

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2020

Commission file number 0-7818

INDEPENDENT BANK CORPORATION

(Exact name of registrant as specified in its charter)

Michigan

(State or jurisdiction of Incorporation or Organization)

38-2032782

(I.R.S. Employer Identification Number)

4200 East Beltline, Grand Rapids, Michigan 49525

(Address of principal executive offices)

(616) 527-5820

(Registrant's telephone number, including area code)

NONE

Former name, address and fiscal year, if changed since last report.

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

Title of each Class	Trading Symbol	Name of each exchange which registered
Common stock, no par value	IBCP	The Nasdaq Stock Market LLC

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes NO

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, smaller reporting company or an emerging growth company.

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. Yes No

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: common stock, no par value, 21,884,495 as of November 4, 2020.

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

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FORWARD-LOOKING STATEMENTS

Statements in this report that are not statements of historical fact, including statements that include terms such as “will,” “may,” “should,” “believe,” “expect,” “forecast,” “anticipate,” “estimate,” “project,” “intend,” “likely,” “optimistic” and “plan” 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 including the impact of the ongoing COVID-19 pandemic on each of these items;
- 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 including the economic impact of the ongoing COVID-19 pandemic in each of these areas;
- 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.

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition

	September 30, 2020	December 31, 2019
	(unaudited)	
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	\$ 42,435	\$ 53,295
Interest bearing deposits	4,121	12,009
	Cash and Cash Equivalents	65,304
Interest bearing deposits - time	-	350
Securities available for sale	985,050	518,400
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	18,427	18,359
Loans held for sale, carried at fair value	99,747	69,800
Loans		
Commercial	1,351,790	1,166,695
Mortgage	1,024,036	1,098,911
Installment	479,653	459,417
	Total Loans	2,725,023
Allowance for loan losses	(35,771)	(26,148)
	Net Loans	2,698,875
Other real estate and repossessed assets, net	1,487	1,865
Property and equipment, net	36,538	38,411
Bank-owned life insurance	55,019	55,710
Deferred tax assets, net	1,572	2,072
Capitalized mortgage loan servicing rights, carried at fair value	15,403	19,171
Other intangibles	4,561	5,326
Goodwill	28,300	28,300
Accrued income and other assets	56,576	42,751
	Total Assets	\$ 4,168,944
		\$ 3,564,694
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	\$ 1,152,072	\$ 852,076
Savings and interest-bearing checking	1,431,841	1,186,745
Reciprocal	557,551	431,027
Time	303,392	376,877
Brokered time	152,889	190,002
	Total Deposits	3,036,727
Other borrowings	30,005	88,646
Subordinated debt	39,261	-
Subordinated debentures	39,507	39,456
Accrued expenses and other liabilities	89,334	49,696
	Total Liabilities	3,214,525
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: 21,885,368 shares at September 30, 2020 and 22,481,643 shares at December 31, 2019	339,408	352,344
Retained earnings	27,538	1,611
Accumulated other comprehensive income (loss)	6,146	(3,786)
	Total Shareholders' Equity	373,092
	Total Liabilities and Shareholders' Equity	\$ 4,168,944
		\$ 3,564,694

See notes to interim condensed consolidated financial statements (unaudited)

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(unaudited)		(unaudited)	
	(In thousands, except per share amounts)			
Interest Income				
Interest and fees on loans	\$ 30,393	\$ 34,226	\$ 92,020	\$ 100,743
Interest on securities available for sale				
Taxable	3,450	2,771	9,356	8,811
Tax-exempt	954	319	2,137	1,017
Other investments	237	495	854	1,449
Total Interest Income	<u>35,034</u>	<u>37,811</u>	<u>104,367</u>	<u>112,020</u>
Interest Expense				
Deposits	2,062	6,236	9,150	17,938
Other borrowings and subordinated debt and debentures	1,006	703	2,598	2,211
Total Interest Expense	<u>3,068</u>	<u>6,939</u>	<u>11,748</u>	<u>20,149</u>
Net Interest Income	<u>31,966</u>	<u>30,872</u>	<u>92,619</u>	<u>91,871</u>
Provision for loan losses	975	(271)	12,884	1,045
Net Interest Income After Provision for Loan Losses	<u>30,991</u>	<u>31,143</u>	<u>79,735</u>	<u>90,826</u>
Non-interest Income				
Interchange income	3,428	2,785	8,411	7,744
Service charges on deposit accounts	2,085	2,883	6,299	8,323
Net gains on assets				
Mortgage loans	20,205	5,677	46,687	13,590
Securities available for sale	-	-	253	304
Mortgage loan servicing, net	(644)	(1,562)	(8,966)	(4,684)
Other	1,937	2,492	5,698	6,862
Total Non-interest Income	<u>27,011</u>	<u>12,275</u>	<u>58,382</u>	<u>32,139</u>
Non-interest Expense				
Compensation and employee benefits	21,954	16,673	54,742	48,955
Occupancy, net	2,199	2,161	6,818	6,797
Data processing	2,215	2,282	6,160	6,597
Furniture, fixtures and equipment	999	1,023	3,125	3,058
Interchange expense	831	891	2,416	2,332
Communications	806	733	2,409	2,219
Loan and collection	768	714	2,329	1,976
Advertising	589	636	1,636	1,935
Legal and professional	566	541	1,427	1,281
FDIC deposit insurance	411	13	1,211	723
Other	2,303	2,181	7,433	6,557
Total Non-interest Expense	<u>33,641</u>	<u>27,848</u>	<u>89,706</u>	<u>82,430</u>
Income Before Income Tax	<u>24,361</u>	<u>15,570</u>	<u>48,411</u>	<u>40,535</u>
Income tax expense	4,777	3,125	9,245	7,979
Net Income	<u>\$ 19,584</u>	<u>\$ 12,445</u>	<u>\$ 39,166</u>	<u>\$ 32,556</u>
Net Income Per Common Share				
Basic	<u>\$ 0.90</u>	<u>\$ 0.55</u>	<u>\$ 1.78</u>	<u>\$ 1.41</u>
Diluted	<u>\$ 0.89</u>	<u>\$ 0.55</u>	<u>\$ 1.76</u>	<u>\$ 1.40</u>

See notes to interim condensed consolidated financial statements (unaudited)

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(unaudited - In thousands)			
Net income	\$ 19,584	\$ 12,445	\$ 39,166	\$ 32,556
Other comprehensive income				
Securities available for sale				
Unrealized gains arising during period	2,675	1,567	12,599	10,851
Change in unrealized gains and losses for which a portion of other than temporary impairment has been recognized in earnings	15	(53)	(66)	(55)
Reclassification adjustments for gains included in earnings	-	-	(253)	(137)
Unrealized gains recognized in other comprehensive income on securities available for sale	2,690	1,514	12,280	10,659
Income tax expense	565	318	2,579	2,238
Unrealized gains recognized in other comprehensive income on securities available for sale, net of tax	2,125	1,196	9,701	8,421
Derivative instruments				
Unrealized loss arising during period	(26)	(72)	(354)	(1,740)
Reclassification adjustment for (income) expense recognized in earnings	310	(102)	646	(393)
Unrealized gains (losses) recognized in other comprehensive income on derivative instruments	284	(174)	292	(2,133)
Income tax expense (benefit)	59	(36)	61	(447)
Unrealized gains (losses) recognized in other comprehensive income on derivative instruments, net of tax	225	(138)	231	(1,686)
Other comprehensive income	2,350	1,058	9,932	6,735
Comprehensive income	\$ 21,934	\$ 13,503	\$ 49,098	\$ 39,291

See notes to interim condensed consolidated financial statements (unaudited)

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Nine months ended September 30,	
	2020	2019
	(unaudited - In thousands)	
Net Income	\$ 39,166	\$ 32,556
Adjustments to Reconcile Net Income to Net Cash From Operating Activities		
Proceeds from the sale of equity securities at fair value	-	560
Proceeds from sales of loans held for sale	1,074,284	422,557
Disbursements for loans held for sale	(1,057,544)	(451,572)
Provision for loan losses	12,884	1,045
Deferred income tax expense (benefit)	(2,140)	1,216
Net deferred loan fees (costs)	5,227	(3,122)
Net depreciation, amortization of intangible assets and premiums and accretion of discounts on securities, loans and interest bearing deposits - time	5,962	4,427
Net gains on mortgage loans	(46,687)	(13,590)
Net gains on securities available for sale	(253)	(304)
Share based compensation	1,506	1,348
Increase in accrued income and other assets	(1,564)	(2,149)
Increase in accrued expenses and other liabilities	7,397	13,088
Total Adjustments	(928)	(26,496)
Net Cash From Operating Activities	38,238	6,060
Cash Flow Used in Investing Activities		
Proceeds from the sale of securities available for sale	36,593	44,305
Proceeds from maturities, prepayments and calls of securities available for sale	197,098	110,517
Purchases of securities available for sale	(639,166)	(123,238)
Proceeds from the maturity of interest bearing deposits - time	350	100
Purchase of Federal Home Loan Bank stock	(68)	-
Net increase in portfolio loans (loans originated, net of principal payments)	(167,506)	(213,116)
Proceeds from the sale of portfolio loans	2,395	50,516
Proceeds from bank-owned life insurance	1,441	470
Proceeds from the sale of other real estate and repossessed assets	564	1,438
Capital expenditures	(2,603)	(2,587)
Net Cash Used in Investing Activities	(570,902)	(131,595)
Cash Flow From Financing Activities		
Net increase in total deposits	561,018	138,884
Net increase (decrease) in other borrowings	(25,001)	18,355
Proceeds from Federal Home Loan Bank Advances	239,254	57,000
Payments of Federal Home Loan Bank Advances	(272,910)	(37,143)
Proceeds from issuance of subordinated debt, net of issuance costs	39,236	-
Dividends paid	(13,239)	(12,507)
Proceeds from issuance of common stock	11	282
Repurchase of common stock	(13,784)	(26,284)
Share based compensation withholding obligation	(669)	(879)
Net Cash From Financing Activities	513,916	137,708
Net Increase (Decrease) in Cash and Cash Equivalents	(18,748)	12,173
Cash and Cash Equivalents at Beginning of Period	65,304	70,244
Cash and Cash Equivalents at End of Period	\$ 46,556	\$ 82,417
Cash paid during the period for		
Interest	\$ 11,636	\$ 20,185
Income taxes	10,500	5,934
Operating leases	1,357	1,692
Transfers to other real estate and repossessed assets	332	1,901
Purchase of securities available for sale not yet settled	23,844	3,075
Securitization of portfolio loans	26,325	29,790
Right of use assets obtained in exchange for lease obligations	279	7,767
Transfer of loans to held for sale	-	36,622

See notes to interim condensed consolidated financial statements (unaudited)

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

	Common Stock	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
(Dollars in thousands, except per share amounts)				
Balances at July 1, 2020	\$ 338,989	\$ 12,338	\$ 3,796	\$ 355,123
Net income, three months ended September 30, 2020	-	19,584	-	19,584
Cash dividends declared, \$0.20 per share	-	(4,384)	-	(4,384)
Repurchase of zero shares of common stock	-	-	-	-
Issuance of zero shares of common stock	-	-	-	-
Share based compensation (issuance of 10,583 shares of common stock)	497	-	-	497
Share based compensation withholding obligation (withholding of 5,398 shares of common stock)	(78)	-	-	(78)
Other comprehensive income	-	-	2,350	2,350
Balances at September 30, 2020	<u>\$ 339,408</u>	<u>\$ 27,538</u>	<u>\$ 6,146</u>	<u>\$ 373,092</u>
Balances at July 1, 2019	\$ 351,894	\$ (16,617)	\$ (4,431)	\$ 330,846
Net income, three months ended September 30, 2019	-	12,445	-	12,445
Cash dividends declared, \$0.18 per share	-	(4,049)	-	(4,049)
Repurchase of 25,000 shares of common stock	(502)	-	-	(502)
Issuance of 1,900 shares of common stock	-	-	-	-
Share based compensation (issuance of 5,991 shares of common stock)	460	-	-	460
Share based compensation withholding obligation (withholding of 919 shares of common stock)	(13)	-	-	(13)
Other comprehensive income	-	-	1,058	1,058
Balances at September 30, 2019	<u>\$ 351,839</u>	<u>\$ (8,221)</u>	<u>\$ (3,373)</u>	<u>\$ 340,245</u>
Balances at January 1, 2020	\$ 352,344	\$ 1,611	\$ (3,786)	\$ 350,169
Net income, nine months ended September 30, 2020	-	39,166	-	39,166
Cash dividends declared, \$0.60 per share	-	(13,239)	-	(13,239)
Repurchase of 678,929 shares of common stock	(13,784)	-	-	(13,784)
Issuance of 11,917 shares of common stock	11	-	-	11
Share based compensation (issuance of 104,465 shares of common stock)	1,506	-	-	1,506
Share based compensation withholding obligation (withholding of 33,728 shares of common stock)	(669)	-	-	(669)
Other comprehensive income	-	-	9,932	9,932
Balances at September 30, 2020	<u>\$ 339,408</u>	<u>\$ 27,538</u>	<u>\$ 6,146</u>	<u>\$ 373,092</u>
Balances at January 1, 2019	\$ 377,372	\$ (28,270)	\$ (10,108)	\$ 338,994
Net income, nine months ended September 30, 2019	-	32,556	-	32,556
Cash dividends declared, \$0.54 per share	-	(12,507)	-	(12,507)
Repurchase of 1,204,688 shares of common stock	(26,284)	-	-	(26,284)
Issuance of 70,299 shares of common stock	282	-	-	282
Share based compensation (issuance of 92,617 shares of common stock)	1,348	-	-	1,348
Share based compensation withholding obligation (withholding of 57,205 shares of common stock)	(879)	-	-	(879)
Other comprehensive income	-	-	6,735	6,735
Balances at September 30, 2019	<u>\$ 351,839</u>	<u>\$ (8,221)</u>	<u>\$ (3,373)</u>	<u>\$ 340,245</u>

See notes to interim condensed consolidated financial statements (unaudited)

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Preparation of Financial Statements

The condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2019 included in our Annual Report on Form 10-K.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of September 30, 2020 and December 31, 2019, and the results of operations for the three and nine-month periods ended September 30, 2020 and 2019. The results of operations for the three and nine-month periods ended September 30, 2020, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period condensed consolidated financial statements to conform to the current period presentation. Our critical accounting policies include the determination of the allowance for loan losses and the valuation of capitalized mortgage loan servicing rights. Refer to our 2019 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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.

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

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 expect to estimate losses over approximately a two year forecast period using the Federal Open Market Committee median economic projections and other economic forecast sources, and then revert to longer term historical loss experience to estimate losses over more extended periods. We were originally required to adopt this ASU on January 1, 2020 but section 4014 of the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act allows for temporary relief from applying this ASU. Under the CARES Act we may delay the adoption of this ASU until the earlier of the termination of the national emergency that President Trump declared on March 13, 2020, or December 31, 2020. As such, we have chosen to delay the adoption of this ASU and continue to utilize the existing incurred loss impairment methodology to calculate our allowance for loan losses and our provision for loan losses as required under Accounting Standards Codification 310 (Receivables). When we adopt this ASU as required under the CARES act we will do so retrospectively to January 1, 2020.

We expect to recognize a one-time cumulative effect adjustment to beginning retained earnings at January 1, 2020 increasing the allowance for loan losses. We are estimating an increase to the allowance for loan losses at that time 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 portfolio 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 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.

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

In March 2020, the FASB issued ASU 2020-04, “Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting”. This new ASU provides temporary optional expedients and exceptions to GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from LIBOR and other interbank offered rates to alternative reference rates. Entities can elect not to apply certain modification accounting requirements to contracts affected by reference rate reform, if certain criteria are met. Entities that make such elections would not have to remeasure contracts at the modification date or reassess a previous accounting determination. Entities can elect various optional expedients that would allow them to continue applying hedge accounting for hedging relationships affected by reference rate reform, if certain criteria are met. This amended guidance and our ability to elect its temporary optional expedients and exceptions are effective for us as of March 12, 2020 through December 31, 2022.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
(In thousands)				
September 30, 2020				
U.S. agency	\$ 10,820	\$ 332	\$ 22	\$ 11,130
U.S. agency residential mortgage-backed	330,914	5,167	521	335,560
U.S. agency commercial mortgage-backed	8,039	382	-	8,421
Private label mortgage-backed	43,190	1,415	320	44,285
Other asset backed	262,435	1,392	456	263,371
Obligations of states and political subdivisions	238,479	6,635	136	244,978
Corporate	71,691	3,558	232	75,017
Trust preferred	1,970	-	200	1,770
Foreign government	500	18	-	518
Total	<u>\$ 968,038</u>	<u>\$ 18,899</u>	<u>\$ 1,887</u>	<u>\$ 985,050</u>
December 31, 2019				
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>

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

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

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
September 30, 2020						
U.S. agency	\$ 1,788	\$ 5	\$ 2,262	\$ 17	\$ 4,050	\$ 22
U.S. agency residential mortgage-backed	81,400	519	1,298	2	82,698	521
Private label mortgage-backed	14,269	268	749	52	15,018	320
Other asset backed	28,630	129	22,210	327	50,840	456
Obligations of states and political subdivisions	19,075	110	2,003	26	21,078	136
Corporate	10,628	232	-	-	10,628	232
Trust preferred	-	-	1,770	200	1,770	200
Total	\$ 155,790	\$ 1,263	\$ 30,292	\$ 624	\$ 186,082	\$ 1,887
December 31, 2019						
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	\$ 130,648	\$ 535	\$ 38,343	\$ 515	\$ 168,991	\$ 1,050

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.

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

U.S. agency and U.S. agency residential mortgage-backed securities — at September 30, 2020, we had 27 U.S. agency and 39 U.S. agency residential mortgage-backed securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to widening spreads to Treasury bonds since acquisition.

Private label mortgage backed, other asset backed and corporate securities — at September 30, 2020, we had 20 private label mortgage backed, 55 other asset backed and 12 corporate securities whose fair value is less than amortized cost. The unrealized losses are primarily due to credit spread widening since 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 September 30, 2020, we had 26 municipal securities whose fair value is less than amortized cost. The unrealized losses are primarily due to wider benchmark pricing spreads since acquisition.

Trust preferred securities — at September 30, 2020, 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 \$0.85 million as of September 30, 2020, 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.

We recorded no credit related OTTI charges in our Condensed Consolidated Statements of Operations related to securities available for sale during the three and nine month periods ended September 30, 2020 and 2019, respectively.

At September 30, 2020, 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)		
Fair value	\$ 403	\$ 536	\$ 939
Amortized cost	386	368	754
Non-credit unrealized loss	-	-	-
Unrealized gain	17	168	185
Cumulative credit related OTTI	757	457	1,214

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

Both of these securities are receiving principal and interest payments similar to principal reductions in the underlying collateral and have unrealized gains at September 30, 2020. 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 both of 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 follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2020	2019	2020	2019
	(In thousands)		(In thousands)	
Balance at beginning of period	\$ 1,214	\$ 1,594	\$ 1,214	\$ 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 (1)	-	(380)	-	(380)
Balance at end of period	<u>\$ 1,214</u>	<u>\$ 1,214</u>	<u>\$ 1,214</u>	<u>\$ 1,214</u>

(1) During the third quarter of 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 September 30, 2020, by contractual maturity, follow:

	Amortized	Fair
	Cost	Value
	(In thousands)	
Maturing within one year	\$ 18,967	\$ 19,048
Maturing after one year but within five years	80,229	83,042
Maturing after five years but within ten years	63,308	66,592
Maturing after ten years	160,956	164,731
	<u>323,460</u>	<u>333,413</u>
U.S. agency residential mortgage-backed	330,914	335,560
U.S. agency commercial mortgage-backed	8,039	8,421
Private label mortgage-backed	43,190	44,285
Other asset backed	262,435	263,371
Total	<u>\$ 968,038</u>	<u>\$ 985,050</u>

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

Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the nine month periods ending September 30, follows:

	Proceeds	Realized	
		Gains	Losses
		(In thousands)	
2020	\$ 36,593	\$ 253	\$ -
2019	44,305	169	32

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

Certain preferred stocks which were all sold during the first quarter of 2019 had been classified as equity securities at fair value in our Condensed Consolidated Statement of Financial Condition. During the nine months ended September 30, 2019 we recognized gains on these preferred stocks of \$0.167 million that are included in net gains on securities available for sale in the Condensed Consolidated Statements of Operations.

4. Loans

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

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

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u> (In thousands)	<u>Subjective</u> <u>Allocation</u>	<u>Total</u>
2020					
Balance at beginning of period	\$ 8,731	\$ 7,261	\$ 1,217	\$ 17,291	\$ 34,500
Additions (deductions)					
Provision for loan losses	(875)	(257)	18	2,089	975
Recoveries credited to the allowance	297	157	196	-	650
Loans charged against the allowance	-	(162)	(192)	-	(354)
Balance at end of period	<u>\$ 8,153</u>	<u>\$ 6,999</u>	<u>\$ 1,239</u>	<u>\$ 19,380</u>	<u>\$ 35,771</u>
2019					
Balance at beginning of period	\$ 8,121	\$ 8,062	\$ 1,293	\$ 8,427	\$ 25,903
Additions (deductions)					
Provision for loan losses	(810)	83	289	167	(271)
Recoveries credited to the allowance	1,215	235	202	-	1,652
Loans charged against the allowance	(303)	(397)	(436)	-	(1,136)
Balance at end of period	<u>\$ 8,223</u>	<u>\$ 7,983</u>	<u>\$ 1,348</u>	<u>\$ 8,594</u>	<u>\$ 26,148</u>

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

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u> (In thousands)	<u>Subjective</u> <u>Allocation</u>	<u>Total</u>
2020					
Balance at beginning of period	\$ 7,922	\$ 8,216	\$ 1,283	\$ 8,727	\$ 26,148
Additions (deductions)					
Provision for loan losses	2,804	(895)	322	10,653	12,884
Recoveries credited to the allowance	1,463	364	577	-	2,404
Loans charged against the allowance	(4,036)	(686)	(943)	-	(5,665)
Balance at end of period	<u>\$ 8,153</u>	<u>\$ 6,999</u>	<u>\$ 1,239</u>	<u>\$ 19,380</u>	<u>\$ 35,771</u>
2019					
Balance at beginning of period	\$ 7,090	\$ 7,978	\$ 895	\$ 8,925	\$ 24,888
Additions (deductions)					
Provision for loan losses	85	270	1,021	(331)	1,045
Recoveries credited to the allowance	1,720	786	603	-	3,109
Loans charged against the allowance	(672)	(1,051)	(1,171)	-	(2,894)
Balance at end of period	<u>\$ 8,223</u>	<u>\$ 7,983</u>	<u>\$ 1,348</u>	<u>\$ 8,594</u>	<u>\$ 26,148</u>

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

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

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u>	<u>Subjective Allocation</u>	<u>Total</u>
	(In thousands)				
September 30, 2020					
Allowance for loan losses:					
Individually evaluated for impairment	\$ 1,699	\$ 4,174	\$ 265	\$ -	\$ 6,138
Collectively evaluated for impairment	6,454	2,825	974	19,380	29,633
Loans acquired with deteriorated credit quality	-	-	-	-	-
Total ending allowance for loan losses balance	<u>\$ 8,153</u>	<u>\$ 6,999</u>	<u>\$ 1,239</u>	<u>\$ 19,380</u>	<u>\$ 35,771</u>
Loans					
Individually evaluated for impairment	\$ 10,543	\$ 40,573	\$ 2,404		\$ 53,520
Collectively evaluated for impairment	1,343,763	987,300	478,281		2,809,344
Loans acquired with deteriorated credit quality	906	560	143		1,609
Total loans recorded investment	<u>1,355,212</u>	<u>1,028,433</u>	<u>480,828</u>		<u>2,864,473</u>
Accrued interest included in recorded investment	3,422	4,397	1,175		8,994
Total loans	<u>\$ 1,351,790</u>	<u>\$ 1,024,036</u>	<u>\$ 479,653</u>		<u>\$ 2,855,479</u>
December 31, 2019					
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	<u>1,169,693</u>	<u>1,103,066</u>	<u>460,611</u>		<u>2,733,370</u>
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>

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

Loans on non-accrual status and past due more than 90 days (“Non-performing Loans”) follow⁽¹⁾:

	<u>90+ and Still Accruing</u>	<u>Non- Accrual</u>	<u>Total Non- Performing Loans</u>
	(In thousands)		
September 30, 2020			
Commercial			
Commercial and industrial (2)	\$ 266	\$ 1,615	\$ 1,881
Commercial real estate	-	554	554
Mortgage			
1-4 family owner occupied - jumbo	-	1,207	1,207
1-4 family owner occupied - non-jumbo (3)	-	2,364	2,364
1-4 family non-owner occupied	-	1,304	1,304
1-4 family - 2nd lien	-	1,548	1,548
Resort lending	-	699	699
Installment			
Boat lending	-	206	206
Recreational vehicle lending	-	96	96
Other	-	378	378
Total recorded investment	<u>\$ 266</u>	<u>\$ 9,971</u>	<u>\$ 10,237</u>
Accrued interest included in recorded investment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
December 31, 2019			
Commercial			
Commercial and industrial (2)	\$ -	\$ 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 (3)	-	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>

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

(2) Non-performing commercial and industrial loans exclude \$0.052 million and \$0.077 million of government guaranteed loans at September 30, 2020 and December 31, 2019, respectively.

(3) Non-performing 1-4 family owner occupied – non jumbo loans exclude \$0.458 million and \$0.569 million of government guaranteed loans at September 30, 2020 and December 31, 2019, respectively.

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

An aging analysis of loans by class follows:

	Loans Past Due				Loans not Past Due	Total Loans
	30-59 days	60-89 days	90+ days	Total		
	(In thousands)					
September 30, 2020						
Commercial						
Commercial and industrial	\$ -	\$ -	\$ 495	\$ 495	\$ 763,757	\$ 764,252
Commercial real estate	130	-	-	130	590,830	590,960
Mortgage						
1-4 family owner occupied - jumbo	1,312	-	632	1,944	437,294	439,238
1-4 family owner occupied - non-jumbo	1,053	372	610	2,035	247,086	249,121
1-4 family non-owner occupied	1,336	60	367	1,763	177,101	178,864
1-4 family - 2nd lien	472	251	545	1,268	99,427	100,695
Resort lending	273	443	391	1,107	59,408	60,515
Installment						
Boat lending	213	38	132	383	211,353	211,736
Recreational vehicle lending	364	19	58	441	168,211	168,652
Other	281	166	225	672	99,768	100,440
Total recorded investment	<u>\$ 5,434</u>	<u>\$ 1,349</u>	<u>\$ 3,455</u>	<u>\$ 10,238</u>	<u>\$ 2,854,235</u>	<u>\$ 2,864,473</u>
Accrued interest included in recorded investment	<u>\$ 102</u>	<u>\$ 17</u>	<u>\$ -</u>	<u>\$ 119</u>	<u>\$ 8,875</u>	<u>\$ 8,994</u>
December 31, 2019						
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>

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

Impaired loans are as follows:

	September 30, 2020	December 31, 2019
Impaired loans with no allocated allowance for loan losses	(In thousands)	
Troubled debt restructurings ("TDR")	\$ 336	\$ 337
Non - TDR	1,562	1,550
Impaired loans with an allocated allowance for loan losses		
TDR - allowance based on collateral	9,412	1,587
TDR - allowance based on present value cash flow	38,934	48,798
Non - TDR - allowance based on collateral	2,963	3,365
Total impaired loans	<u>\$ 53,207</u>	<u>\$ 55,637</u>
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	\$ 1,104	\$ 542
TDR - allowance based on present value cash flow	3,838	4,641
Non - TDR - allowance based on collateral	1,196	972
Total amount of allowance for loan losses allocated	<u>\$ 6,138</u>	<u>\$ 6,155</u>

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

Impaired loans by class are as follows:

	September 30, 2020			December 31, 2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance For Loan Losses	Recorded Investment	Unpaid Principal Balance	Related Allowance For Loan Losses
With no related allowance for loan losses recorded:	(In thousands)					
Commercial						
Commercial and industrial	\$ 122	\$ 124	\$ -	\$ 257	\$ 257	\$ -
Commercial real estate	-	-	-	796	796	-
Mortgage						
1-4 family owner occupied - jumbo	632	632	-	-	-	-
1-4 family owner occupied - non-jumbo	237	314	-	212	217	-
1-4 family non-owner occupied	311	475	-	214	366	-
1-4 family - 2nd lien	442	442	-	407	438	-
Resort lending	154	379	-	-	-	-
Installment						
Boat lending	-	-	-	-	-	-
Recreational vehicle lending	-	-	-	-	-	-
Other	-	-	-	1	41	-
	<u>1,898</u>	<u>2,366</u>	<u>-</u>	<u>1,887</u>	<u>2,115</u>	<u>-</u>
With an allowance for loan losses recorded:						
Commercial						
Commercial and industrial	2,452	2,572	855	1,655	1,706	453
Commercial real estate	7,969	7,980	844	6,685	6,661	578
Mortgage						
1-4 family owner occupied - jumbo	1,091	1,458	126	1,447	1,445	91
1-4 family owner occupied - non-jumbo	21,805	22,414	2,300	10,163	10,695	1,031
1-4 family non-owner occupied	4,473	4,810	470	4,962	5,542	572
1-4 family - 2nd lien	620	629	133	14,059	15,243	1,695
Resort lending	10,808	10,972	1,145	12,110	12,263	1,474
Installment						
Boat lending	139	172	49	-	-	-
Recreational vehicle lending	101	114	23	-	-	-
Other	2,164	2,295	193	2,924	3,153	261
	<u>51,622</u>	<u>53,416</u>	<u>6,138</u>	<u>54,005</u>	<u>56,708</u>	<u>6,155</u>
Total						
Commercial						
Commercial and industrial	2,574	2,696	855	1,912	1,963	453
Commercial real estate	7,969	7,980	844	7,481	7,457	578
Mortgage						
1-4 family owner occupied - jumbo	1,723	2,090	126	1,447	1,445	91
1-4 family owner occupied - non-jumbo	22,042	22,728	2,300	10,375	10,912	1,031
1-4 family non-owner occupied	4,784	5,285	470	5,176	5,908	572
1-4 family - 2nd lien	1,062	1,071	133	14,466	15,681	1,695
Resort lending	10,962	11,351	1,145	12,110	12,263	1,474
Installment						
Boat lending	139	172	49	-	-	-
Recreational vehicle lending	101	114	23	-	-	-
Other	2,164	2,295	193	2,925	3,194	261
Total	<u>\$ 53,520</u>	<u>\$ 55,782</u>	<u>\$ 6,138</u>	<u>\$ 55,892</u>	<u>\$ 58,823</u>	<u>\$ 6,155</u>
Accrued interest included in recorded investment	<u>\$ 313</u>			<u>\$ 255</u>		

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

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

	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(In thousands)				
With no related allowance for loan losses recorded:				
Commercial				
Commercial and industrial	\$ 103	\$ 2	\$ -	\$ -
Commercial real estate	-	-	327	5
Mortgage				
1-4 family owner occupied - jumbo	632	-	-	-
1-4 family owner occupied - non-jumbo	331	-	352	1
1-4 family non-owner occupied	316	2	200	6
1-4 family - 2nd lien	403	-	-	-
Resort lending	77	-	-	-
Installment				
Boat lending	-	-	-	-
Recreational vehicle lending	-	-	-	-
Other	-	-	-	1
	<u>1,862</u>	<u>4</u>	<u>879</u>	<u>13</u>
With an allowance for loan losses recorded:				
Commercial				
Commercial and industrial	2,431	38	1,534	16
Commercial real estate	12,195	130	6,069	71
Mortgage				
1-4 family owner occupied - jumbo	808	11	1,003	9
1-4 family owner occupied - non-jumbo	22,070	277	23,674	336
1-4 family non-owner occupied	4,708	52	5,447	76
1-4 family - 2nd lien	598	3	601	8
Resort lending	11,186	125	12,067	171
Installment				
Boat lending	106	-	86	2
Recreational vehicle lending	96	1	50	1
Other	2,324	33	3,105	50
	<u>56,522</u>	<u>670</u>	<u>53,636</u>	<u>740</u>
Total				
Commercial				
Commercial and industrial	2,534	40	1,534	16
Commercial real estate	12,195	130	6,396	76
Mortgage				
1-4 family owner occupied - jumbo	1,440	11	1,003	9
1-4 family owner occupied - non-jumbo	22,401	277	24,026	337
1-4 family non-owner occupied	5,024	54	5,647	82
1-4 family - 2nd lien	1,001	3	601	8
Resort lending	11,263	125	12,067	171
Installment				
Boat lending	106	-	86	2
Recreational vehicle lending	96	1	50	1
Other	2,324	33	3,105	51
Total	<u>\$ 58,384</u>	<u>\$ 674</u>	<u>\$ 54,515</u>	<u>\$ 753</u>

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

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

	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(In thousands)				
With no related allowance for loan losses recorded:				
Commercial				
Commercial and industrial	\$ 137	\$ 4	\$ -	\$ -
Commercial real estate	199	-	164	5
Mortgage				
1-4 family owner occupied - jumbo	316	-	-	-
1-4 family owner occupied - non-jumbo	353	4	265	3
1-4 family non-owner occupied	309	5	100	6
1-4 family - 2nd lien	399	-	-	-
Resort lending	77	-	-	-
Installment				
Boat lending	-	-	-	-
Recreational vehicle lending	-	-	-	-
Other	-	-	-	1
	<u>1,790</u>	<u>13</u>	<u>529</u>	<u>15</u>
With an allowance for loan losses recorded:				
Commercial				
Commercial and industrial	2,231	105	2,406	52
Commercial real estate	11,657	641	5,552	221
Mortgage				
1-4 family owner occupied - jumbo	1,228	39	1,248	26
1-4 family owner occupied - non-jumbo	19,116	901	24,110	1,031
1-4 family non-owner occupied	4,746	170	6,040	227
1-4 family - 2nd lien	4,017	9	479	14
Resort lending	11,506	358	12,607	493
Installment				
Boat lending	72	-	68	2
Recreational vehicle lending	80	2	65	2
Other	2,545	109	3,211	145
	<u>57,198</u>	<u>2,334</u>	<u>55,786</u>	<u>2,213</u>
Total				
Commercial				
Commercial and industrial	2,368	109	2,406	52
Commercial real estate	11,856	641	5,716	226
Mortgage				
1-4 family owner occupied - jumbo	1,544	39	1,248	26
1-4 family owner occupied - non-jumbo	19,469	905	24,375	1,034
1-4 family non-owner occupied	5,055	175	6,140	233
1-4 family - 2nd lien	4,416	9	479	14
Resort lending	11,583	358	12,607	493
Installment				
Boat lending	72	-	68	2
Recreational vehicle lending	80	2	65	2
Other	2,545	109	3,211	146
Total	<u>\$ 58,988</u>	<u>\$ 2,347</u>	<u>\$ 56,315</u>	<u>\$ 2,228</u>

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

Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance.

TDRs follow:

	September 30, 2020		
	Commercial	Retail (1)	Total
	(In thousands)		
Performing TDRs	\$ 8,292	\$ 37,337	\$ 45,629
Non-performing TDRs (2)	1,203	1,850 ⁽³⁾	3,053
Total	\$ 9,495	\$ 39,187	\$ 48,682

	December 31, 2019		
	Commercial	Retail (1)	Total
	(In thousands)		
Performing TDRs	\$ 7,974	\$ 39,601	\$ 47,575
Non-performing TDRs (2)	540	2,607 ⁽³⁾	3,147
Total	\$ 8,514	\$ 42,208	\$ 50,722

(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 allocated \$4.9 million and \$5.2 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings (“TDR”) at September 30, 2020 and December 31, 2019, respectively.

During the nine months ended September 30, 2020 and 2019, the terms of certain loans were modified as TDRs. The modification of the terms of such loans generally included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for 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 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 360 months in certain circumstances.

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

Loans that have been classified as TDRs during the three-month periods ended September 30 follow:

	<u>Number of Contracts</u>	<u>Pre-modification Recorded Balance</u>	<u>Post-modification Recorded Balance</u>
	(Dollars in thousands)		
2020			
Commercial			
Commercial and industrial	-	\$ -	\$ -
Commercial real estate	-	-	-
Mortgage			
1-4 family owner occupied - jumbo	-	-	-
1-4 family owner occupied - non-jumbo	1	92	95
1-4 family non-owner occupied	1	52	54
1-4 family - 2nd lien	-	-	-
Resort lending	-	-	-
Installment			
Boat lending	-	-	-
Recreational vehicle lending	-	-	-
Other	1	19	19
Total	<u>3</u>	<u>\$ 163</u>	<u>\$ 168</u>
2019			
Commercial			
Commercial and industrial	2	\$ 137	\$ 137
Commercial real estate	-	-	-
Mortgage			
1-4 family owner occupied - jumbo	-	-	-
1-4 family owner occupied - non-jumbo	1	198	202
1-4 family non-owner occupied	-	-	-
1-4 family - 2nd lien	3	75	75
Resort lending	-	-	-
Installment			
Boat lending	-	-	-
Recreational vehicle lending	-	-	-
Other	1	28	28
Total	<u>7</u>	<u>\$ 438</u>	<u>\$ 442</u>

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

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

	<u>Number of Contracts</u>	<u>Pre-modification Balance</u>	<u>Post-modification Balance</u>
		(Dollars in thousands)	
2020			
Commercial			
Commercial and industrial	7	\$ 1,207	\$ 1,207
Commercial real estate	4	7,012	7,012
Mortgage			
1-4 family owner occupied - jumbo	-	-	-
1-4 family owner occupied - non-jumbo	3	195	203
1-4 family non-owner occupied	2	111	116
1-4 family - 2nd lien	2	45	46
Resort lending	-	-	-
Installment			
Boat lending	-	-	-
Recreational vehicle lending	-	-	-
Other	2	52	53
Total	<u>20</u>	<u>\$ 8,622</u>	<u>\$ 8,637</u>
2019			
Commercial			
Commercial and industrial	3	\$ 186	\$ 186
Commercial real estate	2	1,329	1,329
Mortgage			
1-4 family owner occupied - jumbo	-	-	-
1-4 family owner occupied - non-jumbo	2	479	483
1-4 family non-owner occupied	1	506	505
1-4 family - 2nd lien	3	75	75
Resort lending	-	-	-
Installment			
Boat lending	-	-	-
Recreational vehicle lending	-	-	-
Other	7	188	191
Total	<u>18</u>	<u>\$ 2,763</u>	<u>\$ 2,769</u>

The troubled debt restructurings described above for 2020 decreased the allowance for loan losses by \$1.44 million and resulted in zero charge offs during the three months ended September 30, 2020, and increased the allowance for loan losses by \$0.09 million and resulted in zero charge offs during the nine months ended September 30, 2020.

The troubled debt restructurings described above for 2019 increased the allowance for loan losses by \$0.04 million and resulted in zero charge offs during the three months ended September 30, 2019, and increased the allowance for loan losses by \$0.09 million and resulted in zero charge offs during the nine months ended September 30, 2019.

There were no troubled debt restructurings that subsequently defaulted within twelve months following the modification during the three and nine months periods ended September 30, 2020 and 2019.

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

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

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

Non-TDR Loan Modifications and Paycheck Protection Program (“PPP”) due to COVID-19 - On March 22, 2020, the federal banking agencies issued an “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus”. This guidance encourages financial institutions to work prudently with borrowers that may be unable to meet their contractual obligations because of the effects of COVID-19. The guidance goes on to explain that in consultation with the Financial Accounting Standards Board staff that the federal banking agencies conclude that short-term modifications (e.g. six months or less) made on a good faith basis to borrowers who were current as of the implementation date of a relief program are not TDRs. In addition, on March 27, 2020, President Trump signed the CARES Act. Section 4013 of the CARES Act also addressed COVID-19 related modifications and specified that COVID-19 related modifications on loans that were current as of December 31, 2019 are not TDRs. We are assisting both commercial and retail (mortgage and installment) borrowers with reduced or suspended payments. Commercial loan accommodations are typically a three month interest-only period while retail loan (mortgage and installment) forbearances have primarily been payment suspensions for three months. For loans subject to these forbearance agreements each borrower is required to resume making regularly scheduled loan payments at the end of the forbearance period. The deferred principal and interest will be repaid based upon individualized agreements. Options for repayment include separate repayment plans, extending the term of the loan or re-amortizing the loan based upon the affordability of the payment in relationship to a reduced income. While some borrowers may elect to make a lump sum payment, we anticipate the majority will require some type of repayment plan. During the forbearance period, the loan will not be reported as past due in keeping with the guidance discussed previously.

A summary of accommodations entered into under this guidance as of September 30, 2020 follows:

Commercial and Retail Loan COVID-19 Accommodations

Loan Category	Covid-19 Accommodations		Total Loans	% of Total Loans
	Loans (#)	Loans (\$)		
Commercial	17	\$ 25,105	\$ 1,351,790	1.9%
Mortgage	197	32,091	1,024,036	3.1%
Installment	97	2,631	479,653	0.5%
Total	311	\$ 59,827	\$ 2,855,479	2.1%
Mortgage loans serviced for others(1)	416	\$ 66,279	\$ 2,873,153	2.3%

1) We have delegated authority from all investors to grant these deferrals on their behalf.

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

Information on subsequent accommodation extensions follows:

Commercial and Retail Loan COVID-19 Subsequent Accomodations

Loan Category	Loans (#)	Loans (\$)
Commercial	6	\$ 5,726
Mortgage	125	22,571
Installment	51	1,583
Total	<u>182</u>	<u>\$ 29,880</u>

The CARES Act also included an initial \$349 billion loan program administered through the U.S. Small Business Administration (“SBA”) referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. We are participating as a lender in the PPP. The PPP opened on April 3, 2020 intending to provide American small businesses with eight weeks of cash-flow assistance through 100 percent federally guaranteed loans through the SBA. In late April 2020 the Paycheck Protection Program and Health Care Enhancement Act, added another \$310 billion in funding while the Paycheck Protection Program Flexibility Act made certain changes to the program, by allowing for more time to spend the funds, and making it easier to get a loan fully forgiven. The PPP closed on August 8, 2020. Most recently, the SBA released a simpler loan forgiveness application for PPP loans of \$50,000 or less that streamlines the PPP forgiveness process for such loans. As of September 30, 2020, we had 2,117 PPP loans outstanding with a total balance of \$261.1 million. PPP loans are included in the commercial and industrial class of the commercial loan portfolio segment. As these loans are 100% guaranteed through the SBA the allowance for loan losses recorded on these loans is zero. As of September 30, 2020, we have submitted 197 forgiveness applications for loans totaling \$37.2 million. Interest and fees on loans in our condensed consolidated statement of operations includes \$1.3 million and \$2.3 million for the three and nine month periods of 2020, related to the accretion of net loan fees on PPP loans. No such accretion is included in the comparable prior year periods. At September 30, 2020 we had \$6.5 million of remaining unaccreted net fees related to PPP loans.

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.

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

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 the loan 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 portfolio loan segment:

	Commercial				Total
	Non-watch 1-6	Watch 7-8	Substandard Accrual 9	Non- Accrual 10-11	
	(In thousands)				
September 30, 2020					
Commercial and industrial	\$ 715,810	\$ 42,153	\$ 4,674	\$ 1,615	\$ 764,252
Commercial real estate	579,547	8,187	2,672	554	590,960
Total	\$ 1,295,357	\$ 50,340	\$ 7,346	\$ 2,169	\$ 1,355,212
Accrued interest included in total	\$ 3,267	\$ 116	\$ 39	\$ -	\$ 3,422
December 31, 2019					
Commercial and industrial	\$ 515,955	\$ 44,384	\$ 3,967	\$ 565	\$ 564,871
Commercial real estate	580,516	23,036	535	735	604,822
Total	\$ 1,096,471	\$ 67,420	\$ 4,502	\$ 1,300	\$ 1,169,693
Accrued interest included in total	\$ 2,763	\$ 205	\$ 30	\$ -	\$ 2,998

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.

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

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

	Mortgage (1)					
	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	Total
	(In thousands)					
September 30, 2020						
800 and above	\$ 49,057	\$ 35,243	\$ 28,557	\$ 13,443	\$ 10,433	\$ 136,733
750-799	219,844	64,957	78,503	42,292	28,294	433,890
700-749	110,981	74,914	48,228	26,334	11,557	272,014
650-699	41,101	36,963	14,511	11,982	7,277	111,834
600-649	12,387	17,032	4,986	2,954	2,064	39,423
550-599	3,477	12,270	1,908	2,214	494	20,363
500-549	2,391	6,062	1,475	1,134	243	11,305
Under 500	-	1,680	696	342	153	2,871
Unknown	-	-	-	-	-	-
Total	\$ 439,238	\$ 249,121	\$ 178,864	\$ 100,695	\$ 60,515	\$ 1,028,433
Accrued interest included in total	\$ 1,288	\$ 1,891	\$ 590	\$ 363	\$ 265	\$ 4,397
December 31, 2019						
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
Total	\$ 401,553	\$ 347,260	\$ 169,537	\$ 116,542	\$ 68,174	\$ 1,103,066
Accrued interest included in total	\$ 1,139	\$ 1,662	\$ 586	\$ 502	\$ 266	\$ 4,155

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

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

	Installment (1)				
	Boat Lending	Recreational Vehicle Lending		Other	Total
		(In thousands)			
September 30, 2020					
800 and above	\$ 33,385	\$ 29,085	\$ 8,466	\$ 70,936	
750-799	124,751	94,666	36,373	255,790	
700-749	38,729	34,236	26,833	99,798	
650-699	11,557	8,059	21,998	41,614	
600-649	2,089	1,668	3,738	7,495	
550-599	632	449	1,394	2,475	
500-549	242	465	755	1,462	
Under 500	351	24	180	555	
Unknown	-	-	703	703	
Total	<u>\$ 211,736</u>	<u>\$ 168,652</u>	<u>\$ 100,440</u>	<u>\$ 480,828</u>	
Accrued interest included in total	<u>\$ 471</u>	<u>\$ 381</u>	<u>\$ 323</u>	<u>\$ 1,175</u>	
December 31, 2019					
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	
Total	<u>\$ 203,282</u>	<u>\$ 153,445</u>	<u>\$ 103,884</u>	<u>\$ 460,611</u>	
Accrued interest included in total	<u>\$ 490</u>	<u>\$ 378</u>	<u>\$ 326</u>	<u>\$ 1,194</u>	

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

Foreclosed residential real estate properties included in other real estate and repossessed assets on our Condensed Consolidated Statements of Financial Condition totaled \$1.0 million and \$1.2 million at September 30, 2020 and December 31, 2019, respectively. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled \$0.04 million and \$0.70 million at September 30, 2020 and December 31, 2019, respectively.

During the first quarter of 2020, we securitized \$26.3 million of portfolio residential fixed rate mortgage loans servicing retained with Freddie Mac and recognized a gain on sale of \$0.72 million. We also sold \$2.4 million of portfolio residential fixed rate mortgage loans servicing retained into the secondary market and recognized a gain on sale of \$0.07 million. These transactions were done primarily for asset/liability management purposes.

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

During the first quarter of 2019, we sold \$40.6 million of residential adjustable rate mortgage loans servicing released (classified on the Condensed 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 at the lower of cost or fair value. At the time of transfer and at September 30, 2019 the fair value of these loans exceeded their cost. During the fourth quarter of 2019 these loans were securitized servicing retained with Freddie Mac and we recognized a gain on sale of approximately \$1.0 million. These transactions were done primarily for asset/liability management purposes.

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, we consider 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. in the second quarter of 2018 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:

	September 30, 2020	December 31, 2019
	(In thousands)	
Commercial	\$ 906	\$ 1,394
Mortgage	560	575
Installment	143	316
Total carrying amount	1,609	2,285
Allowance for loan losses	-	-
Carrying amount, net of allowance for loan losses	\$ 1,609	\$ 2,285

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

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:

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(unaudited)		(unaudited)	
	(In thousands)		(In thousands)	
Balance at beginning of period	\$ 573	\$ 749	\$ 640	\$ 462
New loans purchased	-	-	-	-
Accretion recorded as loan interest income	(156)	(56)	(223)	(134)
Reclassification from (to) nonaccretable difference	-	-	-	365
Disposals/other adjustments	-	-	-	-
Balance at end of period	<u>\$ 417</u>	<u>\$ 693</u>	<u>\$ 417</u>	<u>\$ 693</u>

5. Shareholders' Equity and Earnings Per Common Share

On December 17, 2019, our Board of Directors authorized a share repurchase plan (the "Repurchase Plan") to buy back up to 1,120,000 shares of our outstanding common stock through December 31, 2020. Shares would be repurchased through open market transactions, though we could execute repurchases through other means, such as privately negotiated transactions. The timing and amount of any share repurchases will depend on a variety of factors, including, among others, securities law restrictions, the trading price of our common stock, regulatory requirements, potential alternative uses for capital, and our financial performance. Due primarily to the economic uncertainty brought on by the COVID-19, we have not purchased any of our shares since March 2020. However, primarily as a result of our financial performance and improved economic conditions, and dependent upon market and other factors, we may begin to purchase our shares under the 2020 share repurchase plan during the last two months of the year. During the nine month periods ended September 30, 2020 and 2019 repurchases were made totaling 678,929 shares and 1,204,688 shares of common stock, respectively, for an aggregate purchase price of \$13.8 million and \$26.3 million, respectively.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(In thousands, except per share data)			
Net income	\$ 19,584	\$ 12,445	\$ 39,166	\$ 32,556
Weighted average shares outstanding (1)	21,881	22,486	22,014	23,033
Stock units for deferred compensation plan for non-employee directors	117	132	119	131
Effect of stock options	85	110	90	116
Performance share units	32	42	33	39
Weighted average shares outstanding for calculation of diluted earnings per share	22,115	22,770	22,256	23,319
Net income per common share				
Basic (1)	\$ 0.90	\$ 0.55	\$ 1.78	\$ 1.41
Diluted	\$ 0.89	\$ 0.55	\$ 1.76	\$ 1.40

(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 the three and nine month periods ended September 30, 2020 and 2019, respectively.

6. Derivative Financial Instruments

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

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

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

	September 30, 2020		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
Fair value hedge designation - Pay-fixed interest rate swap agreements	\$ 7,117	8.6	\$ (860)
No hedge designation			
Rate-lock mortgage loan commitments	\$ 196,646	0.1	\$ 8,356
Mandatory commitments to sell mortgage loans	232,948	0.1	(580)
Pay-fixed interest rate swap agreements - commercial	144,787	4.7	(10,811)
Pay-variable interest rate swap agreements - commercial	144,787	4.7	10,811
Pay-fixed interest rate swap agreements	25,000	0.8	(409)
Interest rate cap agreements	150,000	1.8	5
Purchased options	2,908	0.8	30
Written options	2,848	0.8	(30)
Total	<u>\$ 899,924</u>	1.9	<u>\$ 7,372</u>
December 31, 2019			
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
Fair value hedge designation - Pay-fixed interest rate swap agreements	\$ 7,117	9.4	\$ (242)
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>

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

We use variable-rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our Condensed Consolidated Statements of Financial Condition, which exposes us to variability in interest rates. 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 paid an upfront premium on interest rate caps which was recognized in earnings in the same period in which the hedged item affected earnings. During the first and third quarters of 2020 we transferred all of our Cash Flow Hedge interest rate cap agreements and pay-fixed interest rate swaps, respectively to a no hedge designation. The \$2.0 million and \$0.5 million unrealized loss on our Cash Flow Hedge interest rate cap agreements and pay-fixed interest rate swaps, respectively which were included as a component of accumulated other comprehensive income (loss) at the time of the transfers will be reclassified into earnings over the remaining life of the interest rate cap agreements and pay-fixed interest rate swaps. The interest rate cap agreements and pay-fixed interest rate swaps are classified as a no hedge designation at September 30, 2020 and any changes in fair value since the transfers to the no hedge designation are recorded in earnings.

Prior to moving all of our Cash Flow Hedges to a no hedge designation as discussed above, we had recorded the fair value of these hedges in accrued income and other assets and accrued expenses and other liabilities on our Condensed Consolidated Statements of Financial Condition. On an ongoing basis, we adjusted our Condensed Consolidated Statements of Financial Condition to reflect the then current fair value of Cash Flow Hedges. The related gains or losses were reported in other comprehensive income or loss and were subsequently reclassified into earnings as a yield adjustment in the same period in which the related interest on the hedged items (variable-rate debt obligations) affected earnings. It is anticipated that approximately \$1.1 million, of unrealized losses from the previously classified Cash Flow Hedges (all a result of the unrealized losses discussed in the previous paragraph) at September 30, 2020 will be reclassified to earnings over the next twelve months.

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 Condensed 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 Condensed 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 Condensed Consolidated Statements of Operations.

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

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

In the ordinary course of business, we enter into rate-lock mortgage loan commitments with customers (“Rate-Lock Commitments”). These commitments expose us to interest rate risk. We also enter into mandatory commitments to sell mortgage loans (“Mandatory Commitments”) to reduce the impact of price fluctuations of mortgage loans held for sale and Rate-Lock Commitments. Mandatory Commitments help protect our loan sale profit margin from fluctuations in interest rates. The changes in the fair value of Rate-Lock Commitments and Mandatory Commitments are recognized currently as part of net gains on mortgage loans in our Condensed 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 provides the customer a guaranteed return of principal at maturity plus a potential equity return (a written option), while we receive a like stream of funds based on the equity return (a purchased option). The written and purchased options will generally move in opposite directions resulting in little or no net impact on our Condensed Consolidated Statements of Operations. All of the written and purchased options in the table above relate to this Altitude CD product.

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

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

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

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	September 30, 2020		December 31, 2019		September 30, 2020		December 31, 2019	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)							
Derivatives designated as hedging instruments								
Pay-fixed interest rate swap agreements	Other assets	\$ -	Other assets	\$ -	Other liabilities	\$ 860	Other liabilities	\$ 416
Interest rate cap agreements	Other assets	-	Other assets	214	Other liabilities	-	Other liabilities	-
		<u>-</u>		<u>214</u>		<u>860</u>		<u>416</u>
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	8,356	Other assets	1,412	Other liabilities	-	Other liabilities	-
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	-	Other liabilities	580	Other liabilities	150
Pay-fixed interest rate swap agreements - commercial	Other assets	-	Other assets	28	Other liabilities	10,811	Other liabilities	3,669
Pay-variable interest rate swap agreements - commercial	Other assets	10,811	Other assets	3,669	Other liabilities	-	Other liabilities	28
Pay-fixed interest rate swap agreements	Other assets	-	Other assets	-	Other liabilities	409	Other liabilities	-
Interest rate cap agreements	Other assets	5	Other assets	-	Other liabilities	-	Other liabilities	-
Purchased options	Other assets	30	Other assets	141	Other liabilities	-	Other liabilities	-
Written options	Other assets	-	Other assets	-	Other liabilities	30	Other liabilities	139
		<u>19,202</u>		<u>5,250</u>		<u>11,830</u>		<u>3,986</u>
Total derivatives		<u>\$ 19,202</u>		<u>\$ 5,464</u>		<u>\$ 12,690</u>		<u>\$ 4,402</u>

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

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

		Three Month Periods Ended September 30,										
		Loss Recognized in Other Comprehensive Income (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)		Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)		Location of Gain (Loss) Recognized		Gain (Loss) Recognized in Income		
		2020	2019	2020	2019	2020	2019	2020	2019	2020	2019	
		(In thousands)										
Fair Value												
Hedges												
Pay-fixed interest rate swap agreements												
								Non-interest income- other	\$	6	\$	(188)
Cash Flow												
Hedges												
Interest rate cap agreements												
	\$	-	\$	(37)	Interest expense	\$	(180)	\$	88			
Pay-fixed interest rate swap agreements												
		(26)		(35)	Interest expense		(130)		14			
Total	\$	(26)	\$	(72)		\$	(310)	\$	102			
No hedge designation												
Rate-lock mortgage loan commitments												
								Net gains on mortgage loans	\$	1,096	\$	(96)
Mandatory commitments to sell mortgage loans												
								Net gains on mortgage loans		52		307
Pay-fixed interest rate swap agreements - commercial												
								Interest income		688		(1,670)
Pay-variable interest rate swap agreements - commercial												
								Interest income		(688)		1,670
Pay-fixed interest rate swap agreements												
								Interest expense		117		-
Interest rate cap agreements												
								Interest expense		(14)		-
Purchased options												
								Interest expense		(10)		(46)
Written options												
								Interest expense		10		46
Total						\$	1,251	\$	211			



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

Nine Month Periods Ended September 30,

	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income	Gain (Loss) Recognized in Income	
	2020	2019	2020	2019	2020		2019	
(In thousands)								
Fair Value Hedges								
Pay-fixed interest rate swap agreements						Non-interest income- other	\$ (618)	\$ (391)
Cash Flow Hedges								
Interest rate cap agreements	\$ 126	\$ (1,311)	Interest expense	\$ (413)	\$ 321			
Pay-fixed interest rate swap agreements	(480)	(429)	Interest expense	(233)	72			
Total	<u>\$ (354)</u>	<u>\$ (1,740)</u>		<u>\$ (646)</u>	<u>\$ 393</u>			
No hedge designation								
Rate-lock mortgage loan commitments						Net gains on mortgage loans	\$ 6,944	\$ 1,364
Mandatory commitments to sell mortgage loans						Net gains on mortgage loans	(430)	356
Pay-fixed interest rate swap agreements - commercial						Interest income	(7,170)	(5,254)
Pay-variable interest rate swap agreements - commercial						Interest income	7,170	5,254
Pay-fixed interest rate swap agreements						Interest expense	117	-
Interest rate cap agreements						Interest expense	(56)	-
Purchased options						Interest expense	(111)	9
Written options						Interest expense	109	(8)
Total							<u>\$ 6,573</u>	<u>\$ 1,721</u>

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

7. Goodwill and Other Intangibles

The following table summarizes intangible assets, net of amortization:

	September 30, 2020		December 31, 2019	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets - core deposits	\$ 11,916	\$ 7,355	\$ 11,916	\$ 6,590
Unamortized intangible assets - goodwill	\$ 28,300		\$ 28,300	

We performed our required annual goodwill impairment test as of December 31, 2019 and there was no impairment. Since the first quarter of 2020 bank stocks in general as well as our market capitalization have declined as a result of events surrounding the current COVID-19 pandemic outbreak. As a result, we completed a qualitative goodwill impairment test as of March 31, 2020, June 30, 2020 and September 30, 2020. This qualitative analysis included a review of our earnings and asset quality trends as well as capital levels and the economic conditions of our markets. In addition, this qualitative analysis looked at merger and acquisition analytics for banks in general. Finally, our common stock traded over book value for several days during the second quarter. Based on this qualitative analysis we do not believe this decline is indicative of a permanent deterioration of the fundamental value of our bank. As such we do not believe that it is more likely than not goodwill impairment exists at September 30, 2020. See note 13, Contingencies, for additional information on COVID-19 and its potential impact to us.

A summary of estimated core deposit intangible amortization at September 30, 2020 follows:

	(In thousands)
Three months ending December 31, 2020	\$ 255
2021	970
2022	785
2023	547
2024	516
2025 and thereafter	1,488
Total	\$ 4,561

8. Share Based Compensation

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.4 million shares of common stock as of September 30, 2020. The non-employee director stock purchase plan permits the issuance of additional share based payments for up to 0.2 million shares of common stock as of September 30, 2020. 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.

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

A summary of restricted stock and performance stock units (“PSU”) granted pursuant to our long-term incentive plan follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Restricted stock	3,000	8,000	55,996	64,267
PSU	-	-	20,897	22,016

Except for 0.008 million shares of restricted stock issued during the third quarter of 2019 and 0.002 million shares of restricted stock issued during the first quarter of 2019 that vest ratably over three years, the shares of restricted stock and PSUs shown in the above table cliff vest after a period of three years. The performance feature of the PSUs is based on a comparison of our total shareholder return over the three year period starting on the grant date to the total shareholder return over that period for an index of our banking peers.

Our directors may elect to receive a portion of their quarterly cash retainer fees in the form of common stock (either on a current basis or on a deferred basis pursuant to the non-employee director stock purchase plan referenced above). Shares equal in value to that portion of each director’s fees that he or she has elected to receive in stock 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. During the nine month periods ended September 30, 2020 and 2019 we issued 0.016 million and 0.008 million shares, respectively and expensed their value during those same periods.

Total compensation expense recognized for grants pursuant to our long-term incentive plan was \$0.4 million and \$1.2 million during the three and nine month periods ended September 30, 2020, respectively, and was \$0.4 million and \$1.2 million during the same periods in 2019, respectively. The corresponding tax benefit relating to this expense was \$0.1 million and \$0.3 million for the three and nine month periods ended September 30, 2020, respectively and \$0.1 million and \$0.2 million for the same periods in 2019. Total expense recognized for non-employee director share based payments was \$0.09 million and \$0.26 million during the three and nine month periods ended September 30, 2020, respectively, and was \$0.06 million and \$0.18 million during the same periods in 2019, respectively. The corresponding tax benefit relating to this expense was \$0.02 million and \$0.05 million for the three and nine month periods ended September 30, 2020, respectively and \$0.01 million and \$0.04 million during the same periods in 2019.

At September 30, 2020, 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.

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

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, 2020	138,506	\$ 4.62		
Granted	-			
Exercised	(13,117)	3.50		
Forfeited	-			
Expired	-			
Outstanding at September 30, 2020	<u>125,389</u>	<u>\$ 4.73</u>	<u>2.3</u>	<u>\$ 993</u>
Vested and expected to vest at September 30, 2020	<u>125,389</u>	<u>\$ 4.73</u>	<u>2.3</u>	<u>\$ 993</u>
Exercisable at September 30, 2020	<u>125,389</u>	<u>\$ 4.73</u>	<u>2.3</u>	<u>\$ 993</u>

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

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2020	245,726	\$ 21.72
Granted	76,893	22.46
Vested	(77,092)	20.61
Forfeited	(20,869)	22.64
Outstanding at September 30, 2020	<u>224,658</u>	<u>\$ 22.26</u>

Certain information regarding options exercised during the periods follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(In thousands)		(In thousands)	
Intrinsic value	\$ 11	\$ 32	\$ 224	\$ 868
Cash proceeds received	\$ 4	\$ 6	\$ 46	\$ 701
Tax benefit realized	\$ 2	\$ 6	\$ 47	\$ 182

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

9. Income Tax

Income tax expense was \$4.8 million and \$3.1 million during the three month periods ended September 30, 2020 and 2019, respectively and \$9.2 million and \$8.0 million during the nine months ended September 30, 2020 and 2019, respectively. Our actual federal income tax expense is different than the amount computed by applying our statutory income tax rate to our income before income tax primarily due to tax-exempt interest income and tax-exempt income from the increase in the cash surrender value on life insurance. In addition, the three and nine month periods ending September 30, 2020 include increases (reductions) of \$0.01 million and (\$0.19) million, respectively, of income tax expense related to the impact of the excess value of stock awards that vested and stock options that were exercised as compared to the initial fair values that were expensed. These amounts during the same periods in 2019 were reductions of \$0.01 million and \$0.18 million, respectively.

We assess whether a valuation allowance should be established against our deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. The ultimate realization of this asset is primarily based on generating future income. We concluded at September 30, 2020, September 30, 2019 and December 31, 2019 that the realization of substantially all of our deferred tax assets continues to be more likely than not.

At both September 30, 2020 and December 31, 2019, we had approximately \$0.4 million, of gross unrecognized tax benefits. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2020.

10. Regulatory Matters

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank’s current year net profits, combined with the retained net profits of the preceding two years. Further, the Bank cannot pay a dividend at any time that it has negative undivided profits. As of September 30, 2020, the Bank had positive undivided profits of \$68.3 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 interim condensed 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 September 30, 2020 and December 31, 2019, 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.

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

Our actual capital amounts and ratios follow (1):

	Actual		Minimum for Adequately Capitalized Institutions		Minimum for Well-Capitalized Institutions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
September 30, 2020						
Total capital to risk-weighted assets						
Consolidated	\$ 441,969	15.62%	\$ 226,378	8.00%	NA	NA
Independent Bank	391,033	13.82	226,310	8.00	\$ 282,888	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 366,571	12.95%	\$ 169,783	6.00%	NA	NA
Independent Bank	355,645	12.57	169,733	6.00	\$ 226,310	8.00%
Common equity tier 1 capital to risk-weighted assets						
Consolidated	\$ 328,288	11.60%	\$ 127,338	4.50%	NA	NA
Independent Bank	355,645	12.57	127,299	4.50	\$ 183,877	6.50%
Tier 1 capital to average assets						
Consolidated	\$ 366,571	9.05%	\$ 162,103	4.00%	NA	NA
Independent Bank	355,645	8.78	162,020	4.00	\$ 202,525	5.00%
December 31, 2019						
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%

(1) These ratios do not reflect a capital conservation buffer of 2.50% at September 30, 2020 and December 31, 2019.

NA - Not applicable

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

The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	September 30, 2020	December 31, 2019	September 30, 2020	December 31, 2019
	(In thousands)			
Total shareholders' equity	\$ 373,092	\$ 350,169	\$ 400,449	\$ 366,861
Add (deduct)				
Accumulated other comprehensive income for regulatory purposes	(11,943)	(2,011)	(11,943)	(2,011)
Goodwill and other intangibles	(32,861)	(33,626)	(32,861)	(33,626)
Common equity tier 1 capital	328,288	314,532	355,645	331,224
Qualifying trust preferred securities	38,283	38,232	-	-
Tier 1 capital	366,571	352,764	355,645	331,224
Subordinated debt	40,000	-	-	-
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	35,398	27,690	35,388	27,690
Total risk-based capital	<u>\$ 441,969</u>	<u>\$ 380,454</u>	<u>\$ 391,033</u>	<u>\$ 358,914</u>

11. 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.

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

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

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

Impaired loans with specific loss allocations based on collateral value: From time to time, certain loans are considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. When the fair value of the collateral is based on an appraised value or when an appraised value is not available we record the impaired loan as nonrecurring Level 3. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and thus will typically result in a Level 3 classification of the inputs for determining fair value.

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

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

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 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 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).

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

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

	Fair Value Measure- ments	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)				
September 30, 2020:				
Measured at Fair Value on a Recurring Basis				
Assets				
Securities available for sale				
U.S. agency	\$ 11,130	\$ -	\$ 11,130	\$ -
U.S. agency residential mortgage-backed	335,560	-	335,560	-
U.S. agency commercial mortgage-backed	8,421	-	8,421	-
Private label mortgage-backed	44,285	-	44,285	-
Other asset backed	263,371	-	263,371	-
Obligations of states and political subdivisions	244,978	-	244,978	-
Corporate	75,017	-	75,017	-
Trust preferred	1,770	-	1,770	-
Foreign government	518	-	518	-
Loans held for sale, carried at fair value	99,747	-	99,747	-
Capitalized mortgage loan servicing rights	15,403	-	-	15,403
Derivatives (1)	19,202	-	19,202	-
Liabilities				
Derivatives (2)	12,690	-	12,690	-
Measured at Fair Value on a Non-recurring Basis:				
Assets				
Impaired loans (3)				
Commercial				
Commercial and industrial	1,591	-	-	1,591
Commercial real estate	7,098	-	-	7,098
Mortgage				
1-4 family owner occupied - jumbo	500	-	-	500
1-4 family owner occupied - non-jumbo	284	-	-	284
1-4 family non-owner occupied	58	-	-	58
1-4 family - 2nd lien	200	-	-	200
Resort lending	77	-	-	77
Installment				
Boat lending	90	-	-	90
Recreational vehicle lending	38	-	-	38
Other	139	-	-	139
Other real estate (4)				
Commercial - commercial real estate	474	474	-	-

(1) Included in accrued income and other assets

(2) Included in accrued expenses and other liabilities

(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. The fair value of the commercial real estate property included in this table was based on a purchase agreement executed during the third quarter of 2020 that closed during the fourth quarter of 2020.

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

	Fair Value Measurements Using			
	Fair Value Measure- ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un- observable Inputs (Level 3)
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 (1)	5,464	-	5,464	-
Liabilities				
Derivatives (2)	4,402	-	4,402	-
Measured at Fair Value on a Non-recurring Basis:				
Assets				
Impaired loans (3)				
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 (4)				
Mortgage - 1-4 family owner occupied - non-jumbo	31	-	-	31
Installment - other	28	-	-	28

- (1) Included in accrued income and other assets
(2) Included in accrued expenses and other liabilities
(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.

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

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

	Changes in Fair Values for the Nine-Month Periods Ended September 30 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option			Total Change in Fair Values Included in Current Period Earnings
	Net Gains on Assets		Mortgage	
	Securities Available For Sale	Mortgage Loans	Loan Servicing, net	
	(In thousands)			
2020				
Loans held for sale	-	2,081	-	2,081
Capitalized mortgage loan servicing rights	-	-	(14,028)	(14,028)
2019				
Equity securities at fair value	\$ 167	\$ -	\$ -	\$ 167
Loans held for sale	-	822	-	822
Capitalized mortgage loan servicing rights	-	-	(9,258)	(9,258)

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

The following represent impairment charges recognized during the three and nine month periods ended September 30, 2020 and 2019 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 \$10.1 million, which is net of a valuation allowance of \$2.3 million at September 30, 2020, and had a carrying amount of \$3.4 million, which is net of a valuation allowance of \$1.5 million at December 31, 2019. The provision for loan losses included in our results of operations relating to impaired loans was a net expense of \$0.2 million and \$0.5 million for the three month periods ending September 30, 2020 and 2019, respectively, and a net expense of \$1.1 million and \$0.8 million for the nine month periods ending September 30, 2020 and 2019, respectively.
- Other real estate, which is measured using the fair value of the property, had a carrying amount of 0.47 million which is net of a valuation allowance of \$0.15 million at September 30, 2020, and a carrying amount of \$0.06 million which is net of a valuation allowance of \$0.09 million, at December 31, 2019. Charges included in our results of operations relating to other real estate measured at fair value were zero and \$0.09 million during the three and nine month periods ended September 30, 2020, and were \$0.07 million and \$0.08 million during the three and nine month periods ended September 30, 2019.

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

A reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) follows:

	Capitalized Mortgage Loan Servicing Rights			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(In thousands)		(In thousands)	
Beginning balance	\$ 13,773	\$ 17,894	\$ 19,171	\$ 21,400
Total gains (losses) realized and unrealized:				
Included in results of operations	(2,387)	(3,145)	(14,028)	(9,258)
Included in other comprehensive income	-	-	-	-
Purchases, issuances, settlements, maturities and calls	4,017	2,157	10,260	4,764
Transfers in and/or out of Level 3	-	-	-	-
Ending balance	\$ 15,403	\$ 16,906	\$ 15,403	\$ 16,906
Amount of total losses for the period included in earnings attributable to the change in unrealized gains (losses) relating to assets and liabilities still held at September 30	\$ (2,387)	\$ (3,145)	\$ (14,028)	\$ (9,258)

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:

	Asset Fair Value (In thousands)	Valuation Technique	Unobservable Inputs	Range	Weighted Average
September 30, 2020					
Capitalized mortgage loan servicing rights	\$ 15,403	Present value of net servicing revenue	Discount rate	10.00% to 13.00%	10.10%
			Cost to service	\$ 58 to \$215	\$ 79
			Ancillary income	20 to 37	22
			Float rate	0.35%	0.35%
			Prepayment rate	7.34% to 40.16%	22.01%
December 31, 2019					
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%

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

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

	<u>Asset Fair Value</u> (In thousands)	<u>Valuation Technique</u>	<u>Unobservable Inputs</u>	<u>Range</u>	<u>Weighted Average</u>
September 30, 2020					
Impaired loans					
Commercial					
	\$ 8,689	Sales comparison approach	Adjustment for differences between comparable sales	(40.0)% to 75.0%	4.5%
		Income approach	Capitalization rate	9.5%	9.5%
Mortgage and Installment(1)					
	1,386	Sales comparison approach	Adjustment for differences between comparable sales	(12.0)% to 104.6%	4.0%
December 31, 2019					
Impaired loans					
Commercial					
	\$ 971	Sales comparison approach	Adjustment for differences between comparable sales	(48.0)% to 19.2%	(5.6)%
Mortgage and Installment(1)					
	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)%

(1) In addition to the valuation techniques and unobservable inputs discussed above, at September 30, 2020 and December 31, 2019 certain impaired collateral dependent installment loans totaling approximately \$0.27 million and \$0.14 million, respectively are secured by collateral other than real estate. For the majority of these loans, we apply internal discount rates to industry valuation guides.

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

	<u>Aggregate Fair Value</u>	<u>Difference</u> (In thousands)	<u>Contractual Principal</u>
Loans held for sale			
September 30, 2020	\$ 99,747	\$ 3,975	\$ 95,772
December 31, 2019	69,800	1,894	67,906

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

12. 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.

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

The estimated recorded book balances and fair values follow:

	Recorded Book Balance	Fair Value	Fair Value Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un- observable Inputs (Level 3)
(In thousands)					
September 30, 2020					
Assets					
Cash and due from banks	\$ 42,435	\$ 42,435	\$ 42,435	\$ -	\$ -
Interest bearing deposits	4,121	4,121	4,121	-	-
Securities available for sale	985,050	985,050	-	985,050	-
Federal Home Loan Bank and Federal Reserve Bank Stock	18,427	NA	NA	NA	NA
Net loans and loans held for sale	2,919,455	2,915,489	-	99,747	2,815,742
Accrued interest receivable	12,402	12,402	1	3,409	8,992
Derivative financial instruments	19,202	19,202	-	19,202	-
Liabilities					
Deposits with no stated maturity (1)	\$ 3,105,019	\$ 3,105,019	\$ 3,105,019	\$ -	\$ -
Deposits with stated maturity (1)	492,726	495,694	-	495,694	-
Other borrowings	30,005	31,477	-	31,477	-
Subordinated debt	39,261	40,999	-	40,999	-
Subordinated debentures	39,507	28,941	-	28,941	-
Accrued interest payable	1,408	1,408	62	1,346	-
Derivative financial instruments	12,690	12,690	-	12,690	-
December 31, 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 (1)	\$ 2,427,190	\$ 2,427,190	\$ 2,427,190	\$ -	\$ -
Deposits with stated maturity (1)	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	-

(1) Deposits with no stated maturity include reciprocal deposits with a recorded book balance of \$521.106 million and \$388.369 million at September 30, 2020 and December 31, 2019, respectively. Deposits with a stated maturity include reciprocal deposits with a recorded book balance of \$36.445 million and \$42.658 million at September 30, 2020 and December 31, 2019, respectively.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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.

13. Contingencies

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared COVID-19, the disease caused by the novel coronavirus, a pandemic as a result of the global spread of the coronavirus illness. In response to the outbreak, federal and state authorities in the U.S. introduced various measures to try to limit or slow the spread of the virus, including travel restrictions, nonessential business closures, stay-at-home orders, and strict social distancing. The Governor of Michigan issued her first "stay home, stay safe" executive order effective March 24, 2020. In general, that order and subsequent modifications required individuals in Michigan to stay at home or their place of residence, except for certain specified activities that were deemed necessary to sustain or protect life. That original executive order was amended several times and was later rescinded and replaced entirely by a series of "Safer at Home" executive orders, which generally extended certain social distancing restrictions, but lifted the requirement that individuals remain in their homes. The series of "Safer at Home" orders, along with all other executive orders relating to the pandemic issued by Michigan's Governor after April 30, 2020, were then deemed unconstitutional by the Michigan Supreme Court on October 2, 2020. Since then, the Michigan Department of Health and Human Services (MDHHS) has issued orders similar to the Governor's executive orders under authority granted to the MDHHS by the Michigan Public Health Code – a different statute than the law on which the Governor based her executive orders. Under the MDHHS' orders, social distancing restrictions remain in place; however, certain retail operations, restaurants and bars, and other businesses are permitted to conduct in-person operations, subject to capacity limitations and other workplace safety requirements. The degree to which businesses may resume operations varies based on the region of the state in which they are located. It is currently expected that various forms of state and local government restrictions similar to those described above will continue through the fourth quarter and perhaps beyond. As a result of these events, Michigan has experienced a significant increase in unemployment.

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

The COVID-19 pandemic, the related executive orders, and other government restrictions and guidance have had and continue to have a significant effect on us, our customers and the markets we serve. Our business, results of operations and financial condition may be adversely affected by a number of factors that could impact us and our customers, including but not limited to:

- restrictions on activity and high levels of unemployment may cause increases in loan delinquencies, foreclosures and defaults;
- increases in allowance for loan losses may be necessary;
- declines in collateral values may occur;
- third party disruptions, including outages at network providers, on-line banking vendors and other suppliers;
- increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity;
- operational failures due to changes in our normal business practices necessitated by the pandemic and related governmental actions; and/or
- key personnel or significant numbers of our employees being unable to work effectively, including because of illness or restrictions in connection with COVID-19.

These factors may continue for a significant period of time.

The extent to which the COVID-19 pandemic will impact our business, results of operations and financial condition will depend on future developments, which are highly uncertain and difficult to predict. Those developments and factors include, the duration and spread of the pandemic, its severity, the actions to contain the pandemic or address its impact, and how quickly and to what extent normal economic and operating conditions can resume. We do not yet know the full extent of the impact. However, the effects could have a material adverse impact on our business, asset valuations, financial condition and results of operations. Material adverse impacts may include all or a combination of valuation impairments on our intangible assets, securities available for sale, loans, capitalized mortgage loan servicing rights or deferred tax assets.

Certain industries (such as hotels and restaurants) have been more adversely impacted by the COVID-19 pandemic and related periodic shut downs of our economy. We believe that the following industry concentrations within our commercial loan portfolio represent greater potential risk in the current economic environment. The balances below are as of September 30, 2020.

Commercial and industrial portfolio segment:

- Retail - \$99 million
- Food service - \$59 million
- Hotel - \$45 million

Commercial real estate portfolio segment:

- Retail - \$94 million
- Office - \$53 million
- Multifamily - \$62 million

We are closely monitoring these industry concentrations and at present do not foresee any significant losses relative to this portion of our loan portfolio given the current economic conditions in Michigan and the fact that many businesses have reopened. However, a high degree of uncertainty still exists with respect to the impact of the COVID-19 pandemic and the related economic disruptions on the future performance of our loan portfolio, including these concentrations.

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

Litigation

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.

Loss Reimbursement Obligations

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 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 provision for loss reimbursement on sold loans was an expense of \$0.05 million and \$0.03 million for the three month periods ended September 30, 2020 and 2019 and an expense of \$0.16 million and \$0.18 million for the nine month periods ended September 30, 2020 and 2019, respectively. The reserve for loss reimbursements on sold mortgage loans totaled \$0.98 million and \$0.88 million at September 30, 2020 and December 31, 2019, respectively. This reserve is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. 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.

Visa Stock

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 Class A shares for every 1 Class B share and the closing price of VISA Class A shares on October 28, 2020 of \$180.87 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, which would not have any trading restrictions.

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

14. Accumulated Other Comprehensive Income (Loss) (“AOCIL”)

A summary of changes in AOCIL follows:

	Unrealized Gains (Losses) on Securities Available for Sale	Dispropor- tionate Tax Effects from Securities Available for Sale	Unrealized Losses on Cash Flow Hedges	Total
	(In thousands)			
For the three months ended September 30,				
2020				
Balances at beginning of period	\$ 11,315	\$ (5,798)	\$ (1,721)	\$ 3,796
Other comprehensive income (loss) before reclassifications	2,125	-	(20)	2,105
Amounts reclassified from AOCIL	-	-	245	245
Net current period other comprehensive income	2,125	-	225	2,350
Balances at end of period	<u>\$ 13,440</u>	<u>\$ (5,798)</u>	<u>\$ (1,496)</u>	<u>\$ 6,146</u>
2019				
Balances at beginning of period	\$ 3,040	\$ (5,798)	\$ (1,673)	\$ (4,431)
Other comprehensive income (loss) before reclassifications	1,196	-	(58)	1,138
Amounts reclassified from AOCIL	-	-	(80)	(80)
Net current period other comprehensive income (loss)	1,196	-	(138)	1,058
Balances at end of period	<u>\$ 4,236</u>	<u>\$ (5,798)</u>	<u>\$ (1,811)</u>	<u>\$ (3,373)</u>
For the nine months ended September 30,				
2020				
Balances at beginning of period	\$ 3,739	\$ (5,798)	\$ (1,727)	\$ (3,786)
Other comprehensive income (loss) before reclassifications	9,901	-	(279)	9,622
Amounts reclassified from AOCIL	(200)	-	510	310
Net current period other comprehensive income	9,701	-	231	9,932
Balances at end of period	<u>\$ 13,440</u>	<u>\$ (5,798)</u>	<u>\$ (1,496)</u>	<u>\$ 6,146</u>
2019				
Balances at beginning of period	\$ (4,185)	\$ (5,798)	\$ (125)	\$ (10,108)
Other comprehensive income (loss) before reclassifications	8,529	-	(1,376)	7,153
Amounts reclassified from AOCIL	(108)	-	(310)	(418)
Net current period other comprehensive income (loss)	8,421	-	(1,686)	6,735
Balances at end of period	<u>\$ 4,236</u>	<u>\$ (5,798)</u>	<u>\$ (1,811)</u>	<u>\$ (3,373)</u>

The disproportionate tax effects from securities available for sale arose due to tax effects of other comprehensive income (“OCI”) in the presence of a valuation allowance against our deferred tax assets and a pretax loss from operations. Generally, the amount of income tax expense or benefit allocated to operations is determined without regard to the tax effects of other categories of income or loss, such as OCI. However, an exception to the general rule is provided when, in the presence of a valuation allowance against deferred tax assets, there is a pretax loss from operations and pretax income from other categories in the current period. In such instances, income from other categories must offset the current loss from operations, the tax benefit of such offset being reflected in operations. Release of material disproportionate tax effects from other comprehensive income to earnings is done by the portfolio method whereby the effects will remain in AOCIL as long as we carry a more than inconsequential portfolio of securities available for sale.

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

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

AOCIL Component	Amount Reclassified From AOCIL (In thousands)	Affected Line Item in Condensed Consolidated Statements of Operations
2020		
Unrealized gains on securities available for sale	\$ -	- Net gains on securities available for sale
		- Net impairment loss recognized in earnings
		- Total reclassifications before tax
		- Income tax expense
	<u>\$ -</u>	- Reclassifications, net of tax
Unrealized losses on cash flow hedges	\$ 310	Interest expense
	65	Income tax expense
	<u>\$ 245</u>	Reclassification, net of tax
	<u>\$ (245)</u>	Total reclassifications for the period, net of tax
2019		
Unrealized gains on securities available for sale	\$ -	- Net gains on securities available for sale
		- Net impairment loss recognized in earnings
		- Total reclassifications before tax
		- Income tax expense
	<u>\$ -</u>	- Reclassifications, net of tax
Unrealized losses on cash flow hedges	\$ (102)	Interest expense
	(22)	Income tax expense
	<u>\$ (80)</u>	Reclassification, net of tax
	<u>\$ 80</u>	Total reclassifications for the period, net of tax

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

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

AOCIL Component	Amount Reclassified From AOCIL (In thousands)	Affected Line Item in Condensed Consolidated Statements of Operations
2020		
Unrealized gains on securities available for sale	\$ 253	Net gains on securities available for sale
	-	Net impairment loss recognized in earnings
	<u>253</u>	Total reclassifications before tax
	53	Income tax expense
	<u>\$ 200</u>	Reclassifications, net of tax
Unrealized losses on cash flow hedges	\$ 646	Interest expense
	136	Income tax expense
	<u>\$ 510</u>	Reclassification, net of tax
	<u>\$ (310)</u>	Total reclassifications for the period, net of tax
2019		
Unrealized gains on securities available for sale	\$ 137	Net gains on securities available for sale
	-	Net impairment loss recognized in earnings
	<u>137</u>	Total reclassifications before tax
	29	Income tax expense
	<u>\$ 108</u>	Reclassifications, net of tax
Unrealized losses on cash flow hedges	\$ (393)	Interest expense
	(83)	Income tax expense
	<u>\$ (310)</u>	Reclassification, net of tax
	<u>\$ 418</u>	Total reclassifications for the period, net of tax

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

15. 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 available for sale, mortgage loan servicing, net and bank owned life insurance and were approximately 87.9% and 84.7% of total revenues for the nine month periods ending September 30, 2020 and 2019, respectively.

Material sources of revenue that are included in the scope of this topic include service charges on deposit accounts, 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 September 30, 2020 and 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. 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 is 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) losses 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 the nine month periods ending September 30, 2020 and 2019 that were financed by us.

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

Disaggregation of our revenue sources by attribute follows:

Three months ending September 30, 2020

	Service Charges on Deposit Accounts	Other Deposit Related Income	Interchange Income	Investment and Insurance Commissions	Total
	(In thousands)				
Retail					
Overdraft fees	\$ 1,371	\$ -	\$ -	\$ -	\$ 1,371
Account service charges	544	-	-	-	544
ATM fees	-	320	-	-	320
Other	-	184	-	-	184
Business					
Overdraft fees	170	-	-	-	170
ATM fees	-	7	-	-	7
Other	-	89	-	-	89
Interchange income	-	-	3,428	-	3,428
Asset management revenue	-	-	-	335	335
Transaction based revenue	-	-	-	195	195
Total	\$ 2,085	\$ 600	\$ 3,428	\$ 530	\$ 6,643

Reconciliation to Condensed Consolidated Statement of Operations:

Non-interest income - other:	
Other deposit related income	\$ 600
Investment and insurance commissions	530
Bank owned life insurance	215
Other	592
Total	\$ 1,937

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

Three months ending September 30, 2019

	Service Charges on Deposit Accounts	Other Deposit Related Income	Interchange Income	Investment and Insurance Commissions	Total
	(In thousands)				
Retail					
Overdraft fees	\$ 1,970	\$ -	\$ -	\$ -	\$ 1,970
Account service charges	552	-	-	-	552
ATM fees	-	373	-	-	373
Other	-	240	-	-	240
Business					
Overdraft fees	361	-	-	-	361
ATM fees	-	9	-	-	9
Other	-	91	-	-	91
Interchange income	-	-	2,785	-	2,785
Asset management revenue	-	-	-	292	292
Transaction based revenue	-	-	-	158	158
Total	<u>\$ 2,883</u>	<u>\$ 713</u>	<u>\$ 2,785</u>	<u>\$ 450</u>	<u>\$ 6,831</u>

Reconciliation to Condensed Consolidated Statement of Operations:

Non-interest income - other:	
Other deposit related income	\$ 713
Investment and insurance commissions	450
Bank owned life insurance	301
Other	1,028
Total	<u>\$ 2,492</u>

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

Nine months ending September 30, 2020

	Service Charges on Deposit Accounts	Other Deposit Related Income	Interchange Income	Investment and Insurance Commissions	Total
	(In thousands)				
Retail					
Overdraft fees	\$ 4,130	\$ -	\$ -	\$ -	\$ 4,130
Account service charges	1,501	-	-	-	1,501
ATM fees	-	896	-	-	896
Other	-	577	-	-	577
Business					
Overdraft fees	668	-	-	-	668
ATM fees	-	18	-	-	18
Other	-	252	-	-	252
Interchange income	-	-	8,411	-	8,411
Asset management revenue	-	-	-	937	937
Transaction based revenue	-	-	-	541	541
Total	<u>\$ 6,299</u>	<u>\$ 1,743</u>	<u>\$ 8,411</u>	<u>\$ 1,478</u>	<u>\$ 17,931</u>

Reconciliation to Condensed Consolidated Statement of Operations:

Non-interest income - other:	
Other deposit related income	\$ 1,743
Investment and insurance commissions	1,478
Bank owned life insurance	750
Other	1,727
Total	<u>\$ 5,698</u>

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

Nine months ending September 30, 2019

	Service Charges on Deposit Accounts	Other Deposit Related Income	Interchange Income (In thousands)	Investment and Insurance Commissions	Total
Retail					
Overdraft fees	\$ 5,582	\$ -	\$ -	\$ -	\$ 5,582
Account service charges	1,618	-	-	-	1,618
ATM fees	-	1,041	-	-	1,041
Other	-	703	-	-	703
Business					
Overdraft fees	1,123	-	-	-	1,123
ATM fees	-	26	-	-	26
Other	-	309	-	-	309
Interchange income	-	-	7,744	-	7,744
Asset management revenue	-	-	-	823	823
Transaction based revenue	-	-	-	374	374
Total	\$ 8,323	\$ 2,079	\$ 7,744	\$ 1,197	\$ 19,343

Reconciliation to Condensed Consolidated Statement of Operations:

Non-interest income - other:	
Other deposit related income	\$ 2,079
Investment and insurance commissions	1,197
Bank owned life insurance	813
Other	2,773
Total	\$ 6,862

16. 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 Condensed 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 right of use ("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 September 30, 2020). 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.

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

The cost components of our operating leases follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(In thousands)		(In thousands)	
Operating lease cost	\$ 395	\$ 565	\$ 1,357	\$ 1,692
Variable lease cost	16	43	52	115
Short-term lease cost	10	4	26	14
Total	<u>\$ 421</u>	<u>\$ 612</u>	<u>\$ 1,435</u>	<u>\$ 1,821</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:

	September 30, 2020	December 31, 2019
	(Dollars in thousands)	
Lease right of use asset (1)	<u>\$ 6,713</u>	<u>\$ 8,282</u>
Lease liabilities (2)	<u>\$ 6,945</u>	<u>\$ 8,304</u>
Weighted average remaining lease term (years)	<u>6.84</u>	<u>7.47</u>
Weighted average discount rate	<u>2.6%</u>	<u>2.8%</u>

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

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

Maturity analysis of our lease liabilities at September 30, 2020 based on required contractual payments follows:

	(In thousands)
Three months ending December 31, 2020	\$ 408
2021	1,505
2022	1,324
2023	1,101
2024	692
2025 and thereafter	<u>2,576</u>
Total lease payments	7,606
Less imputed interest	(661)
Total	<u>\$ 6,945</u>

ITEM 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Introduction. The following section presents additional information to assess the financial condition and results of operations of Independent Bank Corporation ("IBCP"), its wholly-owned bank, Independent Bank (the "Bank"), and their subsidiaries. This section should be read in conjunction with the Condensed Consolidated Financial Statements. We also encourage you to read our 2019 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. We also have two loan production offices in Ohio (Columbus and Fairlawn). As a result, our success depends to a great extent upon the economic conditions in Michigan's Lower Peninsula.

Recent Developments. On March 11, 2020, the World Health Organization declared COVID-19, the disease caused by the novel coronavirus, a pandemic as a result of the global spread of the coronavirus illness. In response to the outbreak, federal and state authorities in the U.S. introduced various measures to try to limit or slow the spread of the virus, including travel restrictions, nonessential business closures, stay-at-home orders, and strict social distancing. The Governor of Michigan issued her first "stay home, stay safe" executive order effective March 24, 2020. In general, that order and subsequent modifications required individuals in Michigan to stay at home or their place of residence, except for certain specified activities that were deemed necessary to sustain or protect life. That original executive order was amended several times and was later rescinded and replaced entirely by a series of "Safer at Home" executive orders, which generally extended certain social distancing restrictions, but lifted the requirement that individuals remain in their homes. The series of "Safer at Home" orders, along with all other executive orders relating to the pandemic issued by Michigan's Governor after April 30, 2020, were then deemed unconstitutional by the Michigan Supreme Court on October 2, 2020. Since then, the Michigan Department of Health and Human Services (MDHHS) has issued orders similar to the Governor's executive orders under authority granted to the MDHHS by the Michigan Public Health Code – a different statute than the law on which the Governor based her executive orders. Under the MDHHS' orders, social distancing restrictions remain in place; however, certain retail operations, restaurants and bars, and other businesses are permitted to conduct in-person operations, subject to capacity limitations and other workplace safety requirements. The degree to which businesses may resume operations varies based on the region of the state in which they are located. It is currently expected that various forms of state and local government restrictions similar to those described above will continue through the fourth quarter and perhaps beyond. As a result of these events, Michigan has experienced a significant increase in unemployment.

The COVID-19 pandemic, the related executive orders, and other government restrictions and guidance have had and continue to have a significant effect on us, our customers and the markets we serve. Our business, results of operations and financial condition may be adversely affected by a number of factors that could impact us and our customers, including but not limited to:

- restrictions on activity and high levels of unemployment may cause increases in loan delinquencies, foreclosures and defaults;

- increases in allowance for loan losses may be necessary;
- declines in collateral values may occur;
- third party disruptions, including outages at network providers, on-line banking vendors and other suppliers;
- increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity;
- operational failures due to changes in our normal business practices necessitated by the pandemic and related governmental actions; and/or
- key personnel or significant numbers of our employees being unable to work effectively, including because of illness or restrictions in connection with COVID-19.

These factors may continue for a significant period of time. See note #13 to the Condensed Consolidated Financial Statements included within this report.

The spread of COVID-19 has caused us to modify many of our business practices. Currently, approximately 38% of our total employees work remotely. We have also expanded sick and vacation time for certain employees. We may take further actions as may be required or as we determine to be prudent. There is no certainty that such measures will be sufficient to mitigate the risks posed by COVID-19.

The extent to which the COVID-19 pandemic will impact our business, results of operations and financial condition will depend on future developments, which are highly uncertain and difficult to predict. Those developments and factors include, the duration and spread of the pandemic, its severity, the actions to contain the pandemic or address its impact, and how quickly and to what extent normal economic and operating conditions can resume. We do not yet know the full extent of the impact. However, the effects could have a material adverse impact on our business, financial condition and results of operations.

It is against this backdrop that we discuss our results of operations and financial condition in the third quarter and first nine months of 2020 as compared to 2019.

RESULTS OF OPERATIONS

Summary. We recorded net income of \$19.6 million and \$12.4 million during the three months ended September 30, 2020 and 2019, respectively. The increase in 2020 third quarter results as compared to 2019 primarily reflects increases in net interest income and non-interest income that were partially offset by increases in the provision for loan losses, non-interest expense and income tax expense.

We recorded net income of \$39.2 million and \$32.6 million during the nine months ended September 30, 2020 and 2019, respectively. The increase in 2020 year-to-date results as compared to 2019 is primarily due to increases in net interest income and non-interest income that were partially offset by increases in the provision for loan losses, non-interest expense and income tax expense.

Key performance ratios

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Net income (annualized) to				
Average assets	1.90%	1.42%	1.36%	1.28%
Average shareholders' equity	21.36%	14.64%	14.87%	12.84%
Net income per common share				
Basic	\$ 0.90	\$ 0.55	\$ 1.78	\$ 1.41
Diluted	0.89	0.55	1.76	1.40

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

Our net interest income totaled \$32.0 million during the third quarter of 2020, an increase of \$1.1 million, or 3.5% from the year-ago period. This increase primarily reflects a \$602.4 million increase in average interest-earning assets that was partially offset by a 45 basis point decrease in our tax equivalent net interest income as a percent of average interest-earning assets (the "net interest margin").

For the first nine months of 2020, net interest income totaled \$92.6 million, an increase of \$0.7 million, or 0.8% from 2019. This increase primarily reflects a \$423.6 million increase in average interest-earning assets that was partially offset by a 41 basis point decrease in our net interest margin.

Due to the economic impact of COVID-19, the Federal Reserve Bank has taken a variety of actions to stimulate the economy, including lowering short-term interest rates. These actions, along with lower long-term interest rates as well, have placed pressure on our net interest margin.

The significant increases in average interest-earning assets for the three- and nine-month periods ending September 30, 2020 versus the comparable year earlier periods is primarily due to the deployment of funds from a substantial increase in deposits.

Interest and fees on loans include \$1.3 million and \$2.3 million for the third quarter and first nine months of 2020, of accretion of net loan fees on PPP loans. No such accretion is included in the comparable prior year periods. Interest and fees on loans also include \$0.3 million and \$0.9 million for the third quarter and first nine months of 2020, respectively, and include \$0.4 million and \$1.1 million for the third quarter and first nine months of 2019, respectively, of accretion of the discount recorded on loans acquired in the April 2018 acquisition of Traverse City State Bank ("TCSB"). In addition, the third quarter and first nine months of 2020 include \$0.5 million of discount accretion on a purchased commercial loan that was paid off during the quarter.

Our net interest income is also adversely impacted by our level of non-accrual loans. In the third quarter and first nine months of 2020, non-accrual loans averaged \$10.4 million and \$12.4 million, respectively. In the third quarter and first nine months of 2019, non-accrual loans averaged \$6.9 million and \$8.1 million, respectively. In addition, in the third quarter and first nine months of 2020, we had net recoveries of \$0.44 million and \$0.85 million, respectively, of unpaid interest on loans placed on or taken off non-accrual during each period or on loans previously charged-off compared to net recoveries of \$0.23 million and \$0.66 million, respectively, during the same periods in 2019.

Average Balances and Tax Equivalent Rates

	2020		Three Months Ended September 30,			
	Average Balance	Interest	Rate ⁽²⁾	Average Balance	Interest	Rate ⁽²⁾
(Dollars in thousands)						
Assets						
Taxable loans	\$ 2,918,946	\$ 30,323	4.14%	\$ 2,779,132	\$ 34,151	4.89%
Tax-exempt loans ⁽¹⁾	6,926	88	5.05	7,412	94	5.03
Taxable securities	733,977	3,450	1.88	371,157	2,771	2.99
Tax-exempt securities ⁽¹⁾	157,998	1,194	3.02	52,098	400	3.07
Interest bearing cash	51,181	14	0.11	56,923	229	1.60
Other investments	18,427	223	4.81	18,359	266	5.75
Interest Earning Assets	<u>3,887,455</u>	<u>35,292</u>	3.62	<u>3,285,081</u>	<u>37,911</u>	4.60
Cash and due from banks	52,676			34,598		
Other assets, net	162,187			163,617		
Total Assets	<u>\$ 4,102,318</u>			<u>\$ 3,483,296</u>		
Liabilities						
Savings and interest-bearing checking	\$ 1,922,971	686	0.14	\$ 1,487,820	2,818	0.75
Time deposits	498,796	1,376	1.10	658,426	3,418	2.06
Other borrowings	110,714	1,006	3.61	72,887	703	3.83
Interest Bearing Liabilities	<u>2,532,481</u>	<u>3,068</u>	0.48	<u>2,219,133</u>	<u>6,939</u>	1.24
Non-interest bearing deposits	1,137,303			877,088		
Other liabilities	67,820			49,913		
Shareholders' equity	364,714			337,162		
Total liabilities and shareholders' equity	<u>\$ 4,102,318</u>			<u>\$ 3,483,296</u>		
Net Interest Income		<u>\$ 32,224</u>			<u>\$ 30,972</u>	
Net Interest Income as a Percent of Average Interest Earning Assets			<u>3.31%</u>			<u>3.76%</u>

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

(2) Annualized

Average Balances and Tax Equivalent Rates

	Nine Months Ended September 30,					
	2020			2019		
	Average Balance	Interest	Rate ⁽²⁾	Average Balance	Interest	Rate ⁽²⁾
	(Dollars in thousands)					
Assets						
Taxable loans	\$ 2,861,776	\$ 91,804	4.28%	\$ 2,695,435	\$ 100,513	4.98%
Tax-exempt loans ⁽¹⁾	7,266	273	5.02	7,856	291	4.95
Taxable securities	579,704	9,356	2.15	384,291	8,811	3.06
Tax-exempt securities ⁽¹⁾	114,187	2,682	3.13	52,794	1,275	3.22
Interest bearing cash	52,265	160	0.41	51,260	655	1.71
Other investments	18,404	694	5.04	18,359	794	5.78
Interest Earning Assets	<u>3,633,602</u>	<u>104,969</u>	3.85	<u>3,209,995</u>	<u>112,339</u>	4.67
Cash and due from banks	49,345			34,032		
Other assets, net	163,503			166,037		
Total Assets	<u>\$ 3,846,450</u>			<u>\$ 3,410,064</u>		
Liabilities						
Savings and interest-						
bearing checking	\$ 1,764,933	3,121	0.24	\$ 1,421,114	7,787	0.73
Time deposits	529,248	6,029	1.52	670,479	10,151	2.02
Other borrowings	121,195	2,598	2.86	72,233	2,211	4.09
Interest Bearing Liabilities	<u>2,415,376</u>	<u>11,748</u>	0.65	<u>2,163,826</u>	<u>20,149</u>	1.24
Non-interest bearing deposits	1,016,286			862,929		
Other liabilities	62,984			44,323		
Shareholders' equity	351,804			338,986		
Total liabilities and shareholders' equity	<u>\$ 3,846,450</u>			<u>\$ 3,410,064</u>		
Net Interest Income		<u>\$ 93,221</u>			<u>\$ 92,190</u>	
Net Interest Income as a Percent of Average Interest Earning Assets			<u>3.42%</u>			<u>3.83%</u>

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

(2) Annualized

Reconciliation of Non-GAAP Financial Measures

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars in thousands)			
Net Interest Margin, Fully Taxable Equivalent ("FTE")				
Net interest income	\$ 31,966	\$ 30,872	\$ 92,619	\$ 91,871
Add: taxable equivalent adjustment	258	100	602	319
Net interest income - taxable equivalent	\$ 32,224	\$ 30,972	\$ 93,221	\$ 92,190
Net interest margin (GAAP) ⁽¹⁾	3.28%	3.74%	3.40%	3.82%
Net interest margin (FTE) ⁽¹⁾	3.31%	3.76%	3.42%	3.83%

(1) Annualized.

Provision for loan losses. We have elected to delay the adoption of the Current Expected Credit Losses ("CECL") accounting standard as permitted by Section 4014 of the CARES Act and continue to utilize the existing incurred loss impairment methodology to calculate our allowance for loan losses ("AFL") and our provision for loan losses. See note #2 to the Condensed Consolidated Financial Statements included within this report for our discussion on CECL implementation.

The provision for loan losses was an expense of \$1.0 million and a credit of \$0.3 million for the three months ended September 30, 2020 and 2019, respectively. During the nine-month periods ended September 30, 2020 and 2019, the provision was an expense of \$12.9 million and \$1.0 million, respectively. The provision reflects our assessment of the AFL taking into consideration factors such as loan growth, 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. In particular, the credit impact of the COVID-19 pandemic, and more specifically the periodic closing of various segments of the economy in order to contain it, may have a negative impact on our level of non-performing loans and assets in the future, but as of yet, the magnitude of that impact is undeterminable. As a result of this potential adverse impact, we have increased the subjective portion of our AFL by \$10.7 million (or 122.1%) during the first nine months of 2020. See "Portfolio Loans and asset quality" for a discussion of the various components of the AFL and their impact on the provision for loan losses in 2020. See note #13 to the Condensed Consolidated Financial Statements included within this report for a discussion on industry concentrations.

Non-interest income. Non-interest income is a significant element in assessing our results of operations. Non-interest income totaled \$27.0 million during the third quarter of 2020 compared to \$12.3 million in the third quarter of 2019. For the first nine months of 2020, non-interest income totaled \$58.4 million compared to \$32.1 million for the first nine months of 2019.

The components of non-interest income are as follows:

Non-Interest Income

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(In thousands)			
Interchange income	\$ 3,428	\$ 2,785	\$ 8,411	\$ 7,744
Service charges on deposit accounts	2,085	2,883	6,299	8,323
Net gains on assets				
Mortgage loans	20,205	5,677	46,687	13,590
Securities available for sale	-	-	253	304
Mortgage loan servicing, net	(644)	(1,562)	(8,966)	(4,684)
Investment and insurance commissions	530	450	1,478	1,197
Bank owned life insurance	215	301	750	813
Other	1,192	1,741	3,470	4,852
Total non-interest income	\$ 27,011	\$ 12,275	\$ 58,382	\$ 32,139

Interchange income increased on a comparative quarterly basis and on a year-to-date basis in 2020 as compared to 2019, due to an increase in transaction volume and an increase in our annual volume incentive under our debit brand agreement.

Service charges on deposit accounts decreased on both a comparative quarterly and year-to-date basis in 2020 as compared to 2019. These decreases were principally due to a decrease in non-sufficient funds occurrences (and related fees) caused in part by the COVID-19 pandemic and reduced checking account activity.

Net gains on mortgage loans increased substantially in 2020 from 2019 on both a quarterly and a year to date basis. Mortgage loan activity is summarized as follows:

Mortgage Loan Activity

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(Dollars in thousands)			
Mortgage loans originated	\$ 536,502	\$ 329,461	\$ 1,318,206	\$ 708,621
Mortgage loans sold	417,092	204,058	1,058,400	490,219
Net gains on mortgage loans	20,205	5,677	46,687	13,590
Net gains as a percent of mortgage loans sold ("Loan Sales Margin")	4.84%	2.78%	4.41%	2.77%
Fair value adjustments included in the Loan Sales Margin	0.50	0.22	0.81	0.48

The comparative increase in mortgage loans originated is due primarily to lower interest rates in 2020 that have spurred a significant increase in refinance volumes. Mortgage loans sold increased due to a higher mix of salable loans in our origination volumes and some portfolio mortgage loan sales that were completed during the first quarter of 2020. Net gains on mortgage loans also increased in 2020 as compared to 2019 due to fair value adjustments as discussed below.

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

Our Loan Sales Margin is 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 4.34% and 2.56% in the third quarters of 2020 and 2019, respectively and 3.60% and 2.29% for the comparative 2020 and 2019 year-to-date periods, respectively. The increase in the Loan Sales Margin (excluding fair value adjustments) in 2020 was generally due to a substantial widening of primary-to-secondary market pricing spreads as market interest rates fell during this period and mortgage loan refinance volumes dramatically increased. Once mortgage loan refinance volumes abate, we would expect our Loan Sales Margin to decline to more normal levels. The changes in the fair value accounting adjustments are primarily due to changes in the amount of commitments to originate mortgage loans for sale.

We recorded no net gains (losses) on securities in the comparative quarterly periods. We recorded a net gain of \$0.3 million on securities for both the first nine months of 2020 and 2019. We recorded no net impairment losses in either 2020 or 2019 for other than temporary impairment of securities available for sale. See “Securities” below and note #3 to the Condensed Consolidated Financial Statements.

Mortgage loan servicing, net, generated a loss of \$0.6 million and \$1.6 million in the third quarters of 2020 and 2019, respectively. For the first nine months of 2020 and 2019, mortgage loan servicing, net, generated a loss of \$9.0 million and \$4.7 million, respectively. The significant variances in mortgage loan servicing, net are primarily due to changes in the fair value of capitalized mortgage loan servicing rights associated with changes in mortgage loan interest rates and expected future prepayment levels. Mortgage loan servicing, net activity is summarized in the following table:

Mortgage Servicing Revenue

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Mortgage loan servicing				
Revenue, net	\$ 1,743	\$ 1,583	\$ 5,062	\$ 4,574
Fair value change due to price	(1,089)	(2,163)	(9,941)	(7,036)
Fair value change due to pay-downs	(1,298)	(982)	(4,087)	(2,222)
Total	\$ (644)	\$ (1,562)	\$ (8,966)	\$ (4,684)

Activity related to capitalized mortgage loan servicing rights is as follows:

Capitalized Mortgage Loan Servicing Rights

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(In thousands)			
Balance at beginning of period	\$ 13,773	\$ 17,894	\$ 19,171	\$ 21,400
Originated servicing rights capitalized	4,017	2,157	10,260	4,764
Change in fair value	(2,387)	(3,145)	(14,028)	(9,258)
Balance at end of period	<u>\$ 15,403</u>	<u>\$ 16,906</u>	<u>\$ 15,403</u>	<u>\$ 16,906</u>

At September 30, 2020 we were servicing approximately \$2.87 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of 3.90% and a weighted average service fee of approximately 25.7 basis points. Capitalized mortgage loan servicing rights at September 30, 2020 totaled \$15.4 million, representing approximately 53.6 basis points on the related amount of mortgage loans serviced for others.

Investment and insurance commissions represent revenues generated on the sale or management of investments and insurance for our customers. These revenues were relatively comparable on a quarterly basis, and increased on a year-to-date basis in 2020 as compared to 2019. The year-to-date comparative increase in 2020 was primarily due to slower sales in the first quarter of 2019.

Income from bank owned life insurance (“BOLI”) declined slightly on both a comparative quarterly and year-to-date basis in 2020 compared to 2019 reflecting a lower crediting rate on our cash surrender value. Our BOLI separate account is primarily invested in agency mortgage-backed securities. The crediting rate (on which the earnings are based) reflects the performance of the separate account. The total cash surrender value of our BOLI was \$55.0 million and \$55.7 million at September 30, 2020 and December 31, 2019, respectively.

Other non-interest income decreased significantly on both a comparative quarterly and year-to-date basis in 2020 as compared to 2019. Several categories of fees have been reduced in 2020 due to the impact of the COVID-19 pandemic on transaction volumes, including ATM fees. In addition, we have elected to suspend certain electronic banking fees because of the COVID-19 pandemic and the increased need for our customers to access these channels. Commercial loan swap fee income is also lower in 2020 as customers have not felt the need to execute such transactions given the low interest rate environment. Finally, the first quarter of 2019 included \$0.4 million of recoveries on TCSB loans that had been charged-off prior to our acquisition of TCSB.

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

Non-interest expense increased by \$5.8 million to \$33.6 million and increased by \$7.3 million to \$89.7 million during the three- and nine-month periods ended September 30, 2020, respectively, compared to the same periods in 2019.

The components of non-interest expense are as follows:

Non-Interest Expense

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
	(In thousands)			
Compensation	\$ 10,294	\$ 10,327	\$ 30,665	\$ 30,993
Performance-based compensation	8,310	3,214	14,240	7,730
Payroll taxes and employee benefits	3,350	3,132	9,837	10,232
Compensation and employee benefits	21,954	16,673	54,742	48,955
Occupancy, net	2,199	2,161	6,818	6,797
Data processing	2,215	2,282	6,160	6,597
Furniture, fixtures and equipment	999	1,023	3,125	3,058
Interchange expense	831	891	2,416	2,332
Communications	806	733	2,409	2,219
Loan and collection	768	714	2,329	1,976
Advertising	589	636	1,636	1,935
Legal and professional	566	541	1,427	1,281
FDIC deposit insurance	411	13	1,211	723
Conversion related expenses	643	-	1,045	-
Amortization of intangible assets	255	272	765	817
Supplies	126	163	513	474
Branch closure costs	-	-	417	-
Correspondent bank service fees	101	100	294	300
Costs related to unfunded lending commitments	41	154	271	341
Provision for loss reimbursement on sold loans	46	33	160	179
Net (gains) losses on other real estate and repossessed assets	46	52	146	(27)
Other	1,045	1,407	3,822	4,473
Total non-interest expense	\$ 33,641	\$ 27,848	\$ 89,706	\$ 82,430

Compensation and employee benefits expenses, in total, increased \$5.3 million on a quarterly comparative basis and increased \$5.8 million for the first nine months of 2020 compared to the same periods in 2019.

Compensation expense decreased by \$0.03 million and \$0.3 million in the third quarter and first nine months of 2020, respectively, compared to the same periods in 2019. These comparative decreases in 2020 were primarily due to an increased level of compensation that was deferred as direct loan origination costs (due to higher loan origination volumes) that was partially offset by salary increases that were predominantly effective on January 1, 2020.

Performance-based compensation increased by \$5.1 million and \$6.5 million in the third quarter and first nine months of 2020, respectively, versus the same periods in 2019. The increases reflect the changes in the accrual for anticipated incentive compensation based on our estimated full-year performance as compared to goals as well as \$0.4 million in bonuses paid during the second quarter of 2020 to front-line personnel due to their extraordinary efforts during the COVID-19 pandemic.

Payroll taxes and employee benefits increased by \$0.2 million in the third quarter and decreased by \$0.4 million in the first nine months of 2020, respectively, compared to the same periods in 2019. The quarterly comparative increase is due primarily to higher payroll taxes and our employer 401(k) match reflecting higher overall compensation levels in 2020. The year-to-date comparative decrease is due primarily to a decline in health care costs (due to decreased claims in 2020) as well as a \$0.3 million prescription drug rebate received and recorded in the second quarter of 2020 that related to our 2019 plan year. The decrease in year to date health care claims is due in part to the COVID-19 pandemic that resulted in the closing of many medical and dental facilities except for emergency care during Michigan's "stay home, stay safe" period.

Occupancy, net, furniture, fixtures and equipment, supplies and correspondent bank service fees expenses were all relatively unchanged on a comparative quarterly and year-to-date basis in 2020 as compared to 2019. We have been incurring some additional expenses in 2020 related to the COVID-19 pandemic for more frequent cleaning of our facilities, the installation of safety related fixtures (such as plexiglass shields) and certain supplies (hand sanitizer for example).

Data processing expense decreased by \$0.1 million and \$0.4 million in the third quarter and first nine months of 2020, respectively, compared to the same periods in 2019. These comparative decreases in 2020 are primarily due to a cost savings agreement related to core data processing services that was executed in the second quarter of 2020. This expense reduction was partially offset by new software product additions and increased mobile banking costs.

Interchange expense primarily represents our third-party cost to process debit card transactions. The changes in this expense in 2020 on both a comparative quarterly and year-to-date basis as compared to 2019 are due principally to changes in transaction volume and transaction channel mix.

Communications expense increased by \$0.1 million and \$0.2 million in the third quarter and first nine months of 2020, respectively, compared to the same periods in 2019, due primarily to mailing costs related to the issuance of new contactless debit cards.

Loan and collection expense reflects costs related to new lending activity as well as the management and collection of non-performing loans and other problem credits. These costs increased in 2020 on both a comparative quarterly and year-to-date basis as compared to 2019 due primarily to higher loan origination activity.

Advertising expense decreased by approximately \$0.05 million and \$0.3 million in 2020 on both a comparative quarterly and year-to-date basis as compared to 2019. The year-to-date comparative decrease is due primarily to the receipt of a \$0.2 million reimbursement from our debit card provider for certain eligible marketing costs that we incurred.

Legal and professional fees were essentially unchanged and increased by approximately \$0.1 million in 2020 on a comparative quarterly and year-to-date basis, respectively, as compared to 2019. This year-to-date increase is due primarily to an increase in title search fees and bank examination fees (due to an increase in our asset size).

FDIC deposit insurance expense increased in 2020 on both a comparative quarterly and year-to-date basis as compared to 2019 due to a combination of an increase in our assessment rate and growth in our total assets. In addition, the quarterly and year-to-date 2019 periods included a \$0.3 million small bank assessment credit that reduced this expense.

Conversion related expenses totaled \$0.6 million and \$1.0 million for the third quarter and first nine months of 2020, respectively. We are at the middle stages of a process to convert our core data processing system to a new system hosted by a different vendor. These 2020 expenses represent costs incurred for assistance from our existing vendor and fees from consultants who are assisting us in this conversion. Also see Part II, Item 1A. Risk Factors below for further information on this conversion.

The amortization of intangible assets relates to the TCSB acquisition and prior branch acquisitions and the amortization of the deposit customer relationship value, including core deposit value, which was acquired in connection with those acquisitions. We had remaining unamortized intangible assets of \$4.6 million and \$5.3 million at September 30, 2020 and December 31, 2019, respectively. See note #7 to the Condensed Consolidated Financial Statements for a schedule of future amortization of intangible assets.

Branch closure costs totaled \$0.4 million for the first nine months of 2020. We have closed eight Bank branches in 2020 (two on June 26, 2020 and six on July 31, 2020). These costs primarily represent write-downs of fixed assets (buildings, furniture and equipment) and lease assets.

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 \$0.05 million and \$0.16 million in the third quarter and first nine months of 2020, respectively, compared to an expense of \$0.03 million and \$0.18 million in the third quarter and first nine months of 2019, 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). The small expense provisions in 2020 and 2019 are primarily due to growth in the balance of loans serviced for investors. 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 \$0.98 million and \$0.88 million at September 30, 2020 and December 31, 2019, respectively. This reserve is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition.

Net (gains) losses on other real estate and repossessed assets primarily represent the gain or loss on the sale or additional write downs on these assets subsequent to the transfer of the asset from our loan portfolio. This transfer occurs at the time we acquire the collateral that secured the loan. At the time of acquisition, the other real estate or repossessed asset is valued at fair value, less estimated costs to sell, which becomes the new basis for the asset. Any write-downs at the time of acquisition are charged to the allowance for loan losses.

Other non-interest expenses decreased by \$0.4 million in the third quarter and \$0.7 million for the first nine months of 2020, compared to the same periods in 2019. These decreases in 2020 are primarily due to a decline in travel and entertainment costs due to COVID-19 pandemic related travel restrictions as well as a reduction in deposit account and debit card related fraud costs.

Income tax expense. We recorded an income tax expense of \$4.8 million and \$9.2 million in the third quarter and the first nine months of 2020, respectively. This compares to an income tax expense of \$3.1 million and \$8.0 million in the third quarter and the first nine months of 2019, respectively.

Our actual income tax expense is different than the amount computed by applying our statutory income tax rate to our income before income tax primarily due to tax-exempt interest income, tax-exempt income from the increase in the cash surrender value on life insurance, and differences in the value of stock awards that vest and stock options that are exercised as compared to the initial fair values that were expensed.

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 September 30, 2020 and 2019 and at December 31, 2019, that the realization of substantially all of our deferred tax assets continues to be more likely than not.

FINANCIAL CONDITION

Summary. Our total assets increased by \$604.3 million during the first nine months of 2020. Loans, excluding loans held for sale, (“Portfolio Loans”) were \$2.86 billion at September 30, 2020, compared to \$2.73 billion at December 31, 2019. Growth in commercial loans of \$185.1 million and installment loans of \$20.2 million were partially offset by a decline in mortgage loans of \$74.9 million. The decline in mortgage loans was due in part to a securitization and/or sale of \$28.7 million of portfolio mortgage loans during the first quarter of 2020. (See “Portfolio Loans and asset quality.”)

Deposits totaled \$3.60 billion at September 30, 2020, an increase of \$561.0 million from December 31, 2019. The increase in deposits is primarily due to growth in non-interest bearing deposits, savings and interest bearing checking deposits and reciprocal deposits that were partially offset by a decline in time and brokered time deposits.

The increase in commercial loans in the first nine months of 2020 is due primarily to loans extended under the Paycheck Protection Program (“PPP”) administered by the U.S. Small Business Administration (“SBA”). The increase in deposits is due in part to the significant liquidity that has been injected into the economy through government programs, such as the PPP, as well as by monetary actions by the Federal Reserve Bank, all in response to the COVID-19 pandemic.

It is unclear as to when these various government stimulus programs may end and when ended, what the impact will be on our levels of Portfolio Loans and deposits. However, our liquidity and funding contingency plans take into account the possibility of significant reductions in commercial loans and deposits during 2021.

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

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Securities available for sale		(in thousands)		
September 30, 2020	\$ 968,038	\$ 18,899	\$ 1,887	\$ 985,050
December 31, 2019	513,668	5,782	1,050	518,400

Securities available for sale increased \$466.7 million during the first nine months of 2020. This significant increase reflects the deployment of funds from growth in our total deposits. 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. We recorded no impairment losses related to other than temporary impairment on securities available for sale during the first nine months or third quarters of 2020 or 2019.

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

Sales of Securities

	Nine months ended September 30,	
	2020	2019
	(in thousands)	
Proceeds	\$ 36,593	\$ 44,305
Gross gains	253	169
Gross losses	-	(32)
Net impairment charges	-	-
Fair value adjustments	-	167
Net gains	<u>\$ 253</u>	<u>\$ 304</u>

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 Loans more fixed rate mortgage loans as 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 some fixed rate jumbo and other portfolio mortgage loans in the future.

The PPP, is a short-term, forgivable loan program primarily intended to help businesses impacted by COVID-19 to continue paying their employees. Also see Part II, Item 1A. Risk Factors below regarding the PPP.

A short summary of the Payment Protection Program (PPP) is as follows:

- Terms of two years (five years for loans originated after June 5, 2020) with payments automatically deferred to the date the SBA remits the borrower's loan forgiveness amount to the lender (or, if the borrower does not apply for loan forgiveness, 10 months after the end of the borrower's loan forgiveness covered period);
- One percent interest rate;
- No collateral or personal guarantees required;
- No fees paid by the borrower, rather lenders are paid a fee through the SBA according to a set schedule based on loan size;
- Loans are forgivable if at least 60% of the loan proceeds are used for payroll with the remainder being used for rent, mortgage interest and/or utilities; and
- Streamlined forgiveness application process for PPP loans of \$50,000 or less.

A summary of our participation in the PPP follows:

Paycheck Protection Program Volume

	As of September 30, 2020	
	Amount (#)	Amount
	(Dollars in thousands)	
Closed and outstanding	2,117	\$ 261,182
Loans \$50,000 and under	1,214	25,106
Forgiveness applications submitted to the SBA	197	37,223
Fees accreted into interest income during the quarter	n/a	1,321
Unaccreted fees remaining at quarter-end	n/a	6,494
Average loan yield for the quarter	n/a	3.04%

Congress and the major bank regulatory agencies have encouraged banks to work with their borrowers to provide short-term loan payment relief during the COVID-19 national emergency. On March 22, 2020, an interagency statement was released by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Conference of State Bank Supervisors, and the National Credit Union Administration that contained guidance regarding loan modifications made in response to the pandemic. In general, in order for a loan modification made in response to the pandemic to avoid being classified as a troubled debt restructuring ("TDR"):

- The modified loan must be current when the modification is made;
- The modification must be short term in nature (up to six months); and
- Modifications may include payment deferrals, fee waivers, extensions of repayment terms or other delays in payment that are insignificant.

In addition, Section 4013 of the CARES Act provides temporary relief from the accounting and reporting requirements for TDRs regarding certain loan modifications for our customers. Section 4013 specified that COVID-19 related modifications on loans that were current as of December 31, 2019 are not TDRs.

In response to our customers' needs during this time of economic uncertainty, we have initiated forbearance programs for our retail (mortgage and installment loans) and our commercial customers. We also have similar programs for mortgage loans that we service for others. Commercial loan accommodations are typically a three month interest-only period while retail loan (mortgage and installment) forbearances have primarily been payment suspensions for three months. To date, there have not been a significant number of requests for additional modifications. See note #4 to the Condensed Consolidated Financial Statements included within this report.

A summary of accommodations as of September 30, 2020 follows:

Commercial and Retail Loan COVID-19 Accommodations

Loan Category	Covid-19 Accommodations		Total Loans	% of Total Loans
	Loans (#)	Loans (\$)		
Commercial	17	\$ 25,105	\$ 1,351,790	1.9%
Mortgage	197	32,091	1,024,036	3.1%
Installment	97	2,631	479,653	0.5%
Total	311	\$ 59,827	\$ 2,855,479	2.1%
Mortgage loans serviced for others(1)	416	\$ 66,279	\$ 2,873,153	2.3%

(1) We have delegated authority from all investors to grant these deferrals on their behalf.

A summary of our Portfolio Loans follows:

	September 30, 2020	December 31, 2019
(In thousands)		
Real estate(1)		
Residential first mortgages	\$ 793,691	\$ 843,746
Residential home equity and other junior mortgages	145,929	166,735
Construction and land development	266,081	249,747
Other(2)	646,656	693,580
Consumer	471,372	448,297
Commercial	527,854	318,504
Agricultural	3,896	4,414
Total loans	\$ 2,855,479	\$ 2,725,023

(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.

A summary of our non-performing assets follows:

Non-performing assets ⁽¹⁾

	September 30, 2020	December 31, 2019
	(Dollars in thousands)	
Non-accrual loans	\$ 10,481	\$ 10,178
Loans 90 days or more past due and still accruing interest	266	-
Subtotal	10,747	10,178
Less: Government guaranteed loans	510	646
Total non-performing loans	10,237	9,532
Other real estate and repossessed assets	1,487	1,865
Total non-performing assets	<u>\$ 11,724</u>	<u>\$ 11,397</u>
As a percent of Portfolio Loans		
Non-performing loans	0.36%	0.35
Allowance for loan losses	1.25	0.96
Non-performing assets to total assets	0.28	0.32
Allowance for loan losses as a percent of non-performing loans	349.43	274.32

(1) Excludes loans classified as "trouble debt restructured" that are not past due.

A summary of our troubled debt restructurings follows:

Troubled debt restructurings ("TDR")

	September 30, 2020		
	Commercial	Retail ⁽¹⁾	Total
	(In thousands)		
Performing TDR's	\$ 8,292	\$ 37,337	\$ 45,629
Non-performing TDR's ⁽²⁾	1,203	1,850	⁽³⁾ 3,053
Total	\$ 9,495	\$ 39,187	\$ 48,682

	December 31, 2019		
	Commercial	Retail ⁽¹⁾	Total
	(In thousands)		
Performing TDR's	\$ 7,974	\$ 39,601	\$ 47,575
Non-performing TDR's ⁽²⁾	540	2,607	⁽³⁾ 3,147
Total	\$ 8,514	\$ 42,208	\$ 50,722

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

(2) Included in non-performing assets 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 increased by \$0.7 million since year-end 2019 due to an increase in non-performing commercial loans. Our collection and resolution efforts have generally resulted in a stable trend in non-performing loans. However, the credit impact of the COVID-19 pandemic, and more specifically the periodic, government-mandated closing of various segments of the economy in order to contain it, may have a negative impact on the level of non-performing loans and assets in the future, but as yet, the magnitude of that impact is undeterminable. As a result of this potential adverse impact, we have increased the subjective portion of our allowance for loan losses ("AFL") by \$10.7 million (or 122.1%) during the first nine months of 2020. (See the further discussion of our AFL below.)

Non-performing loans exclude performing loans that are classified as TDRs. Performing TDRs totaled \$45.6 million, or 1.6% of total Portfolio Loans, and \$47.6 million, or 1.7% of total Portfolio Loans, at September 30, 2020 and December 31, 2019, respectively. The decrease in the amount of performing TDRs in 2020 primarily reflects the pay down of retail performing TDRs.

Other real estate and repossessed assets totaled \$1.5 million and \$1.9 million at September 30, 2020 and December 31, 2019, respectively.

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

The following tables reflect activity in and the allocation of the AFLL.

Allowance for loan losses

	Nine months ended September 30,			
	2020		2019	
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(Dollars in thousands)			
Balance at beginning of period	\$ 26,148	\$ 1,542	\$ 24,888	\$ 1,296
Additions (deductions)				
Provision for loan losses	12,884	-	1,045	-
Recoveries credited to allowance	2,404	-	3,109	-
Loans charged against the allowance	(5,665)	-	(2,894)	-
Additions included in non-interest expense	-	271	-	341
Balance at end of period	<u>\$ 35,771</u>	<u>\$ 1,813</u>	<u>\$ 26,148</u>	<u>\$ 1,637</u>
Net loans charged (recovered) against the allowance to average Portfolio Loans	0.16%		(0.01)%	

Allocation of the Allowance for Loan Losses

	September 30,	December 31,
	2020	2019
	(Dollars in thousands)	
Specific allocations	\$ 6,138	\$ 6,155
Other adversely rated commercial loans	2,097	2,502
Historical loss allocations	8,156	8,764
Additional allocations based on subjective factors	19,380	8,727
Total	<u>\$ 35,771</u>	<u>\$ 26,148</u>

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

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.

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 \$9.6 million to \$35.7 million at September 30, 2020 from \$26.1 million at December 31, 2019 and was equal to 1.25% and 0.96% of total Portfolio Loans at September 30, 2020 and December 31, 2019, respectively.

Three of the four components of the AFLL outlined above decreased through the first nine months of 2020. The AFLL related to specific loans decreased \$0.02 million during the first nine months of 2020. The AFLL related to other adversely rated commercial loans decreased \$0.4 million during the first three quarters of 2020, primarily due to a decrease in the balance of such loans included in this component. The AFLL related to historical losses decreased \$0.6 million through the first nine months of 2020, and the AFLL related to subjective factors increased \$10.7 million through the first nine months of 2020. The significant increase in the AFLL related to subjective factors is due principally to the economic shock of COVID-19, various executive orders suspending or restricting businesses and operations that are not necessary to sustain or protect life, or involved in critical infrastructure, the significant increase in unemployment claims, especially in the State of Michigan, and elevated requests for payment relief from our borrowers.

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 \$3.60 billion and \$3.04 billion at September 30, 2020 and December 31, 2019, respectively. The increase in deposits is primarily due to growth in non-interest bearing deposits, savings and interest bearing checking deposits and reciprocal deposits that were partially offset by a decline in time and brokered time deposits. Reciprocal deposits totaled \$557.6 million and \$431.0 million at September 30, 2020 and December 31, 2019, 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 continued increase in reciprocal deposits is due in part to an automated sweep product that we introduced in mid-2018 as well as the marketing and sales efforts of our treasury management team.

We cannot be sure that we will be able to maintain our current level of core deposits. In particular, those deposits that are uninsured may be susceptible to outflow. At September 30, 2020, we had approximately \$741.2 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 an integral part of our asset/liability management efforts.

Other borrowings, comprised primarily of advances from the FHLB and federal funds sold, totaled \$30.0 million and \$88.6 million at September 30, 2020 and December 31, 2019, respectively.

As described above, we utilize wholesale funding, including federal funds purchased, FHLB and FRB borrowings and Brokered CDs to augment our core deposits and fund a portion of our assets. At September 30, 2020, our use of such wholesale funding sources (including reciprocal deposits) amounted to approximately \$740.4 million, or 20.4% of total funding (deposits and all borrowings, excluding subordinated debt and 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 historically employed derivative financial instruments to manage our exposure to changes in interest rates. During the first nine months of 2020 and 2019, we entered into \$12.2 million and \$17.6 million (aggregate notional amounts), respectively, of interest rate swaps with commercial loan customers, which were offset with interest rate swaps that the Bank entered into with a broker-dealer. We recorded \$0.2 million and \$0.7 million of fee income related to these transactions during the first nine months of 2020 and 2019, respectively. See note #6 to the Condensed Consolidated Financial Statements included within this report for more information on our derivative financial instruments.

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

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

At September 30, 2020, we had \$414.2 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, \$3.11 billion of our deposits at September 30, 2020, 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.

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 FRB 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 \$48.3 million as of September 30, 2020 provides sufficient liquidity resources at the parent company to meet operating expenses, to make interest payments on the subordinated debt and the subordinated debentures, and, along with dividends from the Bank, to pay cash dividends on our common stock.

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 subordinated debt (qualifies as Tier 2 capital) and cumulative trust preferred securities.

Capitalization

	September 30, 2020	December 31, 2019
	(In thousands)	
Subordinated debt	\$ 39,261	\$ -
Subordinated debentures	39,507	39,456
Amount not qualifying as regulatory capital	(485)	(1,224)
Amount qualifying as regulatory capital	78,283	38,232
Shareholders' equity		
Common stock	339,408	352,344
Retained earnings	27,538	1,611
Accumulated other comprehensive income (loss)	6,146	(3,786)
Total shareholders' equity	373,092	350,169
Total capitalization	\$ 451,375	\$ 388,401

In May 2020, we issued \$40.0 million of fixed to floating subordinated notes with a ten year maturity and a five year call option. The initial coupon rate is 5.95% fixed for five years and then floats at the Secured Overnight Financing Rate ("SOFR") plus 5.825%. These notes are presented in the Condensed Consolidated Statement of Financial Condition under the caption "Subordinated debt" and the September 30, 2020 balance of \$39.3 million is net of remaining unamortized deferred issuance costs of approximately \$0.7 million that are being amortized through the maturity date into interest expense on other borrowings and subordinated debt and debentures in our Condensed Consolidated Statement of Operations.

We currently have four special purpose entities with \$39.5 million of outstanding cumulative trust preferred securities as of September 30, 2020. These special purpose entities issued common securities and provided cash to our parent company that in turn issued subordinated debentures to these special purpose entities equal to the trust preferred securities and common securities. The subordinated debentures represent the sole asset of the special purpose entities. The common securities and subordinated debentures are included in our Condensed Consolidated Statements of Financial Condition.

The FRB has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities (and certain other capital elements) are limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital, subject to restrictions. At the parent company, all of these securities qualified as Tier 1 capital at September 30, 2020 and December 31, 2019.

Common shareholders' equity increased to \$373.1 million at September 30, 2020, from \$350.2 million at December 31, 2019, due primarily to our net income and an increase in accumulated other comprehensive income that was partially offset by share repurchases and cash dividend payments. Our tangible common equity ("TCE") totaled \$340.2 million and \$316.5 million, respectively, at those same dates. Our ratio of TCE to tangible assets was 8.23% and 8.96% at September 30, 2020, and December 31, 2019, respectively. TCE and the ratio of TCE to tangible assets are non-GAAP measures. TCE represents total common equity less goodwill and other intangible assets.

In December 2019, our Board of Directors authorized a 2020 share repurchase plan. Under the terms of the 2020 share repurchase plan, we were authorized to buy back 1,120,000 shares, or approximately 5%, of our outstanding common stock. During the first three months of 2020, we repurchased 678,929 shares at a weighted average purchase price of \$20.30 per share. Due primarily to the economic uncertainty brought on by the COVID-19 pandemic, we suspended share repurchase activity on March 16, 2020. However, primarily as a result of the Company's strong financial performance and improved economic conditions, and dependent upon market and other factors, we may begin to purchase shares under the 2020 repurchase plan during the last two months of the year.

We pay a quarterly cash dividend on our common stock. These quarterly dividends totaled \$0.60 per share and \$0.54 per share in the first nine months of 2020 and 2019, respectively. We generally favor a dividend payout ratio between 30% and 50% of net income.

As of September 30, 2020 and December 31, 2019, our Bank (and holding company) continued to meet the requirements to be considered "well-capitalized" under federal regulatory standards (also see note #10 to the Condensed Consolidated Financial Statements included within this report).

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

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

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

CHANGES IN MARKET VALUE OF PORTFOLIO EQUITY AND NET INTEREST INCOME

Change in Interest Rates	Market Value of Portfolio Equity(1)	Percent Change	Net Interest Income(2)	Percent Change
	(Dollars in thousands)			
September 30, 2020				
200 basis point rise	\$ 478,200	21.12%	\$ 130,400	4.40%
100 basis point rise	456,400	15.60	128,500	2.88
Base-rate scenario	394,800	-	124,900	-
100 basis point decline	360,300	(8.74)	119,200	(4.56)
December 31, 2019				
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)

- (1) Simulation analyses calculate the change in the net present value of our assets and liabilities, including debt and related financial derivative instruments, under parallel shifts in interest rates by discounting the estimated future cash flows using a market-based discount rate. Cash flow estimates incorporate anticipated changes in prepayment speeds and other embedded options.
- (2) Simulation analyses calculate the change in net interest income under immediate parallel shifts in interest rates over the next twelve months, based upon a static statement of financial condition, which includes debt and related financial derivative instruments, and do not consider loan fees.

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

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

We utilize fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. FASB ASC topic 820 differentiates between those assets and liabilities required to be carried at fair value at every reporting period (“recurring”) and those assets and liabilities that are only required to be adjusted to fair value under certain circumstances (“nonrecurring”). Securities available for sale, loans held for sale, carried at fair value, 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 #11 to the Condensed Consolidated Financial Statements included within this report for a complete discussion on our use of fair valuation of financial instruments and the related measurement techniques.

LITIGATION MATTERS

The aggregate amount we have accrued for losses we consider probable as a result of 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.

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 AFLL 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 consolidated financial position or results of operations. There have been no material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019.

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Item 4.

CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15(e) and 15d – 15(e)) for the period ended September 30, 2020, have concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in Internal Controls.

During the quarter ended September 30, 2020, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II

Item 1A. Risk Factors

In addition to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2019, the following risk factors apply to the Company:

The ongoing COVID-19 pandemic and measures intended to prevent its spread could have a material adverse effect on our business, results of operations and financial condition, and such effects will depend on future developments, which are highly uncertain and are difficult to predict.

Global health concerns relating to the COVID-19 pandemic and related government actions have resulted in significant disruptions and increased economic uncertainty. Government restrictions and recommendations designed to contain the virus and limit its effects have substantially limited the activities of individuals and the operations of businesses in the markets we serve.

The Governor of Michigan issued her first "stay home, stay safe" executive order effective March 24, 2020. In general, that order and subsequent modifications required individuals in Michigan to stay at home or their place of residence, except for certain specified activities that were deemed necessary to sustain or protect life. That original executive order was amended several times and was later rescinded and replaced entirely by a series of "Safer at Home" executive orders, which generally extended certain social distancing restrictions, but lifted the requirement that individuals remain in their homes. The series of "Safer at Home" orders, along with all other executive orders relating to the pandemic issued by Michigan's Governor after April 30, 2020, were then deemed unconstitutional by the Michigan Supreme Court on October 2, 2020. Since then, the Michigan Department of Health and Human Services (MDHHS) has issued orders similar to the Governor's executive orders under authority granted to the MDHHS by the Michigan Public Health Code – a different statute than the law on which the Governor based her executive orders. Under the MDHHS' orders, social distancing restrictions remain in place; however, certain retail operations, restaurants and bars, and other businesses are permitted to conduct in-person operations, subject to capacity limitations and other workplace safety requirements. The degree to which businesses may resume operations varies based on the region of the state in which they are located. It is currently expected that various forms of state and local government restrictions similar to those described above will continue through the fourth quarter and perhaps beyond. As a result of these events, Michigan has experienced a significant increase in unemployment.

The COVID-19 pandemic, the related executive orders, and other government restrictions and guidance have had and continue to have a significant effect on us, our customers and the markets we serve. Our business, results of operations and financial condition may be adversely affected by a number of factors that could impact us and our customers, including but not limited to:

- restrictions on activity and high levels of unemployment may cause increases in loan delinquencies, foreclosures and defaults;
- increases in allowance for loan losses may be necessary;
- declines in collateral values may occur;
- third party disruptions, including outages at network providers, on-line banking vendors and other suppliers;

- increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity;
- operational failures due to changes in our normal business practices necessitated by the pandemic and related governmental actions; and/or
- key personnel or significant numbers of our employees being unable to work effectively, including because of illness or restrictions in connection with COVID-19.

These factors may continue for a significant period of time.

The spread of COVID-19 has caused us to modify many of our business practices. Currently, approximately 38% of our total employees are working remotely. We have also expanded sick and vacation time for certain employees. We may take further actions as may be required or as we determine to be prudent. There is no certainty that such measures will be sufficient to mitigate the risks posed by COVID-19.

The extent to which the COVID-19 pandemic will impact our business, results of operations and financial condition will depend on future developments, which are highly uncertain and difficult to predict. Those developments and factors include the duration and spread of the pandemic, its severity, the actions to contain the pandemic or address its impact, and how quickly and to what extent normal economic and operating conditions can resume. We do not yet know the full extent of the impact. However, the effects could have a material adverse impact on our business, financial condition and results of operations. Material adverse impacts may include valuation impairments on our intangible assets, securities available for sale, loans, capitalized mortgage loan servicing rights and deferred tax assets.

As a participating lender in the U.S. Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”), the Company and the Bank are subject to additional risks regarding the Bank’s processing of loans for the PPP and risks that the SBA may not fund some or all PPP loan guaranties.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which included a \$349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank is participating as a lender in the PPP. The PPP opened on April 3, 2020; however, because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there is some ambiguity in the laws, rules and guidance regarding the operation of the PPP, which exposes us to potential risks relating to noncompliance with the PPP. Since then, the SBA and U.S. Department of Treasury have provided additional guidance and clarity on the PPP through the issuance of over 20 interim final rules implementing the PPP. On or about April 16, 2020, the SBA notified lenders that the \$349 billion earmarked for the PPP was exhausted. The PPP was then expanded by the Paycheck Protection Program and Health Care Enhancement Act in late April 2020, adding an additional \$310 billion in funding while the Paycheck Protection Program Flexibility Act made certain changes to the PPP by allowing for more time to spend the funds and making it easier to get a loan fully forgiven. The PPP closed on August 8, 2020. Most recently, the SBA released a simpler loan forgiveness application for PPP loans of \$50,000 or less that streamlines the PPP forgiveness process for such loans. As of September 30, 2020, we had 2,117 PPP loans outstanding with a total balance of \$261.1 million. We have submitted 197 forgiveness applications for loans totaling \$37.2 million.

Since the initiation of the PPP, several larger banks have been subject to litigation regarding the protocols and procedures that they used in processing applications for the PPP. We may be exposed to the risk of similar litigation, from both customers and non-customers that approached us regarding PPP loans, regarding our policies and procedures used in processing applications for the PPP. If any such litigation is filed against the Company or the Bank and is not resolved in a manner favorable to us, it could result in financial liability or adversely affect our reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP related litigation could have an adverse impact on our business, financial condition and results of operations.

We also have credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by the Bank, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by us, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

Our business is subject to additional risks in the near term related to our plan to complete a core data processing systems conversion.

We are in the process of converting our core data processing system to a new system hosted by a different vendor. A systems conversion of this nature is extremely complicated, time-consuming, and resource intensive. The process will be even more challenging in light of the COVID-19 pandemic, including the challenges presented as a result of a portion of our workforce working remotely. The timing and success of this systems conversion is also heavily dependent on the reliability of the vendors for both our existing and new systems. If either or both of these vendors experience workforce shortages due to the pandemic or otherwise, it could impact our ability to complete the systems conversion on the timeline and budget currently expected. Difficulties in completing the conversion could also negatively impact our operations and financial performance. We expect to complete this conversion in the second quarter of 2021.

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

The Company maintains a Deferred Compensation and Stock Purchase Plan for Non-Employee Directors (the "Plan") pursuant to which non-employee directors can elect to receive shares of the Company's common stock in lieu of fees otherwise payable to the director for his or her service as a director. A director can elect to receive shares on a current basis or to defer receipt of the shares, in which case the shares are issued to a trust to be held for the account of the director and then generally distributed to the director after his or her retirement from the Board. Pursuant to this Plan, during the third quarter of 2020, the Company issued 555 shares of common stock to non-employee directors on a current basis and 5,274 shares of common stock to the trust for distribution to directors on a deferred basis. These shares were issued on July 1, 2020 representing aggregate fees of \$0.08 million. The shares on a current basis were issued at a price of \$14.85 per share and the shares on a deferred basis were issued at a price of \$13.37 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 the Company's common stock as of the date of issuance, as determined in accordance with NASDAQ Marketplace Rules. The Company issued the shares pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the issuance of the shares was made on a private basis pursuant to the Plan.

The following table shows certain information relating to repurchases of common stock for the three-months ended September 30, 2020:

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
July 2020	225	\$ 13.97	-	441,071
August 2020	4,499	14.88	-	441,071
September 2020	674	12.57	-	441,071
Total	5,398	\$ 14.55	-	441,071

- (1) These amounts represent shares withheld from the shares that would otherwise have been issued to an officer in order to satisfy tax withholding obligations resulting from the vesting of restricted stock.

Item 6. Exhibits

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

- [31.1](#) Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- [31.2](#) Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- [32.1](#) Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- [32.2](#) Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 101.INS Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
- 101.SCH Inline XBRL Taxonomy Extension Schema Document
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document
- 104 Cover page interactive data file (formatted as inline XBRL and contained in Exhibit 101)

SIGNATURES

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

Date November 5, 2020

By /s/ Gavin A. Mohr
Gavin A. Mohr, Principal Financial Officer

Date November 5, 2020

By /s/ James J. Twarozynski
James J. Twarozynski, Principal Accounting Officer

CERTIFICATION

I, William B. Kessel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Independent Bank Corporation;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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 15d-15(f)) for the registrant and we 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 quarterly 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 quarterly 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;
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.

INDEPENDENT BANK CORPORATION

/s/ William B. Kessel

William B. Kessel

President and Chief Executive Officer

Date: November 5, 2020

CERTIFICATION

I, Gavin A. Mohr, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Independent Bank Corporation;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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 15d-15(f)) for the registrant and we 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 quarterly 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 quarterly 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;
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.

INDEPENDENT BANK CORPORATION

/s/ Gavin A. Mohr

Gavin A. Mohr
Chief Financial Officer

Date: November 5, 2020

CERTIFICATE OF THE
CHIEF EXECUTIVE OFFICER OF
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, William B. Kessel, President and Chief Executive Officer of Independent Bank Corporation, certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The quarterly report on Form 10-Q for the quarterly period ended September 30, 2020, 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 quarterly report on Form 10-Q for the quarterly period ended September 30, 2020, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

INDEPENDENT BANK CORPORATION

Date: November 5, 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.

CERTIFICATE OF THE
CHIEF FINANCIAL OFFICER OF
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, Gavin A. Mohr, Chief Financial Officer of Independent Bank Corporation, certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The quarterly report on Form 10-Q for the quarterly period ended September 30, 2020, 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 quarterly report on Form 10-Q for the quarterly period ended September 30, 2020, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

INDEPENDENT BANK CORPORATION

Date: November 5, 2020

/s/ Gavin A. Mohr
Gavin A. Mohr
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.
