 2017 include \$0.166 million and \$0.045 million, respectively related to equity securities at fair value. Gains in 2018 include \$0.144 million related to the sale of 1,000 VISA Class B shares.

(2) Losses in 2018 include \$0.062 million related to equity securities at fair value.

Mortgage loan servicing, net, generated a loss of \$3.3 million and earnings of \$3.2 million and \$1.6 million in 2019, 2018 and 2017, respectively. This activity is summarized in the following table:

## MORTGAGE LOAN SERVICING ACTIVITY

	2019	2018	2017
	(In thousands)		
Mortgage loan servicing:			
Revenue, net	\$ 6,196	\$ 5,480	\$ 4,391
Fair value change due to price	(6,408)	191	(718)
Fair value change due to pay-downs	(3,124)	(2,514)	(2,026)
Total	<u>\$ (3,336)</u>	<u>\$ 3,157</u>	<u>\$ 1,647</u>

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Effective on January 1, 2017, we adopted the fair value accounting method for capitalized mortgage loan servicing rights. Activity related to capitalized mortgage loan servicing rights is as follows:

### CAPITALIZED MORTGAGE LOAN SERVICING RIGHTS

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Balance at January 1,	\$ 21,400	\$ 15,699	\$ 13,671
Change in accounting	—	—	542
Balance at January 1, as adjusted	21,400	15,699	14,213
Originated servicing rights capitalized	7,303	4,977	4,230
Servicing rights acquired	—	3,047	—
Change in fair value	(9,532)	(2,323)	(2,744)
Balance at December 31,	<u>\$ 19,171</u>	<u>\$ 21,400</u>	<u>\$ 15,699</u>

At December 31, 2019, we were servicing approximately \$2.58 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of 4.22% and a weighted average service fee of approximately 25.8 basis points. Remaining capitalized mortgage loan servicing rights at December 31, 2019 totaled \$19.2 million, representing approximately 74.3 basis points on the related amount of mortgage loans serviced for others.

Investment and insurance commissions totaled \$1.7 million in 2019 as compared to \$2.0 million in both 2018 and 2017. The lower level of revenue in 2019 as compared to the prior two years was due primarily to lower sales volumes reflecting, in part, changes in and newer personnel in certain markets.

We earned \$1.1 million, \$1.0 million and \$1.1 million in 2019, 2018 and 2017, respectively, on our separate account bank owned life insurance principally as a result of increases in the cash surrender value. Our separate account is primarily invested in agency mortgage-backed securities and managed by a fixed income investment manager. The crediting rate (on which the earnings are based) reflects the performance of the separate account. The total cash surrender value of our bank owned life insurance was \$55.7 million and \$55.1 million at December 31, 2019 and 2018, respectively.

Other non-interest income totaled \$6.5 million, \$5.8 million and \$5.1 million in 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 is due primarily to growth in fees related to interest rate swaps for commercial loan customers. The increase in 2018 as compared to 2017 is primarily due to increases in a variety of categories including: wire transfer fees, credit card interchange income, merchant processing fees, and income from a small business investment company.

*Non-interest expense.* Non-interest expense is an important component of our results of operations. We strive to efficiently manage our cost structure.

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Non-interest expense totaled \$111.7 million in 2019, \$107.5 million in 2018, and \$92.1 million in 2017. Many of our components of non-interest expense increased in 2019 and 2018 as compared to 2017 due to the Merger. The components of non-interest expense are as follows:

### NON-INTEREST EXPENSE

	Year ended December 31,		
	2019	2018	2017
	(In thousands)		
Compensation	\$ 41,719	\$ 37,878	\$ 35,397
Performance-based compensation	12,066	11,942	9,874
Payroll taxes and employee benefits	13,716	12,258	9,818
Compensation and employee benefits	67,501	62,078	55,089
Occupancy, net	9,013	8,912	8,102
Data processing	8,905	8,262	7,657
Furniture, fixtures and equipment	4,113	4,080	3,870
Interchange expense	3,215	2,702	1,156
Communications	2,947	2,848	2,684
Loan and collection	2,685	2,682	2,230
Advertising	2,450	2,155	1,905
Legal and professional	1,814	1,839	1,892
Amortization of intangible assets	1,089	969	346
FDIC deposit insurance	685	1,081	894
Supplies	638	689	666
Credit card and bank service fees	411	414	529
Costs related to unfunded lending commitments	246	171	475
Provision for loss reimbursement on sold loans	229	10	171
Net gains on other real estate and repossessed assets	(90)	(672)	(606)
Merger related expenses	—	3,465	284
Other	5,882	5,776	4,738
Total non-interest expense	\$ 111,733	\$ 107,461	\$ 92,082

Compensation expense, which is primarily salaries, totaled \$41.7 million, \$37.9 million and \$35.4 million in 2019, 2018 and 2017, respectively. The increases in 2019 and 2018 as compared to 2017 were primarily due to annual merit based salary increases, the Merger and additional staffing particularly in commercial lending and information technology (including data analytics).

Performance-based compensation expense totaled \$12.1 million, \$11.9 million and \$9.9 million in 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 was primarily due to an increase in the employee stock ownership plan (“ESOP”) contribution accrual reflecting the aforementioned higher salaries. The increase in 2018 as compared to 2017 primarily related to the level of compensation under our Management Incentive Compensation Plan (“MICP”) based on our performance relative to plan targets and increased ESOP contributions.

We maintain performance-based compensation plans. In addition to commissions and cash incentive awards, such plans include an ESOP and a long-term equity based incentive plan. The amount of expense recognized in 2019, 2018 and 2017 for share-based awards under our long-term equity based incentive plan was \$1.6 million, \$1.5 million and \$1.6 million, respectively. In each of those three years, the Board and Compensation Committee of the Board authorized the grant of restricted stock and performance share awards under the plan.

Payroll taxes and employee benefits expense totaled \$13.7 million, \$12.3 million and \$9.8 million in 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 was primarily due to a \$0.3 million increase in payroll taxes, a \$0.5 million increase in health care insurance, a \$0.2 million increase in 401(k) plan employer contributions and a \$0.4 million increase in employee education and employee relations costs. The increase in 2018 as compared to 2017 was primarily due to a \$0.5 million increase in payroll taxes, a \$1.1 million increase in health care insurance and a \$0.6 million increase in 401(k) plan employer contributions. A portion of the increases in 2019 and 2018 was due to the Merger. However, we maintain a self-insured health care plan (with an individual claim stop

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loss limit) and we experienced a significant rise in claims in 2019 and 2018 as compared to 2017. In 2018, we also increased the 401(k) employer match to 4% (from 3%) of an employee's eligible compensation.

Occupancy expenses, net, totaled \$9.0 million, \$8.9 million and \$8.1 million in 2019, 2018 and 2017, respectively. The increases in 2019 and 2018 as compared to 2017 were primarily due to additional locations acquired in the Merger and a few additional loan production offices that were opened during 2017.

Data processing expenses totaled \$8.9 million, \$8.3 million, and \$7.7 million in 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 was primarily due to higher mobile banking activity and software costs for new applications in several departments. The increase in 2018 as compared to 2017 was primarily due to the Merger as well as higher mobile banking activity and software costs for new applications in several departments.

Furniture, fixtures and equipment expense totaled \$4.1 million, \$4.1 million, and \$3.9 million in 2019, 2018 and 2017, respectively. The increases in 2019 and 2018 as compared to 2017 were primarily due to the Merger.

Interchange expense, which totaled \$3.2 million, \$2.7 million, and \$1.2 million in 2019, 2018 and 2017, respectively, primarily represents fees paid to our core information systems processor and debit card licensor related to debit card and ATM transactions. The increases in 2019 and 2018 as compared to 2017 were due primarily to the impact of the implementation of ASU 2014-09 on January 1, 2018. Prior to 2018, certain processing costs were being netted against interchange income. As described above, under ASU 2014-09 these costs are no longer being netted against interchange income but instead are being reported as part of interchange expense. Increased debit card transaction volumes in 2019 and 2018 also contributed to the rise in this expense as well as the addition of a fraud detection service in early 2019.

Communications expense totaled \$2.9 million, \$2.8 million and \$2.7 million in 2019, 2018 and 2017, respectively. The increases in 2019 and 2018 as compared to 2017 were primarily due to the Merger.

Loan and collection expenses reflect costs related to new lending activity as well as the management and collection of non-performing loans and other problem credits. These expenses totaled \$2.7 million, \$2.7 million and \$2.2 million in 2019, 2018 and 2017, respectively. The reduced level of expense in 2017 primarily reflects a higher level of recoveries of previously incurred expenses related to the resolution and collection of non-performing or previously charged-off loans.

Advertising expense totaled \$2.5 million, \$2.2 million, and \$1.9 million in 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 was primarily due to increased outdoor advertising (billboards). The increase in 2018 as compared to 2017 was primarily due to increased outdoor advertising (billboards) as well as the Merger.

Legal and professional fees totaled \$1.8 million, \$1.8 million, and \$1.9 million in 2019, 2018 and 2017, respectively. The decreases in 2019 and 2018 as compared to 2017 were primarily due to lower consulting costs for certain deposit account programs.

The amortization of intangible assets primarily relates to the Merger (for 2019 and 2018) and branch acquisitions and the related amortization of the deposit customer relationship value, including core deposit value, which was acquired in connection with those transactions. We had remaining unamortized intangible assets of \$5.3 million and \$6.4 million at December 31, 2019 and 2018 respectively. See note #7 to the Consolidated Financial Statements for a schedule of future amortization of intangible assets.

FDIC deposit insurance expense totaled \$0.7 million, \$1.1 million, and \$0.9 million in 2019, 2018 and 2017, respectively. The decrease in 2019 as compared to 2018 was primarily due to the use of our FDIC Small Bank Assessment Credit (the "Assessment Credit") of approximately \$0.7 million. We do not have any remaining Assessment Credit to apply against our 2020 FDIC deposit insurance expense. The increase in 2018 as compared to 2017 was primarily due to the Merger and growth in total assets.

Supplies expenses were relatively unchanged for all periods presented.

Credit card and bank service fees totaled \$0.4 million, \$0.4 million, and \$0.5 million in 2019, 2018 and 2017, respectively. The declines in 2019 and 2018 compared to 2017 were primarily due to the sale of our payment plan processing business in May 2017.

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

The provision for loss reimbursement on sold loans was an expense of \$0.23 million, \$0.01 million and \$0.17 million in 2019, 2018 and 2017, respectively. This provision represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Bank of Indianapolis). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. The reserve for loss reimbursements on sold mortgage loans totaled \$0.88 million and \$0.78 million at December 31, 2019 and 2018, respectively. This reserve is included in accrued expenses and other liabilities in our Consolidated Statements of Financial Condition. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate based upon our prior experience and other assumptions. However, future losses could exceed our current estimate.

Net gains on other real estate and repossessed assets represent the gain or loss on the sale or additional write downs on these assets subsequent to the transfer of the asset from our loan portfolio. This transfer occurs at the time we acquire the collateral that secured the loan. At the time of acquisition, the other real estate or repossessed asset is valued at fair value, less estimated costs to sell, which becomes the new basis for the asset. Any write-downs at the time of acquisition are charged to the allowance for loan losses. The net gains of \$0.1 million in 2019 and \$0.7 million in 2018 were primarily due to improved market conditions leading to better sales prices for both commercial and residential properties. The net gain of \$0.6 million in 2017 was primarily due to the sale of a commercial property in the fourth quarter of that year.

Merger related expenses totaled \$3.5 million and \$0.3 million in 2018 and 2017, respectively. These expenses included our investment banking fees, certain accounting and legal costs, various contract termination fees, data processing conversion costs, payments made on officer change-in-control contracts, and employee severance costs.

Other non-interest expenses totaled \$5.9 million, \$5.8 million, and \$4.7 million in 2019, 2018 and 2017, respectively. The increases in 2019 and 2018 as compared to 2017 was due to increases in several expense categories, including: directors' fees (a new director was added in 2018), travel and entertainment expenses (in part due to the Merger), debit card and check fraud losses and certain outsourcing costs related to mortgage lending.

*Income tax expense.* We recorded an income tax expense of \$11.3 million, \$9.3 million and \$18.0 million in 2019, 2018 and 2017, respectively. 2019 and 2018 reflect a lower corporate federal income tax rate and 2017 includes an additional \$6.0 million of income tax expense related to the remeasurement of our DTA, both as described earlier under "Significant Developments."

Our actual federal income tax expense is different than the amount computed by applying our statutory federal income tax rate to our pre-tax income primarily due to tax-exempt interest income, share based compensation and tax-exempt income from the increase in the cash surrender value on life insurance (and for 2017, the remeasurement of our DTA as well).

We assess whether a valuation allowance should be established against our DTA based on the consideration of all available evidence using a "more likely than not" standard. The ultimate realization of this asset is primarily based on generating future income. We concluded at December 31, 2019 and 2018 that the realization of substantially all of our DTA continues to be more likely than not.

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### FINANCIAL CONDITION

*Summary.* Our total assets increased to \$3.56 billion at December 31, 2019, compared to \$3.35 billion at December 31, 2018, primarily due to growth in securities available for sale and loans.

Loans, excluding loans held for sale (“Portfolio Loans”), totaled \$2.73 billion at December 31, 2019, an increase of 5.5% from \$2.58 billion at December 31, 2018. (See “Portfolio Loans and asset quality”). The increase in Portfolio Loans during the last few years is part of our overall strategy to grow revenues, earnings and improve our operating leverage by increasing our loans to deposits ratio. The expansion of our mortgage banking operations is part of this strategy along with continuing to increase our commercial and consumer installment lending.

Deposits totaled \$3.04 billion at December 31, 2019, compared to \$2.91 billion at December 31, 2018. The \$123.3 million increase in total deposits during the period reflects growth in reciprocal deposits.

*Securities.* We maintain diversified securities portfolios, which include obligations of U.S. government- sponsored agencies, securities issued by states and political subdivisions, residential and commercial mortgage- backed securities, asset-backed securities, corporate securities, trust preferred securities and foreign government securities (that are denominated in U.S. dollars). We regularly evaluate asset/liability management needs and attempt to maintain a portfolio structure that provides sufficient liquidity and cash flow. Except as discussed below, we believe that the unrealized losses on securities available for sale are temporary in nature and are expected to be recovered within a reasonable time period. We believe that we have the ability to hold securities with unrealized losses to maturity or until such time as the unrealized losses reverse. (See “Asset/liability management.”) Securities available for sale increased by \$90.5 million during 2019, reflecting the deployment of a portion of the funds generated from the growth in deposits and borrowings.

Our portfolio of securities available for sale is reviewed quarterly for impairment in value. In performing this review, management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates on the market value of the security, and (4) an assessment of whether we intend to sell, or it is more likely than not that we will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. For securities that do not meet these recovery criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income (loss). We recorded no net impairment losses related to other than temporary impairment on securities available for sale in 2019, 2018 or 2017.

### SECURITIES

	<u>Amortized</u> <u>Cost</u>	<u>Unrealized</u>		<u>Fair</u>
		<u>Gains</u>	<u>Losses</u>	<u>Value</u>
		<u>(In thousands)</u>		
Securities available for sale				
December 31, 2019	\$ 513,668	\$ 5,782	\$ 1,050	\$ 518,400
December 31, 2018	433,224	1,520	6,818	427,926

*Portfolio Loans and asset quality.* In addition to the communities served by our Bank branch and loan production office network, our principal lending markets also include nearby communities and metropolitan areas. Subject to established underwriting criteria, we also may participate in commercial lending transactions with certain non-affiliated banks and make whole loan purchases from other financial institutions.

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

We generally retain loans that may be profitably funded within established risk parameters. (See “Asset/liability management.”) As a result, we may hold adjustable-rate conventional and fixed rate jumbo mortgage loans as Portfolio Loans, while 15- and 30-year fixed-rate non-jumbo mortgage loans are generally sold to mitigate exposure to changes in interest rates. (See “Non-interest income.”) Due primarily to the expansion of our mortgage-banking activities and a change in mix in our mortgage loan originations, we are now originating and putting into Portfolio

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Loans more fixed rate mortgage loans compared to past periods. These fixed rate mortgage loans generally have terms from 15 to 30 years, do not have prepayment penalties and expose us to more interest rate risk. To date, our interest rate risk profile has not changed significantly. However, we are carefully monitoring this change in the composition of our Portfolio Loans and the impact of potential future changes in interest rates on our changes in market value of portfolio equity and changes in net interest income. (See “Asset/liability management.”) As a result, we have added and may continue to add some longer-term borrowings, may utilize derivatives (interest rate swaps and interest rate caps) to manage interest rate risk and may continue to sell certain fixed rate and adjustable rate jumbo or other mortgage loans in the future. In 2019, we sold or securitized \$75.0 million (excludes the \$41.7 million discussed below) of fixed and adjustable rate portfolio mortgage loans. In 2018, we sold \$27.6 million of fixed and adjustable rate portfolio mortgage loans. In addition, in the fourth quarter of 2018 we reclassified \$41.7 million (fair value of \$41.5 million) of adjustable rate portfolio mortgage loans to held for sale. These loans (which totaled \$40.6 million at the time of sale) were sold to another financial institution on a servicing released basis on January 30, 2019. All of these loan sales/securitizations were non-recourse (other than standard representations and warranties) and were executed primarily for asset/liability management purposes.

## LOAN PORTFOLIO COMPOSITION

	December 31,	
	2019	2018
	(In thousands)	
Real estate <sup>(1)</sup>		
Residential first mortgages	\$ 843,746	\$ 811,719
Residential home equity and other junior mortgages	166,735	177,574
Construction and land development	249,747	180,286
Other <sup>(2)</sup>	693,580	707,347
Consumer	448,297	379,607
Commercial	318,504	319,058
Agricultural	4,414	6,929
Total loans	<u>\$ 2,725,023</u>	<u>\$ 2,582,520</u>

(1) Includes both residential and non-residential commercial loans secured by real estate.

(2) Includes loans secured by multi-family residential and non-farm, non-residential property.

## NON-PERFORMING ASSETS<sup>(1)</sup>

	December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Non-accrual loans	\$ 10,178	\$ 9,029	\$ 8,184
Loans 90 days or more past due and still accruing interest	—	5	—
Sub total	10,178	9,034	8,184
Less: Government guaranteed loans	646	460	255
Total non-performing loans	9,532	8,574	7,929
Other real estate and repossessed assets	1,865	1,299	1,643
Total non-performing assets	<u>\$ 11,397</u>	<u>\$ 9,873</u>	<u>\$ 9,572</u>
As a percent of Portfolio Loans			
Non-performing loans	0.35%	0.33%	0.39%
Allowance for loan losses	0.96	0.96	1.12
Non-performing assets to total assets	0.32	0.29	0.34
Allowance for loan losses as a percent of non-performing loans	274.32	290.27	284.87

(1) Excludes loans classified as “troubled debt restructured” that are performing and vehicle service contract counterparty receivables, net.

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### TROUBLED DEBT RESTRUCTURINGS

	December 31, 2019		
	Commercial	Retail <sup>(1)</sup>	Total
	(In thousands)		
Performing TDR's	\$ 7,974	\$39,601	\$ 47,575
Non-performing TDR's <sup>(2)</sup>	540	2,607 <sup>(3)</sup>	3,147
Total	<u>\$ 8,514</u>	<u>\$42,208</u>	<u>\$ 50,722</u>
	December 31, 2018		
	Commercial	Retail <sup>(1)</sup>	Total
	(In thousands)		
Performing TDR's	\$ 6,460	\$46,627	\$ 53,087
Non-performing TDR's <sup>(2)</sup>	74	2,884 <sup>(3)</sup>	2,958
Total	<u>\$ 6,534</u>	<u>\$49,511</u>	<u>\$ 56,045</u>

- (1) Retail loans include mortgage and installment loan portfolio segments.  
(2) Included in non-performing loans table above.  
(3) Also includes loans on non-accrual at the time of modification until six payments are received on a timely basis.

Non-performing loans totaled \$9.5 million, \$8.6 million and \$7.9 million at December 31, 2019, 2018 and 2017, respectively. The increase in 2019 as compared to 2018 was primarily in the residential mortgage loan portfolio segment that was partially offset by the pay-off or liquidation of non-performing commercial loans. The increase in 2018 as compared to 2017 is primarily due to an increase in non-performing commercial loans. In general, stable economic conditions in our market areas, as well as our collection and resolution efforts, have resulted in relatively low levels of non-performing loans the last few years. However, we are still experiencing some loan defaults, particularly related to commercial loans secured by income-producing property and mortgage loans secured by resort/vacation property.

Non-performing loans exclude performing loans that are classified as troubled debt restructurings (“TDRs”). Performing TDRs totaled \$47.6 million, or 1.7% of total Portfolio Loans, and \$53.1 million, or 2.1% of total Portfolio Loans, at December 31, 2019 and 2018, respectively. The decrease in the amount of performing TDRs during 2019 reflects a decline in mortgage loan TDRs due primarily to payoffs and amortization.

ORE and repossessed assets totaled \$1.9 million at December 31, 2019, compared to \$1.3 million at December 31, 2018. The increase in ORE during 2019 primarily reflects the addition of a \$0.6 million commercial office building located in Grand Rapids, Michigan in the second quarter.

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

### ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

	December 31,		
	2019	2018	2017
	(In thousands)		
Specific allocations	\$ 6,155	\$ 6,310	\$ 6,839
Other adversely rated commercial loans	2,502	1,861	1,228
Historical loss allocations	8,764	7,792	7,125
Additional allocations based on subjective factors	8,727	8,925	7,395
Total	<u>\$ 26,148</u>	<u>\$ 24,888</u>	<u>\$ 22,587</u>

Some loans will not be repaid in full. Therefore, an allowance for loan losses (“AFL”) is maintained at a level which represents our best estimate of losses incurred. In determining the AFL and the related provision for loan losses, we consider four principal elements: (i) specific allocations based upon probable losses identified during the

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review of the loan portfolio, (ii) allocations established for other adversely rated commercial loans, (iii) allocations based principally on historical loan loss experience, and (iv) additional allowances based on subjective factors, including local and general economic business factors and trends, portfolio concentrations and changes in the size and/or the general terms of the loan portfolios.

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

No allowance for loan losses was brought forward on any of the TCSB loans acquired in the Merger as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. An allowance for loan losses is being established for any subsequent credit deterioration or adverse changes in expected cash flows.

Increases in the AFLL are recorded by a provision for loan losses charged to expense. Although we periodically allocate portions of the AFLL to specific loans and loan portfolios, the entire AFLL is available for incurred losses. We generally charge-off commercial, homogenous residential mortgage and installment loans when they are deemed uncollectible or reach a predetermined number of days past due based on product, industry practice and other factors. Collection efforts may continue and recoveries may occur after a loan is charged against the AFLL. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors.

The AFLL increased \$1.26 million to \$26.15 million at December 31, 2019 from \$24.89 million at December 31, 2018 and was equal to 0.96% of total Portfolio Loans at both December 31, 2019 and 2018.

During the first quarter of 2019, we deployed a third-party software solution (we previously used spreadsheet software) to assist in the determination of our AFLL. This new third-party software has also assisted us in moving to the expected loss framework that we implemented on January 1, 2020. Although the use of this new third-party software did not have any material impact on our overall AFLL, it did result in some classification shifts from the AFLL related to subjective factors into the AFLL related to historical losses as the new software model allowed us to capture longer historical look-back periods (previously this was being captured in the subjective portion of the AFLL).

Two of the four components of the AFLL outlined above increased during 2019. The AFLL related to specific loans decreased \$0.2 million during 2019 due primarily to a \$2.6 million decline in the amount of such loans. The AFLL related to other adversely rated commercial loans increased \$0.6 million during 2019, primarily due to an increase in the balance of such loans included in this component to \$54.4 million at December 31, 2019 from \$44.7 million at December 31, 2018. The increase in other adversely rated commercial loans was primarily in early watch credit categories and these loans are largely performing. We do not believe that we will experience any

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significant loan losses as a result of this rise in other adversely rated commercial loans. The AFLL related to historical losses increased \$1.0 million during 2019, and the AFLL related to subjective factors decreased \$0.2 million during 2019, due in part to the classification shifts discussed above, as well as loan growth, for the AFLL related to historical losses.

By comparison, three of the four components of the allowance for loan losses outlined above increased during 2018. The allowance for loan losses related to specific loans decreased \$0.5 million in 2018 due primarily to a decline in the balance of individually impaired loans and charge-offs. The allowance for loan losses related to other adversely rated commercial loans increased \$0.6 million in 2018 primarily due to an increase in the balance of such loans included in this component to \$44.7 million at December 31, 2018 from \$27.2 million at December 31, 2017. The allowance for loan losses related to historical losses increased \$0.7 million during 2018 due principally to loan growth. The allowance for loan losses related to subjective factors increased \$1.5 million during 2018 primarily due to loan growth.

## ALLOWANCE FOR LOSSES ON LOANS AND UNFUNDED COMMITMENTS

	2019		2018		2017	
	Loan Losses	Unfunded Commitments	Loan Losses	Unfunded Commitments	Loan Losses	Unfunded Commitments
	(Dollars in thousands)					
Balance at beginning of year	\$24,888	\$ 1,296	\$22,587	\$ 1,125	\$20,234	\$ 650
Additions (deductions)						
Provision for loan losses	824	—	1,503	—	1,199	—
Recoveries credited to allowance	3,961	—	4,622	—	4,205	—
Loans charged against the allowance	(3,525)	—	(3,824)	—	(3,051)	—
Additions included in non-interest expense	—	246	—	171	—	475
Balance at end of year	<u>\$26,148</u>	<u>\$ 1,542</u>	<u>\$24,888</u>	<u>\$ 1,296</u>	<u>\$22,587</u>	<u>\$ 1,125</u>
Net loans charged against the allowance to average Portfolio Loans	(0.02)%		(0.03)%		(0.06)%	

In 2019, 2018 and 2017, we recorded loan net recoveries of \$0.4 million, \$0.8 million and \$1.2 million, respectively. These net recoveries primarily reflect reduced levels of non-performing loans, improvement in collateral liquidation values and on-going collection efforts on previously charged-off loans.

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

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

Deposits totaled \$3.04 billion and \$2.91 billion at December 31, 2019 and 2018, respectively. The \$123.3 million increase in deposits during 2019 is due to growth in reciprocal deposits. Reciprocal deposits totaled \$431.0 million and \$182.1 million at December 31, 2019 and 2018, respectively. These deposits represent demand, money market and time deposits from our customers that have been placed through Promontory Interfinancial Network’s Insured Cash Sweep® service and Certificate of Deposit Account Registry Service®. These services allow our customers to access multi-million dollar FDIC deposit insurance on deposit balances greater than the standard FDIC insurance maximum. The significant increase in reciprocal deposits is due in part to an automated sweep capability we introduced in mid-2018 as well as the marketing and sales efforts of our treasury management team.

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We cannot be sure that we will be able to maintain our current level of core deposits. In particular, those deposits that are uninsured may be susceptible to outflow. At December 31, 2019, we had an estimated \$532.9 million of uninsured deposits. A reduction in core deposits would likely increase our need to rely on wholesale funding sources.

We have also implemented strategies that incorporate using federal funds purchased, other borrowings and Brokered CDs to fund a portion of our interest-earning assets. The use of such alternate sources of funds supplements our core deposits and is also a part of our asset/liability management efforts. Other borrowings, comprised primarily of federal funds purchased and advances from the Federal Home Loan Bank (the "FHLB"), totaled \$88.6 million and \$25.7 million at December 31, 2019 and 2018, respectively.

As described above, we utilize wholesale funding, including federal funds purchased, FHLB borrowings and Brokered CDs to augment our core deposits and fund a portion of our assets. At December 31, 2019, our use of such wholesale funding sources (including reciprocal deposits) amounted to approximately \$709.7 million, or 22.7% of total funding (deposits and total borrowings, excluding subordinated debentures). Because wholesale funding sources are affected by general market conditions, the availability of such funding may be dependent on the confidence these sources have in our financial condition and operations. The continued availability to us of these funding sources is not certain, and Brokered CDs may be difficult for us to retain or replace at attractive rates as they mature. Our liquidity may be constrained if we are unable to renew our wholesale funding sources or if adequate financing is not available in the future at acceptable rates of interest or at all. Our financial performance could also be affected if we are unable to maintain our access to funding sources or if we are required to rely more heavily on more expensive funding sources. In such case, our net interest income and results of operations could be adversely affected.

We have historically employed derivative financial instruments to manage our exposure to changes in interest rates. During 2019, 2018 and 2017, we entered into \$74.5 million, \$23.9 million and \$39.1 million (original aggregate notional amounts), respectively, of interest rate swaps with commercial loan customers, which were offset with interest rate swaps that the Bank entered into with a broker-dealer. We recorded \$0.94 million, \$0.46 million and \$0.41 million of fee income related to these transactions during 2019, 2018 and 2017, respectively. Also in 2018 and 2017, we entered into (notional amounts): \$10.0 million and \$15.0 million, respectively, of pay fixed interest rate swaps and \$105.0 million and \$45.0 million, respectively, of interest rate caps. These swaps and caps are hedging short-term wholesale funding.

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

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

At December 31, 2019, we had \$501.6 million of time deposits that mature in the next 12 months. Historically, a majority of these maturing time deposits are renewed by our customers. Additionally, \$2.43 billion of our deposits at December 31, 2019, were in account types from which the customer could withdraw the funds on demand. Changes in the balances of deposits that can be withdrawn upon demand are usually predictable and the total balances of these accounts have generally grown or have been stable over time as a result of our marketing and promotional activities. However, there can be no assurance that historical patterns of renewing time deposits or overall growth or stability in deposits will continue in the future.

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

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

We also believe that the available cash on hand at the parent company (including time deposits) of approximately \$20.5 million as of December 31, 2019, provides sufficient liquidity resources at the parent company to meet operating expenses, to make interest payments on the subordinated debentures and to pay a cash dividend on our common stock for the foreseeable future.

In the normal course of business we enter into certain contractual obligations. Such obligations include requirements to make future payments on debt and lease arrangements, contractual commitments for capital expenditures, and service contracts. The table below summarizes our significant contractual obligations at December 31, 2019.

### CONTRACTUAL COMMITMENTS<sup>(1)</sup>

	<u>1 Year or Less</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>After 5 Years</u>	<u>Total</u>
	<u>(In thousands)</u>				
Time deposit maturities	\$ 501,609	\$ 87,327	\$ 20,156	\$ 445	\$ 609,537
FHLB advances	28,645	4,995	—	30,000	63,640
Subordinated debentures	—	—	—	39,456	39,456
Operating lease obligations	1,681	2,740	1,988	2,792	9,201
Purchase obligations <sup>(2)</sup>	3,088	8,872	9,720	21,060	42,740
Total	<u>\$ 535,023</u>	<u>\$ 103,934</u>	<u>\$ 31,864</u>	<u>\$ 93,753</u>	<u>\$ 764,574</u>

(1) Excludes approximately \$0.4 million of accrued tax and interest relative to uncertain tax benefits due to the high degree of uncertainty as to when, or if, those amounts would be paid.

(2) Includes contracts with a minimum annual payment of \$1.0 million and are not cancellable within one year.

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

### CAPITALIZATION

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
	<u>(In thousands)</u>	
Subordinated debentures	\$ 39,456	\$ 39,388
Amount not qualifying as regulatory capital	(1,224)	(1,224)
Amount qualifying as regulatory capital	38,232	38,164
Shareholders' equity		
Common stock	352,344	377,372
Retained earnings (accumulated deficit)	1,611	(28,270)
Accumulated other comprehensive loss	(3,786)	(10,108)
Total shareholders' equity	350,169	338,994
Total capitalization	<u>\$ 388,401</u>	<u>\$ 377,158</u>

We currently have four special purpose entities with \$39.5 million of outstanding cumulative trust preferred securities. These special purpose entities issued common securities and provided cash to our parent company that in turn issued subordinated debentures to these special purpose entities equal to the trust preferred securities and common securities. The subordinated debentures represent the sole asset of the special purpose entities. The common securities and subordinated debentures are included in our Consolidated Statements of Financial Condition.

The FRB has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities (and certain other capital elements) is limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of

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trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital, subject to restrictions. Although the Dodd-Frank Act further limited Tier 1 treatment for trust preferred securities, those new limits did not apply to our outstanding trust preferred securities. Further, the New Capital Rules grandfathered the treatment of our trust preferred securities as qualifying regulatory capital.

Common shareholders' equity increased to \$350.2 million at December 31, 2019 from \$339.0 million at December 31, 2018, due primarily to our net income and a decline in our accumulated other comprehensive loss that were partially offset by share repurchases and by dividends that we paid. Our tangible common equity ("TCE") totaled \$316.5 million and \$304.3 million, respectively, at those same dates. Our ratio of TCE to tangible assets was 8.96% and 9.17% at December 31, 2019 and 2018, respectively. TCE and the ratio of TCE to tangible assets are non-GAAP measures. TCE represents total common equity less intangible assets.

In December and January 2018, our Board of Directors authorized the 2019 and 2018 share repurchase plans, respectively. Under the original terms of these share repurchase plans, we were authorized to buy back up to 5% of our outstanding common stock. In June 2019, our Board of Directors supplemented the 2019 share repurchase plan and authorized the repurchase of up to 300,000 additional common shares. These share repurchase plans expired on December 31, 2019 and 2018, respectively. We repurchased 1,204,688 shares during 2019 at an average cost of \$21.82 per share. We repurchased 587,969 shares during 2018 (all in the fourth quarter) at an average cost of \$21.57 per share.

In December 2019, our Board of Directors authorized the 2020 share repurchase plan. Under the terms of the 2020 share repurchase plan, we are authorized to buy back up to 1,120,000 shares, or approximately 5%, of our outstanding common stock. This repurchase plan commenced on January 1, 2020, and is expected to last through December 31, 2020.

We pay a quarterly cash dividend on our common stock. The annual total dividends paid were \$0.72, \$0.60 and \$0.42 per share for 2019, 2018 and 2017, respectively. We generally favor a dividend payout ratio between 30% and 50% of net income.

As of December 31, 2019 and 2018, our Bank (and holding company) continued to meet the requirements to be considered "well-capitalized" under federal regulatory standards (also see note #20 to the Consolidated Financial Statements).

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

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

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

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**CHANGES IN MARKET VALUE OF PORTFOLIO EQUITY AND NET INTEREST INCOME**

<u>Change in Interest Rates</u>	<u>Market Value of Portfolio Equity<sup>(1)</sup></u>	<u>Percent Change</u>	<u>Net Interest Income<sup>(2)</sup></u>	<u>Percent Change</u>
	(Dollars in thousands)			
<b>December 31, 2019</b>				
200 basis point rise	\$ 472,500	1.13%	\$ 123,900	1.23%
100 basis point rise	478,800	2.48	123,300	0.74
Base-rate scenario	467,200	—	122,400	—
100 basis point decline	412,100	(11.79)	118,100	(3.51)
<b>December 31, 2018</b>				
200 basis point rise	\$ 481,100	(3.37)%	\$ 126,200	3.27%
100 basis point rise	495,400	(0.50)	124,800	2.13
Base-rate scenario	497,900	—	122,200	—
100 basis point decline	482,800	(3.03)	119,600	(2.13)

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

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

*Accounting Standards Update.* See note #1 to the Consolidated Financial Statements included elsewhere in this report for details on recently issued accounting pronouncements and their impact on our financial statements.

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### **FAIR VALUATION OF FINANCIAL INSTRUMENTS**

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

We utilize fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. FASB ASC topic 820 differentiates between those assets and liabilities required to be carried at fair value at every reporting period (“recurring”) and those assets and liabilities that are only required to be adjusted to fair value under certain circumstances (“nonrecurring”). Equity securities, securities available for sale, loans held for sale, derivatives and capitalized mortgage loan servicing rights are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or fair value accounting or write-downs of individual assets. See note #21 to the Consolidated Financial Statements for a complete discussion on our use of fair valuation of financial instruments and the related measurement techniques.

### **LITIGATION MATTERS**

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

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, however we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote.

### **CRITICAL ACCOUNTING POLICIES**

Our accounting and reporting policies are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. Accounting and reporting policies for the allowance for loan losses and capitalized mortgage loan servicing rights are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those that we have used could result in material changes in our financial position or results of operations.

Our methodology for determining the allowance and related provision for loan losses is described above in “Portfolio Loans and asset quality.” In particular, this area of accounting requires a significant amount of judgment because a multitude of factors can influence the ultimate collection of a loan or other type of credit. It is extremely difficult to precisely measure the amount of probable incurred losses in our loan portfolio. We use a rigorous process to attempt to accurately quantify the necessary allowance and related provision for loan losses, but there can be no assurance that our modeling process will successfully identify all of the probable incurred losses in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different than the levels that we recorded in prior periods. In June 2016, the FASB issued ASU No. 2016-13 “Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). See note #1 to the Consolidated Financial Statements for a description of our implementation of ASU 2016-13. In particular, since ASU 2016-13 requires a current expected (rather than incurred) credit loss model, our provision for loan losses may be more volatile in future periods.

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At December 31, 2019 and 2018, we had approximately \$19.2 million and \$21.4 million, respectively, of mortgage loan servicing rights capitalized on our Consolidated Statements of Financial Condition. There are several critical assumptions involved in establishing the value of this asset including estimated future prepayment speeds on the underlying mortgage loans, the interest rate used to discount the net cash flows from the mortgage loan servicing, the estimated amount of ancillary income that will be received in the future (such as late fees) and the estimated cost to service the mortgage loans. We believe the assumptions that we utilize in our valuation are reasonable based upon accepted industry practices for valuing mortgage loan servicing rights and represent neither the most conservative or aggressive assumptions.

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**MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING**

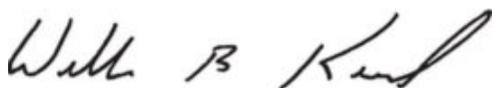
The management of Independent Bank Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to us and the board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We assessed the effectiveness of our internal control over financial reporting as of December 31, 2019. In making this assessment, we used the criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management has concluded that as of December 31, 2019, the Company's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Our independent registered public accounting firm has issued an audit report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. Their report immediately follows our report.



William B. Kessel  
President and  
Chief Executive Officer



Stephen A. Erickson  
Executive Vice President  
and Chief Financial Officer

Independent Bank Corporation  
March 6, 2020

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Shareholders and the Board of Directors of Independent Bank Corporation  
Grand Rapids, Michigan

**Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated statements of financial condition of Independent Bank Corporation (the “Corporation”) as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive income, shareholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively referred to as the “financial statements”). We also have audited the Corporation’s internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

**Basis for Opinions**

The Corporation’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Corporation’s financial statements and an opinion on the Corporation’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Corporation in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

**Definition and Limitations of Internal Control Over Financial Reporting**

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Crew LLP*

We have served as the Corporation's auditor since 2005.

Grand Rapids, Michigan

March 6, 2020

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## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2019	2018
	(In thousands, except share amounts)	
<b>ASSETS</b>		
Cash and due from banks	\$ 53,295	\$ 23,350
Interest bearing deposits	12,009	46,894
Cash and Cash Equivalents	65,304	70,244
Interest bearing deposits - time	350	595
Equity securities at fair value	—	393
Securities available for sale	518,400	427,926
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	18,359	18,359
Loans held for sale, carried at fair value	69,800	44,753
Loans held for sale, carried at lower of cost or fair value	—	41,471
Loans		
Commercial	1,166,695	1,144,481
Mortgage	1,098,911	1,042,890
Installment	459,417	395,149
Total Loans	2,725,023	2,582,520
Allowance for loan losses	(26,148)	(24,888)
Net Loans	2,698,875	2,557,632
Other real estate and repossessed assets, net	1,865	1,299
Property and equipment, net	38,411	38,777
Bank-owned life insurance	55,710	55,068
Deferred tax assets, net	2,072	5,779
Capitalized mortgage loan servicing rights	19,171	21,400
Other intangibles	5,326	6,415
Goodwill	28,300	28,300
Accrued income and other assets	42,751	34,870
Total Assets	\$ 3,564,694	\$ 3,353,281
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Non-interest bearing	\$ 852,076	\$ 879,549
Savings and interest-bearing checking	1,186,745	1,194,865
Reciprocal	431,027	182,072
Time	376,877	385,981
Brokered time	190,002	270,961
Total Deposits	3,036,727	2,913,428
Other borrowings	88,646	25,700
Subordinated debentures	39,456	39,388
Accrued expenses and other liabilities	49,696	35,771
Total Liabilities	3,214,525	3,014,287
Commitments and contingent liabilities		
Shareholders' Equity		
Preferred stock, no par value, 200,000 shares authorized; none issued or outstanding	—	—
Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 22,481,643 shares at December 31, 2019 and 23,579,725 shares at December 31, 2018	352,344	377,372
Retained earnings (accumulated deficit)	1,611	(28,270)
Accumulated other comprehensive loss	(3,786)	(10,108)
Total Shareholders' Equity	350,169	338,994
Total Liabilities and Shareholders' Equity	\$ 3,564,694	\$ 3,353,281

See accompanying notes to consolidated financial statements



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CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2019	2018	2017
(In thousands, except per share amounts)			
<b>INTEREST INCOME</b>			
Interest and fees on loans	\$ 133,883	\$ 116,865	\$ 84,281
<b>Interest on securities</b>			
Taxable	11,842	10,874	10,928
Tax-exempt	1,342	1,743	2,000
Other investments	1,861	1,291	1,100
<b>Total Interest Income</b>	<b>148,928</b>	<b>130,773</b>	<b>98,309</b>
<b>INTEREST EXPENSE</b>			
Deposits	23,425	14,478	6,775
Other borrowings and subordinated debentures	2,922	3,013	2,348
<b>Total Interest Expense</b>	<b>26,347</b>	<b>17,491</b>	<b>9,123</b>
Net Interest Income	122,581	113,282	89,186
Provision for loan losses	824	1,503	1,199
<b>Net Interest Income After Provision for Loan Losses</b>	<b>121,757</b>	<b>111,779</b>	<b>87,987</b>
<b>NON-INTEREST INCOME</b>			
Service charges on deposit accounts	11,208	12,258	12,673
Interchange income	10,297	9,905	8,023
<b>Net gains on assets</b>			
Mortgage loans	19,978	10,597	11,762
Securities	307	138	260
Mortgage loan servicing, net	(3,336)	3,157	1,647
Other	9,282	8,760	8,168
<b>Total Non-interest Income</b>	<b>47,736</b>	<b>44,815</b>	<b>42,533</b>
<b>NON-INTEREST EXPENSE</b>			
Compensation and employee benefits	67,501	62,078	55,089
Occupancy, net	9,013	8,912	8,102
Data processing	8,905	8,262	7,657
Furniture, fixtures and equipment	4,113	4,080	3,870
Interchange expense	3,215	2,702	1,156
Communications	2,947	2,848	2,684
Loan and collection	2,685	2,682	2,230
Advertising	2,450	2,155	1,905
Legal and professional	1,814	1,839	1,892
FDIC deposit insurance	685	1,081	894
Net gains on other real estate and repossessed assets	(90)	(672)	(606)
Merger related expense	—	3,465	284
Other	8,495	8,029	6,925
<b>Total Non-interest Expense</b>	<b>111,733</b>	<b>107,461</b>	<b>92,082</b>
<b>Income Before Income Tax</b>	<b>57,760</b>	<b>49,133</b>	<b>38,438</b>
Income tax expense	11,325	9,294	17,963
<b>Net Income</b>	<b>\$ 46,435</b>	<b>\$ 39,839</b>	<b>\$ 20,475</b>
<b>Net income per common share</b>			
Basic	\$ 2.03	\$ 1.70	\$ 0.96
Diluted	\$ 2.00	\$ 1.68	\$ 0.95

See accompanying notes to consolidated financial statements

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	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(In thousands)</b>		
Net income	\$ 46,435	\$ 39,839	\$ 20,475
Other comprehensive income (loss)			
Securities available for sale			
Unrealized gain (loss) arising during period	10,235	(4,594)	4,065
Change in unrealized gains and losses for which a portion of other than temporary impairment has been recognized in earnings	(65)	(53)	186
Reclassification adjustments for gains included in earnings	(140)	(56)	(215)
Unrealized gains (losses) recognized in other comprehensive income (loss) on securities available for sale	10,030	(4,703)	4,036
Income tax expense (benefit)	2,106	(988)	1,413
Unrealized gains (losses) recognized in other comprehensive income (loss) on securities available for sale, net of tax	7,924	(3,715)	2,623
Derivative instruments			
Unrealized gains (losses) arising during period	(1,603)	(262)	324
Reclassification adjustment for (income) expense recognized in earnings	(425)	(237)	18
Unrealized gains (losses) recognized in other comprehensive income (loss) on derivative instruments	(2,028)	(499)	342
Income tax expense (benefit)	(426)	(105)	120
Unrealized gains (losses) recognized in other comprehensive income (loss) on derivative instruments, net of tax	(1,602)	(394)	222
Other comprehensive income (loss)	6,322	(4,109)	2,845
Comprehensive income	<u>\$ 52,757</u>	<u>\$ 35,730</u>	<u>\$ 23,320</u>

See accompanying notes to consolidated financial statements

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**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

	<u>Common Stock</u>	<u>Retained Earnings (Accumulated Deficit)</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total Shareholders' Equity</u>
	(Dollars in thousands, except per share amounts)			
Balances at January 1, 2017	\$ 323,745	\$ (65,605)	\$ (8,808)	\$ 249,332
Net income for 2017	—	20,475	—	20,475
Cash dividends declared, \$.42 per share	—	(8,960)	—	(8,960)
Issuance of 27,046 shares of common stock	72	—	—	72
Share based compensation (issuance of 71,256 shares of common stock)	1,748	—	—	1,748
Share based compensation withholding obligation (withholding of 22,525 shares of common stock)	(579)	—	—	(579)
Reclassification of certain deferred tax effects	—	36	(36)	—
Other comprehensive income	—	—	2,845	2,845
Balances at December 31, 2017	324,986	(54,054)	(5,999)	264,933
Net income for 2018	—	39,839	—	39,839
Cash dividends declared, \$.60 per share	—	(14,055)	—	(14,055)
Repurchase of 587,969 shares of common stock	(12,681)	—	—	(12,681)
Acquisition of TCSB Bancorp, Inc.	64,536	—	—	64,536
Issuance of 152,549 shares of common stock	267	—	—	267
Share based compensation (issuance of 80,028 shares of common stock)	1,731	—	—	1,731
Share based compensation withholding obligation (withholding of 108,185 shares of common stock)	(1,467)	—	—	(1,467)
Other comprehensive loss	—	—	(4,109)	(4,109)
Balances at December 31, 2018	377,372	(28,270)	(10,108)	338,994
Net income for 2019	—	46,435	—	46,435
Cash dividends declared, \$.72 per share	—	(16,554)	—	(16,554)
Repurchase of 1,204,688 shares of common stock	(26,284)	—	—	(26,284)
Issuance of 71,799 shares of common stock	284	—	—	284
Share based compensation (issuance of 92,275 shares of common stock)	1,854	—	—	1,854
Share based compensation withholding obligation (withholding of 57,468 shares of common stock)	(882)	—	—	(882)
Other comprehensive income	—	—	6,322	6,322
Balances at December 31, 2019	<u>\$ 352,344</u>	<u>\$ 1,611</u>	<u>\$ (3,786)</u>	<u>\$ 350,169</u>

See accompanying notes to consolidated financial statements

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**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(In thousands)</b>		
Net Income	\$ 46,435	\$ 39,839	\$ 20,475
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH FROM OPERATING ACTIVITIES</b>			
Proceeds from the sale of equity securities at fair value	560	—	—
Proceeds from sales of loans held for sale	642,537	463,699	434,682
Disbursements for loans held for sale	(647,606)	(457,077)	(426,410)
Provision for loan losses	824	1,503	1,199
Deferred income tax expense	1,088	9,294	16,009
Deferred loan fees and costs	(2,936)	(4,044)	(5,159)
Net depreciation, amortization of intangible assets and premiums and accretion of discounts on securities, loans and interest bearing deposits - time	6,059	6,033	6,957
Net gains on mortgage loans	(19,978)	(10,597)	(11,762)
Net gains on securities	(307)	(138)	(260)
Net gains on other real estate and repossessed assets	(90)	(672)	(606)
Share based compensation	1,854	1,731	1,748
Increase in accrued income and other assets	(6,573)	(4,890)	(3,708)
Increase in accrued expenses and other liabilities	12,113	240	5,442
Total Adjustments	(12,455)	5,082	18,132
Net Cash From Operating Activities	33,980	44,921	38,607
<b>CASH FLOW USED IN INVESTING ACTIVITIES</b>			
Proceeds from the sale of securities available for sale	68,716	48,736	17,308
Proceeds from maturities, prepayments and calls of securities available for sale	153,938	160,627	173,723
Purchases of securities available for sale	(237,672)	(103,493)	(100,584)
Proceeds from the sale of interest bearing deposits - time	—	2,474	—
Proceeds from the maturity of interest bearing deposits - time	250	3,728	2,850
Purchase of Federal Reserve Bank stock	—	(2,038)	—
Net increase in portfolio loans (loans originated, net of principal payments)	(215,276)	(344,330)	(406,859)
Proceeds from the sale of portfolio loans	50,516	27,658	—
Cash received in the acquisition of TCSB Bancorp Inc.	—	23,516	—
Cash received from the sale of Mepco Finance Corporation assets, net	—	—	33,446
Proceeds from the collection of vehicle service contract counterparty receivables	512	511	528
Proceeds from the sale of other real estate and repossessed assets	1,766	2,526	5,703
Proceeds from bank-owned life insurance	470	474	523
Proceeds from the sale of property and equipment	74	106	26
Capital expenditures	(4,936)	(3,862)	(4,242)
Net Cash Used in Investing Activities	(181,642)	(183,367)	(277,578)
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>			
Net increase in total deposits	123,299	225,185	174,815
Net increase (decrease) in other borrowings	25,002	(6,600)	6,754
Proceeds from Federal Home Loan Bank advances	111,000	1,272,000	622,000
Payments of Federal Home Loan Bank advances	(73,143)	(1,308,697)	(583,587)
Dividends paid	(16,554)	(14,055)	(8,960)
Proceeds from issuance of common stock	284	267	72
Repurchase of common stock	(26,284)	(12,681)	—
Share based compensation withholding obligation	(882)	(1,467)	(579)
Net Cash From Financing Activities	142,722	153,952	210,515
Net Increase (Decrease) in Cash and Cash Equivalents	(4,940)	15,506	(28,456)
Cash and Cash Equivalents at Beginning of Year	70,244	54,738	83,194
Cash and Cash Equivalents at End of Year	\$ 65,304	\$ 70,244	\$ 54,738
<b>Cash paid during the year for</b>			
Interest	\$ 26,697	\$ 16,737	\$ 9,163
Income taxes	9,534	120	1,970
Operating leases	2,201	—	—
Transfers to other real estate and repossessed assets	2,242	1,510	1,735
Transfer of mortgage loans to held for sale	36,622	41,471	—
Securitization of portfolio loans	65,070	10,869	—

Right of use assets obtained in exchange for lease obligations	9,906	—	—
Purchase of securities available for sale and interest bearing deposits - time not yet settled	—	—	1,000
Common stock and stock options issued in TCSB Bancorp, Inc. acquisition	—	64,536	—

See accompanying notes to consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 – ACCOUNTING POLICIES

The accounting and reporting policies and practices of Independent Bank Corporation and subsidiaries (“IBCP”) conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Our critical accounting policies include the determination of the allowance for loan losses (“AFL”) and the valuation of capitalized mortgage loan servicing rights. We are required to make material estimates and assumptions that are particularly susceptible to changes in the near term as we prepare the consolidated financial statements and report amounts for each of these items. Actual results may vary from these estimates.

Our subsidiary, Independent Bank (“Bank”), transacts business in the single industry of commercial banking. Our Bank’s activities cover traditional phases of commercial banking, including checking and savings accounts, commercial lending, direct and indirect consumer financing and mortgage lending. Our principal markets are the rural and suburban communities across Lower Michigan and Ohio that are served by our Bank’s branches and loan production offices. Through April, 2017 we also purchased payment plans from companies (which we referred to as “counterparties”) that provided vehicle service contracts and similar products to consumers, through our wholly owned subsidiary, Mepco Finance Corporation (“Mepco”) which was sold effective May 1, 2017. See note #27. At December 31, 2019, 71.7% of our Bank’s loan portfolio was secured by real estate.

*PRINCIPLES OF CONSOLIDATION* — The consolidated financial statements include the accounts of Independent Bank Corporation and its subsidiaries. The income, expenses, assets and liabilities of the subsidiaries are included in the respective accounts of the consolidated financial statements, after elimination of all intercompany accounts and transactions.

*STATEMENTS OF CASH FLOWS* — For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits and federal funds sold. Generally, federal funds are sold for one-day periods. We report net cash flows for customer loan and deposit transactions and for short-term borrowings.

*INTEREST BEARING DEPOSITS* — Interest bearing deposits consist of overnight deposits with the Federal Reserve Bank.

*INTEREST BEARING DEPOSITS - TIME* — Interest bearing deposits - time consist of deposits with original maturities of 3 months or more. All of these deposits are FDIC insured.

*LOANS HELD FOR SALE* — Mortgage loans originated and intended for sale in the secondary market are carried at fair value. Fair value adjustments, as well as realized gains and losses, are recorded in current earnings. Certain portfolio loans were reclassified to held for sale as of December 31, 2018, were carried at the lower of cost or fair value on an aggregate loan basis and were sold during the first quarter of 2019.

*OPERATING SEGMENTS* — While chief decision-makers monitor the revenue streams of our various products and services, operations are managed and financial performance is evaluated as one single unit. Discrete financial information is not available other than on a consolidated basis for material lines of business.

*CAPITALIZED MORTGAGE LOAN SERVICING RIGHTS* — During the first quarter of 2017, we adopted the fair value method of accounting for our capitalized mortgage loan servicing rights pursuant to Financial Accounting Standards Board (“FASB”) Accounting Standards Codification topic 860 – “Transfers and Servicing”. Prior to January 1, 2017, we were accounting for our capitalized mortgage loan servicing rights under the amortization method. We adopted the fair value method using a modified retrospective adjustment to beginning accumulated deficit.

We recognize as separate assets the rights to service mortgage loans for others. The fair value of capitalized mortgage loan servicing rights has been determined based upon fair value indications for similar servicing. Under the fair value method we measure capitalized mortgage loan servicing rights at fair value at each reporting date and report changes in fair value of capitalized mortgage loan servicing rights in earnings in the period in which the changes occur and are included in mortgage loan servicing, net in the Consolidated Statements of Operations. The fair values of capitalized mortgage loan servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Mortgage loan servicing income is recorded for fees earned for servicing loans previously sold. The fees are generally based on a contractual percentage of the outstanding principal and are recorded as income when earned. Mortgage loan servicing fees, excluding fair value changes of capitalized mortgage loan servicing rights, totaled \$6.2 million, \$5.5 million and \$4.4 million for the years ended December 31, 2019, 2018 and 2017, respectively. Late fees and ancillary fees related to loan servicing are not material.

*TRANSFERS OF FINANCIAL ASSETS* — Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from us, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and we do not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

*SECURITIES* — We classify our securities as equity, trading, held to maturity or available for sale. Equity securities are investments in certain preferred stocks and are reported at fair value with realized and unrealized gains and losses included in earnings. Trading securities are bought and held principally for the purpose of selling them in the near term and are reported at fair value with realized and unrealized gains and losses included in earnings. We did not have any trading securities at December 31, 2019 and 2018. Securities held to maturity represent those securities for which we have the positive intent and ability to hold until maturity and are reported at cost, adjusted for amortization of premiums and accretion of discounts computed on the level-yield method. We did not have any securities held to maturity at December 31, 2019 and 2018. Securities available for sale represent those securities not classified as equity, trading or held to maturity and are reported at fair value with unrealized gains and losses, net of applicable income taxes reported in other comprehensive income (loss).

We evaluate securities for other than temporary impairment (“OTTI”) at least on a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. In performing this evaluation, management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates on the market value of the security and (4) an assessment of whether we intend to sell, or it is more likely than not that we will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. For securities that do not meet the aforementioned recovery criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income (loss). The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

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.

*FEDERAL HOME LOAN BANK (“FHLB”) STOCK* — Our Bank subsidiary is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income in interest income-other investments on the Consolidated Statements of Operations.

*FEDERAL RESERVE BANK (“FRB”) STOCK* — Our Bank subsidiary is a member of its regional Federal Reserve Bank. FRB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income in interest income-other investments on the Consolidated Statements of Operations.

*LOAN REVENUE RECOGNITION* — Interest on loans is accrued based on the principal amounts outstanding. In general, the accrual of interest income is discontinued when a loan becomes 90 days past due for commercial loans and installment loans and when a loan misses four consecutive payments for mortgage loans and the borrower’s capacity to repay the loan and collateral values appear insufficient for each loan class. However, loans may be placed on non-accrual status regardless of whether or not such loans are considered past due if, in management’s opinion, the borrower is unable to meet payment obligations as they become due or as required by regulatory provisions. All interest accrued but not received for all loans placed on non-accrual is reversed from interest income. Payments on such loans are generally applied to the principal balance until qualifying to be returned to accrual status. A non-accrual loan may be restored to accrual status when interest and principal payments are current and the loan

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### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

appears otherwise collectible. Delinquency status for all classes in the commercial and installment loan segments is based on the actual number of days past due as required by the contractual terms of the loan agreement while delinquency status for mortgage loan segment classes is based on the number of payments past due.

Certain loan fees and direct loan origination costs are deferred and recognized as an adjustment of yield generally over the contractual life of the related loan. Fees received in connection with loan commitments are deferred until the loan is advanced and are then recognized generally over the contractual life of the loan as an adjustment of yield. Fees on commitments that expire unused are recognized at expiration. Fees received for letters of credit are recognized as revenue over the life of the commitment.

*PAYMENT PLAN RECEIVABLE REVENUE RECOGNITION* — Payment plan receivables were acquired by Mepco at a discount which was accreted into interest income – interest and fees on loans in the Consolidated Statements of Operations over the life of the receivable computed on a level-yield method.

*ALLOWANCE FOR LOAN LOSSES* — Portfolios are disaggregated into segments for purposes of determining the allowance for loan losses (“AFL”) which include commercial, mortgage and installment loans. These segments are further disaggregated into classes for purposes of monitoring and assessing credit quality based on certain risk characteristics. Classes within the commercial loan segment include (i) commercial and industrial and (ii) commercial real estate. Classes within the mortgage loan segment include (i) 1-4 family owner occupied - jumbo, (ii) 1-4 family owner occupied - non-jumbo, (iii) 1-4 family non-owner occupied (iv) 1-4 family - 2nd lien and (v) resort lending. Classes within the installment loan segment include (i) boat lending, (ii) recreational vehicle lending, and (iii) other. Commercial loans are subject to adverse market conditions which may impact the borrower’s ability to make repayment on the loan or could cause a decline in the value of the collateral that secures the loan. Mortgage and installment loans are subject to adverse employment conditions in the local economy which could increase default rates. In addition, mortgage loans and real estate based installment loans are subject to adverse market conditions which could cause a decline in the value of collateral that secures the loan. For an analysis of the AFL by portfolio segment and credit quality information by class, see note #4.

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

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

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

During the first quarter of 2019, we deployed a third-party software solution (we previously used spreadsheet software) to assist in the determination of our AFLL. This new third-party software also has assisted us in moving to the expected loss framework that was required to be implemented on January 1, 2020. Although the use of this new third-party software did not have any material impact on our overall AFLL, it did result in some classification shifts from the AFLL related to subjective factors into the AFLL related to historical losses as the new software model allowed us to capture longer historical look-back periods (previously this was being captured in the subjective portion of the AFLL).

Increases in the AFLL are recorded by a provision for loan losses charged to expense. Although we periodically allocate portions of the AFLL to specific loans and loan portfolios, the entire AFLL is available for incurred losses.

We generally charge-off commercial, homogenous residential mortgage and installment loans (and payment plan receivables prior to the sale of Mepco) when they are deemed uncollectible or reach a predetermined number of days past due based on loan product, industry practice and other factors. Collection efforts may continue and recoveries may occur after a loan is charged against the AFLL.

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

A loan is impaired when full payment under the loan terms is not expected. Generally, those loans included in each commercial loan class that are rated substandard, classified as non-performing or were classified as non-performing in the preceding quarter, are evaluated for impairment. Those loans included in each mortgage loan or installment loan class whose terms have been modified and considered a troubled debt restructuring are also impaired. Loans which have been modified resulting in a concession, and which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (“TDR”) and classified as impaired. We measure our investment in an impaired loan based on one of three methods: the loan’s observable market price, the fair value of the collateral or the present value of expected future cash flows discounted at the loan’s effective interest rate. Large groups of smaller balance homogeneous loans, such as those loans included in each installment and mortgage loan class (and each payment plan receivable class prior to the sale of Mepco), are collectively evaluated for impairment and accordingly, they are not separately identified for impairment disclosures. TDR loans are measured at the present value of estimated future cash flows using the loan’s effective interest rate at inception of the loan. If a TDR is considered to be a collateral dependent loan, the loan is reported net, at the fair value of collateral. A loan can be removed from TDR status if it is subsequently restructured and the borrower is no longer experiencing financial difficulties and the newly restructured agreement does not contain any concessions to the borrower. The new agreement must specify market terms, including a contractual interest rate not less than a market interest rate for a new loan with similar credit risk characteristics, and other terms no less favorable to us than those we would offer for a similar new loan.

**PROPERTY AND EQUIPMENT** — Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the related assets. Buildings are generally depreciated over a period not exceeding 39 years and equipment is generally depreciated over periods not exceeding 7 years. Leasehold improvements are depreciated over the shorter of their estimated useful life or lease period.

**BANK OWNED LIFE INSURANCE** — We have purchased a group flexible premium non-participating variable life insurance contract on approximately 265 lives (who were salaried employees at the time we purchased the contract) in order to recover the cost of providing certain employee benefits. Bank owned life insurance is recorded at its cash surrender value or the amount that can be currently realized.

**OTHER REAL ESTATE AND REPOSSESSED ASSETS** — Other real estate at the time of acquisition is recorded at fair value, less estimated costs to sell, which becomes the property’s new basis. Fair value is typically determined by a third party appraisal of the property. Any write-downs at date of acquisition are charged to the AFLL. Expense incurred in maintaining other real estate and subsequent write-downs to reflect declines in value and gains or losses on the sale of other real estate are recorded in non-interest expense in the Consolidated Statements of Operations. Non-real estate repossessed assets are treated in a similar manner.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

*OTHER INTANGIBLES* — Other intangible assets consist of core deposits. They are initially measured at fair value and then are amortized on both straight-line and accelerated methods over their estimated useful lives, which range from 10 to 15 years.

*GOODWILL* — Goodwill arises from business combinations and is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill acquired in a purchase business combination and determined to have an indefinite useful life is not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. We have selected December 31 as the date to perform the annual impairment test. Goodwill is the only intangible asset with an indefinite life on our Consolidated Statements of Financial Condition.

*INCOME TAXES* — We employ the asset and liability method of accounting for income taxes. This method establishes deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities at tax rates expected to be in effect when such amounts are realized or settled. Under this method, the effect of a change in tax rates is recognized in the period that includes the enactment date. The deferred tax asset is subject to a valuation allowance for that portion of the asset for which it is more likely than not that it will not be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination.

We recognize interest and/or penalties related to income tax matters in income tax expense in the Consolidated Statements of Operations.

We file a consolidated federal income tax return. Intercompany tax liabilities are settled as if each subsidiary filed a separate return.

*COMMITMENTS TO EXTEND CREDIT AND RELATED FINANCIAL INSTRUMENTS* — Financial instruments may include commitments to extend credit and standby letters of credit. Financial instruments involve varying degrees of credit and interest-rate risk in excess of amounts reflected in the Consolidated Statements of Financial Condition. Exposure to credit risk in the event of non-performance by the counterparties to the financial instruments for loan commitments to extend credit and letters of credit is represented by the contractual amounts of those instruments. In general, we use a similar methodology to estimate our liability for these off-balance sheet credit exposures as we do for our AFL. For commercial related commitments, we estimate liability using our loan rating system and for mortgage and installment commitments we estimate liability principally upon historical loss experience. Our estimated liability for off balance sheet commitments is included in accrued expenses and other liabilities in our Consolidated Statements of Financial Condition and any charge or recovery is recorded in non-interest expense - other in our Consolidated Statements of Operations.

*DERIVATIVE FINANCIAL INSTRUMENTS* — We record derivatives on our 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.

At the inception of the derivative we designate the derivative as one of three types based on our intention and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (“Fair Value Hedge”), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (“Cash Flow Hedge”), or (3) an instrument with no hedging designation. For a Fair Value Hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in non-interest income – other in our Consolidated Statements of Operations. For a Cash Flow Hedge, the gain or loss on the derivative is reported in other comprehensive income (loss) and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For instruments with no hedging designation, the gain or loss on the derivative is reported in earnings. These free standing instruments currently consist of (i) mortgage banking related derivatives and include rate-lock loan commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and mandatory forward commitments for the future delivery of these mortgage loans, (ii) certain pay-fixed and

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

pay-variable interest rate swap agreements related to commercial loan customers and (iii) certain purchased and written options related to a time deposit product. The fair value of rate-lock mortgage loan commitments is based on agency cash window loan pricing for comparable assets and the fair value of mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets. We enter into mandatory forward commitments for the future delivery of mortgage loans generally when interest rate locks are entered into in order to hedge the change in interest rates resulting from our commitments to fund the loans. Changes in the fair values of these derivatives are included in net gains on mortgage loans in the Consolidated Statements of Operations. Fair values of the pay-fixed and pay-variable interest rate swap agreements are derived from proprietary models which utilize current market data and are included in net interest income in the Consolidated Statements of Operations. Fair values of the purchased and written options are based on prices of financial instruments with similar characteristics and are included in net interest income in the Consolidated Statements of Operations.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest expense in the Consolidated Statements of Operations. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in non-interest income (mortgage banking related derivatives) or net interest income (interest rate swap agreements and options) in the Consolidated Statements of Operations. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

We formally document the relationship between derivatives and hedged items, as well as the risk- management objective and the strategy for undertaking hedge transactions, at the inception of the hedging relationship. This documentation includes linking Fair Value or Cash Flow Hedges to specific assets and liabilities on the Consolidated Statements of Financial Condition or to specific firm commitments or forecasted transactions. We discontinue hedge accounting when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded in earnings. When a Fair Value Hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a Cash Flow Hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income (loss) are amortized into earnings over the same periods which the hedged transactions will affect earnings.

*COMPREHENSIVE INCOME* — Comprehensive income consists of net income and unrealized gains and losses, net of tax, on securities available for sale and derivative instruments classified as cash flow hedges.

*NET INCOME PER COMMON SHARE* — Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and participating share awards. All outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. For diluted net income per common share, net income is divided by the weighted average number of common shares outstanding during the period plus the assumed exercise of stock options, restricted stock units, performance share units and stock units for a deferred compensation plan for non-employee directors.

*SHARE BASED COMPENSATION* — Cost is recognized for non-vested share awards issued to employees based on the fair value of these awards at the date of grant. A simulation analysis which considers potential outcomes for a large number of independent scenarios is utilized to estimate the fair value of performance share units and the market price of our common stock at the date of grant is used for other non-vested share awards. Cost is recognized over the required service period, generally defined as the vesting period. Forfeitures are recognized as they occur. Cost is also recognized for stock issued to non-employee directors. These shares vest immediately and cost is recognized during the period they are issued.

*COMMON STOCK* — At December 31, 2019, 0.1 million shares of common stock were reserved for issuance under the dividend reinvestment plan and 0.7 million shares of common stock were reserved for issuance under our long-term incentive plans.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*RECLASSIFICATION* — Certain amounts in the 2018 and 2017 consolidated financial statements have been reclassified to conform to the 2019 presentation.

*ADOPTION OF NEW ACCOUNTING STANDARDS* — In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, “Leases (Topic 842)”. This ASU amends existing guidance related to the accounting for leases. These amendments, among other things, require lessees to account for most leases on the balance sheet while recognizing expense on the income statement in a manner similar to existing guidance. For lessors the guidance modifies the classification criteria and the accounting for sales-type and direct finance leases. This amended guidance was effective for us on January 1, 2019 and did not have a material impact on our consolidated operating results or financial condition. Based on our operating leases that we had in place at the date of adoption we did not have a material change in the recognition, measurement and presentation of lease expense or impact on cash flow. The primary impact was the recognition of certain operating leases on our Consolidated Statements of Financial Condition which resulted in the recording of right of use (“ROU”) assets and offsetting lease liabilities each totaling approximately \$7.7 million at January 1, 2019. See note #18.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities”. This new ASU amends the hedge accounting model in Topic 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments expand an entity’s ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest rate risk. The guidance eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The guidance also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. This amended guidance was effective for us on January 1, 2019, and did not have a material impact on our consolidated operating results or financial condition.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments — Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments”. This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This ASU:

- Replaces the existing incurred loss impairment guidance and establishes a single allowance framework for financial assets carried at amortized cost, which will reflect our estimate of credit losses over the full remaining expected life of the financial assets and will consider expected future changes in macroeconomic conditions.
- Eliminates existing guidance for purchase credit impaired (“PCI”) loans, and requires recognition of the nonaccretable difference as an increase to the allowance for expected credit losses on financial assets purchased with more than insignificant credit deterioration since origination, which will be offset by an increase in the recorded investment of the related loans.
- Requires inclusion of expected recoveries, limited to the cumulative amount of prior write-offs, when estimating the allowance for credit losses for in scope financial assets (including collateral dependent assets).
- Amends existing impairment guidance for securities available for sale to incorporate an allowance, which will allow for reversals of credit impairments in the event that the credit of an issuer improves. Credit losses on securities available for sale are limited to the amount of the decline in fair value regardless of what the credit loss model would show for impairment.
- Generally requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.

We began evaluating this ASU in 2016 and established a company-wide, cross-discipline governance structure, which provides implementation oversight. We continued to test and refine our current expected credit loss models that satisfied the requirements of this ASU. Oversight and testing, as well as efforts to meet expanded disclosure requirements, extended through the end of 2019. We currently estimate losses over approximately a two year forecast

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

period using the Federal Open Market Committee median economic projections as well as considering other economic forecast sources, and then revert to longer term historical loss experience to estimate losses over more extended periods. This amended guidance was effective for us on January 1, 2020. We have not completed finalizing the results of our current expected credit loss (“CECL”) estimate as of year-end. The required financial reporting disclosures are being further refined and internally validated. We are in the process of finalizing the review of our model and assumptions including qualitative adjustments and economic forecasts. During the first quarter of 2020, we expect to finalize our model and all assumptions as well as obtain formal approval from all internal committees and governance processes related to CECL.

We expect to recognize a one-time cumulative effect adjustment increasing the allowance for loan losses. Because we do not have final approval from our oversight and governance committees, we are estimating an increase to the allowance for loan losses to be in the range of \$8.0 million to \$10.0 million primarily driven by the longer contractual maturities of our mortgage and consumer installment loan segments. In addition, we currently expect this ASU to increase the allowance for losses related to unfunded loan commitments between \$1.0 million and \$2.0 million. The ultimate impact of adopting this ASU, and at each subsequent reporting period, is highly dependent on credit quality, economic forecasts and conditions, composition of our loan portfolios and securities available for sale, along with other management judgements. The transition adjustment to record the allowance for credit losses may fall outside of our estimated increase based on the finalization of assumptions including qualitative adjustments and the economic forecast used in calculating the allowance for credit losses upon the adoption of CECL.

We do not expect a material allowance for credit losses to be recorded on securities available for sale upon adoption of this ASU.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820), Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement”. This new ASU amends disclosure requirements in Topic 820 to eliminate, add and modify certain disclosure requirements for fair value measurements as part of its disclosure framework project. The amended guidance eliminates the requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the entity’s policy for the timing of transfers between levels of the fair value hierarchy and the entity’s valuation processes for Level 3 fair value measurements. The amended guidance adds the requirements to disclose the changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level 3 fair value measurements of instruments held at the end of the reporting period and for recurring and nonrecurring Level 3 fair value measurements, the range and weighted average used to develop significant unobservable inputs and how the weighted average was calculated, with certain exceptions. This amended guidance was effective for us on January 1, 2020, and did not have a material impact on our consolidated operating results or financial condition.

**NOTE 2 – RESTRICTIONS ON CASH AND DUE FROM BANKS**

Our Bank is required to maintain reserve balances in the form of vault cash and balances with the FRB. The average reserve balances to be maintained during 2019 and 2018 were \$26.6 million and \$9.6 million, respectively. We do not maintain compensating balances with correspondent banks. We are also required to maintain reserve balances related primarily to our merchant payment processing operations and for certain investment security transactions. These balances are held at unrelated financial institutions and totaled \$0.01 million and \$0.13 million at December 31, 2019 and 2018, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 3 – SECURITIES

Securities available for sale consist of the following at December 31:

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
(In thousands)				
<b>2019</b>				
U.S. agency	\$ 14,591	\$ 89	\$ 19	\$ 14,661
U.S. agency residential mortgage-backed	226,130	1,910	278	227,762
U.S. agency commercial mortgage-backed	10,671	113	28	10,756
Private label mortgage-backed	39,248	544	99	39,693
Other asset backed	94,158	103	375	93,886
Obligations of states and political subdivisions	94,499	1,724	121	96,102
Corporate	31,904	1,296	5	33,195
Trust preferred	1,968	—	125	1,843
Foreign government	499	3	—	502
Total	<u>\$ 513,668</u>	<u>\$ 5,782</u>	<u>\$ 1,050</u>	<u>\$ 518,400</u>
<b>2018</b>				
U.S. agency	\$ 20,198	\$ 9	\$ 193	\$ 20,014
U.S. agency residential mortgage-backed	124,777	817	1,843	123,751
U.S. agency commercial mortgage-backed	5,909	1	184	5,726
Private label mortgage-backed	29,735	321	637	29,419
Other asset backed	83,481	86	248	83,319
Obligations of states and political subdivisions	130,244	257	2,946	127,555
Corporate	34,866	29	586	34,309
Trust preferred	1,964	—	145	1,819
Foreign government	2,050	—	36	2,014
Total	<u>\$ 433,224</u>	<u>\$ 1,520</u>	<u>\$ 6,818</u>	<u>\$ 427,926</u>

Total OTTI recognized in accumulated other comprehensive loss for securities available for sale was zero at both December 31, 2019 and 2018, respectively.

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, at December 31 follows:

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
<b>2019</b>						
U.S. agency	\$ 2,782	\$ 8	\$ 2,712	\$ 11	\$ 5,494	\$ 19
U.S. agency residential mortgage-backed	56,377	126	13,551	152	69,928	278
U.S. agency commercial mortgage-backed	3,284	24	659	4	3,943	28
Private label mortgage-backed	16,387	55	343	44	16,730	99
Other asset backed	34,027	233	13,839	142	47,866	375
Obligations of states and political subdivisions	15,666	84	5,396	37	21,062	121
Corporate	2,125	5	—	—	2,125	5
Trust preferred	—	—	1,843	125	1,843	125
Total	<u>\$ 130,648</u>	<u>\$ 535</u>	<u>\$ 38,343</u>	<u>\$ 515</u>	<u>\$ 168,991</u>	<u>\$ 1,050</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
2018						
U.S. agency	\$ 7,150	\$ 46	\$ 11,945	\$ 147	\$ 19,095	\$ 193
U.S. agency residential mortgage-backed	18,374	180	48,184	1,663	66,558	1,843
U.S. agency commercial mortgage-backed	566	3	5,094	181	5,660	184
Private label mortgage-backed	8,273	57	16,145	580	24,418	637
Other asset backed	53,043	160	10,235	88	63,278	248
Obligations of states and political subdivisions	25,423	262	80,701	2,684	106,124	2,946
Corporate	17,758	343	9,222	243	26,980	586
Trust preferred	939	61	880	84	1,819	145
Foreign government	—	—	2,014	36	2,014	36
Total	<u>\$ 131,526</u>	<u>\$ 1,112</u>	<u>\$ 184,420</u>	<u>\$ 5,706</u>	<u>\$ 315,946</u>	<u>\$ 6,818</u>

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

U.S. agency, U.S. agency residential mortgage-backed securities and U.S. agency commercial mortgage backed securities — at December 31, 2019, we had 29 U.S. agency, 111 U.S. agency residential mortgage-backed and 9 U.S. agency commercial mortgage-backed securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to increases in interest rates since acquisition and widening spreads to Treasury bonds.

Private label mortgage backed, other asset backed and corporate securities — at December 31, 2019, we had 22 private label mortgage backed, 58 other asset backed and two corporate securities whose fair value is less than amortized cost. Unrealized losses are primarily due to credit spread widening and increases in interest rates since their acquisition.

Two private label mortgage-backed securities (discussed further below) were reviewed for other than temporary impairment (“OTTI”) utilizing a cash flow projection. The cash flow analysis forecasts cash flow from the underlying loans in each transaction and then applies these cash flows to the bonds in the securitization.

Obligations of states and political subdivisions — at December 31, 2019, we had 42 municipal securities whose fair value is less than amortized cost. The unrealized losses are primarily due to wider benchmark pricing spreads and increases in interest rates since acquisition.

Trust preferred securities — at December 31, 2019, we had two trust preferred securities whose fair value is less than amortized cost. Both of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities has suffered from credit spread widening. One of the securities is rated by a major rating agency as investment grade while the other one is non-rated. The non-rated issue is a relatively small bank and was never rated. The issuer of this non-rated trust preferred security, which had a total amortized cost of \$1.0 million and total fair value of \$0.91 million as of December 31, 2019, continues to have satisfactory credit metrics and make interest payments.

As management does not intend to liquidate any of the securities discussed above 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 discussed above (other than certain declines related to the two private label mortgage-backed securities currently being reviewed for OTTI) are deemed to be other than temporary.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

We recorded zero credit related OTTI charges in the Consolidated Statements of Operations on securities available for sale during 2019, 2018, and 2017.

At December 31, 2019, two private label mortgage-backed securities had credit related OTTI and are summarized as follows:

	<u>Senior Security</u>	<u>Super Senior Security</u>	<u>Total</u>
	(In thousands)		
As of December 31, 2019			
Fair value	\$ 601	\$ 603	\$ 1,204
Amortized cost	511	442	953
Non-credit unrealized loss	—	—	—
Unrealized gain	90	161	251
Cumulative credit related OTTI	757	457	1,214

Both of these securities are receiving principal and interest payments similar to principal reductions in the underlying collateral and have unrealized gains at December 31, 2019. The original amortized cost (current amortized cost excluding cumulative credit related OTTI) for each of these securities has been permanently adjusted downward for previously recorded credit related OTTI. The unrealized loss (based on original amortized cost) for these securities is now less than previously recorded credit related OTTI amounts.

A roll forward of credit losses recognized in earnings on securities available for sale for the years ending December 31 follow:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Balance at beginning of year	\$ 1,594	\$ 1,594	\$ 1,594
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	—	—	—
Reduction <sup>(1)</sup>	(380)	—	—
Total	<u>\$ 1,214</u>	<u>\$ 1,594</u>	<u>\$ 1,594</u>

(1) During 2019 one security with previously recorded OTTI was settled and balance is now zero.

The amortized cost and fair value of securities available for sale at December 31, 2019, by contractual maturity, follow:

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
Maturing within one year	\$ 10,737	\$ 10,761
Maturing after one year but within five years	50,035	50,839
Maturing after five years but within ten years	47,634	49,070
Maturing after ten years	35,055	35,633
	<u>143,461</u>	<u>146,303</u>
U.S. agency residential mortgage-backed	226,130	227,762
U.S. agency commercial mortgage-backed	10,671	10,756
Private label mortgage-backed	39,248	39,693
Other asset backed	94,158	93,886
Total	<u>\$ 513,668</u>	<u>\$ 518,400</u>

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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.

A summary of proceeds from the sale of securities available for sale and gains and losses for the years ended December 31 follow:

	<u>Proceeds</u>	<u>Realized</u>	
		<u>Gains<sup>(1)</sup></u>	<u>Losses</u>
	<u>(In thousands)</u>		
2019	\$ 68,716	\$ 248	\$ 108
2018	48,736	192	136
2017	17,308	218	3

(1) 2018 excludes a \$0.144 million gain on the sale of 1,000 VISA Class B shares.

Certain preferred stocks which were all sold during the first quarter of 2019 had been classified as equity securities at fair value in our Consolidated Statement of Financial Condition. During 2019, 2018 and 2017, we recognized gains (losses) on these preferred stocks of \$0.17 million, \$(0.06) million and \$0.05 million, respectively, that are included in net gains on securities in the Consolidated Statements of Operations. Zero, \$(0.06) million and \$0.05 million of these amounts relate to gains (losses) recognized on preferred stock still held at each respective year end.

Securities available for sale with a book value of \$8.7 million and zero at December 31, 2019 and 2018, respectively, were pledged to secure borrowings, derivatives, public deposits and for other purposes as required by law. There were no investment obligations of state and political subdivisions that were payable from or secured by the same source of revenue or taxing authority that exceeded 10% of consolidated total shareholders' equity at December 31, 2019 or 2018.

**NOTE 4 – LOANS AND PAYMENT PLAN RECEIVABLES**

Our loan portfolios at December 31 follow:

	<u>2019</u>	<u>2018</u>
	<u>(In thousands)</u>	
Real estate <sup>(1)</sup>		
Residential first mortgages	\$ 843,746	\$ 811,719
Residential home equity and other junior mortgages	166,735	177,574
Construction and land development	249,747	180,286
Other <sup>(2)</sup>	693,580	707,347
Consumer	448,297	379,607
Commercial	318,504	319,058
Agricultural	4,414	6,929
Total loans	<u>\$ 2,725,023</u>	<u>\$ 2,582,520</u>

(1) Includes both residential and non-residential commercial loans secured by real estate.

(2) Includes loans secured by multi-family residential and non-farm, non-residential property.

Loans include net deferred loan costs of \$16.3 million and \$13.3 million at December 31, 2019 and 2018, respectively.

During the first quarter of 2019, we sold \$40.6 million, of residential adjustable rate mortgage loans servicing released (classified on the Consolidated Statements of Financial Condition as held for sale, carried at the lower of cost or fair value at December 31, 2018) to another financial institution and recognized a gain on sale of \$0.01 million. During the first quarter of 2019 we also securitized \$29.8 million, of portfolio residential fixed rate mortgage loans servicing retained with Freddie Mac and recognized a gain on sale of \$0.53 million. During the third quarter of 2019, we sold \$9.9 million of residential fixed and adjustable rate portfolio mortgage loans servicing retained to another financial institution and recognized a gain on sale of \$0.07 million. During the third quarter of 2019 we also transferred \$36.6 million, of portfolio residential fixed rate mortgage loans to loans held for sale, carried

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at the lower of cost or fair value of which \$35.3 million were subsequently securitized in the fourth quarter of 2019 servicing retained with Freddie Mac recognizing a gain on sale of approximately \$1.2 million. These transactions were done primarily for asset/liability management purposes.

During the first and third quarters of 2018, we sold \$16.5 million and \$11.1 million, respectively, of residential fixed and adjustable rate portfolio mortgage loans servicing retained to another financial institution and recognized a gain (loss) on sale of \$0.05 million and (\$0.01) million, respectively. During the fourth quarter of 2018 we securitized \$10.9 million of portfolio residential fixed rate mortgage loans servicing retained with Freddie Mac recognizing a loss on sale of approximately \$0.1 million. These transactions were done primarily for asset/liability management purposes.

An analysis of the allowance for loan losses by portfolio segment for the years ended December 31 follows:

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u>	<u>Subjective Allocation</u>	<u>Total</u>
	(In thousands)				
<b>2019</b>					
Balance at beginning of period	\$ 7,090	\$ 7,978	\$ 895	\$ 8,925	\$ 24,888
Additions (deductions)					
Provision for loan losses	(651)	526	1,147	(198)	824
Recoveries credited to allowance	2,165	933	863	—	3,961
Loans charged against the allowance	(682)	(1,221)	(1,622)	—	(3,525)
Balance at end of period	<u>\$ 7,922</u>	<u>\$ 8,216</u>	<u>\$ 1,283</u>	<u>\$ 8,727</u>	<u>\$ 26,148</u>
<b>2018</b>					
Balance at beginning of period	\$ 5,595	\$ 8,733	\$ 864	\$ 7,395	\$ 22,587
Additions (deductions)					
Provision for loan losses	(946)	457	462	1,530	1,503
Recoveries credited to allowance	2,889	734	999	—	4,622
Loans charged against the allowance	(448)	(1,946)	(1,430)	—	(3,824)
Balance at end of period	<u>\$ 7,090</u>	<u>\$ 7,978</u>	<u>\$ 895</u>	<u>\$ 8,925</u>	<u>\$ 24,888</u>
<b>2017</b>					
Balance at beginning of period	\$ 4,880	\$ 8,681	\$ 1,011	\$ 5,662	\$ 20,234
Additions (deductions)					
Provision for loan losses	(327)	(567)	360	1,733	1,199
Recoveries credited to allowance	1,497	1,741	967	—	4,205
Loans charged against the allowance	(455)	(1,122)	(1,474)	—	(3,051)
Balance at end of period	<u>\$ 5,595</u>	<u>\$ 8,733</u>	<u>\$ 864</u>	<u>\$ 7,395</u>	<u>\$ 22,587</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Allowance for loan losses and recorded investment in loans by portfolio segment at December 31 follows:

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u>	<u>Subjective Allocation</u>	<u>Total</u>
	(In thousands)				
<b>2019</b>					
Allowance for loan losses:					
Individually evaluated for impairment	\$ 1,031	\$ 4,863	\$ 261	\$ —	\$ 6,155
Collectively evaluated for impairment	6,891	3,353	1,022	8,727	19,993
Loans acquired with deteriorated credit quality	—	—	—	—	—
Total ending allowance for loan losses balance	<u>\$ 7,922</u>	<u>\$ 8,216</u>	<u>\$ 1,283</u>	<u>\$ 8,727</u>	<u>\$ 26,148</u>
Loans					
Individually evaluated for impairment	\$ 9,393	\$ 43,574	\$ 2,925		\$ 55,892
Collectively evaluated for impairment	1,158,906	1,058,917	457,370		2,675,193
Loans acquired with deteriorated credit quality	1,394	575	316		2,285
Total loans recorded investment	1,169,693	1,103,066	460,611		2,733,370
Accrued interest included in recorded investment	2,998	4,155	1,194		8,347
Total loans	<u>\$ 1,166,695</u>	<u>\$ 1,098,911</u>	<u>\$ 459,417</u>		<u>\$ 2,725,023</u>
<b>2018</b>					
Allowance for loan losses:					
Individually evaluated for impairment	\$ 1,305	\$ 4,799	\$ 206	\$ —	\$ 6,310
Collectively evaluated for impairment	5,785	3,179	689	8,925	18,578
Loans acquired with deteriorated credit quality	—	—	—	—	—
Total ending allowance for loan losses balance	<u>\$ 7,090</u>	<u>\$ 7,978</u>	<u>\$ 895</u>	<u>\$ 8,925</u>	<u>\$ 24,888</u>
Loans					
Individually evaluated for impairment	\$ 8,697	\$ 46,394	\$ 3,370		\$ 58,461
Collectively evaluated for impairment	1,137,586	1,000,038	392,460		2,530,084
Loans acquired with deteriorated credit quality	1,609	555	349		2,513
Total loans recorded investment	1,147,892	1,046,987	396,179		2,591,058
Accrued interest included in recorded investment	3,411	4,097	1,030		8,538
Total loans	<u>\$ 1,144,481</u>	<u>\$ 1,042,890</u>	<u>\$ 395,149</u>		<u>\$ 2,582,520</u>

Non-performing loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. If these loans had continued to accrue interest in accordance with their original terms, approximately \$0.4 million of interest income would have been recognized in each of the years ended 2019, 2018 and 2017. Interest income recorded on these loans was approximately zero during each of the years ended 2019, 2018 and 2017.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Loans on non-accrual status and past due more than 90 days (“Non-performing Loans”) at December 31 follow<sup>(1)</sup>:

	<u>90+ and Still Accruing</u>	<u>Non- Accrual</u>	<u>Total Non- Performing Loans</u>
	(In thousands)		
<b>2019</b>			
Commercial			
Commercial and industrial <sup>(2)</sup>	\$ —	\$ 565	\$ 565
Commercial real estate	—	735	735
Mortgage			
1-4 family owner occupied - jumbo	—	1,179	1,179
1-4 family owner occupied - non-jumbo <sup>(3)</sup>	—	3,540	3,540
1-4 family non-owner occupied	—	1,039	1,039
1-4 family - 2nd lien	—	979	979
Resort lending	—	690	690
Installment			
Boat lending	—	332	332
Recreational vehicle lending	—	3	3
Other	—	470	470
Total recorded investment	<u>\$ —</u>	<u>\$ 9,532</u>	<u>\$ 9,532</u>
Accrued interest included in recorded investment	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
<b>2018</b>			
Commercial			
Commercial and industrial <sup>(2)</sup>	\$ —	\$ 1,345	\$ 1,345
Commercial real estate	—	778	778
Mortgage			
1-4 family owner occupied - jumbo	—	184	184
1-4 family owner occupied - non-jumbo <sup>(3)</sup>	5	2,974	2,979
1-4 family non-owner occupied	—	1,259	1,259
1-4 family - 2nd lien	—	493	493
Resort lending	—	755	755
Installment			
Boat lending	—	166	166
Recreational vehicle lending	—	7	7
Other	—	608	608
Total recorded investment	<u>\$ 5</u>	<u>\$ 8,569</u>	<u>\$ 8,574</u>
Accrued interest included in recorded investment	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

(1) Non-performing loans exclude purchase credit impaired loans.

(2) Non-performing commercial and industrial loans exclude \$0.077 million and \$0.097 million of government guaranteed loans at December 31, 2019 and 2018, respectively.

(3) Non-performing 1-4 family owner occupied – non jumbo loans exclude \$0.569 million and \$0.363 million of government guaranteed loans at December 31, 2019 and 2018, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

An aging analysis of loans by class at December 31 follows:

	Loans Past Due				Loans not Past Due	Total Loans
	30-59 days	60-89 days	90+ days	Total		
	(In thousands)					
<b>2019</b>						
Commercial						
Commercial and industrial	\$ —	\$ 289	\$ 102	\$ 391	\$ 564,480	\$ 564,871
Commercial real estate	177	—	735	912	603,910	604,822
Mortgage						
1-4 family owner occupied - jumbo	1,757	1,037	—	2,794	398,759	401,553
1-4 family owner occupied - non-jumbo	2,672	852	1,387	4,911	342,349	347,260
1-4 family non-owner occupied	695	136	623	1,454	168,083	169,537
1-4 family - 2nd lien	909	90	386	1,385	115,157	116,542
Resort lending	364	53	565	982	67,192	68,174
Installment						
Boat lending	337	107	88	532	202,750	203,282
Recreational vehicle lending	161	97	3	261	153,184	153,445
Other	377	275	202	854	103,030	103,884
Total recorded investment	<u>\$ 7,449</u>	<u>\$ 2,936</u>	<u>\$ 4,091</u>	<u>\$ 14,476</u>	<u>\$ 2,718,894</u>	<u>\$ 2,733,370</u>
Accrued interest included in recorded investment	<u>\$ 74</u>	<u>\$ 34</u>	<u>\$ —</u>	<u>\$ 108</u>	<u>\$ 8,239</u>	<u>\$ 8,347</u>
<b>2018</b>						
Commercial						
Commercial and industrial	\$ 1,582	\$ —	\$ —	\$ 1,582	\$ 580,935	\$ 582,517
Commercial real estate	—	—	—	—	565,375	565,375
Mortgage						
1-4 family owner occupied - jumbo	—	—	184	184	313,154	313,338
1-4 family owner occupied - non-jumbo	1,519	145	3,524	5,188	362,767	367,955
1-4 family non-owner occupied	265	49	1,259	1,573	162,673	164,246
1-4 family - 2nd lien	446	100	493	1,039	118,628	119,667
Resort lending	252	—	755	1,007	80,774	81,781
Installment						
Boat lending	316	295	166	777	169,117	169,894
Recreational vehicle lending	28	21	7	56	125,780	125,836
Other	552	210	627	1,389	99,060	100,449
Total recorded investment	<u>\$ 4,960</u>	<u>\$ 820</u>	<u>\$ 7,015</u>	<u>\$ 12,795</u>	<u>\$ 2,578,263</u>	<u>\$ 2,591,058</u>
Accrued interest included in recorded investment	<u>\$ 44</u>	<u>\$ 11</u>	<u>\$ —</u>	<u>\$ 55</u>	<u>\$ 8,483</u>	<u>\$ 8,538</u>

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Impaired loans are as follows:

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
	(In thousands)	
Impaired loans with no allocated allowance for loan losses		
TDR	\$ 337	\$ —
Non - TDR	1,550	—
Impaired loans with an allocated allowance for loan losses		
TDR - allowance based on collateral	1,587	2,787
TDR - allowance based on present value cash flow	48,798	53,258
Non - TDR - allowance based on collateral	3,365	2,145
Total impaired loans	<u>\$ 55,637</u>	<u>\$ 58,190</u>
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	\$ 542	\$ 769
TDR - allowance based on present value cash flow	4,641	4,849
Non - TDR - allowance based on collateral	972	692
Total amount of allowance for loan losses allocated	<u>\$ 6,155</u>	<u>\$ 6,310</u>

Impaired loans by class as of December 31 are as follows:

	<u>2019</u>			<u>2018</u>		
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance for Loan Losses</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance for Loan Losses</u>
	(In thousands)					
<b>With no related allowance for loan losses recorded:</b>						
Commercial						
Commercial and industrial	\$ 257	\$ 257	\$ —	\$ —	\$ —	\$ —
Commercial real estate	796	796	—	—	—	—
Mortgage						
1-4 family owner occupied - jumbo	—	—	—	—	—	—
1-4 family owner occupied - non-jumbo	212	217	—	3	474	—
1-4 family non-owner occupied	214	366	—	—	—	—
1-4 family - 2nd lien	407	438	—	—	—	—
Resort lending	—	—	—	—	—	—
Installment						
Boat lending	—	—	—	—	5	—
Recreational vehicle lending	—	—	—	—	—	—
Other	1	41	—	1	137	—
	<u>1,887</u>	<u>2,115</u>	<u>—</u>	<u>4</u>	<u>616</u>	<u>—</u>

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	2019			2018		
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance for Loan Losses</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance for Loan Losses</u>
(In thousands)						
<b>With an allowance for loan losses recorded:</b>						
Commercial						
Commercial and industrial	1,655	1,706	453	3,637	3,735	967
Commercial real estate	6,685	6,661	578	5,060	5,047	338
Mortgage						
1-4 family owner occupied - jumbo	1,447	1,445	91	1,348	1,649	151
1-4 family owner occupied - non-jumbo	10,163	10,695	1,031	25,877	26,737	2,203
1-4 family non-owner occupied	4,962	5,542	572	5,565	5,988	507
1-4 family - 2nd lien	14,059	15,243	1,695	273	272	11
Resort lending	12,110	12,263	1,474	13,328	13,354	1,927
Installment						
Boat lending	—	—	—	—	—	—
Recreational vehicle lending	—	—	—	79	79	4
Other	2,924	3,153	261	3,290	3,421	202
	<u>54,005</u>	<u>56,708</u>	<u>6,155</u>	<u>58,457</u>	<u>60,282</u>	<u>6,310</u>
<b>Total</b>						
Commercial						
Commercial and industrial	1,912	1,963	453	3,637	3,735	967
Commercial real estate	7,481	7,457	578	5,060	5,047	338
Mortgage						
1-4 family owner occupied - jumbo	1,447	1,445	91	1,348	1,649	151
1-4 family owner occupied - non-jumbo	10,375	10,912	1,031	25,880	27,211	2,203
1-4 family non-owner occupied	5,176	5,908	572	5,565	5,988	507
1-4 family - 2nd lien	14,466	15,681	1,695	273	272	11
Resort lending	12,110	12,263	1,474	13,328	13,354	1,927
Installment						
Boat lending	—	—	—	—	5	—
Recreational vehicle lending	—	—	—	79	79	4
Other	2,925	3,194	261	3,291	3,558	202
Total	<u>\$ 55,892</u>	<u>\$ 58,823</u>	<u>\$ 6,155</u>	<u>\$ 58,461</u>	<u>\$ 60,898</u>	<u>\$ 6,310</u>
Accrued interest included in recorded investment						
	<u>\$ 255</u>			<u>\$ 271</u>		

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Average recorded investment in and interest income earned (of which the majority of these amounts were received in cash and related primarily to performing TDR's) on impaired loans by class for the years ended December 31 follows:

	2019		2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(In thousands)						
<b>With no related allowance for loan losses recorded:</b>						
Commercial						
Commercial and industrial	\$ 51	\$ —	\$ 378	\$ 20	\$ 751	\$ 22
Commercial real estate	278	5	961	—	183	—
Mortgage						
1-4 family owner occupied - jumbo	—	—	41	—	—	—
1-4 family owner occupied - non-jumbo	201	—	15	27	52	21
1-4 family non-owner occupied	123	—	—	—	—	—
1-4 family - 2nd lien	136	7	—	—	—	—
Resort lending	—	—	—	—	—	—
Installment						
Boat lending	—	—	—	—	—	—
Recreational vehicle lending	—	—	—	—	—	—
Other	—	1	1	11	1	6
	<u>789</u>	<u>13</u>	<u>1,396</u>	<u>58</u>	<u>987</u>	<u>49</u>
<b>With an allowance for loan losses recorded:</b>						
Commercial						
Commercial and industrial	2,256	72	2,641	127	3,298	132
Commercial real estate	5,778	315	5,199	288	7,242	377
Mortgage						
1-4 family owner occupied - jumbo	995	39	1,335	69	2,425	67
1-4 family owner occupied - non-jumbo	15,183	594	28,183	1,408	31,468	1,439
1-4 family non-owner occupied	2,874	291	5,475	314	5,362	269
1-4 family - 2nd lien	13,383	809	284	12	306	11
Resort lending	11,697	669	14,687	606	16,383	616
Installment						
Boat lending	54	—	1	—	1	1
Recreational vehicle lending	22	—	84	4	100	5
Other	3,186	189	3,640	224	4,335	265
	<u>55,428</u>	<u>2,978</u>	<u>61,529</u>	<u>3,052</u>	<u>70,920</u>	<u>3,182</u>

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	2019		2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b>Total</b>						
Commercial						
Commercial and industrial	2,307	72	3,019	147	4,049	154
Commercial real estate	6,056	320	6,160	288	7,425	377
Mortgage						
1-4 family owner occupied - jumbo	995	39	1,376	69	2,425	67
1-4 family owner occupied - non-jumbo	15,384	594	28,198	1,435	31,520	1,460
1-4 family non-owner occupied	2,997	291	5,475	314	5,362	269
1-4 family - 2nd lien	13,519	816	284	12	306	11
Resort lending	11,697	669	14,687	606	16,383	616
Installment						
Boat lending	54	—	1	—	1	1
Recreational vehicle lending	22	—	84	4	100	5
Other	3,186	190	3,641	235	4,336	271
<b>Total</b>	<b>\$ 56,217</b>	<b>\$ 2,991</b>	<b>\$ 62,925</b>	<b>\$ 3,110</b>	<b>\$ 71,907</b>	<b>\$ 3,231</b>

Troubled debt restructurings at December 31 follow:

	2019		
	Commercial	Retail <sup>(1)</sup>	Total
	(In thousands)		
Performing TDR's	\$ 7,974	\$39,601	\$ 47,575
Non-performing TDR's <sup>(2)</sup>	540	2,607 <sup>(3)</sup>	3,147
<b>Total</b>	<b>\$ 8,514</b>	<b>\$42,208</b>	<b>\$ 50,722</b>
	2018		
	Commercial	Retail <sup>(1)</sup>	Total
	(In thousands)		
Performing TDR's	\$ 6,460	\$46,627	\$ 53,087
Non-performing TDR's <sup>(2)</sup>	74	2,884 <sup>(3)</sup>	2,958
<b>Total</b>	<b>\$ 6,534</b>	<b>\$49,511</b>	<b>\$ 56,045</b>

(1) Retail loans include mortgage and installment loan portfolio segments.

(2) Included in non-performing loans table above.

(3) Also includes loans on non-accrual at the time of modification until six payments are received on a timely basis.

We have allocated \$5.2 million and \$5.6 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2019 and 2018, respectively. We have committed to lend additional amounts totaling up to \$0.05 million and \$0.04 million at December 31, 2019 and 2018, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The terms of certain loans were modified as troubled debt restructurings and 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 a new loan with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan have generally been for periods ranging from 9 months to 36 months but have extended to as much as 480 months in certain circumstances. Modifications

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involving an extension of the maturity date have generally been for periods ranging from 1 month to 60 months but have extended to as much as 230 months in certain circumstances.

Loans that have been classified as troubled debt restructurings during the years ended December 31 follow:

	<u>Number of Contracts</u>	<u>Pre-modification Recorded Balance</u>	<u>Post-modification Recorded Balance</u>
		(Dollars in thousands)	
2019			
Commercial			
Commercial and industrial	8	\$ 1,609	\$ 1,609
Commercial real estate	3	1,479	1,479
Mortgage			
1-4 family owner occupied - jumbo	—	—	—
1-4 family owner occupied - non-jumbo	2	478	483
1-4 family non-owner occupied	1	507	505
1-4 family - 2nd lien	3	75	75
Resort lending	—	—	—
Installment			
Boat lending	—	—	—
Recreational vehicle lending	—	—	—
Other	7	188	191
Total	<u>24</u>	<u>\$ 4,336</u>	<u>\$ 4,342</u>
2018			
Commercial			
Commercial and industrial	7	\$ 652	\$ 652
Commercial real estate	2	204	204
Mortgage			
1-4 family owner occupied - jumbo	1	419	419
1-4 family owner occupied - non-jumbo	9	991	994
1-4 family non-owner occupied	—	—	—
1-4 family - 2nd lien	—	—	—
Resort lending	1	115	114
Installment			
Boat lending	—	—	—
Recreational vehicle lending	—	—	—
Other	14	708	709
Total	<u>34</u>	<u>\$ 3,089</u>	<u>\$ 3,092</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	<u>Number of Contracts</u>	<u>Pre-modification Recorded Balance</u>	<u>Post-modification Recorded Balance</u>
	(Dollars in thousands)		
<b>2017</b>			
Commercial			
Commercial and industrial	15	\$ 925	\$ 925
Commercial real estate	—	—	—
Mortgage			
1-4 family owner occupied - jumbo	—	—	—
1-4 family owner occupied - non-jumbo	5	423	429
1-4 family non-owner occupied	1	33	33
1-4 family - 2nd lien	—	—	—
Resort lending	1	189	189
Installment			
Boat lending	—	—	—
Recreational vehicle lending	—	—	—
Other	15	551	559
Total	<u>37</u>	<u>\$ 2,121</u>	<u>\$ 2,135</u>

The troubled debt restructurings described above increased (decreased) the AFLL by \$0.5 million, \$(0.2) million and \$0.1 million during the years ended December 31, 2019, 2018 and 2017, respectively and resulted in charge offs of zero during each of the years ended December 31, 2019, 2018 and 2017, respectively.

Loans that have been classified as troubled debt restructured during the past twelve months and that have subsequently defaulted during the years ended December 31 follows:

	<u>Number of Contracts</u>	<u>Recorded Balance</u>
	(Dollars in thousands)	
<b>2019</b>		
Commercial		
Commercial and industrial	1	\$ 19
Commercial real estate	—	—
Mortgage		
1-4 family owner occupied - jumbo	—	—
1-4 family owner occupied - non-jumbo	1	12
1-4 family non-owner occupied	—	—
1-4 family - 2nd lien	—	—
Resort lending	—	—
Installment		
Boat lending	—	—
Recreational vehicle lending	—	—
Other	—	—
Total	<u>2</u>	<u>\$ 31</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	<u>Number of Contracts</u>	<u>Recorded Balance</u>
	(Dollars in thousands)	
2018		
Commercial		
Commercial and industrial	—	\$ —
Commercial real estate	—	—
Mortgage		
1-4 family owner occupied - jumbo	—	—
1-4 family owner occupied - non-jumbo	—	—
1-4 family non-owner occupied	—	—
1-4 family - 2nd lien	—	—
Resort lending	—	—
Installment		
Boat lending	—	—
Recreational vehicle lending	—	—
Other	1	13
Total	<u>1</u>	<u>\$ 13</u>
2017		
Commercial		
Commercial and industrial	6	\$ 164
Commercial real estate	—	—
Mortgage		
1-4 family owner occupied - jumbo	—	—
1-4 family owner occupied - non-jumbo	—	—
1-4 family non-owner occupied	—	—
1-4 family - 2nd lien	—	—
Resort lending	—	—
Installment		
Boat lending	—	—
Recreational vehicle lending	—	—
Other	1	13
Total	<u>7</u>	<u>\$ 177</u>

A loan is generally considered to be in payment default once it is 90 days contractually past due under the modified terms for commercial loans and installment loans and when four consecutive payments are missed for mortgage loans.

The troubled debt restructurings that subsequently defaulted described above increased (decreased) the AFLL by zero, zero and \$0.04 million during the years ended December 31, 2019, 2018 and 2017, respectively and resulted in charge offs of zero, zero and \$0.05 million during the years ended December 31, 2019, 2018 and 2017, respectively.

The terms of certain other loans were modified during the years ending December 31, 2019, 2018 and 2017 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

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

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

*Rating 7 and 8:* These loans are generally referred to as our “watch” commercial credits. 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.

*Rating 10 and 11:* These loans are generally referred to as our “substandard - non-accrual” and “doubtful” commercial credits. Our doubtful rating includes a sub classification for a loss rate other than 50% (which is the standard doubtful loss rate). 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.

The following table summarizes loan ratings by loan class for our commercial loan portfolio segment at December 31:

	<b>Commercial</b>				<b>Total</b>
	<b>Non-watch 1-6</b>	<b>Watch 7-8</b>	<b>Substandard Accrual 9</b>	<b>Non- Accrual 10-11</b>	
	(In thousands)				
<b>2019</b>					
Commercial and industrial	\$ 515,955	\$ 44,384	\$ 3,967	\$ 565	\$ 564,871
Commercial real estate	580,516	23,036	535	735	604,822
Total	<u>\$ 1,096,471</u>	<u>\$ 67,420</u>	<u>\$ 4,502</u>	<u>\$ 1,300</u>	<u>\$ 1,169,693</u>
Accrued interest included in total	<u>\$ 2,763</u>	<u>\$ 205</u>	<u>\$ 30</u>	<u>\$ —</u>	<u>\$ 2,998</u>
<b>2018</b>					
Commercial and industrial	\$ 551,441	\$ 23,910	\$ 5,577	\$ 1,589	\$ 582,517
Commercial real estate	531,069	33,274	200	832	565,375
Total	<u>\$ 1,082,510</u>	<u>\$ 57,184</u>	<u>\$ 5,777</u>	<u>\$ 2,421</u>	<u>\$ 1,147,892</u>
Accrued interest included in total	<u>\$ 3,107</u>	<u>\$ 174</u>	<u>\$ 130</u>	<u>\$ —</u>	<u>\$ 3,411</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

For each of our mortgage and installment portfolio segment classes we generally monitor credit quality based on the credit scores of the borrowers. These credit scores are generally updated semi-annually. The following tables summarize credit scores by loan class for our mortgage and installment loan portfolio segments at December 31:

	<b>Mortgage(1)</b>					<b>Total</b>
	<b>1-4 Family Owner Occupied - Jumbo</b>	<b>1-4 Family Owner Occupied - Non-jumbo</b>	<b>1-4 Family Non-owner Occupied</b>	<b>1-4 Family 2nd Lien</b>	<b>Resort Lending</b>	
	(In thousands)					
<b>2019</b>						
800 and above	\$ 48,486	\$ 43,848	\$ 24,315	\$ 13,905	\$ 11,076	\$ 141,630
750-799	198,491	111,521	84,656	50,012	29,364	474,044
700-749	106,609	95,064	34,839	30,697	14,626	281,835
650-699	31,553	51,174	13,995	14,267	8,063	119,052
600-649	13,230	21,938	5,897	4,097	2,074	47,236
550-599	514	12,308	1,863	1,703	673	17,061
500-549	1,519	7,940	1,870	1,281	889	13,499
Under 500	641	2,208	533	511	79	3,972
Unknown	510	1,259	1,569	69	1,330	4,737
<b>Total</b>	<b>\$ 401,553</b>	<b>\$ 347,260</b>	<b>\$ 169,537</b>	<b>\$ 116,542</b>	<b>\$ 68,174</b>	<b>\$ 1,103,066</b>
Accrued interest included in total	<u>\$ 1,139</u>	<u>\$ 1,662</u>	<u>\$ 586</u>	<u>\$ 502</u>	<u>\$ 266</u>	<u>\$ 4,155</u>
<b>2018</b>						
800 and above	\$ 33,337	\$ 46,509	\$ 19,191	\$ 11,077	\$ 10,898	\$ 121,012
750-799	167,992	136,105	79,837	56,008	36,542	476,484
700-749	69,018	96,378	36,103	33,345	17,282	252,126
650-699	28,637	48,663	15,854	11,361	9,945	114,460
600-649	9,911	19,139	5,533	4,077	3,088	41,748
550-599	2,034	9,619	2,396	1,385	1,867	17,301
500-549	—	7,463	1,338	882	106	9,789
Under 500	647	1,181	802	382	143	3,155
Unknown	1,762	2,898	3,192	1,150	1,910	10,912
<b>Total</b>	<b>\$ 313,338</b>	<b>\$ 367,955</b>	<b>\$ 164,246</b>	<b>\$ 119,667</b>	<b>\$ 81,781</b>	<b>\$ 1,046,987</b>
Accrued interest included in total	<u>\$ 851</u>	<u>\$ 1,789</u>	<u>\$ 550</u>	<u>\$ 544</u>	<u>\$ 363</u>	<u>\$ 4,097</u>

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

	<b>Installment(1)</b>			<b>Total</b>
	<b>Boat Lending</b>	<b>Recreational Vehicle Lending</b>	<b>Other</b>	
	(In thousands)			
<b>2019</b>				
800 and above	\$ 28,041	\$ 24,470	\$ 7,611	\$ 60,122
750-799	118,380	88,164	37,583	244,127
700-749	41,490	31,055	27,204	99,749
650-699	11,485	7,267	22,517	41,269
600-649	2,254	1,411	4,470	8,135
550-599	946	592	1,884	3,422
500-549	377	464	1,127	1,968
Under 500	309	22	284	615
Unknown	—	—	1,204	1,204
<b>Total</b>	<b>\$ 203,282</b>	<b>\$ 153,445</b>	<b>\$ 103,884</b>	<b>\$ 460,611</b>
Accrued interest included in total	<u>\$ 490</u>	<u>\$ 378</u>	<u>\$ 326</u>	<u>\$ 1,194</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Installment <sup>(1)</sup>			
	<u>Boat Lending</u>	<u>Recreational Vehicle Lending</u>	<u>Other</u>	<u>Total</u>
		(In thousands)		
2018				
800 and above	\$ 20,767	\$ 20,197	\$ 7,062	\$ 48,026
750-799	100,191	74,154	34,627	208,972
700-749	35,455	24,890	27,633	87,978
650-699	10,581	4,918	12,663	28,162
600-649	1,657	992	5,019	7,668
550-599	652	453	2,255	3,360
500-549	286	225	1,264	1,775
Under 500	266	7	275	548
Unknown	39	—	9,651	9,690
Total	<u>\$ 169,894</u>	<u>\$ 125,836</u>	<u>\$ 100,449</u>	<u>\$ 396,179</u>
Accrued interest included in total	<u>\$ 403</u>	<u>\$ 311</u>	<u>\$ 316</u>	<u>\$ 1,030</u>

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

Mortgage loans serviced for others are not reported as assets on the Consolidated Statements of Financial Condition. The principal balances of these loans at December 31 follow:

	<u>2019</u>	<u>2018</u>
	(In thousands)	
Mortgage loans serviced for :		
Fannie Mae	\$ 1,449,935	\$ 1,350,703
Freddie Mac	852,123	712,740
Ginnie Mae	180,941	165,467
FHLB	69,149	78,687
Other	29,018	26,148
Total	<u>\$ 2,581,166</u>	<u>\$ 2,333,745</u>

Custodial deposit accounts maintained in connection with mortgage loans serviced for others totaled \$29.9 million and \$22.0 million, at December 31, 2019 and 2018, respectively.

If we do not remain well capitalized for regulatory purposes (see note #20), meet certain minimum capital levels or certain profitability requirements or if we incur a rapid decline in net worth, we could lose our ability to sell and/or service loans to these investors. This could impact our ability to generate net gains on mortgage loans and generate servicing income. A forced liquidation of our servicing portfolio could also impact the value that could be recovered on this asset. Fannie Mae has the most stringent eligibility requirements covering capital levels, profitability and decline in net worth. Fannie Mae requires seller/servicers to be well capitalized for regulatory purposes. For the profitability requirement, we cannot record four or more consecutive quarterly losses and experience a 30% decline in net worth over the same period. Our net worth cannot decline by more than 25% in one quarter or more than 40% over two consecutive quarters. The highest level of capital we are required to maintain is at least \$2.5 million plus 0.25% of all loans serviced for others.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

An analysis of capitalized mortgage loan servicing rights for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Balance at beginning of period	\$ 21,400	\$ 15,699	\$ 13,671
Change in accounting (see note #1)	—	—	542
Balance at beginning of period, as adjusted	\$ 21,400	\$ 15,699	\$ 14,213
Originated servicing rights capitalized	7,303	4,977	4,230
Servicing rights acquired	—	3,047	—
Change in fair value due to price	(6,408)	191	(718)
Change in fair value due to pay downs	(3,124)	(2,514)	(2,026)
Balance at end of year	<u>\$ 19,171</u>	<u>\$ 21,400</u>	<u>\$ 15,699</u>
Loans sold and serviced that have had servicing rights capitalized	<u>\$ 2,580,705</u>	<u>\$ 2,333,081</u>	<u>\$ 1,815,668</u>

Fair value of capitalized mortgage loan servicing rights was determined using an average coupon rate of 4.22%, average servicing fee of 0.258%, average discount rate of 10.14% and an average Public Securities Association (“PSA”) prepayment rate of 250 for December 31, 2019; and average coupon rate of 4.23%, average servicing fee of 0.258%, average discount rate of 10.15% and an average PSA prepayment rate of 182 for December 31, 2018.

**Purchase Credit Impaired (“PCI”) Loans**

Loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In determining the estimated fair value of purchased loans, management considers a number of factors including, among others, the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, and net present value of cash flows expected to be received. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income.

As a result of our acquisition of TCSB Bancorp, Inc. (“TCSB”) (see note #26) we purchased loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. For these loans that meet the criteria of ASC 310-30 treatment, the carrying amount was as follows:

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
	(In thousands)	
Commercial	\$ 1,394	\$ 1,609
Mortgage	575	555
Installment	316	349
Total carrying amount	2,285	2,513
Allowance for loan losses	—	—
Carrying amount, net of allowance for loan losses	<u>\$ 2,285</u>	<u>\$ 2,513</u>

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The accretable difference on PCI loans is the difference between the expected cash flows and the net present value of expected cash flows with such difference accreted into earnings using the effective yield method over the term of the loans. Accretion recorded as loan interest income is included in the table below. Accretable yield of PCI loans, or income expected to be collected follows:

	<b>Year ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>(In thousands)</b>		
Balance at beginning of period	\$ 462	\$ —
New loans purchased	—	568
Accretion of income	(187)	(106)
Reclassification from (to) nonaccretable difference	365	—
Disposals/other adjustments	—	—
Balance at end of period	<u>\$ 640</u>	<u>\$ 462</u>

**NOTE 5 – OTHER REAL ESTATE**

A summary of other real estate activity for the years ended December 31 follows<sup>(1)</sup>:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(In thousands)</b>		
Balance at beginning of year, net of valuation allowance	\$ 1,178	\$ 1,628	\$ 4,956
Loans transferred to other real estate	2,242	1,510	1,735
Sales of other real estate	(1,438)	(1,822)	(4,737)
Additions to valuation allowance charged to expense	(267)	(138)	(326)
Balance at end of year, net of valuation allowance	<u>\$ 1,715</u>	<u>\$ 1,178</u>	<u>\$ 1,628</u>

(1) Table excludes other repossessed assets totaling \$0.15 million and \$0.12 million at December 31, 2019 and 2018, respectively.

We periodically review our real estate properties and establish valuation allowances on these properties if values have declined since the date of acquisition. An analysis of our valuation allowance for other real estate follows:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(In thousands)</b>		
Balance at beginning of year	\$ 144	\$ 123	\$ 793
Additions charged to expense	267	138	326
Direct write-downs upon sale	(319)	(117)	(996)
Balance at end of year	<u>\$ 92</u>	<u>\$ 144</u>	<u>\$ 123</u>

At both December 31, 2019 and 2018, the balance of other real estate includes \$1.2 million of foreclosed residential real estate properties. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled \$0.7 million and \$0.3 million at December 31, 2019 and 2018, respectively.

Other real estate and repossessed assets totaling \$1.9 million and \$1.3 million at December 31, 2019 and 2018, respectively, are presented net of the valuation allowance on the Consolidated Statements of Financial Condition.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

**NOTE 6 – PROPERTY AND EQUIPMENT**

A summary of property and equipment at December 31 follows:

	<u>2019</u>	<u>2018</u>
	(In thousands)	
Land and land improvements	\$ 17,478	\$ 16,843
Buildings	57,363	56,385
Equipment	71,194	70,039
	146,035	143,267
Accumulated depreciation and amortization	(107,624)	(104,490)
Property and equipment, net	<u>\$ 38,411</u>	<u>\$ 38,777</u>

Depreciation expense was \$5.2 million, \$5.1 million and \$5.3 million in 2019, 2018 and 2017, respectively.

**NOTE 7 – GOODWILL AND OTHER INTANGIBLES**

Intangible assets, net of amortization, at December 31 follows:

	<u>2019</u>		<u>2018</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
	(In thousands)			
Amortized intangible assets - core deposits	<u>\$ 11,916</u>	<u>\$ 6,590</u>	<u>\$ 11,916</u>	<u>\$ 5,501</u>
Unamortized intangible assets - goodwill	<u>\$ 28,300</u>		<u>\$ 28,300</u>	

At December 31, 2019, the Bank (our reporting unit) had positive equity and we elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the Bank exceeds its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the Bank exceeded its carrying value, resulting in no impairment.

Intangible amortization expense was \$1.1 million, \$1.0 million and \$0.3 million during the years ended 2019, 2018 and 2017, respectively.

A summary of estimated core deposit intangible amortization at December 31, 2019, follows:

	<u>(In thousands)</u>
2020	\$ 1,020
2021	970
2022	785
2023	547
2024	516
2025 and thereafter	1,488
Total	<u>\$ 5,326</u>

**NOTE 8 – DEPOSITS**

A summary of interest expense on deposits for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Savings and interest-bearing checking	\$ 5,371	\$ 4,146	\$ 1,530
Reciprocal	6,024	1,292	342
Time	7,148	5,343	4,288
Brokered time	4,882	3,697	615
Total	<u>\$ 23,425</u>	<u>\$ 14,478</u>	<u>\$ 6,775</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Aggregate time deposits in denominations of \$0.25 million or more amounted to \$71.5 million and \$74.0 million at December 31, 2019 and 2018, respectively.

A summary of the maturity of time deposits at December 31, 2019, follows:

	(In thousands)
2020	\$ 501,609
2021	73,398
2022	13,929
2023	15,136
2024	5,020
2025 and thereafter	445
Total	<u>\$ 609,537</u>

Reciprocal deposits represent demand, money market and time deposits from our customers that have been placed through Promontory Interfinancial Network's Insured Cash Sweep® service and Certificate of Deposit Account Registry Service®. These services allow our customers to access multi-million dollar FDIC deposit insurance on deposit balances greater than the standard FDIC insurance maximum.

A summary of reciprocal deposits at December 31 follows:

	2019	2018
	(In thousands)	
Demand	\$ 383,953	\$ 114,503
Money market	4,416	8,577
Time	42,658	58,992
Total	<u>\$ 431,027</u>	<u>\$ 182,072</u>

**NOTE 9 – OTHER BORROWINGS**

A summary of other borrowings at December 31 follows:

	2019	2018
	(In thousands)	
Advances from the FHLB	\$ 63,640	\$ 25,696
Federal funds purchased	25,000	—
Other	6	4
Total	<u>\$ 88,646</u>	<u>\$ 25,700</u>

Advances from the FHLB are secured by unencumbered qualifying mortgage and home equity loans with a market value equal to at least 132% to 165%, respectively, of outstanding advances. Advances are also secured by FHLB stock that we own, which totaled \$8.6 million at December 31, 2019. Unused borrowing capacity with the FHLB (subject to the FHLB's credit requirements and policies) was \$836.5 million at December 31, 2019. Interest expense on advances amounted to \$0.7 million, \$1.0 million and \$0.9 million for the years ended December 31, 2019, 2018 and 2017, respectively. No FHLB advances were terminated during 2019, 2018 or 2017.

As a member of the FHLB, we must own FHLB stock equal to the greater of 0.75% of the unpaid principal balance of residential mortgage assets or 4.5% of our outstanding advances. At December 31, 2019, we were in compliance with the FHLB stock ownership requirements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The maturity dates, weighted average interest rates and contractually required repayments of FHLB advances at December 31 follow:

	2019		2018	
	Amount	Rate	Amount	Rate
(Dollars in thousands)				
Fixed-rate advances				
2019			\$ 10,000	1.60%
2020	\$ 28,645	2.19%	10,762	3.18
2022	4,995	1.69	4,934	1.69
2025 and thereafter	30,000	0.74		
Total advances	<u>\$ 63,640</u>	1.47%	<u>\$ 25,696</u>	2.28%

Borrowings with the FRB at December 31, 2019 and 2018 were zero. Average borrowings with the FRB during the years ended December 31, 2019, 2018 and 2017 totaled \$0.305 million, \$0.003 million and \$0.047 million. We had unused borrowing capacity with the FRB (subject to the FRB’s credit requirements and policies) of \$348.6 million at December 31, 2019. Collateral for FRB borrowings are certain commercial and installment loans.

Interest expense on federal funds purchased totaled \$0.1 million for each of the years ended December 31, 2019, 2018 and 2017.

Assets, consisting of FHLB stock and loans, pledged to secure other borrowings and unused borrowing capacity totaled \$1.9 billion at December 31, 2019.

**NOTE 10 – SUBORDINATED DEBENTURES**

We have formed various special purpose entities (the “trusts”) for the purpose of issuing trust preferred securities in either public or pooled offerings or in private placements. Independent Bank Corporation owns all of the common stock of each trust and has issued subordinated debentures to each trust in exchange for all of the proceeds from the issuance of the common stock and the trust preferred securities. Trust preferred securities totaling \$38.2 million at both December 31, 2019 and 2018, qualified as Tier 1 regulatory capital.

These trusts are not consolidated with Independent Bank Corporation and accordingly, we report the common securities of the trusts held by us in accrued income and other assets and the subordinated debentures that we have issued to the trusts in the liability section of our Consolidated Statements of Financial Condition.

As a result of our acquisition of TCSB (see note #26) we acquired TCSB Statutory Trust I as summarized in the tables below at a discount. The discount at acquisition totaled \$1.4 million and is being amortized through its maturity date and is included in interest expense – other borrowings and subordinated debentures in the Consolidated Statements of Operations.

Summary information regarding subordinated debentures as of December 31 follows:

Entity Name	Issue Date	2019		
		Subordinated Debentures	Trust Preferred Securities Issued	Common Stock Issued
(In thousands)				
IBC Capital Finance III	May 2007	\$ 12,372	\$ 12,000	\$ 372
IBC Capital Finance IV	September 2007	15,465	15,000	465
Midwest Guaranty Trust I	November 2002	7,732	7,500	232
TCSB Statutory Trust I	March 2005	5,155	5,000	155
Discount on TCSB Statutory Trust I		(1,268)	(1,268)	—
		<u>\$ 39,456</u>	<u>\$ 38,232</u>	<u>\$ 1,224</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)  
2018

Entity Name	Issue Date	Subordinated Debentures	Trust Preferred Securities Issued	Common Stock Issued
		(In thousands)		
IBC Capital Finance III	May 2007	\$ 12,372	\$ 12,000	\$ 372
IBC Capital Finance IV	September 2007	15,465	15,000	465
Midwest Guaranty Trust I	November 2002	7,732	7,500	232
TCSB Statutory Trust I	March 2005	5,155	5,000	155
Discount on TCSB Statutory Trust I		(1,336)	(1,336)	—
		<u>\$ 39,388</u>	<u>\$ 38,164</u>	<u>\$ 1,224</u>

Other key terms for the subordinated debentures and trust preferred securities that were outstanding at December 31, 2019 and 2018 follow:

Entity Name	Maturity Date	Interest Rate	First Permitted Redemption Date
IBC Capital Finance III	July 30, 2037	3 month LIBOR plus 1.60%	July 30, 2012
IBC Capital Finance IV	September 15, 2037	3 month LIBOR plus 2.85%	September 15, 2012
Midwest Guaranty Trust I	November 7, 2032	3 month LIBOR plus 3.45%	November 7, 2007
TCSB Statutory Trust I	March 17, 2035	3 month LIBOR plus 2.20%	March 17, 2010

The subordinated debentures and trust preferred securities are cumulative and have a feature that permits us to defer distributions (payment of interest) from time to time for a period not to exceed 20 consecutive quarters. Interest is payable quarterly on each of the subordinated debentures and trust preferred securities and no distributions were deferred at December 31, 2019 and 2018.

We have the right to redeem the subordinated debentures and trust preferred securities (at par) in whole or in part from time to time on or after the first permitted redemption date specified above or upon the occurrence of specific events defined within the trust indenture agreements.

Distributions (payment of interest) on the trust preferred securities are included in interest expense – other borrowings and subordinated debentures in the Consolidated Statements of Operations.

**NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES**

In the normal course of business, we enter into financial instruments with off-balance sheet risk to meet the financing needs of customers or to reduce exposure to fluctuations in interest rates. These financial instruments may include commitments to extend credit and standby letters of credit. Financial instruments involve varying degrees of credit and interest-rate risk in excess of amounts reflected in the Consolidated Statements of Financial Condition. Exposure to credit risk in the event of non-performance by the counterparties to the financial instruments for loan commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. We do not, however, anticipate material losses as a result of these financial instruments.

A summary of financial instruments with off-balance sheet risk at December 31 follows:

	2019	2018
	(In thousands)	
Financial instruments whose risk is represented by contract amounts		
Commitments to extend credit	\$ 582,457	\$ 505,421
Standby letters of credit	7,207	4,998

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses

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### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

and generally require payment of a fee. Since commitments may expire without being drawn upon, the commitment amounts do not represent future cash requirements. Commitments are issued subject to similar underwriting standards, including collateral requirements, as are generally involved in the extension of credit facilities.

Standby letters of credit are written conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in such transactions is essentially the same as that involved in extending loan facilities and, accordingly, standby letters of credit are issued subject to similar underwriting standards, including collateral requirements, as are generally involved in the extension of credit facilities. The majority of the standby letters of credit are on-demand with no stated maturity date and have variable rates that range from 3.75% to 10.75%.

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

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, however, we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote.

The provision for loss reimbursement on sold loans represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac, Ginnie Mae and the FHLB). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. The provision for loss reimbursement on sold loans was an expense of \$0.23 million, \$0.01 million and \$0.17 million for the years ended December 31, 2019, 2018 and 2017, respectively. The reserve for loss reimbursements on sold mortgage loans totaled \$0.9 million and \$0.8 million at December 31, 2019 and 2018, respectively. This reserve is included in accrued expenses and other liabilities in our Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate given our analyses. However, future losses could exceed our current estimate.

We own 12,566 shares of VISA Class B common stock. At the present time, these shares can only be sold to other Class B shareholders. As a result, there has generally been limited transfer activity in private transactions between buyers and sellers. Given the limited activity that we have become aware of and the continuing uncertainty regarding the likelihood, ultimate timing and eventual exchange rate for Class B shares into Class A shares, we continue to carry these shares at zero, representing cost basis less impairment. However, given the current conversion ratio of 1.6228 to Class A shares and the closing price of VISA Class A shares on February 27, 2020 of \$180.01 per share, our 12,566 Class B shares would have a current “value” of approximately \$3.7 million. We continue to monitor Class B trading activity and the status of the resolution of certain litigation matters at VISA that would trigger the conversion of Class B common shares into Class A common shares that would have no trading restrictions.

#### **NOTE 12 – SHAREHOLDERS’ EQUITY AND INCOME PER COMMON SHARE**

In January, 2019, 2018 and 2017, our Board of Directors authorized share repurchase plans to buy back up to 5% of our outstanding common stock through the end of each respective year. In addition, in June, 2019 our Board of Directors authorized a 300,000 share expansion of the 2019 repurchase plan. During 2019, 2018 and 2017 repurchases were made through open market and negotiated transactions and totaled 1,204,688, 587,969 and zero shares of common stock, respectively for an aggregate purchase price of \$26.3 million, \$12.7 million and zero, respectively.

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A reconciliation of basic and diluted net income per common share for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	<b>(In thousands, except per share amounts)</b>		
Net income	<u>\$ 46,435</u>	<u>\$ 39,839</u>	<u>\$ 20,475</u>
Weighted average shares outstanding <sup>(1)</sup>	22,894	23,412	21,327
Stock units for deferred compensation plan for non-employee directors	132	128	121
Effect of stock options	115	176	142
Performance share units	42	53	60
Weighted average shares outstanding for calculation of diluted earnings per share	<u>23,183</u>	<u>23,769</u>	<u>21,650</u>
Net income per common share			
Basic <sup>(1)</sup>	<u>\$ 2.03</u>	<u>\$ 1.70</u>	<u>\$ 0.96</u>
Diluted	<u>\$ 2.00</u>	<u>\$ 1.68</u>	<u>\$ 0.95</u>

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

Weighted average stock options outstanding that were not considered in computing diluted net income per common share because they were anti-dilutive were zero for each year ended 2019, 2018 and 2017, respectively.

**NOTE 13 – INCOME TAX**

The composition of income tax expense for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	<b>(In thousands)</b>		
Current expense	<u>\$ 10,237</u>	<u>\$ —</u>	<u>\$ 1,927</u>
Deferred expense	1,088	9,294	10,071
Change in statutory rate	—	—	5,965
Income tax expense	<u>\$ 11,325</u>	<u>\$ 9,294</u>	<u>\$ 17,963</u>

The deferred income tax expense of \$1.1 million in 2019 can be primarily attributed to the utilization of our alternative minimum tax credit carryforward while the deferred income tax expense of \$9.3 million during 2018 can be primarily attributed to the utilization of our net operating loss (“NOL”) carryforward and alternative minimum tax credit carryforward while the deferred income tax expense of \$10.1 million during 2017 can be primarily attributed to the utilization of our NOL carryforward.

On December 22, 2017, “H.R. 1”, also known as the “Tax Cuts and Jobs Act”, was signed into law. H.R.1, among other things, reduced the federal corporate income tax rate to 21% effective January 1, 2018. As a result, we concluded that our deferred tax assets, net had to be remeasured. Our deferred tax assets, net represents expected corporate tax benefits anticipated to be realized in the future. The reduction in the federal corporate income tax rate reduces these anticipated future benefits. The remeasurement of our deferred tax assets, net at December 31, 2017 resulted in a reduction of these net assets and a corresponding increase in income tax expense of \$6.0 million that was recorded in the fourth quarter of 2017.

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A reconciliation of income tax expense to the amount computed by applying the statutory federal income tax rate of 21% for 2019 and 2018 and 35% for 2017 to the income before income tax for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Statutory rate applied to income before income tax	\$ 12,130	\$ 10,318	\$ 13,453
Tax-exempt income	(375)	(383)	(777)
Bank owned life insurance	(233)	(229)	(372)
Share-based compensation	(204)	(367)	(287)
Unrecognized tax benefit	(134)	(162)	(123)
Non-deductible meals, entertainment and memberships	86	85	64
Change in statutory rate	—	—	5,965
Other, net	55	32	40
Income tax expense	<u>\$ 11,325</u>	<u>\$ 9,294</u>	<u>\$ 17,963</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 follow:

	<u>2019</u>	<u>2018</u>
	(In thousands)	
<b>Deferred tax assets</b>		
Allowance for loan losses	\$ 5,355	\$ 5,052
Lease liabilities	1,744	—
Property and equipment	1,528	1,569
Share-based compensation	808	900
Unrealized loss on derivative financial instruments	459	33
Reserve for unfunded lending commitments	324	272
Deferred compensation	285	253
Loss reimbursement on sold loans reserve	185	165
Non accrual loan interest income	173	179
Other than temporary impairment charge on securities available for sale	147	187
Vehicle service contract counterparty contingency reserve	38	70
Alternative minimum tax credit carry forward	—	1,686
Unrealized loss on securities available for sale	—	1,113
Unrealized loss on equity securities	—	295
Purchase premiums, net	—	71
Other	—	161
Gross deferred tax assets	<u>11,046</u>	<u>12,006</u>
<b>Deferred tax liabilities</b>		
Capitalized mortgage loan servicing rights	4,026	4,494
Deferred loan fees	1,852	1,706
Lease right of use asset	1,739	—
Unrealized gain on securities available for sale	994	—
Purchase premiums, net	293	—
Federal Home Loan Bank stock	27	27
Other	43	—
Gross deferred tax liabilities	<u>8,974</u>	<u>6,227</u>
Deferred tax assets, net	<u>\$ 2,072</u>	<u>\$ 5,779</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

We assess whether a valuation allowance should be established against our deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. The ultimate realization of this asset is primarily based on generating future income. We concluded at both December 31, 2019 and 2018, that the realization of substantially all of our deferred tax assets continues to be more likely than not.

Changes in unrecognized tax benefits for the years ended December 31 follow:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Balance at beginning of year	\$ 588	\$ 724	\$ 840
Additions based on tax positions related to the current year	20	26	7
Reductions due to the statute of limitations	(170)	(162)	(123)
Reductions due to settlements	—	—	—
Balance at end of year	<u>\$ 438</u>	<u>\$ 588</u>	<u>\$ 724</u>

If recognized, the entire amount of unrecognized tax benefits, net of \$0.1 million of 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 in the next twelve months. No amounts were expensed for interest and penalties for the years ended December 31, 2019, 2018 and 2017. No amounts were accrued for interest and penalties at December 31, 2019, 2018 and 2017. At December 31, 2019, U.S. Federal tax years 2016 through the present remain open to examination.

**NOTE 14 – SHARE BASED COMPENSATION AND BENEFIT PLANS**

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.5 million shares of common stock as of December 31, 2019. 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 December 31, 2019. 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 2019, 2018 and 2017 pursuant to our long-term incentive plan, we granted 0.06 million, 0.05 million and 0.05 million shares, respectively of restricted stock and 0.02 million, 0.02 million and 0.02 million performance stock units (“PSUs”), respectively to certain officers. Except for 0.010 million shares and 0.002 million shares of restricted stock issued in 2019 and 2018, respectively that vest ratably over three years, all shares of restricted stock and PSUs cliff vest after a period of three years. The performance feature of the PSUs is based on a comparison of our total shareholder return over the vesting period starting on the grant date to the total shareholder return over that period for a banking index of our peers. We have not issued stock options since 2013, other than in connection with the Merger (see note #26).

Our directors may elect to receive at least a portion of their quarterly cash retainer fees in the form of common stock (either on a current basis or on a deferred basis) pursuant to the non-employee director stock purchase plan referenced above. Shares equal in value to that portion of each director’s fees that he or she has elected to receive in stock on a current basis are issued each quarter and vest immediately. Shares issued on a deferred basis are credited at the rate of 90% of the current value and vest immediately. We issued 0.01 million shares to directors during each of the years ending 2019, 2018 and 2017 and expensed their value during those same periods.

Total compensation expense recognized for grants pursuant to our long-term incentive plan was \$1.6 million, \$1.5 million and \$1.6 million in 2019, 2018 and 2017, respectively. The corresponding tax benefit relating to this expense was \$0.3 million, \$0.3 million and \$0.6 million in 2019, 2018 and 2017, respectively. Total expense recognized for non-employee director share based payments was \$0.3 million, \$0.2 million and \$0.2 million in 2019, 2018 and 2017, respectively. The corresponding tax benefit relating to this expense was \$0.05 million, \$0.04 million and \$0.06 million in 2019, 2018 and 2017, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

At December 31, 2019, the total expected compensation cost related to non-vested restricted stock and PSUs not yet recognized was \$2.1 million. The weighted-average period over which this amount will be recognized is 1.8 years.

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

	Number of Shares	Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregated Intrinsic Value  (In thousands)
Outstanding at January 1, 2019	211,421	\$ 6.48		
Granted	—			
Exercised	(71,799)	9.84		
Forfeited	—			
Expired	(1,116)	22.35		
Outstanding at December 31, 2019	<u>138,506</u>	<u>\$ 4.62</u>	<u>3.01</u>	<u>\$ 2,498</u>
Vested and expected to vest at December 31, 2019	<u>138,506</u>	<u>\$ 4.62</u>	<u>3.01</u>	<u>\$ 2,498</u>
Exercisable at December 31, 2019	<u>138,506</u>	<u>\$ 4.62</u>	<u>3.01</u>	<u>\$ 2,498</u>

A summary of outstanding non-vested stock and related transactions follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2019	258,419	\$ 19.00
Granted	86,283	22.87
Vested	(85,978)	14.57
Forfeited	(12,998)	22.85
Outstanding at December 31, 2019	<u>245,726</u>	<u>\$ 21.72</u>

Certain information regarding options exercised during the periods ending December 31 follows:

	2019	2018	2017
	(In thousands)		
Intrinsic value	\$ 897	\$ 2,333	\$ 623
Cash proceeds received	\$ 706	\$ 1,420	\$ 142
Tax benefit realized	\$ 188	\$ 490	\$ 218

We maintain 401(k) and employee stock ownership plans covering substantially all of our full-time employees. During 2019, 2018 and 2017, we matched 50% of employee contributions to the 401(k) plan up to a maximum of 8%, 8% and 6% of participating employees' eligible wages, respectively. Contributions to the employee stock ownership plan are determined annually and require approval of our Board of Directors. The maximum contribution is 6% of employees' eligible wages. Contributions to the employee stock ownership plan were 2% for 2019, 2018 and 2017. Amounts expensed for these retirement plans were \$2.6 million, \$2.3 million and \$1.6 million in 2019, 2018 and 2017, respectively.

Our employees participate in various performance-based compensation plans. Amounts expensed for all incentive plans totaled \$9.5 million, \$9.8 million and \$8.0 million in 2019, 2018 and 2017, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

We also provide certain health care and life insurance programs to substantially all full-time employees. Amounts expended for these programs totaled \$5.7 million, \$5.2 million and \$4.0 million in 2019, 2018 and 2017 respectively. These insurance programs are also available to retired employees at their own expense.

**NOTE 15 – OTHER NON-INTEREST INCOME**

Other non-interest income for the years ended December 31 follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In thousands)		
Investment and insurance commissions	\$ 1,658	\$ 1,971	\$ 1,968
ATM fees	1,403	1,457	1,446
Bank owned life insurance	1,111	970	1,061
Other	5,110	4,362	3,693
Total other non-interest income	<u>\$ 9,282</u>	<u>\$ 8,760</u>	<u>\$ 8,168</u>

**NOTE 16 – DERIVATIVE FINANCIAL INSTRUMENTS**

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

Our derivative financial instruments according to the type of hedge in which they are designated at December 31 follow:

	<u>2019</u>		
	<u>Notional Amount</u>	<u>Average Maturity (years)</u>	<u>Fair Value</u>
	(Dollars in thousands)		
Fair value hedge designation - Pay-fixed interest rate swap agreements	<u>\$ 7,117</u>	9.4	<u>\$ (242)</u>
Cash flow hedge designation			
Pay-fixed interest rate swap agreements	\$ 25,000	1.6	\$ (174)
Interest rate cap agreements	150,000	2.6	214
Total	<u>\$ 175,000</u>	2.5	<u>\$ 40</u>
No hedge designation			
Rate-lock mortgage loan commitments	\$ 49,268	0.1	\$ 1,412
Mandatory commitments to sell mortgage loans	95,363	0.1	(150)
Pay-fixed interest rate swap agreements - commercial	153,946	5.5	(3,641)
Pay-variable interest rate swap agreements - commercial	153,946	5.5	3,641
Purchased options	2,908	1.5	141
Written options	2,848	1.5	(139)
Total	<u>\$ 458,279</u>	3.7	<u>\$ 1,264</u>

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	2018		
	Notional Amount	Average Maturity (years)	Fair Value
(Dollars in thousands)			
<b>Cash flow hedge designation</b>			
Pay-fixed interest rate swap agreements	\$ 25,000	2.6	\$ 280
Interest rate cap agreements	150,000	3.6	2,245
Total	<u>\$ 175,000</u>	3.5	<u>\$ 2,525</u>
<b>No hedge designation</b>			
Rate-lock mortgage loan commitments	\$ 32,473	0.1	\$ 687
Mandatory commitments to sell mortgage loans	57,583	0.1	(383)
Pay-fixed interest rate swap agreements - commercial	94,451	5.5	405
Pay-variable interest rate swap agreements - commercial	94,451	5.5	(405)
Purchased options	3,095	2.5	116
Written options	3,095	2.5	(116)
Total	<u>\$ 285,148</u>	3.7	<u>\$ 304</u>

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.

To meet our asset/liability management 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 included certain pay-fixed interest rate swaps and interest rate cap agreements. 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 \$2.2 million and \$2.7 million at December 31, 2019 and 2018, respectively.

It is anticipated that \$0.05 million, net of tax, of unrealized losses on Cash Flow Hedges at December 31, 2019, will be reclassified into earnings over the next twelve months. The maximum term of any Cash Flow Hedge at December 31, 2019 is 3.8 years.

Beginning in the second quarter of 2019 we entered into a pay-fixed interest rate swap to protect a portion of the fair value of a certain fixed rate commercial loan commitment (“Fair Value Hedge”). As a result, changes in the fair value of the pay-fixed interest rate swap is expected to offset changes in the fair value of the fixed rate commercial loan commitment due to fluctuations in interest rates. We record the fair value of Fair Value Hedges in accrued income and other assets and accrued expenses and other liabilities on our Consolidated Statements of Financial Condition. The hedged item (fixed rate commercial loan commitment) is also recorded at fair value which offsets the adjustment to the Fair Value Hedge. On an ongoing basis, we adjust our Consolidated Statements of Financial Condition to reflect the then current fair value of both the Fair Value Hedge and the hedged item. The related gains or losses are reported in non-interest income – other in our Consolidated Statements of Operations.

Certain derivative financial instruments have not been designated as hedges. The fair value of these derivative financial instruments has been recorded on our 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

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

commitments to sell mortgage loans (“Mandatory Commitments”) to reduce the impact of price fluctuations of mortgage loans held for sale and Rate-Lock Commitments. Mandatory Commitments help protect our loan sale profit margin from fluctuations in interest rates. The changes in the fair value of Rate Lock Commitments and Mandatory Commitments are recognized currently as part of net gains on mortgage loans in the Consolidated Statements of Operations. We obtain market prices on Mandatory Commitments and Rate-Lock Commitments. Net gains on mortgage loans, as well as net income, may be more volatile as a result of these derivative instruments, which are not designated as hedges.

In prior periods we offered to our deposit customers an equity linked time deposit product (“Altitude CD”). The Altitude CD was a time deposit that provided the customer a guaranteed return of principal at maturity plus a potential equity return (a written option), while we receive a like stream of funds based on the equity return (a purchased option). The written and purchased options will generally move in opposite directions resulting in little or no net impact on our Consolidated Statements of Operations. All of the written and purchased options in the table above relate to this Altitude CD product.

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

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

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	December 31,				December 31,			
	2019		2018		2019		2018	
	Balance Sheet Location	Fair Value						
(In thousands)								
Derivatives designated as hedging instruments								
Pay-fixed interest rate swap agreements	Other assets	\$ —	Other assets	\$ 280	Other liabilities	\$ 416	Other liabilities	\$ —
Interest rate cap agreements	Other assets	214	Other assets	2,245	Other liabilities	—	Other liabilities	—
		<u>214</u>		<u>2,525</u>		<u>416</u>		<u>—</u>
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	1,412	Other assets	687	Other liabilities	—	Other liabilities	—
Mandatory commitments to sell mortgage loans	Other assets	—	Other assets	—	Other liabilities	150	Other liabilities	383
Pay-fixed interest rate swap agreements - commercial	Other assets	28	Other assets	1,116	Other liabilities	3,669	Other liabilities	711
Pay-variable interest rate swap agreements - commercial	Other assets	3,669	Other assets	711	Other liabilities	28	Other liabilities	1,116
Purchased options	Other assets	141	Other assets	116	Other liabilities	—	Other liabilities	—
Written options	Other assets	—	Other assets	—	Other liabilities	139	Other liabilities	116
		<u>5,250</u>		<u>2,630</u>		<u>3,986</u>		<u>2,326</u>
Total derivatives		<u>\$ 5,464</u>		<u>\$ 5,155</u>		<u>\$ 4,402</u>		<u>\$ 2,326</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

	Year Ended December 31,										
	Gain (loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)			Location Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss 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)		
	2019	2018	2017		2019	2018	2017		2019	2018	2017
	(In thousands)										
<b>Fair Value Hedges</b>											
Pay-fixed interest rate swap agreements								Non-interest income- other	\$ (242)	\$ —	\$ —
<b>Cash Flow Hedges</b>											
Interest rate cap agreements	\$(1,211)	\$(340)	\$ 108	Interest expense	\$ 363	\$ 206	\$ —	Interest expense	\$ —	\$ —	\$ —
Pay-fixed interest rate swap agreements	(392)	78	216	Interest expense	62	31	(18)	Interest expense	—	(12)	(12)
Total	<u>\$(1,603)</u>	<u>\$(262)</u>	<u>\$ 324</u>		<u>\$ 425</u>	<u>\$ 237</u>	<u>\$ (18)</u>		<u>\$ —</u>	<u>\$ (12)</u>	<u>\$ (12)</u>
<b>No hedge designation</b>											
Rate-lock mortgage loan commitments								Net gains on mortgage loans	\$ 725	\$ 157	\$(116)
Mandatory commitments to sell mortgage loans								Net gains on mortgage loans	233	(420)	(593)
Pay-fixed interest rate swap agreements - commercial								Interest income	(4,046)	113	43
Pay-variable interest rate swap agreements -commercial								Interest income	4,046	(113)	(43)
Purchased options								Interest expense	25	(206)	84
Written options								Interest expense	(23)	206	(84)
Total									<u>\$ 960</u>	<u>\$(263)</u>	<u>\$(709)</u>

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

**NOTE 17 – RELATED PARTY TRANSACTIONS**

Certain of our directors and executive officers, including companies in which they are officers or have significant ownership, were loan and deposit customers during 2019 and 2018.

A summary of loans to our directors and executive officers (which includes loans to entities in which the individual owns a 10% or more voting interest) for the years ended December 31 follows:

	2019	2018
	(In thousands)	
Balance at beginning of year	\$ 14,205	\$ 2,621
New loans and advances	713	13,572
Repayments	(1,841)	(1,988)
Balance at end of year	<u>\$ 13,077</u>	<u>\$ 14,205</u>

Deposits held by us for directors and executive officers totaled \$2.0 million and \$1.5 million at December 31, 2019 and 2018, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**NOTE 18 – LEASES**

We have entered into leases in the normal course of business primarily for office facilities, some of which include renewal options and escalation clauses. Certain leases also include both lease components (fixed payments including rent, taxes and insurance costs) and non-lease components (common area or other maintenance costs) which are accounted for as a single lease component as we have elected the practical expedient to group lease and non-lease components together for all leases. We have also elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on our Consolidated Statements of Financial Condition. Most of our leases include one or more options to renew. The exercise of lease renewal options is typically at our sole discretion and are included in our ROU assets and lease liabilities if they are reasonably certain of exercise.

Leases are classified as operating or finance leases at the lease commencement date (we did not have any finance leases as of December 31, 2019). Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. The ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of the lease payment over the lease term.

As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments.

The cost components of our operating leases follows:

	<u>2019</u>
	<u>(In thousands)</u>
Operating lease cost	\$ 2,217
Variable lease cost	142
Short-term lease cost	<u>19</u>
Total	<u>\$ 2,378</u>

Variable lease costs consist primarily of taxes, insurance, and common area or other maintenance costs for our leased facilities.

Supplemental balance sheet information related to our operating leases follows:

	<u>2019</u>
	<u>(In thousands)</u>
Lease right of use asset(1)	<u>\$ 8,282</u>
Lease liabilities(2)	<u>\$ 8,304</u>
Weighted average remaining lease term (years)	<u>7.47</u>
Weighted average discount rate	<u>2.8%</u>

(1) Included in Accrued income and other assets in our Consolidated Statements of Financial Condition.

(2) Included in Accrued expenses and other liabilities in our Consolidated Statements of Financial Condition.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Maturity analysis of our lease liabilities at December 31, 2019 based on required contractual payments follows:

	<u>(In thousands)</u>
2020	\$ 1,681
2021	1,418
2022	1,322
2023	1,186
2024	802
2025 and thereafter	2,792
Total lease payments	9,201
Less imputed interest	(897)
Total	<u>\$ 8,304</u>

**NOTE 19 – CONCENTRATIONS OF CREDIT RISK**

Credit risk is the risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with our organization or otherwise fail to perform as agreed. Credit risk can occur outside of our traditional lending activities and can exist in any activity where success depends on counterparty, issuer or borrower performance. Concentrations of credit risk (whether on- or off-balance sheet) arising from financial instruments can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries or certain geographic regions. Credit risk associated with these concentrations could arise when a significant amount of loans or other financial instruments, related by similar characteristics, are simultaneously impacted by changes in economic or other conditions that cause their probability of repayment or other type of settlement to be adversely affected. Our major concentrations of credit risk arise by collateral type and by industry. The significant concentrations by collateral type at December 31, 2019, include \$1.010 billion of loans secured by residential real estate and \$249.7 million of construction and development loans.

Additionally, within our commercial real estate and commercial loan portfolio, we had significant standard industry classification concentrations in the following categories as of December 31, 2019: Lessors of Nonresidential Real Estate (\$379.9 million); Lessors of Residential Real Estate (\$142.0 million); Construction (\$97.3 million); Accommodation and Food Services (\$76.6 million); Manufacturing (\$74.6 million) and Health Care and Social Assistance (\$58.9 million). A geographic concentration arises because we primarily conduct our lending activities in the State of Michigan.

**NOTE 20 – REGULATORY MATTERS**

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank's current year net profits, combined with the retained net profits of the preceding two years. Further, the Bank cannot pay a dividend at any time that it has negative undivided profits. As of December 31, 2019, the Bank had positive undivided profits of \$44.7 million. It is not our intent to have dividends paid in amounts that would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

We are also subject to various regulatory capital requirements. The prompt corrective action regulations establish quantitative measures to ensure capital adequacy and require minimum amounts and ratios of total, Tier 1, and common equity Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can result in certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. In addition, capital adequacy rules include a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets that applies to all supervised financial institutions. To avoid limits on capital distributions and certain discretionary bonus payments we must meet the minimum ratio for adequately capitalized institutions plus the buffer. 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 December 31, 2019 and 2018, 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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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Our actual capital amounts and ratios at December 31 follow<sup>(1)</sup>:

	Actual		Minimum for Adequately Capitalized Institutions		Minimum for Well-Capitalized Institutions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
<b>2019</b>						
Total capital to risk-weighted assets						
Consolidated	\$ 380,454	13.74%	\$ 221,562	8.00%	NA	NA
Independent Bank	358,914	12.96	221,482	8.00	\$ 276,852	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 352,764	12.74%	\$ 166,171	6.00%	NA	NA
Independent Bank	331,224	11.96	166,111	6.00	\$ 221,482	8.00%
Common equity tier 1 capital to risk-weighted assets						
Consolidated	\$ 314,532	11.36%	\$ 124,628	4.50%	NA	NA
Independent Bank	331,224	11.96	124,583	4.50	\$ 179,954	6.50%
Tier 1 capital to average assets						
Consolidated	\$ 352,764	10.11%	\$ 139,632	4.00%	NA	NA
Independent Bank	331,224	9.49	139,615	4.00	\$ 174,519	5.00%
<b>2018</b>						
Total capital to risk-weighted assets						
Consolidated	\$ 371,603	14.25%	\$ 208,572	8.00%	NA	NA
Independent Bank	337,227	12.94	208,456	8.00	\$ 260,569	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 345,419	13.25%	\$ 156,429	6.00%	NA	NA
Independent Bank	311,043	11.94	156,342	6.00	\$ 208,456	8.00%
Common equity tier 1 capital to risk-weighted assets						
Consolidated	\$ 307,255	11.79%	\$ 117,322	4.50%	NA	NA
Independent Bank	311,043	11.94	117,256	4.50	\$ 169,370	6.50%
Tier 1 capital to average assets						
Consolidated	\$ 345,419	10.47%	\$ 131,930	4.00%	NA	NA
Independent Bank	311,043	9.44	131,778	4.00	\$ 164,723	5.00%

(1) These ratios do not reflect a capital conservation buffer of 2.50% and 1.875% at December 31, 2019 and 2018, respectively.

NA - Not applicable

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	December 31,		December 31,	
	2019	2018	2019	2018
	(In thousands)			
Total shareholders' equity	\$ 350,169	\$ 338,994	\$ 366,861	\$ 341,496
Add (deduct)				
Accumulated other comprehensive loss for regulatory purposes	(2,011)	4,311	(2,011)	4,311
Goodwill and other intangibles	(33,626)	(34,715)	(33,626)	(34,715)
Disallowed deferred tax assets	—	(1,335)	—	(49)
Common equity tier 1 capital	314,532	307,255	331,224	311,043
Qualifying trust preferred securities	38,232	38,164	—	—
Disallowed deferred tax assets	—	—	—	—
Tier 1 capital	352,764	345,419	331,224	311,043
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	27,690	26,184	27,690	26,184
Total risk-based capital	\$ 380,454	\$ 371,603	\$ 358,914	\$ 337,227

**NOTE 21 – FAIR VALUE DISCLOSURES**

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

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

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

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

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

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

*Securities:* Where quoted market prices are available in an active market, securities (equity securities at fair value or available for sale) are classified as Level 1 of the valuation hierarchy. Level 1 securities include certain preferred stocks included in our equity securities at fair value for which there are quoted prices in active markets (at December 31, 2018). If quoted market prices are not available for the specific security, then fair values are estimated by (1) using quoted market prices of securities with similar characteristics, (2) matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted prices, or (3) a discounted cash flow analysis whose significant fair value inputs can generally be verified and do not typically involve judgment by management. These securities are classified as Level 2 of the valuation hierarchy and

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

primarily include agency securities, private label mortgage-backed securities, other asset backed securities, obligations of states and political subdivisions, trust preferred securities, corporate securities and foreign government securities.

*Loans held for sale:* The fair value of mortgage loans held for sale, carried at fair value is based on agency cash window loan pricing for comparable assets (recurring Level 2) and the fair value of mortgage loans held for sale, carried at the lower of cost or fair value is based on a quoted sales price (non-recurring Level 1).

*Impaired loans with specific loss allocations based on collateral value:* From time to time, certain loans are considered impaired and an AFLL is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. We measure our investment in an impaired loan based on one of three methods: the loan's observable market price, the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2019 and 2018, all of our total impaired loans were evaluated based on either the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. When the fair value of the collateral is based on an appraised value we record the impaired loan as nonrecurring Level 3. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and thus will typically result in a Level 3 classification of the inputs for determining fair value.

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

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

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

*Derivatives:* The fair value of rate-lock mortgage loan commitments is based on agency cash window loan pricing for comparable assets and the fair value of mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets (recurring Level 2). The fair value of interest rate swap and interest rate cap agreements are derived from proprietary models which utilize current market data. The significant

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

fair value inputs can generally be observed in the market place and do not typically involve judgment by management (recurring Level 2). The fair value of purchased and written options is based on prices of financial instruments with similar characteristics and do not typically involve judgment by management (recurring Level 2).

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

	Fair Value Measurements	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
(In thousands)				
December 31, 2019:				
Measured at Fair Value on a Recurring Basis				
Assets				
Securities available for sale				
U.S. agency	\$ 14,661	\$ —	\$ 14,661	\$ —
U.S. agency residential mortgage-backed	227,762	—	227,762	—
U.S. agency commercial mortgage-backed	10,756	—	10,756	—
Private label mortgage-backed	39,693	—	39,693	—
Other asset backed	93,886	—	93,886	—
Obligations of states and political subdivisions	96,102	—	96,102	—
Corporate	33,195	—	33,195	—
Trust preferred	1,843	—	1,843	—
Foreign government	502	—	502	—
Loans held for sale, carried at fair value	69,800	—	69,800	—
Capitalized mortgage loan servicing rights	19,171	—	—	19,171
Derivatives <sup>(1)</sup>	5,464	—	5,464	—
Liabilities				
Derivatives <sup>(2)</sup>	4,402	—	4,402	—
Measured at Fair Value on a Non-recurring Basis:				
Assets				
Impaired loans <sup>(3)</sup>				
Commercial				
Commercial and industrial	655	—	—	655
Commercial real estate	316	—	—	316
Mortgage				
1-4 family owner occupied - jumbo	987	—	—	987
1-4 family owner occupied - non-jumbo	470	—	—	470
1-4 family non-owner occupied	281	—	—	281
1-4 family - 2nd lien	294	—	—	294
Resort lending	245	—	—	245
Installment				
Boat lending	67	—	—	67
Recreational vehicle lending	2	—	—	2
Other	121	—	—	121
Other real estate <sup>(4)</sup>				
Mortgage - 1-4 family owner occupied - non-jumbo	31	—	—	31
Installment - other	28	—	—	28

(1) Included in accrued income and other assets in the Consolidated Statements of Financial Condition.

(2) Included in accrued expenses and other liabilities in the Consolidated Statements of Financial Condition.

(3) Only includes impaired loans with specific loss allocations based on collateral value.

(4) Only includes other real estate with subsequent write downs to fair value.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Fair Value Measurements Using			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
(In thousands)				
December 31, 2018:				
Measured at Fair Value on a Recurring Basis				
Assets				
Equity securities at fair value	\$ 393	\$ 393	\$ —	\$ —
Securities available for sale				
U.S. agency	20,014	—	20,014	—
U.S. agency residential mortgage-backed	123,751	—	123,751	—
U.S. agency commercial mortgage-backed	5,726	—	5,726	—
Private label mortgage-backed	29,419	—	29,419	—
Other asset backed	83,319	—	83,319	—
Obligations of states and political subdivisions	127,555	—	127,555	—
Corporate	34,309	—	34,309	—
Trust preferred	1,819	—	1,819	—
Foreign government	2,014	—	2,014	—
Loans held for sale, carried at fair value	44,753	—	44,753	—
Capitalized mortgage loan servicing rights	21,400	—	—	21,400
Derivatives <sup>(1)</sup>	5,155	—	5,155	—
Liabilities				
Derivatives <sup>(2)</sup>	2,326	—	2,326	—
Measured at Fair Value on a Non-recurring Basis:				
Assets				
Loans held for sale, carried at the lower of cost or fair value	41,471	41,471	—	—
Impaired loans <sup>(3)</sup>				
Commercial				
Commercial and industrial	2,243	—	—	2,243
Commercial real estate	323	—	—	323
Mortgage				
1-4 family owner occupied - non-jumbo	316	—	—	316
1-4 family non-owner occupied	17	—	—	17
Resort lending	572	—	—	572
Other real estate <sup>(4)</sup>				
Mortgage				
1-4 family owner occupied - non-jumbo	95	—	—	95
1-4 family - 2nd lien	59	—	—	59

(1) Included in accrued income and other assets in the Consolidated Statements of Financial Condition.

(2) Included in accrued expenses and other liabilities in the Consolidated Statements of Financial Condition.

(3) Only includes impaired loans with specific loss allocations based on collateral value.

(4) Only includes other real estate with subsequent write downs to fair value.

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2019 and 2018.

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Changes in fair values of financial assets for which we have elected the fair value option for the years ended December 31 were as follows:

	Net Gains (Losses) on Assets		Mortgage Loan Servicing, net	Total Change in Fair Values Included in Current Period Earnings
	Securities	Mortgage Loans		
(In thousands)				
<b>2019</b>				
Equity securities at fair value	\$ 167	\$ —	\$ —	\$ 167
Loans held for sale	—	637	—	637
Capitalized mortgage loan servicing rights	—	—	(9,532)	(9,532)
<b>2018</b>				
Trading securities	\$ (62)	\$ —	\$ —	\$ (62)
Loans held for sale	—	413	—	413
Capitalized mortgage loan servicing rights	—	—	(2,323)	(2,323)
<b>2017</b>				
Trading securities	\$ 45	\$ —	\$ —	\$ 45
Loans held for sale	—	407	—	407
Capitalized mortgage loan servicing rights	—	—	(2,744)	(2,744)

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

The following represent impairment charges recognized during the years ended December 31, 2019, 2018 and 2017 relating to assets measured at fair value on a non-recurring basis:

- Loans which are measured for impairment using the fair value of collateral for collateral dependent loans had a carrying amount of \$3.4 million, which is net of a valuation allowance of \$1.5 million at December 31, 2019, and had a carrying amount of \$3.5 million, which is net of a valuation allowance of \$1.5 million at December 31, 2018. An additional provision for loan losses relating to these impaired loans of \$1.3 million, \$1.3 million and \$0.5 million was included in our results of operations for the years ending December 31, 2019, 2018 and 2017, respectively.
- Other real estate, which is measured using the fair value of the property, had a carrying amount of \$0.06 million which is net of a valuation allowance of \$0.09 million at December 31, 2019, and a carrying amount of \$0.15 million which is net of a valuation allowance of \$0.14 million, at December 31, 2018. An additional charge relating to other real estate measured at fair value of \$0.03 million, \$0.09 million and \$0.08 million was included in our results of operations during the years ended December 31, 2019, 2018 and 2017, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

A reconciliation for all assets and (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31 follows:

	<b>Capitalized Mortgage Loan Servicing Rights</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(In thousands)</b>		
Beginning balance	\$ 21,400	\$ 15,699	\$ —
Change in accounting	—	—	14,213
Beginning balance, as adjusted	21,400	15,699	14,213
Total losses realized and unrealized:			
Included in results of operations	(9,532)	(2,323)	(2,744)
Included in other comprehensive income (loss)	—	—	—
Purchases, issuances, settlements, maturities and calls	7,303	8,024	4,230
Transfers in and/or out of Level 3	—	—	—
Ending balance	<u>\$ 19,171</u>	<u>\$ 21,400</u>	<u>\$ 15,699</u>

Amount of total losses for the period included in earnings attributable to the change in unrealized losses relating to assets and liabilities still held at December 31	<u>\$ (9,532)</u>	<u>\$ (2,323)</u>	<u>\$ (2,744)</u>
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The fair value of our capitalized mortgage loan servicing rights has been determined based on a valuation model used by an independent third party as discussed above. The significant unobservable inputs used in the fair value measurement of the capitalized mortgage loan servicing rights are discount rate, cost to service, ancillary income, float rate and prepayment rate. Significant changes in all five of these assumptions in isolation would result in significant changes to the value of our capitalized mortgage loan servicing rights. Quantitative information about our Level 3 fair value measurements measured on a recurring basis follows:

	<b>Asset Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Range</b>	<b>Weighted Average</b>
	<b>(In thousands)</b>				
<b>2019</b>					
Capitalized mortgage loan servicing rights	\$19,171	Present value of net servicing revenue	Discount rate	10.00% to 13.00%	10.14%
			Cost to service	\$66 to \$316	\$81
			Ancillary income	20 to 37	22
			Float rate	1.73%	1.73%
			Prepayment rate	7.01% to 69.34%	14.96
<b>2018</b>					
Capitalized mortgage loan servicing rights	\$21,400	Present value of net servicing revenue	Discount rate	10.00% to 13.00%	10.15%
			Cost to service	\$68 to \$216	\$81
			Ancillary income	20 to 36	23
			Float rate	2.57%	2.57%
			Prepayment rate	6.68% to 78.78%	10.54

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

	<u>Asset Fair Value</u>		<u>Valuation Technique</u>	<u>Unobservable Inputs</u>	<u>Range</u>	<u>Weighted Average</u>
	(In thousands)					
<b>2019</b>						
Impaired loans						
Commercial	\$ 971		Sales comparison approach	Adjustment for differences between comparable sales	(48.0)% to 19.2%	(5.6)%
Mortgage and Installment <sup>(1)</sup>	2,467		Sales comparison approach	Adjustment for differences between comparable sales	(25.2) to 49.2	11.5
Other real estate						
Mortgage and Installment	59		Sales comparison approach	Adjustment for differences between comparable sales	(11.6) to 5.0	(5.1)
<b>2018</b>						
Impaired loans						
Commercial <sup>(2)</sup>	\$ 2,566		Sales comparison approach	Adjustment for differences between comparable sales	(32.5)% to 60.0%	(1.9)%
Mortgage	905		Sales comparison approach	Adjustment for differences between comparable sales	(40.1) to 25.6	0.7
Other real estate						
Mortgage	154		Sales comparison approach	Adjustment for differences between comparable sales	0.0 to 34.1	11.2

(1) In addition to the valuation techniques and unobservable inputs discussed above, at December 31, 2019 certain impaired collateral dependent installment loans totaling approximately \$0.14 million are secured by collateral other than real estate. For the majority of these loans, we apply internal discount rates to industry valuation guides.

(2) In addition to the valuation techniques and unobservable inputs discussed above, at December 31, 2018, we had an impaired collateral dependent commercial relationship that totaled \$0.7 million that was secured by collateral other than real estate. Collateral securing this relationship primarily included accounts receivable, inventory and cash at December 31, 2018. Valuation techniques at December 31, 2018, included discounting financial statement values for each particular asset type. Discount rates used ranged from 20% to 80% of stated values at December 31, 2018.

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding for loans held for sale for which the fair value option has been elected at December 31:

	<u>Aggregate Fair Value</u>	<u>Difference</u>	<u>Contractual Principal</u>
	(In thousands)		
<b>Loans held for sale</b>			
2019	\$ 69,800	\$ 1,894	\$ 67,906
2018	44,753	1,257	43,496
2017	39,436	844	38,592

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 22 – FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

The estimated recorded book balances and fair values at December 31 follow:

	Recorded Book Balance	Fair Value	Fair Value Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un- observable Inputs (Level 3)
(In thousands)					
2019					
Assets					
Cash and due from banks	\$ 53,295	\$ 53,295	\$ 53,295	\$ —	\$ —
Interest bearing deposits	12,009	12,009	12,009	—	—
Interest bearing deposits - time	350	350	—	350	—
Securities available for sale	518,400	518,400	—	518,400	—
Federal Home Loan Bank and Federal Reserve Bank Stock	18,359	NA	NA	NA	NA
Net loans and loans held for sale	2,768,675	2,768,817	—	69,800	2,699,017
Accrued interest receivable	10,108	10,108	8	1,752	8,348
Derivative financial instruments	5,464	5,464	—	5,464	—
Liabilities					
Deposits with no stated maturity <sup>(1)</sup>	\$ 2,427,190	\$ 2,427,190	\$ 2,427,190	\$ —	\$ —
Deposits with stated maturity <sup>(1)</sup>	609,537	610,235	—	610,235	—
Other borrowings	88,646	88,680	—	88,680	—
Subordinated debentures	39,456	33,149	—	33,149	—
Accrued interest payable	1,296	1,296	97	1,199	—
Derivative financial instruments	4,402	4,402	—	4,402	—
2018					
Assets					
Cash and due from banks	\$ 23,350	\$ 23,350	\$ 23,350	\$ —	\$ —
Interest bearing deposits	46,894	46,894	46,894	—	—
Interest bearing deposits - time	595	594	—	594	—
Equity securities at fair value	393	393	393	—	—
Securities available for sale	427,926	427,926	—	427,926	—
Federal Home Loan Bank and Federal Reserve Bank Stock	18,359	NA	NA	NA	NA
Net loans and loans held for sale	2,643,856	2,606,256	41,471	44,753	2,520,032
Accrued interest receivable	10,164	10,164	22	1,789	8,353
Derivative financial instruments	5,155	5,155	—	5,155	—
Liabilities					
Deposits with no stated maturity <sup>(1)</sup>	\$ 2,197,494	\$ 2,197,494	\$ 2,197,494	\$ —	\$ —
Deposits with stated maturity <sup>(1)</sup>	715,934	711,312	—	711,312	—
Other borrowings	25,700	25,706	—	25,706	—
Subordinated debentures	39,388	35,021	—	35,021	—
Accrued interest payable	1,646	1,646	114	1,532	—
Derivative financial instruments	2,326	2,326	—	2,326	—

NA – Not applicable

(1) Deposits with no stated maturity include reciprocal deposits with a recorded book balance of \$388.369 million and \$123.080 million at December 31, 2019 and 2018, respectively. Deposits with a stated maturity include reciprocal deposits with a recorded book balance of \$42.658 million and \$58.992 million at December 31, 2019 and 2018, respectively.



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

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

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

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

**NOTE 23 – ACCUMULATED OTHER COMPREHENSIVE LOSS**

A summary of changes in accumulated other comprehensive loss (“AOCL”), net of tax during the years ended December 31 follows:

	Unrealized Gains (Losses) on Securities Available for Sale	Dispropor- tionate Tax Effects from Securities Available for Sale	Unrealized Gains (Losses) on Cash Flow Hedges	Dispropor- tionate Tax Effects from Cash Flow Hedges	Total
<b>2019</b>					
Balances at beginning of period	\$ (4,185)	\$ (5,798)	\$ (125)	\$ —	\$ (10,108)
Other comprehensive income (loss) before reclassifications	8,035	—	(1,266)	—	6,769
Amounts reclassified from AOCL	(111)	—	(336)	—	(447)
Net current period other comprehensive income (loss)	7,924	—	(1,602)	—	6,322
Balances at end of period	<u>\$ 3,739</u>	<u>\$ (5,798)</u>	<u>\$ (1,727)</u>	<u>\$ —</u>	<u>\$ (3,786)</u>
<b>2018</b>					
Balances at beginning of period	\$ (470)	\$ (5,798)	\$ 269	\$ —	\$ (5,999)
Other comprehensive loss before reclassifications	(3,671)	—	(207)	—	(3,878)
Amounts reclassified from AOCL	(44)	—	(187)	—	(231)
Net current period other comprehensive loss	(3,715)	—	(394)	—	(4,109)
Balances at end of period	<u>\$ (4,185)</u>	<u>\$ (5,798)</u>	<u>\$ (125)</u>	<u>\$ —</u>	<u>\$ (10,108)</u>
<b>2017</b>					
Balances at beginning of period	\$ (3,310)	\$ (5,798)	\$ —	\$ —	\$ (9,108)
Cumulative effect of change in accounting	300	—	—	—	300
Balances at beginning of period, as adjusted	(3,010)	(5,798)	—	—	(8,808)
Other comprehensive income before reclassifications	2,763	—	210	—	2,973
Amounts reclassified from AOCL	(140)	—	12	—	(128)
Net current period other comprehensive income	2,623	—	222	—	2,845
Disproportionate tax effects due to change in tax rate	(83)	83	47	(47)	—
Reclassification of certain deferred tax effects <sup>(1)</sup>	—	(83)	—	47	(36)
Balances at end of period	<u>\$ (470)</u>	<u>\$ (5,798)</u>	<u>\$ 269</u>	<u>\$ —</u>	<u>\$ (5,999)</u>

(1) Amounts reclassified to accumulated deficit due to adoption of ASU 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” during the fourth quarter of 2017.

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

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other categories must offset the current loss from operations, the tax benefit of such offset being reflected in operations. Release of material disproportionate tax effects from other comprehensive income to earnings is done by the portfolio method whereby the effects will remain in AOCL as long as we carry a more than inconsequential portfolio of securities available for sale.

A summary of reclassifications out of each component of AOCL for the years ended December 31 follows:

AOCL Component	Reclassified From AOCL (In thousands)	Affected Line Item in Consolidated Statements of Operations
<b>2019</b>		
Unrealized gains (losses) on securities available for sale	\$ 140	Net gains on securities
	—	Net impairment loss recognized in earnings
	140	Total reclassifications before tax
	29	Income tax expense
	<u>\$ 111</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ (425)	Interest expense
	(89)	Income tax expense
	<u>\$ (336)</u>	Reclassification, net of tax
	<u>\$ 447</u>	Total reclassifications for the period, net of tax
<b>2018</b>		
Unrealized gains (losses) on securities available for sale	\$ 56	Net gains on securities
	—	Net impairment loss recognized in earnings
	56	Total reclassifications before tax
	12	Income tax expense
	<u>\$ 44</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ (237)	Interest expense
	(50)	Income tax expense
	<u>\$ (187)</u>	Reclassification, net of tax
	<u>\$ 231</u>	Total reclassifications for the period, net of tax
<b>2017</b>		
Unrealized gains (losses) on securities available for sale	\$ 215	Net gains on securities
	—	Net impairment loss recognized in earnings
	215	Total reclassifications before tax
	75	Income tax expense
	<u>\$ 140</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ 18	Interest expense
	6	Income tax expense
	<u>\$ 12</u>	Reclassification, net of tax
	<u>\$ 128</u>	Total reclassifications for the period, net of tax

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 24 – INDEPENDENT BANK CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION

Presented below are condensed financial statements for our parent company.

## CONDENSED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2019	2018
	(In thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 10,505	\$ 7,624
Interest bearing deposits - time	10,000	25,000
Investment in subsidiaries	369,861	343,872
Accrued income and other assets	463	2,857
Total Assets	<u>\$ 390,829</u>	<u>\$ 379,353</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Subordinated debentures	\$ 39,456	\$ 39,388
Accrued expenses and other liabilities	575	530
Shareholders' equity	350,798	339,435
Total Liabilities and Shareholders' Equity	<u>\$ 390,829</u>	<u>\$ 379,353</u>

## CONDENSED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2019	2018	2017
	(In thousands)		
<b>OPERATING INCOME</b>			
Dividends from subsidiary	\$ 29,000	\$ 33,500	\$ 16,000
Interest income	230	160	29
Other income	61	56	41
Total Operating Income	<u>29,291</u>	<u>33,716</u>	<u>16,070</u>
<b>OPERATING EXPENSES</b>			
Interest expense	2,104	1,924	1,347
Administrative and other expenses	655	748	714
Total Operating Expenses	<u>2,759</u>	<u>2,672</u>	<u>2,061</u>
Income Before Income Tax and Equity in Undistributed Net Income of Subsidiaries	26,532	31,044	14,009
Income tax expense (benefit)	(423)	(515)	1,587
Income Before Equity in Undistributed Net Income of Subsidiaries	26,955	31,559	12,422
Equity in undistributed net income of subsidiaries	19,480	8,280	8,053
Net Income	<u>\$ 46,435</u>	<u>\$ 39,839</u>	<u>\$ 20,475</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**CONDENSED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2019	2018	2017
	(In thousands)		
Net Income	\$ 46,435	\$ 39,839	\$ 20,475
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH FROM			
OPERATING ACTIVITIES			
Deferred income tax expense	1,503	6,620	2,146
Share based compensation	65	53	45
Accretion of discount on subordinated debentures	68	51	—
(Increase) decrease in accrued income and other assets	891	(1,307)	(32)
Increase in accrued expenses and other liabilities	45	21	121
Equity in undistributed net income of subsidiaries	(19,480)	(8,280)	(8,053)
Total Adjustments	(16,908)	(2,842)	(5,773)
Net Cash From Operating Activities	29,527	36,997	14,702
CASH FLOW FROM (USED IN) INVESTING ACTIVITIES			
Purchases of interest bearing deposits - time	(20,000)	(30,000)	(10,000)
Maturity of interest bearing deposits - time	35,000	10,000	10,000
Acquisition of business, less cash received	—	431	—
Net Cash From (Used In) Investing Activities	15,000	(19,569)	—
CASH FLOW USED IN FINANCING ACTIVITIES			
Dividends paid	(16,554)	(14,055)	(8,960)
Proceeds from issuance of common stock	2,074	1,945	1,776
Share based compensation withholding obligation	(882)	(1,467)	(579)
Repurchase of common stock	(26,284)	(12,681)	—
Net Cash Used in Financing Activities	(41,646)	(26,258)	(7,763)
Net Increase (Decrease) in Cash and Cash Equivalents	2,881	(8,830)	6,939
Cash and Cash Equivalents at Beginning of Year	7,624	16,454	9,515
Cash and Cash Equivalents at End of Year	\$ 10,505	\$ 7,624	\$ 16,454

**NOTE 25 – REVENUE FROM CONTRACTS WITH CUSTOMERS**

We account for revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers. We derive the majority of our revenue from financial instruments and their related contractual rights and obligations which for the most part are excluded from the scope of this topic. These sources of revenue that are excluded from the scope of this topic include interest income, net gains on mortgage loans, net gains on securities, mortgage loan servicing, net and bank owned life insurance and were approximately 84.9% and 82.9% of total revenues at December 31, 2019 and 2018, respectively.

Material sources of revenue that are included in the scope of ASC Topic 606 include service charges on deposits, other deposit related income, interchange income and investment and insurance commissions and are discussed in the following paragraphs. Generally these sources of revenue are earned at the time the service is delivered or over the course of a monthly period and do not result in any contract asset or liability balance at any given period end. As a result, there were no contract assets or liabilities recorded as of December 31, 2019.

*Service charges on deposit accounts and other deposit related income:* Revenues are earned on depository accounts for commercial and retail customers and include fees for transaction-based, account maintenance and overdraft services. Transaction-based fees, which includes services such as ATM use fees, stop payment charges and ACH fees are recognized at the time the transaction is executed as that is the time we fulfill our customer's request.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Account maintenance fees, which includes monthly maintenance services are earned over the course of a month representing the period over which the performance obligation is satisfied. Our obligation for overdraft services is satisfied at the time of the overdraft.

*Interchange income:* Interchange income primarily includes debit card interchange and network revenues. Debit card interchange and network revenues are earned on debit card transactions conducted through payment networks such as MasterCard and NYCE. Interchange income is recognized concurrently with the delivery of services on a daily basis. Interchange and network revenues are presented gross of interchange expenses, which are presented separately as a component of non-interest expense.

*Investment and insurance commissions:* Investment and insurance commissions include fees and commissions from asset management, custody, recordkeeping, investment advisory and other services provided to our customers. Revenue is recognized on an accrual basis at the time the services are performed and are generally based on either the market value of the assets managed or the services provided. We have an agent relationship with a third party provider of these services and net certain direct costs charged by the third party provider associated with providing these services to our customers.

*Net gains on other real estate and repossessed assets:* We record a gain or loss from the sale of other real estate when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. If we were to finance the sale of other real estate to the buyer, we would assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction is probable. Once these criteria are met, the other real estate asset would be derecognized and the gain or loss on sale would be recorded upon the transfer of control of the property to the buyer. There were no other real estate properties sold during 2019 that were financed by us.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Disaggregation of our revenue sources by attribute for the years ended December 31 follow:

2019

	<u>Service Charges on Deposit Accounts</u>	<u>Other Deposit Related Income</u>	<u>Interchange Income</u>	<u>Investment and Insurance Commissions</u>	<u>Total</u>
	(In thousands)				
<b>Retail</b>					
Overdraft fees	\$ 7,590	\$ —	\$ —	\$ —	\$ 7,590
Account service charges	2,103	—	—	—	2,103
ATM fees	—	1,368	—	—	1,368
Other	—	965	—	—	965
<b>Business</b>					
Overdraft fees	1,515	—	—	—	1,515
ATM fees	—	35	—	—	35
Other	—	422	—	—	422
Interchange income	—	—	10,297	—	10,297
Asset management revenue	—	—	—	1,123	1,123
Transaction based revenue	—	—	—	535	535
<b>Total</b>	<u>\$ 11,208</u>	<u>\$ 2,790</u>	<u>\$ 10,297</u>	<u>\$ 1,658</u>	<u>\$ 25,953</u>

**Reconciliation to Consolidated Statement of Operations:**

Non-interest income - other:	
Other deposit related income	\$ 2,790
Investment and insurance commissions	1,658
Bank owned life insurance	1,111
Other	3,723
<b>Total</b>	<u>\$ 9,282</u>

2018

	<u>Service Charges on Deposit Accounts</u>	<u>Other Deposit Related Income</u>	<u>Interchange Income</u>	<u>Investment and Insurance Commissions</u>	<u>Total</u>
	(In thousands)				
<b>Retail</b>					
Overdraft fees	\$ 8,285	\$ —	\$ —	\$ —	\$ 8,285
Account service charges	2,406	—	—	—	2,406
ATM fees	—	1,423	—	—	1,423
Other	—	941	—	—	941
<b>Business</b>					
Overdraft fees	1,567	—	—	—	1,567
ATM fees	—	34	—	—	34
Other	—	594	—	—	594
Interchange income	—	—	9,905	—	9,905
Asset management revenue	—	—	—	1,100	1,100
Transaction based revenue	—	—	—	871	871
<b>Total</b>	<u>\$ 12,258</u>	<u>\$ 2,992</u>	<u>\$ 9,905</u>	<u>\$ 1,971</u>	<u>\$ 27,126</u>

**Reconciliation to Consolidated Statement of Operations:**

Non-interest income - other:	
Other deposit related income	\$ 2,992
Investment and insurance commissions	1,971
Bank owned life insurance	970
Other	2,827
<b>Total</b>	<u>\$ 8,760</u>



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 26 – RECENT ACQUISITION

Effective April 1, 2018, we completed the acquisition of all of the issued and outstanding shares of common stock of TCSB through a merger of TCSB into Independent Bank Corporation (“IBCP”), with IBCP as the surviving corporation (the “Merger”). On that same date we also consolidated Traverse City State Bank, TCSB’s wholly-owned subsidiary bank, into Independent Bank (with Independent Bank as the surviving institution). Under the terms of the merger agreement each holder of TCSB common stock received 1.1166 shares of IBCP common stock plus cash in lieu of fractional shares totaling \$0.005 million. TCSB option holders had their options converted into IBCP stock options. As a result we issued 2.71 million shares of common stock and 0.19 million stock options with a fair value of approximately \$64.5 million to the shareholders and option holders of TCSB. The fair value of common stock and stock options issued as the consideration paid for TCSB was determined using the closing price of our common stock on the acquisition date. This acquisition was accounted for under the acquisition method of accounting. Accordingly, we recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values. TCSB results of operations are included in our results beginning April 1, 2018. Non-interest expense includes zero, \$3.5 million and \$0.3 million of costs incurred during the years ended December 31, 2019, 2018 and 2017, respectively related to the Merger.

The following table reflects our preliminary valuation of the assets acquired and liabilities assumed:

	<u>(In thousands)</u>
Cash and cash equivalents	\$ 23,521
Interest bearing deposits - time	4,054
Securities available for sale	6,066
Federal Home Loan Bank stock	778
Loans, net	295,799
Property and equipment, net	1,067
Capitalized mortgage loan servicing rights	3,047
Accrued income and other assets	3,362
Other intangibles <sup>(1)</sup>	5,798
Total assets acquired	<u>343,492</u>
Deposits	287,710
Other borrowings	14,345
Subordinated debentures	3,768
Accrued expenses and other liabilities	1,429
Total liabilities assumed	<u>307,252</u>
Net assets acquired	<u>36,240</u>
Goodwill	28,300
Purchase price (fair value of consideration)	<u>\$ 64,540</u>

(1) Relates to core deposit intangibles (see note #7).

Management views the disclosed fair values presented above to be final as the one-year measurement period for finalizing acquisition-date fair values has expired. During this measurement period we had one adjustment to our acquisition date fair values. During the third quarter of 2018, goodwill was reduced by \$0.7 million (to \$28.3 million) related to the collection of a TCSB acquired loan that had been charged off in full prior to the Merger. Because of the status of the collection activities related to this loan at the time of the Merger, we determined that this transaction was a measurement period adjustment and reduced goodwill accordingly.

Goodwill related to this acquisition will not be deductible for tax purposes and consists largely of synergies and cost savings resulting from the combining of the operations of TCSB into ours as well as expansion into a new market.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The estimated fair value of the core deposit intangible was \$5.8 million and is being amortized over an estimated useful life of 10 years.

The fair value of net assets acquired includes fair value adjustments to certain receivables that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. However, we believe that all contractual cash flows related to these financial instruments will be collected. As such, these receivables were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans which have shown evidence of credit deterioration since origination. Receivables acquired that are not subject to these requirements included non-impaired customer receivables with a fair value and gross contractual amounts receivable of \$292.9 million and \$298.6 million on the date of acquisition.

**NOTE 27 – MEPCO SALE**

On December 30, 2016, Mepco executed an Asset Purchase Agreement (the “APA”) with Seabury Asset Management LLC (“Seabury”). Pursuant to the terms of the APA, we sold our payment plan processing business, payment plan receivables, and certain other assets to Seabury, who also assumed certain liabilities of Mepco.

This transaction closed on May 18, 2017, with an effective date of May 1, 2017. As a result of the closing, Mepco sold \$33.1 million of net payment plan receivables, \$0.5 million of commercial loans, \$0.2 million of furniture and equipment and \$1.6 million of other assets to Seabury, who also assumed \$2.0 million of specified liabilities. We received cash totaling \$33.4 million and recorded no gain or loss in 2017 as the assets were sold and the liabilities were assumed at book value.

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**QUARTERLY FINANCIAL DATA (UNAUDITED)**

A summary of selected quarterly results of operations for the years ended December 31 follows:

	<b>Three Months Ended</b>			
	<b>March 31,</b>	<b>June 30,</b>	<b>September 30,</b>	<b>December 31,</b>
	<b>(In thousands, except per share amounts)</b>			
<b>2019</b>				
Interest income	\$ 36,636	\$ 37,573	\$ 37,811	\$ 36,908
Net interest income	30,243	30,756	30,872	30,710
Provision for loan losses	664	652	(271)	(221)
Income before income tax	11,548	13,417	15,570	17,225
Net income	9,381	10,730	12,445	13,879
Net income per common share				
Basic	0.40	0.47	0.55	0.62
Diluted	0.39	0.46	0.55	0.61
<b>2018</b>				
Interest income	\$ 26,797	\$ 33,103	\$ 34,452	\$ 36,421
Net interest income	23,936	28,980	29,697	30,669
Provision for loan losses	315	650	(53)	591
Income before income tax	11,199	10,884	14,846	12,204
Net income	9,161	8,817	11,925	9,936
Net income per common share				
Basic	0.43	0.37	0.49	0.41
Diluted	0.42	0.36	0.49	0.41

During the fourth quarter of 2019, we recognized a positive fair value adjustment due to price on our capitalized mortgage loan servicing rights of \$0.6 million (see note #4). During the fourth quarter of 2018, we recognized a negative fair value adjustment due to price on our capitalized mortgage loan servicing rights of \$2.4 million (see note #4).

**QUARTERLY SUMMARY (UNAUDITED)**

	<b>Reported Sales Prices of Common Shares</b>						<b>Cash Dividends Declared</b>	
	<b>2019</b>			<b>2018</b>			<b>2019</b>	<b>2018</b>
	<b>High</b>	<b>Low</b>	<b>Close</b>	<b>High</b>	<b>Low</b>	<b>Close</b>		
First quarter	\$ 23.64	\$ 20.40	\$ 21.50	\$ 24.50	\$ 22.06	\$ 22.90	\$ 0.18	\$ 0.15
Second quarter	22.42	20.60	21.79	27.10	22.20	25.50	0.18	0.15
Third quarter	22.25	18.94	21.32	26.65	21.51	23.65	0.18	0.15
Fourth quarter	23.93	20.40	22.65	25.13	20.18	21.02	0.18	0.15

We have approximately 1,400 holders of record of our common stock. Our common stock trades on the NASDAQ Global Select Market System under the symbol "IBCP." The prices shown above are supplied by NASDAQ and reflect the inter-dealer prices and may not include retail markups, markdowns or commissions. There may have been transactions or quotations at higher or lower prices of which we are not aware.

In addition to limitations imposed by the provisions of the Michigan Business Corporation Act (which, among other things, limits us from paying dividends to the extent we are insolvent), our ability to pay dividends is limited by our ability to obtain funds from our Bank and by regulatory capital guidelines applicable to us (see note #20).

INDEPENDENT BANK CORPORATION  
Subsidiaries of the Registrant

	<u>State of Incorporation</u>
IBC Capital Finance III Grand Rapids, Michigan	Delaware
IBC Capital Finance IV Grand Rapids, Michigan	Delaware
Midwest Guaranty Trust I Grand Rapids, Michigan	Delaware
TCSB Statutory Trust I Grand Rapids, Michigan	Delaware
Independent Bank Grand Rapids, Michigan	Michigan
IB Wealth Management, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan
IB Insurance Services, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan
Independent Title Services, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank Corporation)	Michigan
Independent Life Insurance Trust, Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan

Note: Table excludes insignificant subsidiaries, such as single-member limited liability companies formed solely to hold other real estate.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements (Nos. 333-89072, 333-125484, 333-189437, and 333-221177) on Forms S-8 of Independent Bank Corporation of our report dated March 6, 2020 with respect to the consolidated financial statements and effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K for the year ended December 31, 2019.

/s/ Crowe LLP

Grand Rapids, Michigan  
March 6, 2020

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## CERTIFICATION

I, William B. Kessel, certify that:

1. I have reviewed this annual report on Form 10-K of Independent Bank Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15.15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 6, 2020

/s/ William B. Kessel  
William B. Kessel  
President and Chief Executive Officer

## CERTIFICATION

I, Stephen A. Erickson, certify that:

1. I have reviewed this annual report on Form 10-K of Independent Bank Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15.15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 6, 2020

/s/ Stephen A. Erickson  
Stephen A. Erickson  
Chief Financial Officer

CERTIFICATE OF THE  
CHIEF EXECUTIVE OFFICER OF  
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

I, William B. Kessel, President and Chief Executive Officer of Independent Bank Corporation, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- (1) The annual report on Form 10-K for the annual period ended December 31, 2019, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;
- (2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2018, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

Date: March 6, 2020

/s/ William B. Kessel  
William B. Kessel  
President and Chief Executive Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Independent Bank Corporation and will be retained by Independent Bank Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

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# The Future **LOOKS BRIGHT**

2020 was a year like no other.

**As a community, we pulled together.**

We supported local businesses through the Small Business Association's Paycheck Protection Program. We took the highest precautions to keep our customers and employees safe. Overall, we navigated uncharted territory, all while continuing to offer the best banking experience, both digitally and in-person.

Whatever the future holds, we'll help you

**Be Independent** 

CERTIFICATE OF THE  
CHIEF FINANCIAL OFFICER OF  
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

I, Stephen A. Erickson, Chief Financial Officer of Independent Bank Corporation, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- (1) The annual report on Form 10-K for the annual period ended December 31, 2019, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;
- (2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2018, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

Date: March 6, 2020

/s/ Stephen A. Erickson  
Stephen A. Erickson  
Chief Financial Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Independent Bank Corporation and will be retained by Independent Bank Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

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