INDEPENDENT BANK CORP
Form 10-Q
November 03, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
Commission File Number: 1-9047

Independent Bank Corp.
(Exact name of registrant as specified in its charter)

Massachusetts	04-2870273
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Office Address: 2036 Washington Street, Hanover Massachusetts 02339
Mailing Address: 288 Union Street, Rockland, Massachusetts 02370
(Address of principal executive offices, including zip code)
(781) 878-6100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.   Yes 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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	x	Accelerated Filer	o
Non-accelerated Filer	o	Smaller Reporting Company	o

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

As of November 1, 2016, there were 26,329,185 shares of the issuer's common stock outstanding, par value $0.01 per share.

Table of Contents

Table of Contents

Table of Contents

Table of Contents

Table of Contents

PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements
INDEPENDENT BANK CORP.
CONSOLIDATED BALANCE SHEETS
(Unaudited—Dollars in thousands, except share data)

	September 30, 2016	December 31 2015
Assets		
Cash and due from banks	$ 92,185	$ 84,813
Interest-earning deposits with banks	265,618	190,952
Securities		
Securities - trading	809	356
Securities - available for sale	387,008	367,249
Securities - held to maturity (fair value $441,834 and $478,749)	430,763	477,507
Total securities	818,580	845,112
Loans held for sale (at fair value)	13,334	5,990
Loans		
Commercial and industrial	857,713	843,276
Commercial real estate	2,787,660	2,653,434
Commercial construction	376,245	373,368
Small business	115,054	96,246
Residential real estate	632,685	638,606
Home equity - first position	559,867	543,092
Home equity - subordinate positions	405,245	384,711
Other consumer	11,664	14,988
Total loans	5,746,133	5,547,721
Less: allowance for loan losses	(58,205)	(55,825)
Net loans	5,687,928	5,491,896
Federal Home Loan Bank stock	11,304	14,431
Bank premises and equipment, net	76,429	75,663
Goodwill	201,083	201,083
Other intangible assets	9,751	11,826
Cash surrender value of life insurance policies	137,723	134,627
Other real estate owned and other foreclosed assets	1,798	2,159
Other assets	186,276	150,917
Total assets	$ 7,502,009	$ 7,209,469
Liabilities and Stockholders' Equity		
Deposits		
Demand deposits	2,024,235	1,846,593
Savings and interest checking accounts	2,417,195	2,370,141
Money market	1,198,959	1,089,139
Time certificates of deposit of $100,000 and over	257,638	274,701
Other time certificates of deposits	371,433	410,129
Total deposits	6,269,460	5,990,703
Borrowings		
Federal Home Loan Bank borrowings	50,826	102,080
Customer repurchase agreements and other short-term borrowings	140,914	133,958

4

Table of Contents

Junior subordinated debentures (less unamortized debt issuance costs of $141 and $158)	73,157	73,306
Subordinated debentures (less unamortized debt issuance costs of $376 and $411)	34,624	34,589
Total borrowings	299,521	343,933
Other liabilities	114,786	103,370
Total liabilities	6,683,767	6,438,006
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $.01 par value. authorized: 1,000,000 shares, outstanding: none	—	—
Common stock, $.01 par value. authorized: 75,000,000 shares, issued and outstanding: 26,320,467 shares at September 30, 2016 and 26,236,352 shares at December 31, 2015 (includes 212,673 and 230,900 shares of unvested participating restricted stock awards, respectively)	261	260
Shares held in rabbi trust at cost: 169,075 shares at September 30, 2016 and 173,378 shares at December 31, 2015	(4,199)	(3,958)
Deferred compensation and other retirement benefit obligations	4,199	3,958
Additional paid in capital	409,731	405,486
Retained earnings	404,750	368,169
Accumulated other comprehensive income (loss), net of tax	3,500	(2,452)
Total stockholders’ equity	818,242	771,463
Total liabilities and stockholders' equity	$7,502,009	$7,209,469

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

Table of Contents

INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited—Dollars in thousands, except share and per share data)

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2016	2015	2016	2015
Interest income				
Interest and fees on loans	$56,778	$ 54,557	$166,683	$ 160,261
Taxable interest and dividends on securities	5,034	5,455	15,500	14,934
Nontaxable interest and dividends on securities	28	31	89	95
Interest on loans held for sale	81	64	170	173
Interest on federal funds sold and short-term investments	387	121	767	212
Total interest and dividend income	62,308	60,228	183,209	175,675
Interest expense				
Interest on deposits	2,733	2,951	8,339	8,636
Interest on borrowings	1,907	2,232	5,778	6,997
Total interest expense	4,640	5,183	14,117	15,633
Net interest income	57,668	55,045	169,092	160,042
Provision for loan losses	950	800	2,075	1,000
Net interest income after provision for loan losses	56,718	54,245	167,017	159,042
Noninterest income				
Deposit account fees	4,622	4,754	13,563	13,385
Interchange and ATM fees	4,190	3,949	12,050	10,817
Investment management	5,446	4,981	16,183	15,616
Mortgage banking income	1,963	1,480	4,458	3,832
Gain on sale of equity securities	—	—	5	19
Gain on sale of fixed income securities	—	—	—	798
Increase in cash surrender value of life insurance policies	984	958	2,980	2,685
Loan level derivative income	810	968	4,627	2,816
Other noninterest income	2,401	2,157	6,800	6,096
Total noninterest income	20,416	19,247	60,666	56,064
Noninterest expenses				
Salaries and employee benefits	27,395	26,685	81,561	78,291
Occupancy and equipment expenses	5,433	5,443	16,927	17,509
Data processing and facilities management	1,400	1,112	3,831	3,462
FDIC assessment	725	1,020	2,655	2,993
Advertising expense	1,654	1,414	4,134	4,101
Consulting expense	770	867	2,235	2,451
Legal fees	321	746	1,132	1,462
Loss on extinguishment of debt	—	—	437	122
Loss on sale of equity securities	—	—	32	8
Loss on sale of fixed income securities	—	—	—	1,124
Merger and acquisition expense	151	—	691	10,501
Other noninterest expenses	9,008	9,744	26,850	28,628
Total noninterest expenses	46,857	47,031	140,485	150,652
Income before income taxes	30,277	26,461	87,198	64,454
Provision for income taxes	9,793	7,867	27,729	18,949
Net income	$20,484	$ 18,594	$59,469	$ 45,505

Basic earnings per share	$0.78	$ 0.71	$2.26	$ 1.77
Diluted earnings per share	$0.78	$ 0.71	$2.26	$ 1.76
Weighted average common shares (basic)	26,324,316	26,200,621	26,301,340	25,774,571
Common shares equivalents	53,072	63,493	48,354	72,921
Weighted average common shares (diluted)	26,377,388	26,264,114	26,349,694	25,847,492
Cash dividends declared per common share	$0.29	$ 0.26	$0.87	$ 0.78

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

Table of Contents

INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited—Dollars in thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Net income	$20,484	$18,594	$59,469	$45,505
Other comprehensive income (loss), net of tax				
Net change in fair value of securities available for sale	(816)	1,211	5,119	544
Net change in fair value of cash flow hedges	674	132	653	596
Net change in other comprehensive income for defined benefit postretirement plans	59	110	180	309
Total other comprehensive income (loss)	(83)	1,453	5,952	1,449
Total comprehensive income	$20,401	$20,047	$65,421	$46,954

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

Table of Contents

INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited—Dollars in thousands, except share data)

	Common Stock Outstanding	Common Stock	Value of Shares Held in Rabbi Trust at Cost	Deferred Compensation and Other Retirement Benefit Obligations	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 31, 2015	26,236,352	$ 260	$ (3,958)	$ 3,958	$ 405,486	$ 368,169	$ (2,452)	$ 771,463
Net income	—	—	—	—	—	59,469	—	59,469
Other comprehensive income	—	—	—	—	—	—	5,952	5,952
Common dividend declared ($0.87 per share)	—	—	—	—	—	(22,888)	—	(22,888)
Proceeds from exercise of stock options, net of cash paid	9,022	—	—	—	160	—	—	160
Tax benefit related to equity award activity	—	—	—	—	354	—	—	354
Stock based compensation	—	—	—	—	2,308	—	—	2,308
Restricted stock awards issued, net of awards surrendered	32,567	1	—	—	(674)	—	—	(673)
Shares issued under direct stock purchase plan	42,526	—	—	—	1,918	—	—	1,918
Deferred compensation and other retirement benefit obligations	—	—	(241)	241		—	—	—
Tax benefit related to deferred compensation distributions	—	—	—	—	179	—	—	179
Balance September 30, 2016	26,320,467	$ 261	$ (4,199)	$ 4,199	$ 409,731	$ 404,750	$ 3,500	$ 818,242
Balance December 31, 2014	23,998,738	$ 237	$ (3,666)	$ 3,666	$ 311,978	$ 330,444	$ (2,132)	$ 640,527
Net income	—	—	—	—	—	45,505	—	45,505
Other comprehensive income	—	—	—	—	—	—	1,449	1,449
Common dividend declared ($0.78 per share)	—	—	—	—	—	(20,412)	—	(20,412)
Common stock issued for acquisition	2,052,137	21	—	—	86,394	—	—	86,415
Proceeds from exercise of stock options, net of cash	78,240	1	—	—	1,364	—	—	1,365

paid								
Tax benefit related to equity award activity	—	—	—	—	776	—	—	776
Stock based compensation	—	—	—	—	2,028	—	—	2,028
Restricted stock awards issued, net of awards surrendered	36,901	1	—	—	(646)	—	—	(645)
Shares issued under direct stock purchase plan	46,222	—	—	—	2,023	—	—	2,023
Deferred compensation and other retirement benefit obligations	—	—	(217)	217	—	—	—	—
Tax benefit related to deferred compensation distributions	—	—	—	—	172	—	—	172
Balance September 30, 2015	26,212,238	$ 260	$ (3,883)	$ 3,883	$404,089	$355,537	$ (683)	$759,203

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

8

Table of Contents

INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited—Dollars in thousands)

	Nine Months Ended September 30	
	2016	2015
Cash flow from operating activities		
Net income	$59,469	$45,505
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	10,729	9,327
Provision for loan losses	2,075	1,000
Deferred income tax expense	314	5,372
Net loss on sale of securities	27	315
Net loss on fixed assets	10	213
Loss on extinguishment of debt	437	122
Net loss on other real estate owned and foreclosed assets	41	1,070
Realized gain on sale leaseback transaction	(775)	(775)
Stock based compensation	2,308	2,028
Excess tax benefit related to equity award activity	(354)	(776)
Increase in cash surrender value of life insurance policies	(2,980)	(2,685)
Change in fair value on loans held for sale	(60)	(3)
Net change in:		
Trading assets	(453)	(454)
Loans held for sale	(7,284)	(4,585)
Other assets	(42,044)	4,366
Other liabilities	18,314	2,035
Total adjustments	(19,695)	16,570
Net cash provided by operating activities	39,774	62,075
Cash flows used in investing activities		
Proceeds from sales of securities available for sale	285	14,344
Proceeds from maturities and principal repayments of securities available for sale	48,421	60,507
Purchases of securities available for sale	(60,888)	(49,086)
Proceeds from maturities and principal repayments of securities held to maturity	62,005	44,706
Purchases of securities held to maturity	(14,998)	(117,286)
Redemption of Federal Home Loan Bank stock	3,127	—
Investments in low income housing projects	(5,473)	(14,817)
Purchases of life insurance policies	(116)	(115)
Net increase in loans	(198,731)	(65,650)
Cash used in business combinations, net of cash acquired	—	(13,448)
Purchases of bank premises and equipment	(6,022)	(6,846)
Proceeds from the sale of bank premises and equipment	26	1,233
Proceeds from the sale of other real estate owned and foreclosed assets	842	7,378
Net payments relating to other real estate owned and foreclosed assets	(145)	(961)
Net cash used in investing activities	(171,667)	(140,041)
Cash flows provided by financing activities		
Net decrease in time deposits	(55,759)	(54,293)

9

Table of Contents

Net increase in other deposits	334,516	326,440
Net repayments of short-term Federal Home Loan Bank borrowings	—	(10,000)
Repayments of long-term Federal Home Loan Bank borrowings	(51,641)	(7,000)
Net increase (decrease) in customer repurchase agreements	6,956	(9,441)
Repayments of wholesale repurchase agreements	—	(50,000)
Repayments of subordinated debentures	—	(30,000)
Net proceeds from exercise of stock options	160	1,365
Restricted stock awards issued, net of awards surrendered	(673)	(645)
Excess tax benefit from stock based compensation	354	776
Tax benefit from deferred compensation distribution	179	172
Proceeds from shares issued under direct stock purchase plan	1,918	2,023
Common dividends paid	(22,079)	(19,357)
Net cash provided by financing activities	213,931	150,040
Net increase in cash and cash equivalents	82,038	72,074
Cash and cash equivalents at beginning of year	275,765	178,254
Cash and cash equivalents at end of period	357,803	250,328
Supplemental schedule of noncash investing and financing activities		
Transfer of loans to other real estate owned & foreclosed assets	$ 377	$ 2,134
Other net transfers to other real estate owned	$ —	$ 142
Net increase in capital commitments relating to low income housing project investments	$ 163	$ 2,085
In conjunction with the Peoples Federal Bancshares, Inc. acquisition, assets were acquired and liabilities were assumed as follows		
Common stock issued for acquisition	$ —	$ 86,415
Fair value of assets acquired, net of cash acquired	$ —	$ 598,376
Fair value of liabilities assumed	$ —	$ 498,513

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

Table of Contents

CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Independent Bank Corp. (the “Company”) is a state chartered, federally registered bank holding company, incorporated in 1985. The Company is the sole stockholder of Rockland Trust Company (“Rockland Trust” or the “Bank”), a Massachusetts trust company chartered in 1907.

All material intercompany balances and transactions have been eliminated in consolidation. Certain previously reported amounts may have been reclassified to conform to the current year’s presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, primarily consisting of normal recurring adjustments, have been included. Operating results for the quarter ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or any other interim period.

For further information, refer to the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission.

NOTE 2 - RECENT ACCOUNTING STANDARDS UPDATES

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 606 "Revenue from Contracts with Customers" Update No. 2014-09. Update No. 2014-09 was issued in May 2014 to address the previous revenue recognition requirements in GAAP that differ from those in International Financial Reporting Standards (IFRS). Accordingly, the FASB and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. The largely converged revenue recognition standards will supersede virtually all revenue recognition guidance in GAAP and IFRS. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Since the issuance of Update 2014-09, the FASB has finalized various amendments to the standard as summarized below:

FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-12
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-10
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-08.
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2015-14.

Through Updates 2016-12, 2016-10 and 2016-08, the FASB amended its new revenue guidance on licenses of intellectual property, identification of performance obligations, collectability, noncash consideration and the presentation of sales and other similar taxes. The FASB also clarified the definition of a completed contract at transition and added a practical expedient to ease transition for contracts that were modified prior to adoption. The FASB also amended the new revenue recognition guidance on determining whether an entity is a principal or an agent in an arrangement which affects whether revenue should be reported gross or net.

Following the issuance of Update 2015-14, Update 2014-09, as amended, is effective for the Company for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. A full or modified retrospective transition method is required. The Company's revenue is comprised of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The Company plans to adopt the revenue recognition guidance in the first quarter of 2018 and is currently evaluating the potential impact on noninterest income on the Company's consolidated financial position, other presentation and disclosure issues, as well as evaluating its selection of transition method.

FASB ASC Topic 230 "Statement of Cash Flows" Update No. 2016-15. Update No. 2016-15 was issued in August 2016 to reduce diversity of practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in this update provide guidance on the following eight specific cash flow issues; (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions, and (8) separately identifiable cash flows and application of the Predominance Principle. The amendments in this topic will provide guidance for these eight issues, thereby reducing the current and potential future diversity in practice. The amendments in this update are effective for annual periods and interim periods within those annual periods beginning after December 31, 2017. Earlier adoption is permitted, including interim reporting periods within that reporting period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 326 "Financial Instruments - Credit Losses" Update No. 2016-13. Update No. 2016-13 was issued in June 2016 to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with earlier adoption permitted as of fiscal years beginning after December 15, 2018, including interim periods with those fiscal years. The Company is currently assessing the impact of the adoption of this standard on the Company's consolidated financial position.

FASB ASC Topic 605 "Revenue Recognition" and Topic 815 "Derivatives and Hedging" Update No. 2016-11. Update No. 2016-11 was issued in May 2016 and is a rescission of SEC guidance because of ASU Updates 2014-09 and 2014-16 pursuant to staff announcements at the March 3, 2016 Emerging Issues Task Force meeting. The amendments in this update are effective upon adoption of Topic 606 "Revenue from Contracts with Customers." The Company is currently assessing the impact of the adoption of this standard on the Company's consolidated financial position.

FASB ASC Topic 718 "Compensation - Stock Compensation" Update No. 2016-09. Update No. 2016-09 was issued in March 2016 and affects all entities that issue share-based awards to their employees. This update was issued as part of the FASB’s simplification initiative. The areas for simplification in this update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this standard on the Company's consolidated financial position.

FASB ASC Topic 323 "Investments -Equity Method and Joint Ventures" Update No. 2016-07. Update No. 2016-07 was issued in March 2016 and eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments in this update require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 815 "Derivative and Hedging - Contingent Put and Call Options in Debt Instruments" Update No. 2016-6. Update No. 2016-6 was issued in March 2016 to clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. An entity performing the assessment under the amendments in this update is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. For public entities, the amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. An entity has an option to apply

Table of Contents

the amendments in this update on either a prospective basis or a modified retrospective basis. Early adoption is permitted, including adoption in an interim period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 815 "Derivative and Hedging - Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships" Update No. 2016-05. Update No. 2016-05 was issued in March 2016 and applies to all reporting entities for which there is a change in the counterpart to a derivative instrument that has been designated as a hedging instrument under Topic 815. The amendments in this update clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) continue to be met. For public entities, the amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. An entity has an option to apply the amendments in this update on either a prospective basis or a modified retrospective basis. Early adoption is permitted, including adoption in an interim period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 842 "Leases" Update No. 2016-02. Update No. 2016-02 was issued in February 2016 and affects any entity that enters into a lease (as that term is defined in this update), with some specified scope exemptions. The core principle of this update is that a lessee should recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease have not significantly changed from previous GAAP. In addition, the accounting applied by a lessor is largely unchanged from that applied under previous GAAP. For public companies, the amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this standard on the Company's consolidated financial position.

FASB ASC Topic 825-10 "Financial Instruments - Overall Recognition and Measurement of Financial Assets and Financial Liabilities" Update No. 2016-01. Update No. 2016-01 was issued in January 2016 to amend the guidance in U.S. GAAP on the classification and measurement of financial instruments. Although the update retains many current requirements, it significantly revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. The update also amends certain disclosure requirements associated with the fair value of financial instruments and various other aspects of recognition, measurement, presentation and disclosure of financial instruments. For public entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted for only certain guidance. The Company is currently assessing the impact of the adoption of this standard on the Company's consolidated financial position.

FASB ASC Subtopic 835-30 "Interest - Imputation of Interest" Update No. 2015-03. Update No. 2015-03 was issued in April 2015 to simplify presentation of debt issuance costs. The amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuances costs are not affected by the amendments in this update. The amendments in this update were adopted by the Company effective January 1, 2016, with applicable prior period presentation updated as well. The adoption of this standard did not have a material impact on the Company's consolidated financial position.

Table of Contents

NOTE 3 - SECURITIES
Trading Securities

The Company had trading securities of $809,000 and $356,000 as of September 30, 2016 and December 31, 2015, respectively. These securities are held in a rabbi trust and will be used for future payments associated with the Company’s non-qualified 401(k) Restoration Plan and Non-Qualified Deferred Compensation Plan.

Available for Sale and Held to Maturity Securities
The following table presents a summary of the amortized cost and gross unrealized holding gains and losses recorded in other comprehensive income and fair value of securities available for sale and securities held to maturity for the periods below:

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)							
Available for sale securities								
U.S. government agency securities	$24,502	$ 804	$ —	$25,306	$29,958	$ 261	$ (4)	$30,215
Agency mortgage-backed securities	178,095	7,481	(3)	185,573	207,693	4,227	(983)	210,937
Agency collateralized mortgage obligations	107,466	1,286	(156)	108,596	64,157	179	(752)	63,584
State, county, and municipal securities	4,255	105	—	4,360	4,543	116	—	4,659
Single issuer trust preferred securities issued by banks	2,324	4	(31)	2,297	2,865	8	(81)	2,792
Pooled trust preferred securities issued by banks and insurers	2,200	—	(662)	1,538	2,217	—	(645)	1,572
Small business administration pooled securities	38,678	1,202	—	39,880	40,472	87	(110)	40,449
Equity securities	19,000	701	(243)	19,458	13,235	374	(568)	13,041
Total available for sale securities	$376,520	$ 11,583	$ (1,095)	$387,008	$365,140	$ 5,252	$ (3,143)	$367,249
Held to maturity securities								
U.S. Treasury securities	$1,008	$ 81	$ —	$1,089	$1,009	$ 55	$ —	$1,064
Agency mortgage-backed securities	148,822	6,309	—	155,131	167,134	3,460	(219)	170,375
Agency collateralized mortgage obligations	246,744	4,072	(556)	250,260	267,348	1,195	(3,652)	264,891
State, county, and municipal securities	—	—	—	—	225	2	—	227
Single issuer trust preferred securities issued by banks	1,500	47	—	1,547	1,500	22	—	1,522
Small business administration pooled securities	32,689	1,118	—	33,807	35,291	437	(64)	35,664

Corporate debt securities	—	—	—	—	5,000	6	—	5,006
Total held to maturity securities	$430,763	$ 11,627	$ (556)	$441,834	$477,507	$ 5,177	$ (3,935)	$478,749
Total	$807,283	$ 23,210	$ (1,651)	$828,842	$842,647	$ 10,429	$ (7,078)	$845,998

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on the sale.

The actual maturities of certain securities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. A schedule of the contractual maturities of securities available for sale and securities held to maturity as of September 30, 2016 is presented below:

Table of Contents

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$999	$1,003	$11	$11
Due after one year to five years	30,422	31,258	16,099	16,739
Due after five to ten years	86,511	89,455	24,594	25,602
Due after ten years	239,588	245,834	390,059	399,482
Total debt securities	$357,520	$367,550	$430,763	$441,834
Equity securities	$19,000	$19,458	$—	$—
Total	$376,520	$387,008	$430,763	$441,834

Inclusive in the table above is $11.9 million of callable securities in the Company’s investment portfolio at September 30, 2016.

The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law, was $451.7 million and $444.8 million at September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016 and December 31, 2015, the Company had no investments in obligations of individual states, counties, or municipalities which exceeded 10% of stockholders’ equity.

Other-Than-Temporary Impairment ("OTTI")

The Company continually reviews investment securities for the existence of OTTI, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, the credit worthiness of the obligor of the security, volatility of earnings, current analysts’ evaluations, the Company’s intent to sell the security, or whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment.

The following tables show the gross unrealized losses and fair value of the Company’s investments in an unrealized loss position, which the Company has not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	September 30, 2016						
		Less than 12 months		12 months or longer		Total	
	# of holdings	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)						
Agency mortgage-backed securities	2	$1,016	$ (3)	$—	$—	$1,016	$(3)
Agency collateralized mortgage obligations	9	14,530	(30)	51,578	(682)	66,108	(712)
Single issuer trust preferred securities issued by banks and insurers	2	—	—	2,048	(31)	2,048	(31)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,537	(662)	1,537	(662)
Equity securities	21	515	(16)	6,903	(227)	7,418	(243)
Total temporarily impaired securities	35	$16,061	$ (49)	$62,066	$(1,602)	$78,127	$(1,651)

	December 31, 2015						
		Less than 12 months		12 months or longer		Total	
	# of holdings	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)						
U.S.government agency securities	3	$ 1,990	$ (4)	$—	$ —	$ 1,990	$ (4)
Agency mortgage-backed securities	57	112,648	(1,062)	4,297	(140)	116,945	(1,202)
Agency collateralized mortgage obligations	23	147,707	(1,420)	80,927	(2,984)	228,634	(4,404)
Single issuer trust preferred securities issued by banks and insurers	2	1,018	(33)	1,018	(48)	2,036	(81)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,572	(645)	1,572	(645)
Small business administration pooled securities	3	37,986	(174)	—	—	37,986	(174)
Equity securities	34	3,481	(189)	4,971	(379)	8,452	(568)
Total temporarily impaired securities	123	$ 304,830	$ (2,882)	$ 92,785	$ (4,196)	$ 397,615	$ (7,078)

The Company does not intend to sell these investments and has determined based upon available evidence that it is more likely than not that the Company will not be required to sell the security before the recovery of its amortized cost basis. As a result, the Company does not consider these investments to be OTTI. The Company made this determination by reviewing various qualitative and quantitative factors regarding each investment category, such as current market conditions, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, and current analysts' evaluations.

As a result of the Company's review of these qualitative and quantitative factors, the causes of the impairments listed in the table above by category are as follows at September 30, 2016:

- Agency Mortgage-Backed Securities and Agency Collateralized Mortgage Obligations: These portfolios have contractual terms that generally do not permit the issuer to settle the securities at a price less than the current par value of the investment. The decline in market value of these securities is attributable to changes in interest rates and not credit quality. Additionally, these securities are either implicitly or explicitly guaranteed by the U.S. Government or one of its agencies.
- Single Issuer Trust Preferred Securities: This portfolio consists of two securities, one of which is below investment grade. The unrealized loss on these securities is attributable to the illiquid nature of the trust preferred market in the current economic environment. Management evaluates various financial metrics for the issuers, including regulatory capital ratios of the issuers.
- Pooled Trust Preferred Securities: This portfolio consists of one below investment grade security which is performing. The unrealized loss on this security is attributable to the illiquid nature of the trust preferred market in the current economic and regulatory environment. Management evaluates collateral credit and instrument structure, including current and expected deferral and default rates and timing. In addition, discount rates are determined by evaluating comparable spreads observed currently in the market for similar instruments.
- Equity Securities: This portfolio consists of mutual funds and other equity investments. During some periods, the mutual funds in the Company's investment portfolio may have unrealized losses resulting from market fluctuations as well as the risk premium associated with that particular asset class. For example, emerging market equities tend to trade at a higher risk premium than U.S. government bonds and thus, will fluctuate to a greater degree on both the upside and the downside. In the context of a well-diversified portfolio, however, the correlation amongst the various asset classes represented by the funds serves to minimize downside risk. The Company evaluates each mutual fund in the portfolio regularly and measures performance on both an absolute and relative basis. A reasonable recovery period for positions with an unrealized loss is based on management's assessment of general economic data, trends within a particular asset class, valuations, earnings forecasts and bond durations. The Company has the ability and intent to hold these equity securities until a recovery of fair value.

Table of Contents

The following table shows the total OTTI that the Company recorded for the periods indicated:

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Dollars in thousands)			
Gross change in OTTI recorded on certain investments	$ —	$ —	$ —	$ 84
Portion of OTTI recognized in OCI	—	—	—	(84)
Total credit related OTTI recognized in earnings	$ —	$ —	$ —	$ —

The following table shows the cumulative credit related component of OTTI for the periods indicated:

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Dollars in thousands)			
Balance at beginning of period	$ —	$ —	$ —	$ (9,997)
Add				
Incurred on securities not previously impaired	—	—	—	—
Incurred on securities previously impaired	—	—	—	—
Less				
Securities sold during the period	—	—	—	9,997
Reclassification due to changes in Company's intent	—	—	—	—
Increases in cash flow expected to be collected	—	—	—	—
Balance at end of period	$ —	$ —	$ —	$ —

Table of Contents

NOTE 4 - LOANS, ALLOWANCE FOR LOAN LOSSES, AND CREDIT QUALITY

The following tables bifurcate the amount of loans and the allowance allocated to each loan category based on the type of impairment analysis as of the periods indicated:

	September 30, 2016 (Dollars in thousands)								
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total	
Financing receivables ending balance:									
Collectively evaluated for impairment	$853,245	$2,759,158	$376,245	$114,085	$609,854	$958,999	$11,244	$5,682,830	
Individually evaluated for impairment	$4,468	$18,077	$—	$969	$14,193	$5,904	$418	$44,029	
Purchased credit impaired loans	$—	$10,425	$—	$—	$8,638	$209	$2	$19,274	
Total loans by group	$857,713	$2,787,660	$376,245	$115,054	$632,685	$965,112	$11,664	$5,746,133	(1)

	December 31, 2015 (Dollars in thousands)								
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total	
Financing receivables ending balance:									
Collectively evaluated for impairment	$838,129	$2,619,294	$373,064	$95,225	$614,014	$921,563	$14,427	$5,475,716	
Individually evaluated for impairment	$5,147	$22,986	$304	$1,021	$15,405	$5,989	$558	$51,410	
Purchased credit impaired loans	$—	$11,154	$—	$—	$9,187	$251	$3	$20,595	
Total loans by group	$843,276	$2,653,434	$373,368	$96,246	$638,606	$927,803	$14,988	$5,547,721	(1)

(1) The amount of net deferred fees on loans and net unamortized discounts on acquired loans not deemed to be purchased credit impaired ("PCI") included in the ending balance was $10.9 million at both September 30, 2016 and December 31, 2015 respectively.

The following tables summarize changes in allowance for loan losses by loan category for the periods indicated:

	Three Months Ended September 30, 2016 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$14,027	$29,011	$5,216	$1,441	$2,578	$4,986	$468	$57,727

Charge-offs	(27)	(341)	—	(98)	—	(154)	(523)	(1,143)
Recoveries	63	124	—	28	130	24	302	671
Provision (benefit)	(189)	609	117	113	(44)	196	148	950
Ending balance	$13,874	$ 29,403	$ 5,333	$1,484	$ 2,664	$ 5,052	$ 395	$58,205

Table of Contents

	Three Months Ended September 30, 2015 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$15,279	$ 26,359	$ 4,071	$1,248	$ 2,551	$ 4,871	$ 616	$54,995
Charge-offs	(497)	(28)	—	(2)	(40)	(249)	(349)	(1,165)
Recoveries	22	152	—	57	6	130	208	575
Provision (benefit)	(518)	582	422	(20)	75	128	131	800
Ending balance	$14,286	$ 27,065	$ 4,493	$1,283	$ 2,592	$ 4,880	$ 606	$55,205

	Nine Months Ended September 30, 2016 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$13,802	$ 27,327	$ 5,366	$ 1,264	$ 2,590	$ 4,889	$ 587	