INDEPENDENT BANK CORP /MI/
Form 10-Q
May 09, 2012

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 March 31, 2012

Commission file number 0-7818

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

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

230 West Main Street, P.O. Box 491, Ionia, Michigan 48846
(Address of principal executive offices)

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

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

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

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

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

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

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

Common stock, no par value	8,575,471
Class	Outstanding at May 9, 2012

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

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Discussions and statements in this report that are not statements of historical fact, including, without limitation, statements that include terms such as “will,” “may,” “should,” “believe,” “expect,” “forecast,” “anticipate,” “estimate,” “proje “likely,” “optimistic” and “plan,” and statements about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions and other statements that are not historical facts, are forward-looking statements. Forward-looking statements include, but are not limited to, descriptions of plans and objectives for future operations, products or services; projections of our future revenue, earnings or other measures of economic performance; forecasts of credit losses and other asset quality trends; predictions as to our Bank’s ability to maintain certain regulatory capital standards; our expectation that we will have sufficient cash on hand to meet expected obligations during 2012; and descriptions of steps we may take to improve our capital position. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals and, by their nature, are subject to assumptions, risks, and uncertainties. Although we believe that the expectations, forecasts, and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including, among others:

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

service contracts, the value to us of collateral that may be available to recover funds due from our counterparties, and our ability to enforce the contractual obligations of our counterparties to pay amounts owing to us;

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

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report, but the list is not intended to be all inclusive. The risk factors disclosed in Part I – Item A of our Annual Report on Form 10-K for the year ended December 31, 2011, as updated by any new or modified risk factors disclosed in Part II – Item 1A of any subsequently filed Quarterly Report on Form 10-Q, include all known risks that our management believes could materially affect the results described by forward-looking statements in this report. However, those risks may not be the only risks we face. Our results of operations, cash flows, financial position, and prospects could also be materially and adversely affected by additional factors that are not presently known to us, that we currently consider to be immaterial, or that develop after the date of this report. We cannot assure you that our future results will meet expectations. While we believe the forward-looking statements in this report are reasonable, you should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. We do not undertake, and expressly disclaim, any obligation to update or alter any statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

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Part I - Item 1. INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Financial Condition

	March 31, 2012	December 31, 2011
	(unaudited)	
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$ 53,690	$ 62,777
Interest bearing deposits	299,159	278,331
Cash and Cash Equivalents	352,849	341,108
Trading securities	69	77
Securities available for sale	303,658	157,444
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	20,828	20,828
Loans held for sale, carried at fair value	40,321	44,801
Loans		
Commercial	649,552	651,155
Mortgage	571,251	590,876
Installment	210,360	219,559
Payment plan receivables	103,544	115,018
Total Loans	1,534,707	1,576,608
Allowance for loan losses	(56,006)	(58,884)
Net Loans	1,478,701	1,517,724
Other real estate and repossessed assets	30,918	34,042
Property and equipment, net	63,417	62,548
Bank-owned life insurance	49,695	49,271
Other intangibles	7,337	7,609
Capitalized mortgage loan servicing rights	11,795	11,229
Prepaid FDIC deposit insurance assessment	11,788	12,609
Vehicle service contract counterparty receivables, net	28,925	29,298
Accrued income and other assets	18,977	18,818
Total Assets	$ 2,419,278	$ 2,307,406
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$ 519,819	$ 497,718
Savings and interest-bearing checking	1,093,799	1,019,603
Retail time	524,694	526,525
Brokered time	46,000	42,279
Total Deposits	2,184,312	2,086,125
Other borrowings	33,039	33,387
Subordinated debentures	50,175	50,175
Vehicle service contract counterparty payables	6,813	6,633
Accrued expenses and other liabilities	39,907	28,459
Total Liabilities	2,314,246	2,204,779
Shareholders' Equity		
Convertible preferred stock, no par value, 200,000 shares authorized; 74,426 shares issued and outstanding at March 31, 2012 and December 31, 2011; liquidation preference: $82,024 at March 31, 2012 and $81,023 at December 31, 2011	80,913	79,857

Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 8,546,342 shares at March 31, 2012 and 8,491,526 shares at December 31, 2011	248,995	248,950
Accumulated deficit	(211,811)	(214,259)
Accumulated other comprehensive loss	(13,065)	(11,921)
Total Shareholders' Equity	105,032	102,627
Total Liabilities and Shareholders' Equity	$ 2,419,278	$ 2,307,406

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

	Three Months Ended	
	March 31, 2012	March 31, 2011
	(unaudited) (In thousands, except per share amounts)	
Interest Income		
Interest and fees on loans	$ 24,346	$ 29,484
Interest on securities		
Taxable	658	467
Tax-exempt	296	332
Other investments	396	435
Total Interest Income	25,696	30,718
Interest Expense		
Deposits	2,424	4,945
Other borrowings	1,172	1,323
Total Interest Expense	3,596	6,268
Net Interest Income	22,100	24,450
Provision for loan losses	5,131	10,702
Net Interest Income After Provision for Loan Losses	16,969	13,748
Non-interest Income		
Service charges on deposit accounts	4,201	4,282
Interchange income	2,322	2,168
Net gains (losses) on assets		
Mortgage loans	3,860	1,935
Securities	684	213
Other than temporary impairment loss on securities		
Total impairment loss	(177)	(469)
Loss recognized in other comprehensive loss	-	327
Net impairment loss recognized in earnings	(177)	(142)
Mortgage loan servicing	736	896
Title insurance fees	508	473
(Increase) decrease in fair value of U.S. Treasury warrant	(154)	354
Other	2,604	2,532
Total Non-interest Income	14,584	12,711
Non-interest Expense		
Compensation and employee benefits	12,482	12,349
Loan and collection	2,890	3,867
Occupancy, net	2,716	3,101
Data processing	2,339	2,310
Furniture, fixtures and equipment	1,294	1,418
Net losses on other real estate and repossessed assets	987	1,406
Legal and professional	897	778
Communications	875	948
FDIC deposit insurance	857	1,235
Credit card and bank service fees	651	1,047

Advertising		556			554	
Vehicle service contract counterparty contingencies		471			2,346	
Provision for loss reimbursement on sold loans		432			406	
Cost (recoveries) related to unfunded lending commitments		(47	)		95	
Other		649			2,008	
Total Non-interest Expense		28,049			33,868	
Income (Loss) Before Income Tax		3,504			(7,409	)
Income tax expense (benefit)		-			(8	)
Net Income (Loss)	$	3,504		$	(7,401	)
Preferred stock dividends and discount accretion		1,056			1,008	
Net Income (Loss) Applicable to Common Stock	$	2,448		$	(8,409	)
Net Income (Loss) Per Common Share						
Basic	$	.29		$	(1.06	)
Diluted		.07			(1.06	)
Dividends Per Common Share						
Declared	$	.00		$	.00	
Paid		.00			.00	

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (Loss)

	Three months ended March 31, 2012	2011
	(unaudited) (In thousands)	
Net income (loss)	$ 3,504	$ (7,401)
Other comprehensive income (loss), before tax		
Unrealized losses on available for sale securities		
Unrealized gain (loss) arising during period	(860)	321
Change in unrealized losses for which a portion of other than temporary impairment has been recognized in earnings	129	(327)
Reclassification adjustments for (gains) losses included in earnings	(692)	(140)
Unrealized losses on available for sale securities, net	(1,423)	(146)
Unrealized losses on derivative instruments		
Unrealized loss arising during period	(51)	(23)
Reclassification adjustment for expense recognized in earnings	185	202
Reclassfication adjustment for accretion on settled derivatives	145	222
Unrealized gains on derivative instruments	279	401
Other comprehensive income (loss), before tax	(1,144)	255
Income tax expense related to components of other comprehesive income (loss)	-	-
Other comprehensive income (loss)	(1,144)	255
Comprehensive income (loss)	$ 2,360	$ (7,146)

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Three months ended March 31, 2012	2011
	(unaudited - In thousands)	
Net Income (Loss)	$ 3,504	$ (7,401)
Adjustments to Reconcile Net Income (Loss) to Net Cash from Operating Activities		
Proceeds from sales of loans held for sale	116,422	122,838
Disbursements for loans held for sale	(108,082)	(91,156)
Provision for loan losses	5,131	10,702
Deferred loan fees	(97)	(28)
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	(1,313)	(3,736)
Net gains on sales of mortgage loans	(3,860)	(1,935)
Net gains on securities	(684)	(213)
Securities impairment recognized in earnings	177	142
Net losses on other real estate and repossessed assets	987	1,406
Vehicle service contract counterparty contingencies	471	2,346
Share based compensation	45	153
(Increase) decrease in accrued income and other assets	(934)	1,821
Increase (decrease) in accrued expenses and other liabilities	1,576	(188)
Total Adjustments	9,839	42,152
Net Cash from Operating Activities	13,343	34,751
Cash Flow from (used in) Investing Activities		
Proceeds from the sale of securities available for sale	9,206	12,399
Proceeds from the maturity of securities available for sale	545	295
Principal payments received on securities available for sale	4,261	1,228
Purchases of securities available for sale	(150,607)	(62,894)
Net decrease in portfolio loans (loans originated, net of principal payments)	34,293	63,644
Proceeds from the collection of vehicle service contract counterparty receivables	210	544
Proceeds from the sale of other real estate and repossessed assets	5,298	4,519
Capital expenditures	(2,827)	(757)
Net Cash from (used in) Investing Activities	(99,621)	18,978
Cash Flow from (used in) Financing Activities		
Net increase (decrease) in total deposits	98,187	(28,871)
Net increase (decrease) in other borrowings	6	(6)
Proceeds from Federal Home Loan Bank advances	12,000	4,000
Payments of Federal Home Loan Bank advances	(12,354)	(29,011)
Net increase in vehicle service contract counterparty payables	180	1,929
Proceeds from issuance of common stock	-	846
Net Cash from (used in) Financing Activities	98,019	(51,113)
Net Increase in Cash and Cash Equivalents	11,741	2,616
Cash and Cash Equivalents at Beginning of Period	341,108	385,374
Cash and Cash Equivalents at End of Period	$ 352,849	$ 387,990
Cash paid during the period for		
Interest	$ 3,034	$ 5,806
Income taxes	131	20
Transfers to other real estate and repossessed assets	3,161	4,025

Transfer of payment plan receivables to vehicle service contract counterparty receivables	368	6,312
Purchase of securities available for sale not yet settled	10,817	-

See notes to interim condensed consolidated financial statements (unaudited)

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

	Three months ended March 31	
	2012	2011
	(unaudited) (In thousands)	
Balance at beginning of period	$102,627	$119,085
Net income (loss)	3,504	(7,401)
Issuance of common stock	-	846
Share based compensation	45	153
Net change in accumulated other comprehensive loss, net of related tax effect	(1,144)	255
Balance at end of period	$105,032	$112,938

See notes to interim condensed consolidated financial statements (unaudited)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Preparation of Financial Statements

The interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2011 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 March 31, 2012 and December 31, 2011, and the results of operations for the three-month periods ended March 31, 2012 and 2011. The results of operations for the three-month periods ended March 31, 2012, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the assessment for other than temporary impairment (“OTTI”) on investment securities, the determination of the allowance for loan losses, the determination of vehicle service contract counterparty contingencies, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2011 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

In May 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2011-04, “Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs”. This ASU amended guidance that will result in common fair value measurement and disclosure requirements between U.S. GAAP and International Financial Reporting Standards (“IFRS”). Under the amended guidance, entities are required to expand disclosure for fair value instruments categorized within Level 3 of the fair value hierarchy to include (1) the valuation processes used; and (2) a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs for recurring fair value measurements and the interrelationships between those unobservable inputs, if any. They are also required to disclose the categorization by level of the fair value hierarchy for items that are not measured at fair value in the Consolidated Statement of Financial Condition but for which the fair value is required to be disclosed (e.g. portfolio loans). This amended guidance became effective for us at January 1, 2012. The effect of adopting this standard did not have a material impact on our consolidated operating results or financial condition, but the additional disclosures are included in notes #12 and #13.

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

In June 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". This ASU amended guidance on the presentation requirements for comprehensive income. The amended guidance requires an entity to present total comprehensive income, the components of net income and the components of other comprehensive income on the face of the financial statements, either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amended guidance did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This amended guidance became effective for us at January 1, 2012 and was applied retrospectively. The effect of adopting this standard did not have a material impact on our consolidated operating results or financial condition, but we have included separate Condensed Consolidated Statements of Comprehensive Income (Loss) immediately following our Condensed Consolidated Statements of Operations in our Condensed Consolidated Financial Statements.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
		(In thousands)		
March 31, 2012				
U.S. agency	$97,511	$32	$1,479	$96,064
U.S. agency residential mortgage-backed	161,735	640	221	162,154
Private label residential mortgage-backed	10,528	-	2,497	8,031
Obligations of states and political subdivisions	34,152	464	202	34,414
Trust preferred	4,734	-	1,739	2,995
Total	$308,660	$1,136	$6,138	$303,658
December 31, 2011				
U.S. agency	$24,980	$58	$21	$25,017
U.S. agency residential mortgage-backed	93,415	1,007	216	94,206
Private label residential mortgage-backed	11,066	-	2,798	8,268
Obligations of states and political subdivisions	26,865	510	58	27,317
Trust preferred	4,697	-	2,061	2,636
Total	$161,023	$1,575	$5,154	$157,444

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

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

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
March 31, 2012						
U.S. agency	$78,629	$1,479	$-	$-	$78,629	$1,479
U.S. agency residential mortgage-backed	72,387	221	-	-	72,387	221
Private label residential mortgage-backed	-	-	8,028	2,497	8,028	2,497
Obligations of states and political subdivisions	7,971	202	-	-	7,971	202
Trust preferred	-	-	2,995	1,739	2,995	1,739
Total	$158,987	$1,902	$11,023	$4,236	$170,010	$6,138
December 31, 2011						
U.S. agency	$9,974	$21	$-	$-	$9,974	$21
U.S. agency residential mortgage-backed	42,500	216	-	-	42,500	216
Private label residential mortgage-backed	163	90	8,102	2,708	8,265	2,798
Obligations of states and political subdivisions	-	-	1,729	58	1,729	58
Trust preferred	591	1,218	2,045	843	2,636	2,061
Total	$53,228	$1,545	$11,876	$3,609	$65,104	$5,154

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

U.S. Agency and U.S. Agency residential mortgage-backed securities — at March 31, 2012 we had 11 U.S. Agency and 19 U.S. Agency residential mortgage-backed securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to increases in interest rates during the first quarter of 2012 and widening discount margins. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Private label residential mortgage backed securities — at March 31, 2012 we had eight securities whose fair value is less than amortized cost. Two of the issues are rated by a major rating agency as investment grade while four are below investment grade and two are split rated. Six of these bonds have impairment in excess of 10% and all of these holdings have been impaired for more than 12 months.

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

The unrealized losses are largely attributable to credit spread widening on these securities since their acquisition. The underlying loans within these securities include Jumbo (76%) and Alt A (24%) at March 31, 2012.

	March 31, 2012		December 31, 2011	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Private label residential mortgage-backed				
Jumbo	$6,074	$(1,846)	$6,454	$(1,937)
Alt-A	1,957	(651)	1,814	(861)

Seven of the private label residential mortgage-backed transactions have geographic concentrations in California, ranging from 22% to 58% of the collateral pool. Typical exposure levels to California (median exposure is 47%) are consistent with overall market collateral characteristics. Three transactions have modest exposure to Florida, ranging from 5% to 7% and one transaction has modest exposure to Nevada (5%). The underlying collateral pools do not have meaningful exposure to Arizona, Michigan or Ohio. None of the issues involve subprime mortgage collateral. Thus the impact of this market segment is only indirect, in that it has impacted liquidity and pricing in general for private label residential mortgage-backed securities. The majority of transactions are backed by fully amortizing loans. However, six transactions have concentrations in loans that pay interest only for a specified period of time and will fully amortize thereafter ranging from 31% to 94% (at origination date). The structure of the residential mortgage securities portfolio provides protection to credit losses. The portfolio primarily consists of senior securities as demonstrated by the following: super senior (21%), senior (45%), senior support (24%) and mezzanine (10%). The mezzanine class is from a seasoned transaction (91 months) with a significant level of subordination (8.39%). Except for the additional discussion below relating to other than temporary impairment, each private label residential mortgage-backed security has sufficient credit enhancement via subordination to reasonably assure full realization of book value. This assertion is based on a transaction level review of the portfolio.

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

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

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

In addition to the review discussed above, all private label residential mortgage-backed securities are reviewed for OTTI utilizing a cash flow projection. The cash flow analysis forecasted cash flow from the underlying loans in each transaction and then applied these cash flows to the bonds in the securitization. The cash flows from the underlying loans considered contractual payment terms (scheduled amortization), prepayments, defaults and severity of loss given default. The analysis used dynamic assumptions for prepayments, defaults and loss severity. Near term prepayment assumptions were based on recently observed prepayment rates. More weight was given to longer term historic performance (12 months). In some cases, recently observed prepayment rates are lower than historic norms due to the absence of new jumbo loan issuances. This loan market is heavily dependent upon securitization for funding, and new securitization transactions have been minimal. Our model projections anticipate that prepayment rates gradually revert to historical levels. For seasoned ARM transactions, normalized prepayment rates range from 10% to 18% CPR which is at the lower end of historically observed speeds for seasoned ARM collateral. For fixed rate collateral (one transaction), the prepayment speeds are projected to rise modestly.

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

At March 31, 2012 three below investment grade private label residential mortgage-backed securities with fair values of $3.6 million, $1.7 million and $0.1 million, respectively and unrealized losses of $1.2 million, $0.3 million and $0.03 million, respectively (amortized cost of $4.8 million, $2.0 million and $0.1 million, respectively) had losses that were considered other than temporary.

The underlying loans in the first transaction are 30 year fixed rate jumbos with an average FICO of 744 and an average loan-to-value ratio of 72%. The loans backing this transaction were originated in 2007 and this is our only security backed by 2007 vintage loans. We believe that this vintage is a key differentiating factor between this security and the others in our portfolio that do not have unrealized losses that are considered OTTI. The bond is a senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.560 million of credit related OTTI as of March 31, 2012 and was recognized in our Condensed Consolidated Statements of Operations ($0.085 million and $0.052 million of this amount was recognized in our Condensed Consolidated Statements of Operations during the three months ended March 31, 2012 and 2011, respectively while the balance was recognized in other periods). The remaining unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The underlying loans in the second transaction are 30 year hybrid ARM Alt-A with an average FICO of 717 and an average loan-to-value ratio of 78%. The loans backing this transaction were originated in 2005. The bond is a super senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.457 million of credit related OTTI as of March 31, 2012 and was recognized in our Condensed Consolidated Statements of Operations ($0.032 million and zero of this amount was recognized in our Condensed Consolidated Statements of Operations during the three months ended March 31, 2012 and 2011, respectively while the balance was recognized in other periods). The remaining unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

The underlying loans in the third transaction are 30 year hybrid ARM jumbos with an average FICO of 738 and an average loan-to-value ratio of 57%. The loans backing this transaction were originated in 2005. The bond is a senior support security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated credit related OTTI of $0.380 million as of March 31, 2012 and was recognized in our Condensed Consolidated Statements of Operations ($0.060 million and $0.090 million of this amount was recognized in our Condensed Consolidated Statements of Operations during the three months ended March 31, 2012 and 2011, respectively while the balance was recognized in other periods). The remaining unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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

Obligations of states and political subdivisions — at March 31, 2012 we had 11 municipal securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to increases in interest rates and widening of market spreads. Eight of the impaired securities are rated by a major rating agency as investment grade. The non rated securities have a periodic internal credit review according to established procedures. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Trust preferred securities — at March 31, 2012 we had four securities whose fair value is less than amortized cost. All of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities over the past several years has suffered from significant credit spread widening fueled by uncertainty regarding potential losses of financial companies, the absence of a liquid functioning secondary market and potential supply concerns from financial companies issuing new debt to recapitalize themselves.

One of the four securities is rated by two major rating agencies as investment grade, while one is split rated (this security is rated as investment grade by one major rating agency and below investment grade by another) and the other two are non-rated. The non-rated issues are relatively small banks and were never rated. The issuers of these non-rated trust preferred securities, which had a total amortized cost of $2.8 million and total fair value of $1.5 million as of March 31, 2012, continue to have satisfactory credit metrics and one continues to make interest payments. The other non-rated issue began deferring dividend payments in the third quarter of 2011 apparently due to an increase in non-performing assets. Nevertheless, this issuer continues to have satisfactory capital measures and interim profitability.

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The following table breaks out our trust preferred securities in further detail as of March 31, 2012 and December 31, 2011:

	March 31, 2012		December 31, 2011	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Trust preferred securities				
Rated issues	$1,447	$(444)	$1,405	$(484)
Unrated issues - no OTTI	1,548	(1,295)	1,231	(1,577)

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

During the three month periods ended March 31, 2012 and 2011 we recorded in earnings OTTI charges on securities available for sale of $0.177 million and $0.142 million, respectively (see discussion above).

A roll forward of credit losses recognized in earnings on securities available for sale for the three month periods ending March 31, follows:

	2012	2011
	(In thousands)	
Balance at beginning of year	$ 1,470	$ 710
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	177	142
Total	$ 1,647	$ 852

The amortized cost and fair value of securities available for sale at March 31, 2012, by contractual maturity, follow. The actual maturity may differ from the contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$1,360	$1,374
Maturing after one year but within five years	6,722	6,934
Maturing after five years but within ten years	25,349	25,470
Maturing after ten years	102,966	99,695
	136,397	133,473
U.S. agency residential mortgage-backed	161,735	162,154
Private label residential mortgage-backed	10,528	8,031
Total	$308,660	$303,658

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Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the three month periods ending March 31, follows:

	Proceeds	Realized Gains	Losses(1)
		(In thousands)	
2012	$ 9,206	$ 692	$ -
2011	12,399	185	45

(1) Losses in 2012 and 2011 exclude $0.177 million and $0.142 million, respectively of credit related OTTI recognized in earnings.

During 2012 and 2011 our trading securities consisted of various preferred stocks. During the first three months of 2012 and 2011 we recognized gains (losses) on trading securities of $(0.008) million and $0.073 million, respectively, that are included in net gains (losses) on securities in the Condensed Consolidated Statements of Operations. Both of these amounts, relate to gains (losses) recognized on trading securities still held at each respective period end.

4. Loans

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

An analysis of the allowance for loan losses by portfolio segment for the three months ended March 31, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
2012						
Balance at beginning of period	$18,183	$22,885	$6,146	$197	$11,473	$58,884
Additions (deductions)						
Provision for loan losses	1,496	4,235	289	30	(919)	5,131
Recoveries credited to allowance	1,006	548	326	-	-	1,880
Loans charged against the allowance	(4,244)	(4,397)	(1,227)	(21)	-	(9,889)
Balance at end of period	$16,441	$23,271	$5,534	$206	$10,554	$56,006
2011						
Balance at beginning of period	$23,836	$22,642	$6,769	$389	$14,279	$67,915
Additions (deductions)						
Provision for loan losses	4,710	5,369	1,235	8	(620)	10,702
	219	355	359	2	-	935

Recoveries credited to allowance						
Loans charged against the allowance	(7,486)	(4,595)	(1,644)	(66)	-	(13,791)
Balance at end of period	$21,279	$23,771	$6,719	$333	$13,659	$65,761

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

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

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
March 31, 2012						
Allowance for loan losses:						
Individually evaluated for impairment	$9,285	$11,002	$1,736	$-	$-	$22,023
Collectively evaluated for impairment	7,156	12,269	3,798	206	10,554	33,983
Total ending allowance balance	$16,441	$23,271	$5,534	$206	$10,554	$56,006
Loans						
Individually evaluated for impairment	$58,760	$91,894	$7,737	$-		$158,391
Collectively evaluated for impairment	592,760	481,970	203,466	103,544		1,381,740
Total loans recorded investment	651,520	573,864	211,203	103,544		1,540,131
Accrued interest included in recorded investment	1,968	2,613	843	-		5,424
Total loans	$649,552	$571,251	$210,360	$103,544		$1,534,707
December 31, 2011						
Allowance for loan losses:						
Individually evaluated for impairment	$10,252	$10,285	$1,762	$-	$-	$22,299
Collectively evaluated for impairment	7,931	12,600	4,384	197	11,473	36,585
Total ending allowance balance	$18,183	$22,885	$6,146	$197	$11,473	$58,884
Loans						
Individually evaluated for impairment	$58,674	$93,702	$7,554	$-		$159,930
Collectively evaluated for impairment	594,665	499,919	212,907	115,018		1,422,509
Total loans recorded investment	653,339	593,621	220,461	115,018		1,582,439
Accrued interest included in recorded investment	2,184	2,745	902	-		5,831
Total loans	$651,155	$590,876	$219,559	$115,018		$1,576,608

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

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

	90+ and Still Accruing	Non-Accrual	Total Non-Performing Loans
		(In thousands)	
March 31, 2012			
Commercial			
Income producing - real estate	$ -	$ 11,000	$ 11,000
Land, land development and construction - real estate	-	5,578	5,578
Commercial and industrial	261	7,759	8,020
Mortgage			
1-4 family	-	14,321	14,321
Resort lending	-	7,828	7,828
Home equity line of credit - 1st lien	-	665	665
Home equity line of credit - 2nd lien	-	730	730
Installment			
Home equity installment - 1st lien	-	1,226	1,226
Home equity installment - 2nd lien	-	935	935
Loans not secured by real estate	-	951	951
Other	-	1	1
Payment plan receivables			
Full refund	-	225	225
Partial refund	-	244	244
Other	-	12	12
Total recorded investment	$ 261	$ 51,475	$ 51,736
Accrued interest included in recorded investment	$ 3	$ -	$ 3
December 31, 2011			
Commercial			
Income producing - real estate	$ 490	$ 13,788	$ 14,278
Land, land development and construction - real estate	43	6,990	7,033
Commercial and industrial	-	7,984	7,984
Mortgage			
1-4 family	54	15,929	15,983
Resort lending	-	8,819	8,819
Home equity line of credit - 1st lien	-	523	523
Home equity line of credit - 2nd lien	-	889	889
Installment			
Home equity installment - 1st lien	-	1,542	1,542
Home equity installment - 2nd lien	-	1,023	1,023
Loans not secured by real estate	-	880	880
Other	-	4	4
Payment plan receivables			

Full refund	-	491	491
Partial refund	-	424	424
Other	-	23	23
Total recorded investment	$ 587	$ 59,309	$ 59,896
Accrued interest included in recorded investment	$ 13	$ -	$ 13

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

An aging analysis of loans by class follows:

	Loans Past Due				Loans not	Total
	30-59 days	60-89 days	90+ days	Total	Past Due	Loans
	(In thousands)					
March 31, 2012						
Commercial						
Income producing - real estate	$1,098	$2,681	$4,170	$7,949	$269,429	$277,378
Land, land development and construction - real estate	864	265	1,713	2,842	46,969	49,811
Commercial and industrial	3,756	1,819	4,094	9,669	314,662	324,331
Mortgage						
1-4 family	2,674	1,609	14,321	18,604	287,737	306,341
Resort lending	1,337	1,157	7,828	10,322	177,770	188,092
Home equity line of credit - 1st lien	120	6	665	791	24,264	25,055
Home equity line of credit - 2nd lien	359	248	730	1,337	53,039	54,376
Installment						
Home equity installment - 1st lien	385	92	1,226	1,703	40,101	41,804
Home equity installment - 2nd lien	536	172	935	1,643	49,544	51,187
Loans not secured by real estate	1,084	296	951	2,331	112,852	115,183
Other	13	2	1	16	3,013	3,029
Payment plan receivables						
Full refund	2,222	540	225	2,987	90,921	93,908
Partial refund	238	80	244	562	8,456	9,018
Other	15	3	12	30	588	618
Total recorded investment	$14,701	$8,970	$37,115	$60,786	$1,479,345	$1,540,131
Accrued interest included in recorded investment	$127	$118	$3	$248	$5,176	$5,424
December 31, 2011						
Commercial						
Income producing - real estate	$1,701	$937	$6,408	$9,046	$264,620	$273,666
Land, land development and construction - real estate	487	66	2,720	3,273	51,453	54,726
Commercial and industrial	1,861	1,132	3,516	6,509	318,438	324,947
Mortgage						
1-4 family	3,507	1,418	15,983	20,908	294,771	315,679
Resort lending	2,129	932	8,819	11,880	184,943	196,823
Home equity line of credit - 1st lien	96	196	523	815	24,705	25,520
Home equity line of credit - 2nd lien	506	159	889	1,554	54,045	55,599

Installment						
Home equity installment - 1st lien	757	264	1,542	2,563	41,239	43,802
Home equity installment - 2nd lien	676	365	1,023	2,064	51,224	53,288
Loans not secured by real estate	1,173	463	880	2,516	117,661	120,177
Other	36	10	4	50	3,144	3,194
Payment plan receivables						
Full refund	2,943	951	491	4,385	99,284	103,669
Partial refund	380	200	424	1,004	9,918	10,922
Other	23	24	23	70	357	427
Total recorded investment	$16,275	$7,117	$43,245	$66,637	$1,515,802	$1,582,439
Accrued interest included in recorded investment	$160	$105	$13	$278	$5,553	$5,831

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Impaired loans are as follows :

	March 31, 2012	December 31, 2011
Impaired loans with no allocated allowance		
TDR	$29,416	$ 26,945
Non - TDR	400	423
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	18,297	20,142
TDR - allowance based on present value cash flow	98,485	98,130
Non - TDR - allowance based on collateral	11,281	13,773
Non - TDR - allowance based on present value cash flow	-	-
Total impaired loans	$157,879	$ 159,413
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$5,911	$ 6,004
TDR - allowance based on present value cash flow	12,574	12,048
Non - TDR - allowance based on collateral	3,538	4,247
Non - TDR - allowance based on present value cash flow	-	-
Total amount of allowance for loan losses allocated	$22,023	$ 22,299

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Impaired loans by class are as follows (1):

	March 31, 2012			December 31, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			(In thousands)			
Commercial						
Income producing - real estate	$2,573	$3,929	$-	$4,626	$6,386	$-
Land, land development & construction-real estate	2,960	3,039	-	219	243	-
Commercial and industrial	4,460	4,734	-	3,593	3,677	-
Mortgage						
1-4 family	7,578	10,269	-	6,975	9,242	-
Resort lending	6,354	6,736	-	7,156	7,680	-
Home equity line of credit - 1st lien	-	-	-	-	-	-
Home equity line of credit - 2nd lien	46	119	-	134	211	-
Installment						
Home equity installment - 1st lien	1,554	1,603	-	2,100	2,196	-
Home equity installment - 2nd lien	1,735	1,792	-	1,987	1,987	-
Loans not secured by real estate	417	427	-	637	688	-
Other	23	23	-	24	24	-
	27,700	32,671	-	27,451	32,334	-
With an allowance recorded:						
Commercial						
Income producing - real estate	21,664	27,653	3,235	22,781	29,400	3,642
Land, land development & construction-real estate	10,787	12,974	2,775	12,362	14,055	3,633
Commercial and industrial	16,316	19,327	3,275	15,093	18,357	2,977
Mortgage						
1-4 family	59,315	60,986	7,384	61,214	63,464	7,716
Resort lending	18,437	18,937	3,501	18,159	19,351	2,534
Home equity line of credit - 1st lien	70	87	34	64	73	35
Home equity line of credit - 2nd lien	94	92	83	-	-	-
Consumer						
Home equity installment - 1st lien	2,020	2,125	649	1,232	1,293	660
Home equity installment - 2nd lien	1,786	1,796	1,051	1,421	1,458	1,062

Loans not secured by real estate	202	250	36	153	156	40
Other	-	-	-	-	-	-
	130,691	144,227	22,023	132,479	147,607	22,299
Total						
Commercial						
Income producing - real estate	24,237	31,582	3,235	27,407	35,786	3,642
Land, land development & construction-real estate	13,747	16,013	2,775	12,581	14,298	3,633
Commercial and industrial	20,776	24,061	3,275	18,686	22,034	2,977
Mortgage						
1-4 family	66,893	71,255	7,384	68,189	72,706	7,716
Resort lending	24,791	25,673	3,501	25,315	27,031	2,534
Home equity line of credit - 1st lien	70	87	34	64	73	35
Home equity line of credit - 2nd lien	140	211	83	134	211	-
Consumer						
Home equity installment - 1st lien	3,574	3,728	649	3,332	3,489	660
Home equity installment - 2nd lien	3,521	3,588	1,051	3,408	3,445	1,062
Loans not secured by real estate	619	677	36	790	844	40
Other	23	23	-	24	24	-
Total	$158,391	$176,898	$22,023	$159,930	$179,941	$22,299
Accrued interest included in recorded investment	$512			$517		

(1) There were no impaired payment plan receivables at March 31, 2012 or December 31, 2011.

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Average recorded investment in and interest income earned on impaired loans by class for the three month periods ending March 31, follows:

	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$3,600	$17	$3,399	$18
Land, land development & construction-real estate	1,590	-	1,236	13
Commercial and industrial	4,027	2	3,678	-
Mortgage			-	
1-4 family	7,277	74	8,886	112
Resort lending	6,755	66	6,923	98
Home equity line of credit - 1st lien	-	-	-	-
Home equity line of credit - 2nd lien	90	1	106	1
Installment			-	