INDEPENDENT BANK CORP
Form 10-Q
August 03, 2017
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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 June 30, 2017
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,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Acts. 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 August 1, 2017, there were 27,437,090 shares of the issuer's common stock outstanding, par value $0.01 per share.

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

	June 30, 2017	December 31 2016
Assets		
Cash and due from banks	$110,249	$97,196
Interest-earning deposits with banks	126,073	191,899
Securities		
Securities - trading	1,293	804
Securities - available for sale	415,943	363,644
Securities - held to maturity (fair value $499,059 and $485,650)	498,392	487,076
Total securities	915,628	851,524
Loans held for sale (at fair value)	9,381	6,139
Loans		
Commercial and industrial	910,936	902,053
Commercial real estate	3,083,020	3,010,798
Commercial construction	340,757	320,391
Small business	131,663	122,726
Residential real estate	749,392	644,426
Home equity - first position	612,428	577,006
Home equity - subordinate positions	431,031	411,141
Other consumer	10,469	11,064
Total loans	6,269,696	5,999,605
Less: allowance for loan losses	(59,479)	(61,566)
Net loans	6,210,217	5,938,039
Federal Home Loan Bank stock	14,421	11,497
Bank premises and equipment, net	92,664	78,480
Goodwill	231,806	221,526
Other intangible assets	11,199	9,848
Cash surrender value of life insurance policies	149,319	144,503
Other real estate owned and other foreclosed assets	3,029	4,173
Other assets	143,307	154,551
Total assets	$8,017,293	$7,709,375
Liabilities and Stockholders' Equity		
Deposits		
Demand deposits	$2,118,506	$2,057,086
Savings and interest checking accounts	2,676,389	2,469,237
Money market	1,292,311	1,236,778
Time certificates of deposit of $100,000 and over	238,439	266,190
Other time certificates of deposits	369,735	382,962
Total deposits	6,695,380	6,412,253
Borrowings		
Federal Home Loan Bank borrowings	53,279	50,819

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Customer repurchase agreements	159,371	176,913
Junior subordinated debentures (less unamortized debt issuance costs of $128 and $136)	73,069	73,107
Subordinated debentures (less unamortized debt issuance costs of $341 and $365)	34,659	34,635
Total borrowings	320,378	335,474
Other liabilities	86,951	96,958
Total liabilities	7,102,709	6,844,685
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: 27,431,171 shares at June 30, 2017 and 27,005,813 shares at December 31, 2016 (includes 185,006 and 212,698 shares of unvested participating restricted stock awards, respectively)	272	268
Value of shares held in rabbi trust at cost: 162,559 shares at June 30, 2017 and 170,036 shares at December 31, 2016	(4,414)	(4,277)
Deferred compensation and other retirement benefit obligations	4,414	4,277
Additional paid in capital	476,684	451,664
Retained earnings	437,587	414,095
Accumulated other comprehensive income (loss), net of tax	41	(1,337)
Total stockholders’ equity	914,584	864,690
Total liabilities and stockholders' equity	$8,017,293	$7,709,375

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

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

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
Interest income				
Interest and fees on loans	$62,287	$ 55,636	$121,080	$ 109,905
Taxable interest and dividends on securities	5,609	5,269	10,976	10,466
Nontaxable interest and dividends on securities	26	29	52	61
Interest on loans held for sale	21	57	35	89
Interest on federal funds sold and short-term investments	190	169	397	380
Total interest and dividend income	68,133	61,160	132,540	120,901
Interest expense				
Interest on deposits	2,912	2,738	5,679	5,606
Interest on borrowings	1,466	1,889	2,906	3,871
Total interest expense	4,378	4,627	8,585	9,477
Net interest income	63,755	56,533	123,955	111,424
Provision for loan losses	1,050	600	1,650	1,125
Net interest income after provision for loan losses	62,705	55,933	122,305	110,299
Noninterest income				
Deposit account fees	4,392	4,618	8,936	9,213
Interchange and ATM fees	4,434	4,136	8,356	7,860
Investment management	5,995	5,734	11,609	10,737
Mortgage banking income	1,314	1,363	2,271	2,495
Gain on sale of equity securities	3	5	7	5
Increase in cash surrender value of life insurance policies	1,017	982	1,981	1,996
Loan level derivative income	1,337	2,095	1,943	3,817
Other noninterest income	2,906	2,162	5,207	4,127
Total noninterest income	21,398	21,095	40,310	40,250
Noninterest expenses				
Salaries and employee benefits	28,654	26,977	56,978	54,166
Occupancy and equipment expenses	6,059	5,667	12,217	11,494
Data processing and facilities management	1,188	1,225	2,460	2,431
FDIC assessment	778	920	1,561	1,930
Advertising expense	1,365	1,223	2,659	2,480
Consulting expense	1,262	864	1,816	1,465
Debit card expense	852	744	1,624	1,432
Loss on extinguishment of debt	—	—	—	437
Loss on sale of equity securities	2	3	5	32
Merger and acquisition expense	2,909	206	3,393	540
Software maintenance	896	735	1,826	1,489
Other noninterest expenses	8,844	8,582	17,043	15,732
Total noninterest expenses	52,809	47,146	101,582	93,628
Income before income taxes	31,294	29,882	61,033	56,921
Provision for income taxes	10,731	9,508	19,745	17,936
Net income	$20,563	$ 20,374	$41,288	$ 38,985
Basic earnings per share	$0.75	$ 0.77	$1.52	$ 1.48

Diluted earnings per share	$0.75	$ 0.77	$1.52	$ 1.48
Weighted average common shares (basic)	27,257,799	26,304,129	27,144,350	26,289,726
Common share equivalents	74,497	47,885	78,757	45,679
Weighted average common shares (diluted)	27,332,296	26,352,014	27,223,107	26,335,405
Cash dividends declared per common share	$0.32	$ 0.29	$0.64	$ 0.58

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

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

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
Net income	$20,563	$20,374	$41,288	$38,985
Other comprehensive income, net of tax				
Net change in fair value of securities available for sale	792	1,854	1,323	5,935
Net change in fair value of cash flow hedges	(190)	(144)	(101)	(21)
Net change in other comprehensive income for defined benefit postretirement plans	78	61	156	121
Total other comprehensive income	680	1,771	1,378	6,035
Total comprehensive income	$21,243	$22,145	$42,666	$45,020

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

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INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited—Dollars in thousands, except per 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, 2016	27,005,813	$ 268	$ (4,277)	$ 4,277	$451,664	$414,095	$ (1,337)	$864,690
Cumulative effect accounting adjustment (1)	—	—	—	—	542	(365)	—	177
Net income	—	—	—	—	—	41,288	—	41,288
Other comprehensive income	—	—	—	—	—	—	1,378	1,378
Common dividend declared ($0.64 per share)	—	—	—	—	—	(17,431)	—	(17,431)
Common stock issued for acquisition	369,286	4	—	—	23,464	—	—	23,468
Proceeds from exercise of stock options, net of cash paid	11,174	—	—	—	8	—	—	8
Stock based compensation	—	—	—	—	1,560	—	—	1,560
Restricted stock awards issued, net of awards surrendered	32,524	—	—	—	(1,361)	—	—	(1,361)
Shares issued under direct stock purchase plan	12,374	—	—	—	807	—	—	807
Deferred compensation and other retirement benefit obligations	—	—	(137)	137	—	—	—	—
Balance June 30, 2017	27,431,171	$ 272	$ (4,414)	$ 4,414	$476,684	$437,587	$ 41	$914,584
Balance December 31, 2015	26,236,352	$ 260	$ (3,958)	$ 3,958	$405,486	$368,169	$ (2,452)	$771,463
Net income	—	—	—	—	—	38,985	—	38,985
Other comprehensive income	—	—	—	—	—	—	6,035	6,035
Common dividend declared ($0.58 per share)	—	—	—	—	—	(15,256)	—	(15,256)
Proceeds from exercise of stock options, net of cash paid	6,652	—	—	—	144	—	—	144
Tax benefit related to equity award activity	—	—	—	—	327	—	—	327

Stock based compensation	—	—	—	—	1,633	—	—	1,633
Restricted stock awards issued, net of awards surrendered	42,967	1	—	—	(674)	—	—	(673)
Shares issued under direct stock purchase plan	23,916	—	—	—	1,060	—	—	1,060
Deferred compensation and other retirement benefit obligations	—	—	(155)	155	—	—	—	—
Tax benefit related to deferred compensation distributions	—	—	—	—	179	—	—	179
Balance June 30, 2016	26,309,887	$ 261	$ (4,113)	$ 4,113	$408,155	$391,898	$ 3,583	$803,897

(1) Represents adjustment needed to reflect the cumulative impact on retained earnings for previously recognized stock based compensation, which included an adjustment for estimated forfeitures. Pursuant to the Company's adoption of Accounting Standards Update 2016-09, the Company has elected to recognize stock based compensation without inclusion of a forfeiture estimate, and as such has recognized this adjustment to present retained earnings consistent with this election.

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

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

	Six Months Ended June 30	
	2017	2016
Cash flow from operating activities		
Net income	$41,288	$38,985
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	7,454	7,242
Provision for loan losses	1,650	1,125
Deferred income tax expense	642	415
Net (gain) loss on sale of securities	(2)	27
Net (gain) loss on bank premises and equipment	(92)	13
Loss on extinguishment of debt	—	437
Net loss on other real estate owned and foreclosed assets	70	41
Realized gain on sale leaseback transaction	(517)	(517)
Stock based compensation	1,560	1,633
Excess tax benefit related to equity award activity	—	(327)
Increase in cash surrender value of life insurance policies	(1,981)	(1,996)
Change in fair value on loans held for sale	(6)	(13)
Net change in:		
Trading assets	(489)	(443)
Loans held for sale	(3,236)	(6,924)
Other assets	8,973	(45,265)
Other liabilities	(6,104)	19,615
Total adjustments	7,922	(24,937)
Net cash provided by operating activities	49,210	14,048
Cash flows used in investing activities		
Proceeds from sales of securities available for sale	35	285
Proceeds from maturities and principal repayments of securities available for sale	24,406	32,625
Purchases of securities available for sale	(74,956)	(46,358)
Proceeds from maturities and principal repayments of securities held to maturity	38,634	39,028
Purchases of securities held to maturity	(49,802)	—
Redemption (purchases) of Federal Home Loan Bank stock	(2,438)	3,127
Investments in low income housing projects	(3,871)	(4,431)
Purchases of life insurance policies	(101)	(101)
Net increase in loans	(118,579)	(126,406)
Cash acquired in business combinations, net of cash paid	6,289	—
Purchases of bank premises and equipment	(14,182)	(4,003)
Proceeds from the sale of bank premises and equipment	1,918	14
Proceeds from the sale of other real estate owned and foreclosed assets	1,531	795
Net payments relating to other real estate owned and foreclosed assets	—	(145)
Net cash used in investing activities	(191,116)	(105,570)
Cash flows provided by financing activities		
Net decrease in time deposits	(55,787)	(40,755)

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Net increase in other deposits	179,495	247,944
Repayments of long-term Federal Home Loan Bank borrowings	—	(51,641)
Net increase (decrease) in customer repurchase agreements	(17,542)	5,758
Net proceeds from exercise of stock options	8	144
Restricted stock awards issued, net of awards surrendered	(1,361)	(673)
Excess tax benefit from stock based compensation	—	327
Tax benefit from deferred compensation distribution	—	179
Proceeds from shares issued under direct stock purchase plan	807	1,060
Common dividends paid	(16,487)	(14,449)
Net cash provided by financing activities	89,133	147,894
Net increase (decrease) in cash and cash equivalents	(52,773)	56,372
Cash and cash equivalents at beginning of year	289,095	275,765
Cash and cash equivalents at end of period	$236,322	$332,137
Supplemental schedule of noncash investing and financing activities		
Transfer of loans to other real estate owned & foreclosed assets	$457	$377
Net increase (decrease) in capital commitments relating to low income housing project investments	$46	$(180)
In conjunction with the Company's acquisitions, assets were acquired and liabilities were assumed as follows		
Common stock issued for acquisition	$23,468	$—
Fair value of assets acquired, net of cash acquired	$179,252	$—
Fair value of liabilities assumed	$162,073	$—

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

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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 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. Results for the quarter ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 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, 2016, filed with the Securities and Exchange Commission.

NOTE 2 - RECENT ACCOUNTING STANDARDS UPDATES

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("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 adopted this standard effective January 1, 2017. Upon adoption, the Company elected to no longer estimate forfeitures on stock compensation and instead recognize forfeitures when they occur. The election required a cumulative effect adjustment to retained earnings which did not materially impact the Company's consolidated financial position. Additionally, the disclosure requirements of this standard will be applied on a prospective basis.

FASB ASC Topic 718 "Compensation - Stock Compensation" Update No. 2017-09. Update No. 2017-09 was issued in May 2017 to provide clarity and reduce diversity in practice when applying guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all the following are met: (1) The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification. (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified. (3) The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The current disclosure requirements in Topic 718 apply regardless of whether an entity is required to apply modification accounting under the amendments in this update. The amendments in this update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for public business entities for reporting periods for which financial statements have not yet been issued and all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this update should be applied prospectively to an award

modified on or after the adoption date. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 310-20 "Receivables - Nonrefundable fees and Other Costs" Update No. 2017-08. Update No. 2017-08 was issued in March 2017 to shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. The Company early adopted this standard effective January 1, 2017 and the impact on the Company's consolidated financial position was immaterial.

FASB ASC Topic 715 "Compensation - Retirement Benefits" Update No. 2017-07. Update No. 2017-07 was issued in March 2017 to improve the presentation of net periodic pension cost and net periodic postretirement benefit costs. This update requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable. The amendments in this update are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted as of the beginning of an annual period for which the financial statements (interim or annual) have not been issued or made available for issuance. That is, early adoption should be within the first interim period if an employer issues interim financial statements. Disclosures of the nature of and reason for the change in accounting principle are required in the first interim and annual periods of adoption. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.
FASB ASC Subtopic 610-20 "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets" Update No. 2017-05. Update No. 2017-05 was issued in February 2017 to clarify that a financial asset is within the scope of Subtopic 610-20 if it meets the definition of an in substance nonfinancial asset. The amendments define the term in substance nonfinancial asset, in part, as a financial asset promised to a counterparty in a contract if substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets. The amendments in this update also clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets. For purposes of that evaluation, the amendments require an entity to evaluate the underlying assets in consolidated subsidiaries to determine whether those assets are within the scope of Subtopic 610-20. The amendments are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The guidance may be applied earlier but only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods in that reporting period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.
FASB ASC Topic 350 "Intangibles - Goodwill and Other " Update No. 2017-04. Update No. 2017-04 was issued in January 2017 to simplify the subsequent measurement of goodwill, by eliminating Step 2 for the goodwill impairment test. The amendments in this update modify the concept of impairment from the condition that exists when the carrying amount of a reporting unit exceeds its fair value. An entity is no longer required to determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit has been acquired in a business combination. An entity should apply the amendments in this update on a prospective basis. An entity is required to disclose the nature of and reason for the change in accounting principle upon transition. That disclosure should be provided in the first annual period and in the interim period within the first annual period when the entity initially adopts the amendments in this update. A public business entity that is a U.S. Securities and Exchange Commission (SEC)filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.
FASB 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. 2016-20
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.

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

The amendments in Update 2016-20 make minor corrections or minor improvements to the codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities.

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, and noninterest income. Interest income, mortgage banking income, gain on sale of equity securities, increase in cash surrender value of life insurance policies and loan level derivative income are accounted for under other U.S. GAAP standards, and are therefore anticipated to be out of scope of the ASC 606 revenue standard. Deposit account fees, interchange and ATM fees, investment management and certain categories of other noninterest income are anticipated to be within the scope of the ASC 606 revenue standard. As such, the Company is currently reviewing contracts related to these revenue streams and at this point does not anticipate any material changes to revenue recognition upon adoption, however, the Company’s review is still ongoing. The Company plans to adopt the revenue recognition standard as of January 1, 2018 and anticipates using the modified retrospective transition method upon adoption.

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NOTE 3 - ACQUISITIONS

Island Bancorp, Inc.

On May 12, 2017, the Company completed its acquisition of Island Bancorp, Inc., the parent of The Edgartown National Bank ("Island Bancorp"). The transaction qualified as a tax-free reorganization for federal income tax purposes and Island Bancorp shareholders received, for each share of Island Bancorp common stock, the right to receive either $500 in cash per share or 9.525 shares of the Company's stock (valued at $605.31 per share, based upon the highest trading value of the Company's stock on May 12, 2017 of $63.55). The total deal consideration was $28.3 million and was comprised of 20% cash and 80% stock consideration. The cash consideration was $4.8 million in the aggregate, inclusive of cash paid in lieu of fractional shares. The total stock consideration was $23.5 million resulting in an increase to the Company's outstanding shares of 369,286 shares.

The Company accounted for the acquisition using the acquisition method pursuant to the Business Combinations Topic of the FASB ASC. Accordingly, the Company recorded merger and acquisition expenses of $2.9 million and $3.2 million during the three and six months ended June 30, 2017. Additionally, the acquisition method requires the acquirer to recognize the assets acquired and the liabilities assumed at their fair values as of the acquisition date. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed as of the date of the acquisition:

	Net Assets Acquired at Fair Value (Dollars in thousands)
Assets	
Cash	$ 11,137
Loans	155,551
Premises and equipment	5,828
Goodwill	10,280
Core deposit and other intangibles	2,964
Other assets	4,629
Total assets acquired	190,389
Liabilities	
Deposits	159,580
Borrowings	2,475
Other liabilities	18
Total liabilities assumed	162,073
Purchase price	$ 28,316

Fair value adjustments to assets acquired and liabilities assumed are generally amortized using either an effective yield or straight-line basis over periods consistent with the average life, useful life and/or contractual term of the related assets and liabilities.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

Cash and Cash Equivalents

The fair values of cash and cash equivalents approximate the respective carrying amounts because the instruments are payable on demand or have short-term maturities.

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Loans

The loans acquired were recorded at fair value without a carryover of the allowance for loan losses. Fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected, as adjusted for an estimate of future credit losses and prepayments, and then applying a market-based discount rate to those cash flows. The overall discount on the loans acquired in this transaction was due to anticipated credit loss, as well as considerations for liquidity and market interest rates. In addition, the acquired loans were reviewed to determine if the loan had evidence of deterioration of credit quality at the purchase date and also reviewed to determine if it was probable that all contractually required payments will not be collected. Based on the review of the loan portfolio at the time of the acquisition it was deemed that there was no evidence to show that any of the acquired loans were purchased credit impaired.

Premises and Equipment

The fair value of the premises, including land, buildings and improvements, was determined based upon appraisals by licensed real estate appraisers. The appraisals were based upon the best and highest use of the property with final values determined based upon an analysis of the cost, sales comparison and income capitalization approaches for each property appraised.

Core Deposit Intangible

The fair value of the core deposit intangible is derived by comparing the interest rate and servicing costs that the financial institution pays on the core deposit liability versus the current market rate for alternative sources of financing, while factoring in estimates over the remaining life and attrition rate of the deposit accounts. The intangible asset represents the stable and relatively low cost source of funds that the deposits and accompanying relationships provide the Company, when compared to alternative funding sources.

Deposits

The fair value of acquired savings and transaction deposit accounts was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits were determined based on the present value of the contractual cash flows over the remaining period to maturity using a market interest rate.

Borrowings

The fair values of Federal Home Loan Bank ("FHLB") advances were derived based upon the present value of the principal and interest payments using a current market discount rate.

Selected Pro Forma Results

The following summarizes the unaudited pro forma results of operations as if the Company acquired Island Bancorp on January 1, 2017 (2016 amounts represent combined results for the Company and Island Bancorp). The selected pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the financial results of the combined companies had the acquisition actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period.

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
	(Dollars in thousands)			
Net interest income after provision for loan losses	$63,370	$57,352	$124,412	$113,102
Net income	22,698	20,629	44,109	39,488

Excluded from the pro forma results of operations for the three and six months ended June 30, 2017 are merger-related costs of $2.1 million and $2.6 million, net of tax, recognized by both the Company and Island Bancorp in the aggregate. There were no merger and acquisition expenses recognized during the three and six months ended June 30, 2016. These costs were primarily made up of contract terminations arising due to the change in control, the

acceleration of certain compensation and benefit costs, and other merger expenses.

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NOTE 4 - SECURITIES
Trading Securities

The Company had trading securities of $1.3 million and $804,000 as of June 30, 2017 and December 31, 2016, 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, gross unrealized gains and losses and fair value of securities available for sale and securities held to maturity for the periods indicated:

	June 30, 2017				December 31, 2016			
	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	$24,009	$ 269	$ —	$24,278	$24,006	$ 238	$ —	$24,244
Agency mortgage-backed securities	189,780	3,065	(175)	192,670	173,268	2,852	(736)	175,384
Agency collateralized mortgage obligations	121,292	433	(1,028)	120,697	101,094	106	(1,332)	99,868
State, county, and municipal securities	3,723	52	—	3,775	3,743	50	—	3,793
Single issuer trust preferred securities issued by banks	2,285	43	—	2,328	2,311	3	(3)	2,311
Pooled trust preferred securities issued by banks and insurers	2,202	—	(609)	1,593	2,200	—	(616)	1,584
Small business administration pooled securities	51,044	—	(265)	50,779	37,561	—	(372)	37,189
Equity securities	19,161	1,086	(424)	19,823	19,183	641	(553)	19,271
Total available for sale securities	$413,496	$ 4,948	$ (2,501)	$415,943	$363,366	$ 3,890	$ (3,612)	$363,644
Held to maturity securities								
U.S. Treasury securities	$1,006	$ 46	$ —	$1,052	$1,007	$ 47	$ —	$1,054
Agency mortgage-backed securities	178,358	2,506	(416)	180,448	156,088	2,274	(858)	157,504
Agency collateralized mortgage obligations	288,428	1,285	(2,881)	286,832	297,445	1,002	(3,797)	294,650
Single issuer trust preferred securities issued by banks	1,500	37	—	1,537	1,500	44	—	1,544
Small business administration pooled securities	29,100	247	(157)	29,190	31,036	189	(327)	30,898
Total held to maturity securities	$498,392	$ 4,121	$ (3,454)	$499,059	$487,076	$ 3,556	$ (4,982)	$485,650
Total	$911,888	$ 9,069	$ (5,955)	$915,002	$850,442	$ 7,446	$ (8,594)	$849,294

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 June 30, 2017 is presented below:

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$3,660	$3,672	$—	$—
Due after one year to five years	35,607	36,122	15,824	16,064
Due after five to ten years	96,985	97,760	19,574	20,045
Due after ten years	258,083	258,566	462,994	462,950
Total debt securities	$394,335	$396,120	$498,392	$499,059
Equity securities	$19,161	$19,823	$—	$—
Total	$413,496	$415,943	$498,392	$499,059

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Inclusive in the table above are $9.4 million of callable securities in the Company's investment portfolio at June 30, 2017.

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 $515.0 million and $482.1 million at June 30, 2017 and December 31, 2016, respectively.

At June 30, 2017 and December 31, 2016, 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, 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:

	June 30, 2017						
		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	36	$111,741	$(589)	$325	$(2)	$112,066	$(591)
Agency collateralized mortgage obligations	25	163,824	(2,228)	44,015	(1,681)	207,839	(3,909)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,593	(609)	1,593	(609)
Small business administration pooled securities	6	72,140	(422)	—	—	72,140	(422)
Equity securities	21	1,703	(37)	5,953	(387)	7,656	(424)
Total temporarily impaired securities	89	$349,408	$(3,276)	$51,886	$(2,679)	$401,294	$(5,955)

	December 31, 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	57	$137,949	$(1,594)	$—	$—	$137,949	$(1,594)
Agency collateralized mortgage obligations	32	243,051	(3,140)	47,403	(1,989)	290,454	(5,129)
Single issuer trust preferred securities issued by banks and insurers	1	—	—	1,036	(3)	1,036	(3)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,583	(616)	1,583	(616)
Small business administration pooled securities	5	59,846	(699)	—	—	59,846	(699)
Equity securities	25	3,625	(77)	6,334	(476)	9,959	(553)
Total temporarily impaired securities	121	$444,471	$(5,510)	$56,356	$(3,084)	$500,827	$(8,594)

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

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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 June 30, 2017:

- Agency Mortgage-Backed Securities, Agency Collateralized Mortgage Obligations and Small Business Administration Pooled Securities: 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.
- 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.

For the three and six months ended June 30, 2017 and 2016 there was no OTTI recorded and no cumulative credit related component of OTTI.

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NOTE 5 - 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:

	June 30, 2017 (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	$874,664	$3,055,924	$340,757	$130,804	$728,109	$1,037,064	$10,124	$6,177,446
Individually evaluated for impairment	$36,272	$17,065	$—	$859	$13,879	$6,190	$345	$74,610
Purchased credit impaired loans	$—	$10,031	$—	$—	$7,404	$205	$—	$17,640
Total loans by group	$910,936	$3,083,020	$340,757	$131,663	$749,392	$1,043,459	$10,469	$6,269,696(1)

	December 31, 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	$862,875	$2,983,642	$320,391	$121,855	$622,392	$982,095	$10,666	$5,903,916
Individually evaluated for impairment	$39,178	$16,813	$—	$871	$14,175	$5,863	$397	$77,297
Purchased credit impaired loans	$—	$10,343	$—	$—	$7,859	$189	$1	$18,392
Total loans by group	$902,053	$3,010,798	$320,391	$122,726	$644,426	$988,147	$11,064	$5,999,605(1)

(1) The amount of net deferred costs on originated loans included in the ending balance was $5.6 million and $5.1 million at June 30, 2017 and December 31, 2016, respectively. Net unamortized discounts on acquired loans not deemed to be purchased credit impaired ("PCI") included in the ending balance was $10.2 million and $8.6 million at June 30, 2017 and December 31, 2016, respectively.

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

	Three Months Ended June 30, 2017 (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	$16,518	$ 30,743	$ 5,023	$1,533	$ 2,716	$ 5,345	$ 440	$62,318
Charge-offs	(3,591)	—	—	(24)	(116)	(122)	(345)	(4,198)
Recoveries	13	26	—	13	2	26	229	309
Provision (benefit)	604	178	(209)	91	91	104	191	1,050
Ending balance	$13,544	$ 30,947	$ 4,814	$1,613	$ 2,693	$ 5,353	$ 515	$59,479

	Three Months Ended June 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	$13,485	$ 28,595	$ 5,100	$1,341	$ 2,567	$ 4,915	$ 429	$56,432
Charge-offs	(2)	(25)	—	(30)	(8)	(190)	(322)	(577)
Recoveries	649	223	—	73	51	26	250	1,272
Provision (benefit)	(105)	218	116	57	(32)	235	111	600
Ending balance	$14,027	$ 29,011	$ 5,216	$1,441	$ 2,578	$ 4,986	$ 468	$57,727

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Six Months Ended June 30, 2017
(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	$16,921	$30,369	$4,522	$1,502	$2,621	$5,238	$393	$61,566
Charge-offs	(3,591)	—	—	(94)	(139)	(136)	(746)	(4,706)
Recoveries	200	57	—	79	14	102	517	969
Provision	14	521	292	126	197	149	351	1,650
Ending balance	$13,544	$30,947	$4,814	$1,613	$2,693	$5,353	$515	$59,479
Ending balance: individually evaluated for impairment	$70	$166	$—	$1	$1,036	$243	$20	$1,536
Ending balance: collectively evaluated for impairment	$13,474	$30,781	$4,814	$1,612	$1,657	$5,110	$495	$57,943

Six Months Ended June 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	$55,825
Charge-offs	(4)	(25)	—	(93)	(27)	(337)	(628)	(1,114)
Recoveries	787	412	—	94	51	53	494	1,891
Provision (benefit)	(558)	1,297	(150)	176	(36)	381	15	1,125
Ending balance	$14,027	$29,011	$5,216	$1,441	$2,578	$4,986	$468	$57,727
Ending balance: individually evaluated for impairment	$255	$791	$—	$3	$1,188	$228	$27	$2,492
Ending balance: collectively evaluated for impairment	$13,772	$28,220	$5,216	$1,438	$1,390	$4,758	$441	$55,235

For the purpose of estimating the allowance for loan losses, management segregates the loan portfolio into the portfolio segments detailed in the above tables. Each of these loan categories possesses unique risk characteristics that are considered when determining the appropriate level of allowance for each segment. Some of the risk characteristics unique to each loan category include:

Commercial Portfolio

- Commercial and Industrial: Loans in this category consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to: accounts receivable, inventory, plant and equipment, or real estate, if applicable. Repayment sources consist of primarily, operating cash flow, and secondarily, liquidation of assets.
- Commercial Real Estate: Loans in this category consist of mortgage loans to finance investment in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties. Loans are typically written with amortizing payment structures. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources consist of, primarily, cash flow from operating leases and rents and, secondarily, liquidation of assets.
- Commercial Construction: Loans in this category consist of short-term construction loans, revolving and nonrevolving credit lines and construction/permanent loans to finance the acquisition, development and construction or rehabilitation of real property. Project types include residential 1-4 family, condominium and multi-family homes, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties. Loans may be written with nonamortizing or hybrid payment structures depending upon the type of project.

Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources vary depending upon the type of project and may consist of sale or lease of units, operating cash flows or liquidation of other assets.

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- Small Business: Loans in this category consist of revolving, term loan and mortgage obligations extended to sole proprietors and small businesses for purposes of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to, accounts receivable, inventory, plant and equipment, or real estate if applicable. Repayment sources consist primarily of operating cash flows and, secondarily, liquidation of assets.

For the commercial portfolio it is the Company's policy to obtain personal guarantees for payment from individuals holding material ownership interests of the borrowing entities.

Consumer Portfolio

- Residential Real Estate: Residential mortgage loans held in the Company's portfolio are made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors such as current and expected income, employment status, current assets, other financial resources, credit history and the value of the collateral. Collateral consists of mortgage liens on 1-4 family residential properties. The Company does not originate or purchase sub-prime loans.
- Home Equity: Home equity loans and credit lines are made to qualified individuals and are primarily secured by senior or junior mortgage liens on owner-occupied 1-4 family homes, condominiums or vacation homes. Each home equity loan has a fixed rate and is billed in equal payments comprised of principal and interest. Each home equity line of credit has a variable rate and is billed in interest-only payments during the draw period. At the end of the draw period, each home equity line of credit is billed as a percentage of the principal balance plus all accrued interest. Additionally, the Company has the option of renewing each line of credit for additional draw periods. Borrower qualifications include favorable credit history combined with supportive income requirements and combined loan to value ratios within established policy guidelines.
- Other Consumer: Other consumer loan products include personal lines of credit and amortizing loans made to qualified individuals for various purposes such as education, debt consolidation, personal expenses or overdraft protection. Borrower qualifications include favorable credit history combined with supportive income and collateral requirements within established policy guidelines. These loans may be secured or unsecured.

Credit Quality

The Company continually monitors the asset quality of the loan portfolio using all available information. Based on this information, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower's ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring ("TDR").

The Company reviews numerous credit quality indicators when assessing the risk in its loan portfolio. For the commercial portfolio, the Company utilizes a 10-point commercial risk-rating system, which assigns a risk-grade to each borrower based on a number of quantitative and qualitative factors associated with a commercial loan transaction. Factors considered include industry and market conditions, position within the industry, earnings trends, operating cash flow, asset/liability values, debt capacity, guarantor strength, management and controls, financial reporting, collateral, and other considerations. The risk-ratings categories are defined as follows:

- 1- 6 Rating — Pass: Risk-rating grades "1" through "6" comprise those loans ranging from 'Substantially Risk Free' which indicates borrowers are of unquestioned credit standing and the pinnacle of credit quality, well established companies with a very strong financial condition, and loans fully secured by cash collateral, through 'Acceptable Risk', which indicates borrowers may exhibit declining earnings, strained cash flow, increasing or above average leverage and/or weakening market fundamentals that indicate below average asset quality, margins and market share. Collateral coverage is protective.
- 7 Rating — Potential Weakness: Borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Company's asset and position. While potentially weak, currently these borrowers are marginally acceptable; no loss of principal or interest is envisioned.
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8 Rating — Definite Weakness Loss Unlikely: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. Loan may be inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. However, there is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Collateral coverage may be inadequate to cover the principal obligation.

- 9 Rating — Partial Loss Probable: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt with the added provision that the weaknesses make collection of the debt in full, on the basis of currently existing facts,

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conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely.

- 10 Rating — Definite Loss: Borrowers deemed incapable of repayment. Loans to such borrowers are considered uncollectible and of such little value that continuation as active assets of the Company is not warranted.

The credit quality of the commercial loan portfolio is actively monitored and any changes in credit quality are reflected in risk-rating changes. Risk-ratings are assigned or reviewed for all new loans, when advancing significant additions to existing relationships (over $50,000), at least quarterly for all actively managed loans, and any time a significant event occurs, including at renewal of the loan.

The Company utilizes a comprehensive strategy for monitoring commercial credit quality. Borrowers are required to provide updated financial information at least annually which is carefully evaluated for any changes in credit quality. Larger loan relationships are subject to a full annual credit review by an experienced credit analysis group. Additionally, the Company retains an independent loan review firm to evaluate the credit quality of the commercial loan portfolio. The independent loan review process achieves significant penetration into the commercial loan portfolio and reports the results of these reviews to the Audit Committee of the Board of Directors on a quarterly basis.

The following table details the amount of outstanding principal balances relative to each of the risk-rating categories for the Company’s commercial portfolio:

		June 30, 2017				
Category	Risk Rating	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Total
		(Dollars in thousands)				
Pass	1 - 6	$812,178	$2,951,048	$ 338,208	$ 129,275	$4,230,709
Potential weakness	7	23,925	89,313	1,633	1,612	116,483
Definite weakness-loss unlikely	8	68,563	40,247	916	771	110,497
Partial loss probable	9	6,270	2,412	—	5	8,687
Definite loss	10	—	—	—	—	—
Total		$910,936	$3,083,020	$ 340,757	$ 131,663	$4,466,376

		December 31, 2016				
Category	Risk Rating	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Total
		(Dollars in thousands)				
Pass	1 - 6	$783,825	$2,876,570	$ 317,099	$ 120,304	$4,097,798
Potential weakness	7	46,176	84,641	1,363	1,859	134,039
Definite weakness-loss unlikely	8	71,991	47,164	1,929	556	121,640
Partial loss probable	9	61	2,423	—	7	2,491
Definite loss	10	—	—	—	—	—
Total		$902,053	$3,010,798	$ 320,391	$ 122,726	$4,355,968

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For the Company's consumer portfolio, the quality of the loan is best indicated by the repayment performance of an individual borrower. However, the Company does supplement performance data with current Fair Isaac Corporation ("FICO") scores and Loan to Value ("LTV") estimates. Current FICO data is purchased and appended to all consumer loans on a regular basis. In addition, automated valuation services and broker opinions of value are used to supplement original value data for the residential and home equity portfolios, periodically. The following table shows the weighted average FICO scores and the weighted average combined LTV ratios as of the periods indicated below:

	June 30, 2017		December 31, 2016	
Residential portfolio				
FICO score (re-scored)(1)	744		743	
LTV (re-valued)(2)	60.9	%	63.2	%
Home equity portfolio				
FICO score (re-scored)(1)	766		767	
LTV (re-valued)(2)	55.5	%	55.9	%

(1) The average FICO scores for June 30, 2017 are based upon rescores available from May 31, 2017 and origination score data for loans booked between June 1, 2017 and June 30, 2017. The average FICO scores for December 31, 2016 are based upon rescores available from November 30, 2016 and origination score data for loans booked between December 1, 2016 and December 31, 2016.

(2) The combined LTV ratios for June 30, 2017 and December 31, 2016 are based upon updated automated valuations as of March 31, 2015 and origination value data for loans booked between April 1, 2015 and through the dates indicated. For home equity loans and lines in a subordinate lien position, the LTV data represents a combined LTV, taking into account the senior lien data for loans and lines.

Asset Quality

The Company's philosophy toward managing its loan portfolios is predicated upon careful monitoring, which stresses early detection and response to delinquent and default situations. Delinquent loans are managed by a team of seasoned collection specialists and the Company seeks to make arrangements to resolve any delinquent or default situation over the shortest possible time frame. As a general rule, loans more than 90 days past due with respect to principal or interest are classified as nonaccrual loans. The Company also may use discretion regarding other loans over 90 days delinquent if the loan is well secured and/or in process of collection.

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The following table shows information regarding nonaccrual loans at the dates indicated:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Commercial and industrial	$33,630	$ 37,455
Commercial real estate	4,679	6,266
Small business	453	302
Residential real estate	7,683	7,782
Home equity	5,240	5,553
Other consumer	90	47
Total nonaccrual loans (1)	$51,775	$ 57,405

(1) Included in these amounts were $5.7 million and $5.2 million of nonaccruing TDRs at June 30, 2017 and December 31, 2016, respectively.

The following table shows information regarding foreclosed residential real estate property at the dates indicated:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Foreclosed residential real estate property held by the creditor	$2,669	$ 3,775
Recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure	$1,563	$ 1,715

The following table shows the age analysis of past due financing receivables as of the dates indicated:

	June 30, 2017										
	30-59 days		60-89 days		90 days or more		Total Past Due				
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Current	Total Financing Receivables	Recorded Investment >90 Days and Accruing
	(Dollars in thousands)										
Loan Portfolio											
Commercial and industrial	3	$ 222	7	$ 18,644	42	$ 14,716	52	$ 33,582	$ 877,354	$ 910,936	$ —
Commercial real estate	8	3,847	2	422	9	3,121	19	7,390	3,075,630	3,083,020	—
Commercial construction	—	—	—	—	—	—	—	—	340,757	340,757	—
Small business	10	198	5	49	16	311	31	558	131,105	131,663	—
Residential real estate	14	1,712	8	1,529	18	3,051	40	6,292	743,100	749,392	—
Home equity	17	946	10	1,258	15	1,256	42	3,460	1,039,999	1,043,459	—
Other consumer (1)	223	147	9	44	22	42	254	233	10,236	10,469	8
Total	275	$ 7,072	41	$ 21,946	122	$ 22,497	438	$ 51,515	$ 6,218,181	$ 6,269,696	$ 8

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	December 31, 2016										
	30-59 days		60-89 days		90 days or more		Total Past Due				
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Current	Total Financing Receivables	Recorded Investment >90 Days and Accruing
	(Dollars in thousands)										
Loan Portfolio											
Commercial and industrial	8	$ 100	32	$ 253	6	$ 2,480	46	$ 2,833	$ 899,220	$ 902,053	$ —
Commercial real estate	5	1,518	8	1,957	8	3,105	21	6,580	3,004,218	3,010,798	—
Commercial construction	—	—	—	—	—	—	—	—	320,391	320,391	—
Small business	9	323	—	—	19	140	28	463	122,263	122,726	—
Residential real estate	11	1,277	9	1,950	27	3,507	47	6,734	637,692	644,426	—
Home equity	19	1,117	11	767	16	1,209	46	3,093	985,054	988,147	—
Other consumer (1)	249	184	12	17	15	7	276	208	10,856	11,064	2
Total	301	$ 4,519	72	$ 4,944	91	$ 10,448	464	$ 19,911	$ 5,979,694	$ 5,999,605	$ 2

(1) Other consumer portfolio is inclusive of deposit account overdrafts recorded as loan balances.

Troubled Debt Restructurings

In the course of resolving nonperforming loans, the Bank may choose to restructure the contractual terms of certain loans. The Bank attempts to work out an alternative payment schedule with the borrower in order to avoid foreclosure actions. Any loans that are modified are reviewed by the Bank to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

The following table shows the Company's total TDRs and other pertinent information as of the dates indicated:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
TDRs on accrual status	$ 26,908	$ 27,093
TDRs on nonaccrual	5,728	5,199
Total TDRs	$ 32,636	$ 32,292
Amount of specific reserves included in the allowance for loan losses associated with TDRs	$ 1,421	$ 1,417
Additional commitments to lend to a borrower who has been a party to a TDR	$ 817	$ 1,378

The Company's policy is to have any restructured loan which is on nonaccrual status prior to being modified remain on nonaccrual status for six months subsequent to being modified before management considers its return to accrual status. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. Additionally, loans classified as TDRs are adjusted to reflect the changes in value of the recorded investment in the loan, if any, resulting from the granting of a concession. For all residential loan modifications, the borrower must perform during a 90 day trial period before the modification is finalized.

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The following table shows the modifications which occurred during the periods indicated and the change in the recorded investment subsequent to the modifications occurring:

	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)
	(Dollars in thousands)					
Troubled debt restructurings						
Commercial and industrial	6	$ 1,299	$ 1,299	8	$ 1,379	$ 1,379
Commercial real estate	2	950	950	6	1,884	1,884
Small business	4	121	121	8	264	264
Residential real estate	5	889	900	5	889	900
Home equity	8	851	854	10	991	994
Total	25	$ 4,110	$ 4,124	37	$ 5,407	$ 5,421

	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment (1)
	(Dollars in thousands)					
Troubled debt restructurings						
Commercial and industrial	4	$ 253	$ 253	7	$ 528	$ 528
Commercial real estate	4	918	918	6	1,343	1,343
Small business	2	109	109	2	109	109
Residential real estate	3	744	744	5	1,167	1,209
Home equity	3	123	123	4	304	304
Other consumer	1	22	22	5	107	107
Total	17	$ 2,169	$ 2,169	29	$ 3,558	$ 3,600

(1) The post-modification balances represent the legal principal balance of the loan on the date of modification. These amounts may show an increase when modifications include a capitalization of interest.

The following table shows the Company's post-modification balance of TDRs listed by type of modification as of the periods indicated:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
	(Dollars in thousands)		(Dollars in thousands)	
Extended maturity	$2,872	$1,189	$ 4,079	$ 2,382
Adjusted interest rate	—	92	—	92
Combination rate and maturity	—	22	—	260
Court ordered concession	1,252	866	1,342	866
Total	$4,124	$2,169	$ 5,421	$ 3,600

The Company considers a loan to have defaulted when it reaches 90 days past due. There was one loan modified during the past twelve months with a recorded investment of $205,000 which has subsequently defaulted during the

three and six months ended June 30, 2017. There were no loans modified during the preceding twelve months that had subsequently defaulted during the three and six months ended June 30, 2016.
All TDR loans are considered impaired and therefore are subject to a specific review for impairment. The impairment analysis appropriately discounts the present value of the anticipated cash flows by the loan’s contractual rate of interest in effect

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prior to the loan's modification. The amount of impairment, if any, is recorded as a specific loss allocation to each individual loan in the allowance for loan losses. Commercial loans (commercial and industrial, commercial construction, commercial real estate and small business loans), residential loans, and home equity loans that have been classified as TDRs and which subsequently default are reviewed to determine if the loan should be deemed collateral dependent. In such an instance, any shortfall between the value of the collateral and the carrying value of the loan is determined by measuring the recorded investment in the loan against the fair value of the collateral less costs to sell. The Company charges off the amount of any confirmed loan loss in the period when the loans, or portion of loans, are deemed uncollectible. Smaller balance consumer TDR loans are reviewed for performance to determine when a charge-off is appropriate.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

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The tables below set forth information regarding the Company’s impaired loans by loan portfolio at the dates indicated:

	June 30, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded			
Commercial and industrial	$34,807	$39,396	$ —
Commercial real estate	11,450	12,623	—
Small business	547	616	—
Residential real estate	4,041	4,216	—
Home equity	4,708	4,808	—
Other consumer	112	113	—
Subtotal	55,665	61,772	—
With an allowance recorded			
Commercial and industrial	$1,465	$1,465	$ 70
Commercial real estate	5,615	5,961	166
Small business	312	327	1
Residential real estate	9,838	10,475	1,036
Home equity	1,482	1,687	243
Other consumer	233	234	20
Subtotal	18,945	20,149	1,536
Total	$74,610	$81,921	$ 1,536

	December 31, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded			
Commercial and industrial	$28,776	$29,772	$ —
Commercial real estate	11,628	12,891	—
Small business	494	569	—
Residential real estate	4,216	4,427	—
Home equity	4,485	4,572	—
Other consumer	146	146	—
Subtotal	49,745	52,377	—
With an allowance recorded			
Commercial and industrial	$10,402	$10,440	$ 3,661
Commercial real estate	5,185	5,533	196
Small business	377	392	8
Residential real estate	9,959	10,530	1,086
Home equity	1,378	1,547	242
Other consumer	251	252	21
Subtotal	27,552	28,694	5,214
Total	$77,297	$81,071	$ 5,214

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The following tables set forth information regarding interest income recognized on impaired loans, by portfolio, for the periods indicated:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
With no related allowance recorded				
Commercial and industrial	$49,477	$ 19	$49,502	$ 240
Commercial real estate	11,547	110	11,655	217
Small business	549	3	559	7
Residential real estate	4,064	48	4,082	96
Home equity	4,746	48	4,781	96
Other consumer	114	2	118	4
Subtotal	70,497	230	70,697	660
With an allowance recorded				
Commercial and industrial	$1,521	$ 18	$1,555	$ 37
Commercial real estate	5,633	56	5,656	112
Small business	316	3	321	7
Residential real estate	9,841	77	9,882	157
Home equity	1,489	13	1,497	26
Other consumer	237	2	241	3
Subtotal	19,037	169	19,152	342
Total	$89,534	$ 399	$89,849	$ 1,002

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	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
With no related allowance recorded				
Commercial and industrial	$2,349	$ 15	$2,415	$ 30
Commercial real estate	12,205	103	12,327	207
Small business	677	5	691	11
Residential real estate	4,315	51	4,331	101
Home equity	4,537	46	4,567	93
Other consumer	138	3	142	5
Subtotal	24,221	223	24,473	447
With an allowance recorded				
Commercial and industrial	$2,458	$ 6	$2,487	$ 12
Commercial real estate	6,716	51	6,744	102
Small business	401	6	410	13
Residential real estate	10,394	91	10,424	184
Home equity	1,311	13	1,316	23
Other consumer	357	2	362	4
Subtotal	21,637	169	21,743	338
Total	$45,858	$ 392	$46,216	$ 785

Purchased Credit Impaired Loans

Certain loans acquired by the Company may have shown evidence of deterioration of credit quality since origination and it was therefore deemed unlikely that the Company would be able to collect all contractually required payments. As such, these loans were deemed to be PCI loans and the carrying value and prospective income recognition are predicated upon future cash flows expected to be collected. The following table displays certain information pertaining to PCI loans at the dates indicated:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Outstanding balance	$19,606	$ 20,477
Carrying amount	$17,640	$ 18,392

The following table summarizes activity in the accretable yield for the PCI loan portfolio:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
	(Dollars in thousands)			
Beginning balance	$2,279	$2,779	$2,370	$2,827
Acquisition	—	—	—	—
Accretion	(302)	(420)	(609)	(829)
Other change in expected cash flows (1)	190	234	406	531
Reclassification from nonaccretable difference for loans which have paid off (2)	18	32	18	96
Ending balance	$2,185	$2,625	$2,185	$2,625

(1) Represents changes in cash flows expected to be collected and resulting in increased interest income as a prospective yield adjustment over the remaining life of the loan(s).
(2) Results in increased interest income during the period in which the loan paid off at amount greater than originally expected.

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NOTE 6 - BANK PREMISES AND EQUIPMENT

During the first half of 2017, the Company purchased equipment that was subject to a master lease agreement with a third party lessee. As such, the Company assumed the role of lessor in conjunction with the purchase, which was deemed to be an operating lease for accounting purposes. During the first six months of 2017, the Company purchased a total of $10.6 million of equipment subject to the lease agreement, $4.3 million of which was purchased during the first three months of 2017. In addition, the Company recognized rental income of $392,000 and $448,000 for the three and six months ended June 30, 2017, respectively, as well as depreciation expense of $245,000 and $289,000 for the same time periods.

NOTE 7 -EARNINGS PER SHARE

Earnings per share consisted of the following components for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
	(Dollars in thousands, except per share data)			
Net income	$20,563	$ 20,374	$41,288	$ 38,985
Weighted Average Shares				
Basic shares	27,257,79[illegible]	26,304,129	27,144,35[illegible]	26,289,726
Effect of dilutive securities	74,497	47,885	78,757	45,679
Diluted shares	27,332,29[illegible]	26,352,014	27,223,10[illegible]	26,335,405
Net income per share				
Basic EPS	$0.75	$ 0.77	$1.52	$ 1.48
Effect of dilutive securities	—	—	—	—
Diluted EPS	$0.75	$ 0.77	$1.52	$ 1.48

The following table illustrates the options to purchase common stock or shares of performance-based restricted stock that were excluded from the calculation of diluted earnings per share because they were anti-dilutive for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
Stock options	—	—	—	3,626
Performance-based restricted stock	—	—	—	—

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NOTE 8 - STOCK BASED COMPENSATION

Time Vested Restricted Stock Awards

During the six months ended June 30, 2017, the Company made the following awards of restricted stock:

Date	Shares Granted	Plan	Grant Date Fair Value Per Share	Vesting Period
2/13/2017	1,200	2005 Employee Stock Plan	$ 62.53	Ratably over 5 years from grant date
2/16/2017	34,150	2005 Employee Stock Plan	$ 63.10	Ratably over 5 years from grant date
3/31/2017	500	2005 Employee Stock Plan	$ 65.63	Ratably over 5 years from grant date
4/3/2017	1,500	2005 Employee Stock Plan	$ 64.14	Ratably over 5 years from grant date
5/15/2017	1,000	2005 Employee Stock Plan	$ 64.03	Ratably over 5 years from grant date
5/23/2017	7,000	2010 Non-Employee Director Stock Plan	$ 61.95	At the end of 5 years from grant date (1)
6/15/2017	950	2005 Employee Stock Plan	$ 66.18	Ratably over 5 years from grant date

(1) These restricted stock grants will vest at the end of a five year period, or earlier if the director ceases to be a director for any reason other than cause, such as, for example, by retirement.

The fair value of the restricted stock awards is based upon the average of the high and low price at which the Company’s common stock traded on the date of grant. The holders of restricted stock awards participate fully in the rewards of stock ownership of the Company, including voting and dividend rights.

Performance-Based Restricted Stock Awards

On February 16, 2017, the Company granted 14,400 performance-based restricted stock awards to certain executive level employees. These performance-based restricted stock awards were issued from the 2005 Employee Stock Plan and were determined to have a grant date fair value per share of $63.10, determined by the average of the high and low price at which the Company's common stock traded on the date of grant. The number of shares to be vested will be contingent upon the Company's attainment of certain performance measures outlined in the award agreement and will be measured as of the end of the three year performance period, January 1, 2017 through December 31, 2019. The awards will vest upon the later of the date on which it is determined if the performance goal is achieved subsequent to the performance period or March 31, 2020. These awards will be accounted for as equity awards due to the nature of these awards and the fact that these shares will not be settled in cash.

The holders of these awards are not entitled to receive dividends or vote until the shares are vested.

On February 28, 2017, the performance-based restricted stock awards that were awarded on March 20, 2014 vested at 94% of the maximum target shares awarded, or 15,289 shares.

Stock Options

The Company did not grant any awards of options to purchase shares of common stock during the six months ended June 30, 2017.

NOTE 9 - REPURCHASE AGREEMENTS

The Company can raise additional liquidity by entering into repurchase agreements at its discretion. These repurchases are accounted for as a secured borrowing transaction for accounting purposes. Payments on such borrowings are interest only until the scheduled repurchase date. In a repurchase agreement the Company is subject to the risk that the purchaser may default at maturity and not return the securities underlying the agreements. In order to minimize this potential risk, the Company enters into repurchase agreements that stipulate that the securities underlying the agreement are not delivered to the customer and instead are held in segregated safekeeping accounts by the Company's safekeeping agents.

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The table below sets forth information regarding the Company’s repurchase agreements allocated by source of collateral at the dates indicated:

	June 30, 2017	
	Remaining Contractual Maturity of the Agreements	
	Overnight and Continuous	Total
	(Dollars in thousands)	
Sources of collateral		
U.S. government agency securities	$19,326	$19,326
Agency mortgage-backed securities	63,364	63,364
Agency collateralized mortgage obligations	76,681	76,681
Total borrowings	$159,371	$159,371

	December 31, 2016	
	Remaining Contractual Maturity of the Agreements	
	Overnight and Continuous	Total
	(Dollars in thousands)	
Sources of Collateral		
U.S. government agency securities	$20,233	$20,233
Agency mortgage-backed securities	79,079	79,079
Agency collateralized mortgage obligations	77,601	77,601
Total borrowings	$176,913	$176,913

Certain counterparties monitor collateral, and may request additional collateral to be posted from time to time. For further information regarding the Company's repurchase agreements see Note 11 - Balance Sheet Offsetting.

NOTE 10 - DERIVATIVE AND HEDGING ACTIVITIES

The Company’s derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company’s known or expected cash receipts and its known or expected cash payments principally to manage the Company’s interest rate risk. Additionally, the Company enters into interest rate derivatives and foreign exchange contracts to accommodate the business requirements of its customers (“customer related positions”). The Company minimizes the market and liquidity risks of customer related positions by entering into similar offsetting positions with broker-dealers. Derivative instruments are carried at fair value in the Company’s financial statements. The accounting for changes in the fair value of a derivative instrument is dependent upon whether or not it qualifies as a hedge for accounting purposes, and further, by the type of hedging relationship.

The Company does not enter into proprietary trading positions for any derivatives.

Interest Rate Positions

The Company currently utilizes interest rate swap agreements as hedging instruments against interest rate risk associated with the Company's borrowings. An interest rate swap is an agreement whereby one party agrees to pay a floating rate of interest on a notional principal amount in exchange for receiving a fixed rate of interest on the same notional amount, for a predetermined period of time, from a second party. The amounts relating to the notional principal amount are not actually exchanged. The maximum length of time over which the Company is currently hedging its exposure to the variability in future cash flows for forecasted transactions related to the payment of variable interest on existing financial instruments is five years.

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The following table reflects the Company’s derivative positions for the periods indicated below for interest rate swaps which qualify as cash flow hedges for accounting purposes:

June 30, 2017

Notional Amount	Trade Date	Effective Date	Maturity Date	Receive (Variable) Index	Current Rate Received		Pay Fixed Swap Rate		Fair Value	
(Dollars in thousands)										
$25,000	9-Dec-08	10-Dec-08	10-Dec-18	3 Month LIBOR	1.23	%	2.94	%	$ (522	)
25,000	1-Apr-16	17-Jan-17	15-Dec-21	3 Month LIBOR	1.25	%	1.36	%	555	
25,000	1-Apr-16	17-Jan-17	15-Dec-21	3 Month LIBOR	1.25	%	1.36	%	545	
$75,000									$ 578	

December 31, 2016

Notional Amount	Trade Date	Effective Date	Maturity Date	Receive (Variable) Index	Current Rate Received		Pay Fixed Swap Rate		Fair Value	
			(Dollars in thousands)							
$25,000	9-Dec-08	10-Dec-08	10-Dec-18	3 Month LIBOR	0.95	%	2.94	%	$ (740	)
25,000	1-Apr-16	17-Jan-17	15-Dec-21	3 Month LIBOR	N/A		1.36	%	689	
25,000	1-Apr-16	17-Jan-17	15-Dec-21	3 Month LIBOR	N/A		1.36	%	675	
$75,000									$ 624	

For derivative instruments that are designated and qualify as cash flow hedging instruments, the effective portion of the gains or losses is reported as a component of other comprehensive income ("OCI"), and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company expects approximately $109,000 (pre-tax) to be reclassified to interest expense from OCI related to the Company’s cash flow hedges in the next twelve months. This reclassification is due to anticipated payments that will be made and/or received on the swaps based upon the forward curve as of June 30, 2017.

The Company recognized $61,000 and $122,000 of net amortization income that was an offset to interest expense related to previously terminated swaps for the three and six month periods ended June 30, 2017 and 2016, respectively.

The Company had no fair value hedges as of June 30, 2017 or December 31, 2016.

Customer Related Positions

Loan level derivatives, primarily interest rate swaps, offered to commercial borrowers through the Company’s loan level derivative program do not qualify as hedges for accounting purposes. The Company believes that its exposure to commercial customer derivatives is limited because these contracts are simultaneously matched at inception with an offsetting dealer transaction. The commercial customer derivative program allows the Company to retain variable-rate commercial loans while allowing the customer to synthetically fix the loan rate by entering into a variable-to-fixed interest rate swap.

Foreign exchange contracts offered to commercial borrowers through the Company’s derivative program do not qualify as hedges for accounting purposes. The Company acts as a seller and buyer of foreign exchange contracts to accommodate its customers. To mitigate the market and liquidity risk associated with these derivatives, the Company enters into similar offsetting positions.

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The following table reflects the Company's customer related derivative positions for the periods indicated below for those derivatives not designated as hedging:

	Number of Positions (1)	Notional Amount Maturing Less than 1 year	Less than 2 years	Less than 3 years	Less than 4 years	Thereafter	Total	Fair Value
	June 30, 2017 (Dollars in thousands)							
Loan level swaps								
Receive fixed, pay variable	235	$31,311	$57,570	$71,039	$194,784	$560,115	$914,819	$12,239
Pay fixed, receive variable	220	$31,311	$57,570	$71,039	$194,784	$560,115	$914,819	$(12,242)
Foreign exchange contracts								
Buys foreign currency, sells U.S. currency	24	$43,032	$—	$—	$—	$—	$43,032	$1,862
Buys U.S. currency, sells foreign currency	24	$43,032	$—	$—	$—	$—	$43,032	$(1,845)
	December 31, 2016 (Dollars in thousands)							
Loan level swaps								
Receive fixed, pay variable	222	$30,245	$21,708	$63,771	$165,783	$567,897	$849,404	$12,005
Pay fixed, receive variable	207	$30,245	$21,708	$63,771	$165,783	$567,897	$849,404	$(12,008)
Foreign exchange contracts								
Buys foreign currency, sells U.S. currency	33	$45,711	$—	$—	$—	$—	$45,711	$(2,250)
Buys U.S. currency, sells foreign currency	33	$45,711	$—	$—	$—	$—	$45,711	$2,277

(1) The Company may enter into one dealer swap agreement which offsets multiple commercial borrower swap agreements.

Mortgage Derivatives

Prior to closing and funding certain 1- 4 family residential mortgage loans, an interest rate lock commitment is generally extended to the borrower. During the period from commitment date to closing date, the Company is subject to the risk that market rates of interest may change. If market rates rise, investors generally will pay less to purchase such loans resulting in a reduction in the gain on sale of the loans or, possibly, a loss. In an effort to mitigate such risk, forward delivery sales commitments are executed, under which the Company agrees to deliver whole mortgage loans to various investors. These forward commitments carry a market price that has a strong inverse relationship to that of mortgage prices. Certain assumptions, including pull through rates and rate lock periods, are used in managing the existing and future hedges. The effectiveness of the economic hedges rely on the accuracy of these assumptions.

The change in fair value on the interest rate lock commitments and forward delivery sale commitments are recorded in current period earnings as a component of mortgage banking income. In addition, the Company has elected the fair value option to carry loans held for sale at fair value. The change in fair value of loans held for sale is recorded in current period earnings as a component of mortgage banking income in accordance with the Company's fair value election. The change in fair value associated with loans held for sale was an increase of $153,000 and a decrease of $41,000 for the three month periods ended June 30, 2017 and 2016, respectively, and an increase of $6,000 and $13,000 for the six month periods ended June 30, 2017 and 2016, respectively. These amounts were offset in earnings by the change in the fair value of mortgage derivatives. Additionally, the aggregate amount of net realized gains or losses on sales of such loans included within mortgage banking income amounted to $977,000 and $1.3 million for the three month periods ended June 30, 2017 and 2016, respectively, and $2.0 million and $2.2 million for

the six month periods ended June 30, 2017 and 2016, respectively.

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet at the periods indicated:

	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	Fair Value at June 30 2017	Fair Value at December 31 2016	Balance Sheet Location	Fair Value at June 30 2017	Fair Value at December 31 2016
	(Dollars in thousands)					
Derivatives designated as hedges						
Interest rate derivatives	Other assets	$1,100	$ 1,364	Other liabilities	$522	$ 740
Derivatives not designated as hedges						
Customer Related Positions						
Loan level derivatives	Other assets	$17,968	$ 18,629	Other liabilities	$17,971	$ 18,632
Foreign exchange contracts	Other assets	1,862	2,338	Other liabilities	1,845	2,311
Mortgage Derivatives						
Interest rate lock commitments	Other assets	347	430	Other liabilities	—	—
Forward sales agreements	Other assets	—	—	Other liabilities	46	233
		$20,177	$ 21,397		$19,862	$ 21,176
Total		$21,277	$ 22,761		$20,384	$ 21,916

The table below presents the effect of the Company's derivative financial instruments included in OCI and current earnings for the periods indicated:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
	(Dollars in thousands)			
Derivatives designated as hedges				
Loss in OCI on derivatives (effective portion), net of tax	$(190)	$(144)	$(101)	$(21)
Loss reclassified from OCI into interest expense (effective portion)	$(80)	$(640)	$(173)	$(1,301)
Loss recognized in income on derivatives (ineffective portion and amount excluded from effectiveness testing)				
Interest expense	$—	$—	$—	$—
Other expense	—	—	—	—
Total	$—	$—	$—	$—
Derivatives not designated as hedges				
Changes in fair value of customer related positions				
Other income	$7	$41	$—	$113
Other expense	(4)	(18)	(10)	(34)
Changes in fair value of mortgage derivatives				
Mortgage banking income	54	190	$104	304
Total	$57	$213	$94	$383

The Company's derivative agreements with institutional counterparties contain various credit-risk related contingent provisions, such as requiring the Company to maintain a well-capitalized capital position. If the Company fails to meet these conditions, the counterparties could request the Company make immediate payment or demand that the Company provide immediate and ongoing full collateralization on derivative positions in net liability positions. The

aggregate fair value of all

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derivative instruments with credit-risk related contingent features that were in a net liability position was $12.2 million and $12.8 million at June 30, 2017 and December 31, 2016, respectively. Although none of the contingency provisions has applied as of June 30, 2017 and December 31, 2016, the Company has posted collateral to fully offset the net liability exposures with institutional counterparties.

By using derivatives, the Company is exposed to credit risk to the extent that counterparties to the derivative contracts do not perform as required. Should a counterparty fail to perform under the terms of a derivative contract, the Company's credit exposure on interest rate swaps is limited to the net positive fair value and accrued interest of all swaps with each counterparty. The Company seeks to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, and obtaining collateral, where appropriate. Institutional counterparties must have an investment grade credit rating and be approved by the Company's Board of Directors. As such, management believes the risk of incurring credit losses on derivative contracts with those counterparties is remote. The Company's exposure relating to institutional counterparties was $4.0 million and $4.7 million at June 30, 2017 and December 31, 2016, respectively. The Company’s exposure relating to customer counterparties was approximately $15.7 million and $16.1 million at June 30, 2017 and December 31, 2016, respectively. Credit exposure may be reduced by the amount of collateral pledged by the counterparty.

NOTE 11 - BALANCE SHEET OFFSETTING

The Company does not offset fair value amounts recognized for derivative instruments or repurchase agreements. The Company does net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement. Collateral legally required to be maintained at dealer banks by the Company is monitored and adjusted as necessary.

The following tables present the Company's asset and liability derivative positions and the potential effect of netting arrangements on its financial position, as of the periods indicated:

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts Recognized in the Statement of Financial Position	Gross Amounts Offset in the Statement of Financial Position	Net Amounts Presented in the Statement of Financial Position	Financial Instruments (1)	Collateral Pledged (Received)	Net Amount
	June 30, 2017					
	(Dollars in thousands)					
Derivative Assets						
Interest rate swaps	$1,100	$ —	$1,100	$1,100	$—	$—
Loan level derivatives	17,968	—	17,968	2,862	—	15,106
Customer foreign exchange contracts	1,862	—	1,862	—	—	1,862
	$20,930	$ —	$20,930	$3,962	$—	$16,968
Derivative Liabilities						
Interest rate swaps	$522	$ —	$522	$—	$522	$—
Loan level derivatives	17,971	—	17,971	3,962	10,813	3,196

Customer foreign exchange contracts	1,845	—	1,845	—	—	1,845
Repurchase agreements						
Customer repurchase agreements	159,371	—	159,371	—	159,371	—
	$179,709	$ —	$179,709	$3,962	$170,706	$5,041

(1) Reflects offsetting derivative positions with the same counterparty.

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	Gross Amounts Recognized in the Statement of Financial Position	Gross Amounts Offset in the Statement of Financial Position	Net Amounts Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments (1)	Collateral Pledged (Received)	Net Amount
	December 31, 2016 (Dollars in thousands)					
Derivative Assets						
Interest rate swaps	$1,364	$ —	$1,364	$961	$ —	$403
Loan level derivatives	18,629	—	18,629	3,261	—	15,368
Customer foreign exchange contracts	2,338	—	2,338	—	—	2,338
	$22,331	$ —	$22,331	$4,222	$ —	$18,109
Derivative Liabilities						
Interest rate swaps	$740	$ —	$740	$—	$ 740	$—
Loan level derivatives	18,632	—	18,632	4,222	11,106	3,304
Customer foreign exchange contracts	2,311	—	2,311	—	—	2,311
Repurchase agreements						
Customer repurchase agreements	176,913	—	176,913	—	176,913	—
	$198,596	$ —	$198,596	$4,222	$ 188,759	$5,615

(1) Reflects offsetting derivative positions with the same counterparty.

NOTE 12 - FAIR VALUE MEASUREMENTS

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company’s own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another.

The Fair Value Measurements and Disclosures Topic of the FASB ASC defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the Fair Value Measurements and Disclosures Topic of the FASB ASC are described below:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Valuation Techniques

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There have been no changes in the valuation techniques used during the current period.

Securities

Trading and Equity Securities

These equity securities are valued based on market quoted prices. These securities are categorized in Level 1 as they are actively traded and no valuation adjustments have been applied.

U.S. Government Agency Securities

Fair value is estimated using either multi-dimensional spread tables or benchmarks. The inputs used include benchmark yields, reported trades, and broker/dealer quotes. These securities are classified as Level 2.

Agency Mortgage-Backed Securities

Fair value is estimated using either a matrix or benchmarks. The inputs used include benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. These securities are categorized as Level 2.

Agency Collateralized Mortgage Obligations and Small Business Administration Pooled Securities

The valuation model for these securities is volatility-driven and ratings based, and uses multi-dimensional spread tables. The inputs used include benchmark yields, reported trades, new issue data, broker dealer quotes, and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are categorized as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

State, County, and Municipal Securities

The fair value is estimated using a valuation matrix with inputs including bond interest rate tables, recent transaction, and yield relationships. These securities are categorized as Level 2.

Single and Pooled Issuer Trust Preferred Securities

The fair value of trust preferred securities, including pooled and single issuer preferred securities, is estimated using external pricing models, discounted cash flow methodologies or similar techniques. The inputs used in these valuations include benchmark yields, reported trades, new issue data, broker dealer quotes, and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are classified as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

Loans Held for Sale

The Company has elected the fair value option to account for originated closed loans intended for sale. The fair value is measured on an individual loan basis using quoted market prices and when not available, comparable market value or discounted cash flow analysis may be utilized. These assets are typically classified as Level 2.

Derivative Instruments

Derivatives

The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Company incorporates credit valuation adjustments to appropriately reflect nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings. Additionally, in conjunction with fair value measurement guidance, the Company has made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of June 30, 2017 and December 31, 2016, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified as Level 2.

Mortgage Derivatives

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The fair value of mortgage derivatives is determined based on current market prices for similar assets in the secondary market and, therefore, classified as Level 2 within the fair value hierarchy.

Impaired Loans

Collateral dependent loans that are deemed to be impaired are valued based upon the lower of cost or fair value of the underlying collateral less costs to sell. The inputs used in the appraisals of the collateral are not always observable, and therefore the loans may be classified as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

Other Real Estate Owned and Other Foreclosed Assets

The fair values are generally estimated based upon recent appraisal values of the property less costs to sell the property, as Other Real Estate Owned ("OREO") and Other Foreclosed Assets are valued at the lower of cost or fair value of the property, less estimated costs to sell. Certain inputs used in appraisals are not always observable, and therefore OREO and Other Foreclosed Assets may be classified as Level 3 within the fair value hierarchy.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing. The Company conducts an annual impairment test of goodwill in the third quarter of each year, or more frequently if necessary, and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. To estimate the fair value of goodwill and, if necessary, other intangible assets, the Company utilizes both a comparable analysis of relevant price multiples in recent market transactions and discounted cash flow analysis. Both valuation models require a significant degree of management judgment. In the event the fair value as determined by the valuation model is less than the carrying value, the intangibles may be impaired. If the impairment testing resulted in impairment, the Company would classify the impaired goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3.

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Assets and liabilities measured at fair value on a recurring and nonrecurring basis were as follows as of the dates indicated:

	Balance	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2017 (Dollars in thousands)			
Recurring fair value measurements				
Assets				
Trading securities	$1,293	$1,293	$—	$ —
Securities available for sale				
U.S. Government agency securities	24,278	—	24,278	$ —
Agency mortgage-backed securities	192,670	—	192,670	—
Agency collateralized mortgage obligations	120,697	—	120,697	—
State, county, and municipal securities	3,775	—	3,775	—
Single issuer trust preferred securities issued by banks and insurers	2,328	—	2,328	—
Pooled trust preferred securities issued by banks and insurers	1,593	—	—	1,593
Small business administration pooled securities	50,779	—	50,779	—
Equity securities	19,823	19,823	—	—
Loans held for sale	9,381	—	9,381	—
Derivative instruments	21,277	—	21,277	—
Liabilities				
Derivative instruments	20,384	—	20,384	—
Total recurring fair value measurements	$427,510	$21,116	$404,801	$ 1,593
Nonrecurring fair value measurements				
Assets				
Collateral dependent impaired loans	$36,504	$—	$—	$ 36,504
Other real estate owned and other foreclosed assets	3,029	—	—	3,029
Total nonrecurring fair value measurements	$39,533	$—	$—	$ 39,533

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	Balance	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2016 (Dollars in thousands)			
Recurring fair value measurements				
Assets				
Trading securities	$804	$804	$—	$ —
Securities available for sale				
U.S. Government agency securities	$24,244	$—	$ 24,244	$ —
Agency mortgage-backed securities	175,384	—	175,384	—
Agency collateralized mortgage obligations	99,868	—	99,868	—
State, county, and municipal securities	3,793	—	3,793	—
Single issuer trust preferred securities issued by banks and insurers	2,311	—	2,311	—
Pooled trust preferred securities issued by banks and insurers	1,584	—	—	1,584
Small business administration pooled securities	37,189	—	37,189	—
Equity securities	19,271	19,271	—	—
Loans held for sale	6,139	—	6,139	—
Derivative instruments	22,761	—	22,761	—
Liabilities				
Derivative instruments	21,916	—	21,916	—
Total recurring fair value measurements	$371,432	$20,075	$ 349,773	$ 1,584
Nonrecurring fair value measurements:				
Assets				
Collateral dependent impaired loans	$33,974	$—	$—	$ 33,974
Other real estate owned and other foreclosed assets	4,173	—	—	4,173
Total nonrecurring fair value measurements	$38,147	$—	$—	$ 38,147

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3), which were valued using pricing models and discounted cash flow methodologies, as of the dates indicated:

	Three Months Ended June 30	
	2017	2016
	(Dollars in thousands)	
Pooled Trust Preferred Securities		
Beginning balance	$1,596	$1,500
Gains and (losses) (realized/unrealized)		
Included in other comprehensive income	(4)	13

Settlements	1	(7)
Ending balance	$1,593	$1,506

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	Six Months Ended June 30	
	2017	2016
	(Dollars in thousands)	
Pooled Trust Preferred Securities		
Beginning balance	$1,584	$1,572
Gains and (losses) (realized/unrealized)		
Included in other comprehensive income	7	(58)
Settlements	2	(8)
Ending balance	$1,593	$1,506

It is the Company's policy to recognize the transfers between levels of the fair value hierarchy as of the end of the reporting period. There were no transfers between the levels of the fair value hierarchy for any assets or liabilities measured at fair value on a recurring basis during the six month periods ended June 30, 2017 or 2016.

The following table sets forth certain unobservable inputs regarding the Company's investment in securities that are classified as Level 3 for the periods indicated:

	June 30 2017	December 31 2016		June 30 2017	December 31 2016	June 30 2017	December 31 2016
Valuation Technique	Fair Value		Unobservable Inputs	Range		Weighted Average	
	(Dollars in thousands)						
Discounted cash flow methodology							
Pooled trust preferred securities	$1,593	$ 1,584	Cumulative prepayment	0% - 62%	0% - 62%	2.3%	2.5%
			Cumulative default	5% - 100%	5% - 100%	12.6%	12.8%
			Loss given default	85% - 100%	85% - 100%	94.3%	94.2%
			Cure given default	0% - 75%	0% - 75%	60.9%	60.9%
Appraisals of collateral(1)							
Collateral dependent impaired loans	$36,504	$ 33,974					
Other real estate owned and foreclosed assets	$3,029	$ 4,173					

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable. Appraisals may be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments may vary.

For the fair value measurements in the table above, which are classified as Level 3 within the fair value hierarchy, the Company's Treasury and Finance groups determine the valuation policies and procedures. For the pricing of the securities, the Company uses third-party pricing information, without adjustment. Depending on the type of the security, management employs various techniques to analyze the pricing it receives from third parties, such as analyzing changes in market yields and in certain instances reviewing the underlying collateral of the security. Management reviews changes in fair value from period to period and performs testing to ensure that prices received from the third parties are consistent with their expectation of the market. For the securities whose market is deemed to be inactive and which are categorized as Level 3, the fair value models are calibrated and significant inputs are back

tested on a quarterly basis, to the extent possible. This testing is done by the third party service provider, who performs this testing by comparing anticipated inputs to actual results. Significant changes in fair value from period to period are closely scrutinized to ensure fair value models are not flawed. The driver(s) of the respective change in fair value and the method for forecasting the driver(s) is closely considered by management.

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The significant unobservable inputs used in the fair value measurement of the Company's pooled trust preferred securities are cumulative prepayment rates, cumulative default rates, loss given default rates and cure given default rates. Significant increases (decreases) in deferrals or defaults, in isolation, would result in a significantly lower (higher) fair value measurement. Alternatively, significant increases (decreases) in cure rates, in isolation, would result in a significantly higher (lower) fair value measurement.

Additionally, the Company has certain assets which are marked to fair value on a nonrecurring basis which are categorized within Level 3. These assets include collateral dependent impaired loans and OREO. The determination of the fair value amount is derived from the use of independent third party appraisals and evaluations. Real estate appraisals are prepared by firms from a predetermined list of qualified and approved appraisers or evaluators. Upon receipt of a real estate appraisal or evaluation, the Company's Commercial Real Estate Appraisal Department will review the report for compliance with regulatory and Company standards, as well as reasonableness and acceptance of the value conclusions. Any issues or concerns regarding compliance or value conclusions will be addressed with the engaged firm and the report may be adjusted or revised. If a disagreement cannot be resolved, the Company will either address the key issues and modify the report for acceptance or reject the report and re-order a new report. Ultimately, the Company will confirm the collateral value as part of its review process.

The estimated fair values and related carrying amounts for assets and liabilities for which fair value is only disclosed are shown below as of the periods indicated:

			Fair Value Measurements at Reporting Date Using		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2017 (Dollars in thousands)				
Financial assets					
Securities held to maturity(a)					
U.S. Treasury securities	$1,006	$ 1,052	$ —	$ 1,052	$ —
Agency mortgage-backed securities	178,358	180,448	—	180,448	—
Agency collateralized mortgage obligations	288,428	286,832	—	286,832	—
Single issuer trust preferred securities issued by banks	1,500	1,537	—	1,537	—
Small business administration pooled securities	29,100	29,190	—	29,190	—
Loans, net of allowance for loan losses(b)	6,173,713	6,055,275	—	—	6,055,275
Federal Home Loan Bank stock(c)	14,421	14,421	—	14,421	—
Cash surrender value of life insurance policies(d)	149,319	149,319	—	149,319	—
Financial liabilities					
Deposit liabilities, other than time deposits(e)	$6,087,206	6,087,206	—	6,087,206	—
Time certificates of deposits(f)	$608,174	605,802	—	605,802	—
Federal Home Loan Bank borrowings(f)	53,279	53,227	—	53,227	—
Customer repurchase agreements and other short-term borrowings(f)	159,371	159,371	—	—	159,371
Junior subordinated debentures(g)	73,069	74,146	—	74,146	—
Subordinated debentures(f)	34,659	33,161	—	—	33,161

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	Carrying Value	Fair Value	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2016 (Dollars in thousands)				
Financial assets					
Securities held to maturity(a)					
U.S. Treasury securities	$1,007	$ 1,054	$ —	$ 1,054	$ —
Agency mortgage-backed securities	156,088	157,504	—	157,504	—
Agency collateralized mortgage obligations	297,445	294,650	—	294,650	—
Single issuer trust preferred securities issued by banks	1,500	1,544	—	1,544	—
Small business administration pooled securities	31,036	30,898	—	30,898	—
Loans, net of allowance for loan losses(b)	5,904,065	5,784,778	—	—	5,784,778
Federal Home Loan Bank stock(c)	11,497	11,497	—	11,497	—
Cash surrender value of life insurance policies(d)	144,503	144,503	—	144,503	—
Financial liabilities					
Deposit liabilities, other than time deposits(e)	5,763,101	5,763,101	—	5,763,101	—
Time certificates of deposits(f)	649,152	647,038	—	647,038	—
Federal Home Loan Bank borrowings(f)	50,819	50,898	—	50,898	—
Customer repurchase agreements and other short-term borrowings(f)	176,913	176,913	—	—	176,913
Junior subordinated debentures(g)	73,107	72,510	—	72,510	—
Subordinated debentures(f)	34,635	34,241	—	—	34,241

(a) The fair values presented are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments and/or discounted cash flow analysis.

(b) Fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or cash flows. Additionally, this amount excludes collateral dependent impaired loans, which are deemed to be marked to fair value on a nonrecurring basis.

(c) FHLB stock has no quoted market value and is carried at cost, therefore the carrying amount approximates fair value.

(d) Cash surrender value of life insurance is recorded at its cash surrender value (or the amount that can be realized upon surrender of the policy), therefore carrying amount approximates fair value.

(e) Fair value of demand deposits, savings and interest checking accounts and money market deposits is the amount payable on demand at the reporting date.

(f) Fair value was determined by discounting anticipated future cash payments using rates currently available for instruments with similar remaining maturities.

(g) Fair value was determined based upon market prices of securities with similar terms and maturities.

This summary excludes certain financial assets and liabilities for which the carrying value approximates fair value. For financial assets, these may include cash and due from banks, federal funds sold and short-term investments. For financial liabilities, these may include federal funds purchased. These instruments would all be considered to be classified as Level 1 within the fair value hierarchy. Also excluded from the summary are financial instruments

measured at fair value on a recurring and nonrecurring basis, as previously described.
The Company considers its financial instruments' current use to be the highest and best use of the instruments.

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NOTE 13 - COMPREHENSIVE INCOME (LOSS)

The following table presents a reconciliation of the changes in the components of other comprehensive income (loss) for the dates indicated, including the amount of income tax (expense) benefit allocated to each component of other comprehensive income (loss):

	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
	Pre Tax Amount	Tax (Expense) Benefit	After Tax Amount	Pre Tax Amount	Tax (Expense) Benefit	After Tax Amount
	(Dollars in thousands)					
Change in fair value of securities available for sale	$1,277	$ (485)	$ 792	$2,173	$ (849)	$1,324
Less: net security gains reclassified into other noninterest income (expense)	1	(1)	—	2	(1)	1
Net change in fair value of securities available for sale	1,276	(484)	792	2,171	(848)	1,323
Change in fair value of cash flow hedges	(399)	162	(237)	(341)	138	(203)
Less: net cash flow hedge losses reclassified into interest on borrowings expense (1)	(80)	33	(47)	(173)	71	(102)
Net change in fair value of cash flow hedges	(319)	129	(190)	(168)	67	(101)
Net unamortized loss related to defined benefit pension and other postretirement adjustments arising during the period	(7)	3	(4)	(14)	6	(8)
Amortization of net actuarial losses	69	(28)	41	139	(57)	82
Amortization of net prior service costs	69	(28)	41	138	(56)	82
Net change in other comprehensive income for defined benefit postretirement plans (2)	131	(53)	78	263	(107)	156
Total other comprehensive income	$1,088	$ (408)	$ 680	$2,266	$ (888)	$1,378

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	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	Pre Tax Amount	Tax (Expense) Benefit	After Tax Amount	Pre Tax Amount	Tax (Expense) Benefit	After Tax Amount
	(Dollars in thousands)					
Change in fair value of securities available for sale	$3,016	$(1,161)	$1,855	$9,666	$(3,747)	$5,919
Less: net security gains (losses) reclassified into other noninterest income	2	(1)	1	(27)	11	(16)
Net change in fair value of securities available for sale	3,014	(1,160)	1,854	9,693	(3,758)	5,935
Change in fair value of cash flow hedges	(882)	360	(522)	(1,338)	548	(790)
Less: net cash flow hedge losses reclassified into interest on borrowings expense (1)	(640)	262	(378)	(1,301)	532	(769)
Net change in fair value of cash flow hedges	(242)	98	(144)	(37)	16	(21)
Net unamortized loss related to defined benefit pension and other postretirement adjustments arising during the period	(28)	11	(17)	(56)	22	(34)
Amortization of net actuarial losses	61	(25)	36	122	(50)	72
Amortization of net prior service credits	69	(27)	42	138	(55)	83
Net change in other comprehensive income for defined benefit postretirement plans (2)	102	(41)	61	204	(83)	121
Total other comprehensive income	$2,874	$(1,103)	$1,771	$9,860	$(3,825)	$6,035

(1) Includes the amortization of the remaining balance of a realized but unrecognized gain, net of tax, from the termination of interest rate swaps in 2009. The original gain of $1.4 million, net of tax, is being recognized in earnings through December 2018, the original maturity date of the swap. The balance of this gain has amortized to $209,000 and $281,000 at June 30, 2017 and December 31, 2016, respectively.

(2) The amortization of prior service costs is included in the computation of net periodic pension cost as disclosed in the Employee Benefit Plans footnote in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission.

Information on the Company’s accumulated other comprehensive income (loss), net of tax, is comprised of the following components as of the periods indicated:

	Unrealized Gain on Securities	Unrealized Gain (Loss) on Cash Flow Hedge	Deferred Gain on Hedge Transactions	Defined Benefit Postretirement Plans	Accumulated Other Comprehensive Income (Loss)
	(Dollars in thousands)				
	2017				
Beginning balance: January 1, 2017	$173	$361	$ 281	$ (2,152)	$ (1,337)
Net change in other comprehensive income (loss)	1,323	(29)	(72)	156	1,378
Ending balance: June 30, 2017	$1,496	$332	$ 209	$ (1,996)	$ 41
	2016				
Beginning balance: January 1, 2016	$1,306	$(1,955)	$ 427	$ (2,230)	$ (2,452)
Net change in other comprehensive income (loss)	5,935	53	(74)	121	6,035
Ending balance: June 30, 2016	$7,241	$(1,902)	$ 353	$ (2,109)	$ 3,583

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Company enters into various transactions to meet the financing needs of its customers, which, in accordance with GAAP, are not included in its consolidated balance sheets. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in

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excess of the amounts recognized in the consolidated balance sheets. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.
The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of these commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding.
Standby letters of credit are written conditional commitments issued to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Company would be entitled to seek recovery from the customer. The Company’s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.
The fees collected in connection with the issuance of standby letters of credit are representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, fees collected in connection with the issuance of standby letters of credit are deferred. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The deferred standby letter of credit fees represent the fair value of the Company's potential obligations under the standby letter of credit guarantees.
The following table summarizes the above financial instruments at the dates indicated:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Commitments to extend credit	$2,359,266	$ 2,227,955
Standby letters of credit	16,232	18,190
Deferred standby letter of credit fees	93	108

Lease Commitments
The Company leases office space, space for ATM locations, and certain branch locations under noncancelable operating leases.
Rent expense incurred under operating leases was approximately $2.1 million for both the three months ended June 30, 2017 and 2016, respectively, and $4.2 million and $4.3 million for the six months ended June 30, 2017 and 2016, respectively. Renewal options ranging from 4 months to 10 years exist for several of these leases.
There has been no significant change in the future minimum lease payments payable by the Company since December 31, 2016. See the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 for information regarding our leases and other commitments.
Other Contingencies
At June 30, 2017, Rockland Trust was involved in pending lawsuits that arose in the ordinary course of business. Management has reviewed these pending lawsuits with legal counsel and has taken into consideration the view of counsel as to their outcome. In the opinion of management, the final disposition of pending lawsuits is not expected to have a material adverse effect on the Company’s financial position or results of operations.
The Bank is required to maintain certain reserve requirements of vault cash and/or deposits with the Federal Reserve Bank of Boston. The amount of this reserve requirement was $32.3 million and $31.8 million at June 30, 2017 and December 31, 2016, respectively.

NOTE 15 - LOW INCOME HOUSING PROJECT INVESTMENTS
The Company has invested in low income housing projects that generate Low Income Housing Tax Credits (“LIHTC”) which provide the Company with tax credits and operating loss tax benefits over a period of approximately 15 years. None of the original investment is expected to be repaid.

The following table presents certain information related to Company's investments in low income housing projects as of the dates indicated:

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	June 30, 2017		December 31, 2016
	(Dollars in thousands)		
Original investment value	$47,425		$ 47,379
Current recorded investment	37,666		39,606
Unfunded liability obligation	8,336		12,161
Tax credits and benefits	5,716	(1)	5,366
Amortization of investments	3,994	(2)	3,725
Net income tax benefit	1,722	(3)	1,641

(1) This amount reflects anticipated tax credits and tax benefits for the full year ended December 31, 2017.
(2) The amortization amount reduces the tax credits and benefits anticipated for the full year ended December 31, 2017.
(3) This amount represents the net tax benefit expected to be realized for the full year ended December 31, 2017 in determining the Company's effective tax rate.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the Securities and Exchange Commission.

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, in the Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's confidence and strategies and management's expectations about new and existing programs and products, acquisitions, relationships, opportunities, taxation, technology, market conditions and economic expectations. These statements may be identified by forward-looking terminology such as "should," "expect," "believe," "view," "opportunity," "allow," "continues," "reflects," "typically," "usually," "anticipate," or similar statements or variations of such terms. Such forward-looking statements involve certain risks and uncertainties and our actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements, in addition to those risk factors listed under the "Risk Factors" section of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, include, but are not limited to:

- a weakening in the United States economy in general and the regional and local economies within the New England region and the Company's market area;
- adverse changes or volatility in the local real estate market;
- adverse changes in asset quality including an unanticipated credit deterioration in our loan portfolio including those related to one or more large commercial relationships;
- acquisitions may not produce results at levels or within time frames originally anticipated and may result in unforeseen integration issues or impairment of goodwill and/or other intangibles;
- changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- higher than expected tax expense, resulting from failure to comply with general tax laws, changes in tax laws, or failure to comply with requirements of the federal New Markets Tax Credit program;
- unexpected changes in market interest rates for interest earning assets and/or interest bearing liabilities;
- unexpected increased competition in the Company's market area;
- unanticipated loan delinquencies, loss of collateral, decreased service revenues, and other potential negative effects on our business caused by severe weather or other external events;
- a deterioration in the conditions of the securities markets;
- a deterioration of the credit rating for U.S. long-term sovereign debt;
- our inability to adapt to changes in information technology, including changes to industry accepted service delivery models driven by a migration to the internet as a means of service delivery;
- electronic fraudulent activity within the financial services industry, especially in the commercial banking sector;
- adverse changes in consumer spending and savings habits;
- the inability to realize expected synergies from merger transactions in the amounts or in the timeframe anticipated;
- inability to retain customers and employees, including those acquired in previous acquisitions;
- the effect of laws and regulations regarding the financial services industry including, but not limited to, the Dodd-Frank Wall Street Reform and the Consumer Protection Act and regulatory uncertainty surrounding these laws and regulations;
- changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) generally applicable to the Company's business;
- changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting

standard setters;
- cyber security attacks or intrusions that could adversely impact our businesses; and
- other unexpected material adverse changes in our operations or earnings.

Except as required by law, the Company disclaims any intent or obligation to update publicly any such forward-looking statements, whether in response to new information, future events or otherwise. Any public statements or disclosures by the Company following this Quarterly Report on Form 10-Q which modify or impact any of the forward-looking statements contained in this Quarterly Report on Form 10-Q will be deemed to modify or supersede such statements in this Quarterly Report on Form 10-Q.

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Selected Quarterly Financial Data

The selected consolidated financial and other data of the Company set forth below does not purport to be complete and should be read in conjunction with, and is qualified in its entirety by, the more detailed information, including the Consolidated Financial Statements and related notes, appearing elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended				
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
	(Dollars in thousands, except per share data)				
Financial condition data					
Securities available for sale	$415,943	$401,837	$363,644	$387,008	$389,824
Securities held to maturity	498,392	502,123	487,076	430,763	438,656
Loans	6,269,696	6,064,366	5,999,605	5,746,133	5,674,253
Allowance for loan losses	(59,479)	(62,318)	(61,566)	(58,205)	(57,727)
Goodwill and other intangible assets	243,005	230,613	231,374	210,834	211,526
Total assets	8,017,293	7,738,114	7,709,375	7,502,009	7,418,866
Total deposits	6,695,380	6,470,674	6,412,253	6,269,460	6,197,892
Total borrowings	320,378	304,297	335,474	299,521	298,368
Stockholders' equity	914,584	877,480	864,690	818,242	803,897
Nonperforming loans	51,783	55,052	57,407	24,793	25,628
Nonperforming assets	54,812	58,456	61,580	26,591	27,473
Income statement					
Interest income	$68,133	$64,407	$63,428	$62,308	$61,160
Interest expense	4,378	4,207	4,676	4,640	4,627
Net interest income	63,755	60,200	58,752	57,668	56,533
Provision for loan losses	1,050	600	4,000	950	600
Noninterest income	21,398	18,912	21,762	20,416	21,095
Noninterest expenses	52,809	48,773	51,637	46,857	47,146
Net income	20,563	20,725	17,179	20,484	20,374
Per share data					
Net income—basic	$0.75	$0.77	$0.64	$0.78	$0.77
Net income—diluted	0.75	0.76	0.64	0.78	0.77
Cash dividends declared	0.32	0.32	0.29	0.29	0.29
Book value per share	33.34	32.44	32.02	31.09	30.55
Tangible book value per share (1)	24.48	23.92	23.45	23.08	22.52
Performance ratios					
Return on average assets	1.06%	1.10%	0.89%	1.09%	1.13%
Return on average common equity	9.15%	9.59%	8.07%	9.98%	10.24%
Net interest margin (on a fully tax equivalent basis)	3.60%	3.51%	3.36%	3.40%	3.47%
Equity to assets	11.41%	11.34%	11.22%	10.91%	10.84%
Dividend payout ratio	42.09%	37.79%	44.43%	37.25%	37.43%
Asset Quality Ratios					
Nonperforming loans as a percent of gross loans	0.83%	0.91%	0.96%	0.43%	0.45%
Nonperforming assets as a percent of total assets	0.68%	0.76%	0.80%	0.35%	0.37%

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Allowance for loan losses as a percent of total loans	0.95 %	1.03 %	1.03 %	1.01 %	1.02 %
Allowance for loan losses as a percent of nonperforming loans	114.86 %	113.20 %	107.24 %	234.76 %	225.25 %
Capital ratios					
Tier 1 leverage capital ratio	10.07 %	9.92 %	9.77 %	9.59 %	9.66 %
Common equity tier 1 capital ratio	10.95 %	10.89 %	10.82 %	10.78 %	10.64 %
Tier 1 risk-based capital ratio	12.07 %	12.05 %	11.99 %	12.01 %	11.88 %
Total risk-based capital ratio	13.58 %	13.66 %	13.60 %	13.63 %	13.51 %

(1) Represents a non-GAAP measure. For reconciliation to GAAP book value per share, see Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Executive Level Overview - Non-GAAP Measures" below.

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Executive Level Overview

Management evaluates the Company's operating results and financial condition using measures that include net income, earnings per share, return on assets and equity, return on tangible common equity, net interest margin, tangible book value per share, asset quality indicators, and many others. These metrics are used by management to make key decisions regarding the Company's balance sheet, liquidity, interest rate sensitivity, and capital resources and assist with identifying opportunities for improving the Company's financial position or operating results. The Company is focused on organic growth, but will also consider acquisition opportunities that can provide a satisfactory financial return. The Company completed the acquisition of Island Bancorp Inc. ("Island Bancorp") in the second quarter of 2017.

Interest-Earning Assets

Management’s balance sheet strategy emphasizes commercial and home equity lending. The results depicted in the following table reflect an overall increase in total loans over the past five quarters due to the results of that strategy, as well as the impact from the 2016 Q4 New England Bancorp, Inc. ("NEB") acquisition and 2017 Q2 Island Bancorp acquisition. Excluding the impact of the Island Bancorp acquisition, organic loan growth in the quarter was driven primarily by increases in the commercial and industrial, small business (commercial), home equity and residential categories, partly offset by a decline in construction related balances.

Management strives to be disciplined about loan pricing and considers interest rate sensitivity when generating loan assets. The Company has gradually and intentionally shifted its balance sheet composition so that its interest-rate risk position is fundamentally asset-sensitive.

Management takes a disciplined approach to credit underwriting, seeking to avoid undue credit risk and loan losses.

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Funding and Net Interest Margin

The Company's overall sources of funding reflect strong business and retail deposit growth, supporting management's emphasis on core deposit growth to fund loans, as depicted by the following chart:

As of June 30, 2017, core deposits comprised 90.5% of total deposits. The continued emphasis on core deposits has resulted in a cost of deposits of 0.18% for the 2017 second quarter, which remained consistent when compared to the first quarter of 2017.

The Company's net interest margin was 3.60% for the quarter ended June 30, 2017, a 9 basis point increase from the first quarter of 2017, reflecting the Company's asset sensitive position, as shown by the following chart:

Noninterest Income

Management continues to focus on noninterest income growth, which can often experience volatility due to seasonality and overall economic related conditions. Noninterest income is primarily comprised of deposit account fees, interchange and

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ATM fees, investment management fees and mortgage banking income. The following chart shows the components of noninterest income over the past five quarters:

Expense Control

Management seeks to take a balanced approach to noninterest expense control by monitoring the management of ongoing operating expenses while making needed capital expenditures and prudently investing in growth initiatives. The Company’s primary expenses arise from Rockland Trust’s employee salaries and benefits and expenses associated with buildings and equipment. The following chart depicts the Company's efficiency ratio on a GAAP basis (calculated by dividing noninterest expense by the sum of noninterest income and net interest income), as well as the Company's efficiency ratio on a non-GAAP operating basis (calculated by dividing noninterest expense, excluding certain noncore items, by the sum of noninterest income, excluding certain noncore items, and net interest income) over the past five quarters:

*See "Non-GAAP Measures" below for a reconciliation to GAAP financial measures.

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Tax Effectiveness

The Company participates in federal and state tax credit programs designed to promote economic development, affordable housing, and job creation. The Company continues to participate in the federal New Markets Tax Credit program and has also made low-income housing tax credit investments. The Company has also established security corporation subsidiaries and, through its subsidiaries, purchased tax-exempt bonds. Federal and state tax credit program participation and other tax strategies help the Company operate in a more tax effective manner and sometimes also creates a competitive advantage for Rockland Trust and its community development subsidiaries. During the second quarter of 2017, the Company’s effective tax rate was 34.29%, an increase from the prior quarter rate of 30.31%. The rate in the first quarter was lower as a result excess tax benefits associated with a higher volume of stock compensation transactions in the first quarter.

Capital

The Company's disciplined approach with respect to revenue, expense, and tax effectiveness is designed to promote long-term earnings growth. Strong earnings growth has contributed to healthy capital growth. Book value per share increased 2.8% in the second quarter of 2017 and 9.1% over the past four quarters (see "Non-GAAP Measures" below for a reconciliation of non-GAAP measures). In addition, tangible book value per share increased 2.3% in the second quarter of 2017 and has increased by 8.7% over the past four quarters. Stockholders' equity as a percentage of total assets was 11.41% for the second quarter of 2017, compared to 11.34% in the first quarter of 2017. The Company's tangible common equity ratio (or tangible common equity as a percentage of tangible assets) increased to 8.64% for the second quarter of 2017, as compared to 8.62% in the first quarter of 2017. See "Non-GAAP Measures" below for a reconciliation of non-GAAP measures. The following chart shows the Company's book value and tangible book value per share over the past five quarters:

*See "Non-GAAP Measures" below for a reconciliation to GAAP financial measures.

The Company's strong growth in capital enables the payment of cash dividends. The Company paid quarterly cash dividends during the first two quarters of 2017 of $0.32 per share, representing a 10.3% increase from the 2016 quarterly cash dividends of $0.29 per share.

Second Quarter 2017 Results

Net income for the second quarter of 2017 was $20.6 million, or $0.75 on a diluted earnings per share basis, an increase of 0.9% and a decrease of 2.6%, respectively, as compared to $20.4 million, or $0.77 per diluted share, for the prior year second quarter. Second quarter 2017 net operating earnings were $22.4 million, or $0.82 on a diluted earnings per share basis, an increase of 9.2% and 5.1%, respectively, when compared to net operating earnings of $20.5 million, or $0.78 per diluted share, for the second quarter of 2016. See "Non-GAAP Measures" below for a reconciliation of non-GAAP measures.

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2017 Outlook

During the Company’s second quarter 2017 earnings call, the Company stated that it anticipates the following for the full year ending December 31, 2017 (as compared with the year ending December 31, 2016 and as of December 31, 2016, as applicable):

•Organic loan growth at a mid-to-upper single digit pace;
•Organic deposit growth relatively consistent with organic growth in the second quarter of 2017;
•Net interest margin improvement of 15-20 basis points as compared to the full 3.40% reported for the full year 2016;
•Fee income growth in the low single digit pace;
•Quarterly efficiency ratio at year end expected to be mid 50s; and
•An effective tax rate of approximately 34%.

Non-GAAP Measures
When management assesses the Company’s financial performance for purposes of making day-to-day and strategic decisions, it does so based upon the performance of its core banking business, which is primarily derived from the combination of net interest income and noninterest or fee income, reduced by operating expenses, the provision for loan losses, and the impact of income taxes and other noncore items shown in the table that follows. There are items that impact the Company's results that management believes are unrelated to its core banking business such as gains or losses on the sales of securities, merger and acquisition expenses, loss on extinguishment of debt, impairment and other items. Management, therefore, computes the Company’s non-GAAP operating earnings and operating EPS, noninterest income on an operating basis and efficiency ratio on an operating basis, which exclude items management considers to be noncore. Management believes excluding these items facilitates greater visibility into the Company’s core banking business and underlying trends that may, to some extent, be obscured by inclusion of such items.

Management also supplements its evaluation of financial performance with analysis of tangible book value per share (which is computed by dividing stockholders' equity less goodwill and identifiable intangible assets, or "tangible common equity", by common shares outstanding) and with the Company's tangible common equity ratio (which is computed by dividing tangible common equity by tangible assets). The Company has included information on these tangible ratios which are non-GAAP measures because management believes that investors may find it useful to have access to the same analytical tools used by management to assess performance and identify trends. The Company has recognized goodwill and other intangible assets in conjunction with merger and acquisition activities. Excluding the impact of goodwill and other intangibles in measuring asset and capital values for the ratios provided, along with other bank standard capital ratios, facilitates comparison of the capital adequacy of the Company to other companies in the financial services industry.

These non-GAAP measures should not be viewed as a substitute for financial results determined in accordance with GAAP. An item which management deems to be noncore and excludes when computing these non-GAAP measures can be of substantial importance to the Company’s results for any particular period. The Company’s non-GAAP performance measures are not necessarily comparable to similarly named non-GAAP performance measures which may be presented by other companies.

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The following tables summarize adjustments for noncore items for the time periods indicated below and reconciles non-GAAP measures:

	Three Months Ended June 30			
	Net Income		Diluted Earnings Per Share	
	2017	2016	2017	2016
	(Dollars in thousands, except per share data)			
Net income available to common shareholders (GAAP)	$20,563	$20,374	$ 0.75	$ 0.77
Non-GAAP adjustments				
Noninterest expense components				
Merger and acquisition expenses	2,909	206	0.11	0.01
Total impact of noncore items	2,909	206	0.11	0.01
Net tax benefit associated with noncore items (1)	(1,088)	(84)	(0.04)	—
Net operating earnings (Non-GAAP)	$22,384	$20,496	$ 0.82	$ 0.78

	Six Months Ended June 30			
	Net Income		Diluted Earnings Per Share	
	2017	2016	2017	2016
	(Dollars in thousands, except per share data)			
Net income available to common shareholders (GAAP)	$41,288	$38,985	$ 1.52	$ 1.48
Non-GAAP adjustments				
Noninterest expense components				
Loss on extinguishment of debt	—	437	—	0.02
Merger and acquisition expenses	3,393	540	0.12	0.02
Total impact of noncore items	3,393	977	0.12	0.04
Net tax benefit associated with noncore items (1)	(1,241)	(400)	(0.04)	(0.02)
Net operating earnings (Non-GAAP)	$43,440	$39,562	$ 1.60	$ 1.50

(1) The net tax benefit associated with noncore items is determined by assessing whether each noncore item is included or excluded from net taxable income and applying the Company's combined marginal tax rate to only those items included in net taxable income.

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	Three Months Ended					
	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016	
	(Dollars in thousands)					
Net interest income (GAAP)	$63,755	$60,200	$58,752	$57,668	$56,533	(a)
Noninterest income (GAAP) *	$21,398	$18,912	$21,762	$20,416	$21,095	(b)
Noninterest income on an operating basis (Non-GAAP)	$21,398	$18,912	$21,762	$20,416	$21,095	(c)
Noninterest expense (GAAP)	$52,809	$48,773	$51,637	$46,857	$47,146	(d)
Less:						
Merger and acquisition expense	2,909	484	4,764	151	206	
Noninterest expense on an operating basis (Non-GAAP)	$49,900	$48,289	$46,873	$46,706	$46,940	(e)
Total revenue (GAAP)	$85,153	$79,112	$80,514	$78,084	$77,628	(a+b)
Total operating revenue (Non-GAAP)	$85,153	$79,112	$80,514	$78,084	$77,628	(a+c)
Ratios						
Noninterest income as a % of revenue (GAAP based)	25.13 %	23.91 %	27.03 %	26.15 %	27.17 %	(b/(a+b))
Noninterest income as a % of revenue on an operating basis (Non-GAAP)	25.13 %	23.91 %	27.03 %	26.15 %	27.17 %	(c/(a+c))
Efficiency ratio (GAAP based)	62.02 %	61.65 %	64.13 %	60.01 %	60.73 %	(d/(a+b))
Efficiency ratio on an operating basis (Non-GAAP)	58.60 %	61.04 %	58.22 %	59.82 %	60.47 %	(e/(a+c))

* There were no adjustments for the periods presented.

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The following table summarizes the calculation of the Company's tangible common equity ratio and tangible book value per share for the periods indicated:

	June 30, 2017	March 31 2017	December 31 2016	September 30 2016	June 30, 2016	
	(Dollars in thousands, except per share data)					
Tangible common equity						
Stockholders' equity (GAAP)	$914,584	$877,480	$864,690	$818,242	$803,897	(a)
Less: Goodwill and other intangibles	243,005	230,613	231,374	210,834	211,526	
Tangible common equity (Non-GAAP)	671,579	646,867	633,316	607,408	592,371	(b)
Tangible assets						
Assets (GAAP)	8,017,293	7,738,114	7,709,375	7,502,009	7,418,866	(c)
Less: Goodwill and other intangibles	243,005	230,613	231,374	210,834	211,526	
Tangible assets (Non-GAAP)	$7,774,288	$7,507,501	$7,478,001	$7,291,175	$7,207,340	(d)
Common shares	27,431,171	27,046,768	27,005,813	26,320,467	26,309,887	(e)
Common equity to assets ratio (GAAP)	11.41 %	11.34 %	11.22 %	10.91 %	10.84 %	(a/c)
Tangible common equity to tangible assets ratio (Non-GAAP)	8.64 %	8.62 %	8.47 %	8.33 %	8.22 %	(b/d)
Book value per share (GAAP)	$33.34	$32.44	$32.02	$31.09	$30.55	(a/e)
Tangible book value per share (Non-GAAP)	$24.48	$23.92	$23.45	$23.08	$22.52	(b/e)

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. The Company believes that the most critical accounting policies are those which the Company’s financial condition depends upon, and which involve the most complex or subjective decisions or assessments.

There have been no material changes in critical accounting policies during the first six months of 2017. Please refer to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 for a complete listing of critical accounting policies.

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FINANCIAL POSITION

Securities Portfolio The Company’s securities portfolio consists of trading securities, securities available for sale, and securities which management intends to hold until maturity. Securities increased by $64.1 million, or 7.5%, at June 30, 2017 as compared to at December 31, 2016 reflecting new purchases made during the six month period, partially offset by paydowns on existing securities. The ratio of securities to total assets was 11.4% and 11.0% at June 30, 2017 and December 31, 2016, respectively.

The Company monitors investment securities for the presence of other-than-temporary impairment (“OTTI”). For debt securities, the primary consideration in determining whether impairment is OTTI is whether or not the Bank expects to collect all contractual cash flows. Further details regarding the Company's analysis of potential OTTI can be found in Note 4 “Securities” within Condensed Notes to Consolidated Financial Statements included in Item 1 hereof.

Residential Mortgage Loan Sales The Company’s primary loan sale activity arises from the sale of government sponsored enterprise eligible residential mortgage loans. During the six months ended June 30, 2017 and 2016, the Bank originated residential loans with the intention of selling them in the secondary market or to hold in the Company's residential portfolio. When a loan is sold, the Company enters into agreements that contain representations and warranties about the characteristics of the loans sold and their origination. The Company may be required to either repurchase mortgage loans or to indemnify the purchaser from losses if representations and warranties are breached. The Company incurred no losses during the three and six months ended June 30, 2017 and June 30, 2016 related to these activities.

The following table shows the total residential loans that were closed and whether the amounts were held in the portfolio or sold/held for sale in the secondary market during the period indicated:

Table 1 - Closed Residential Real Estate Loans

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
	(Dollars in thousands)			
Held in portfolio	$42,191	$29,570	$84,771	$51,279
Sold or held for sale in the secondary market	54,077	67,625	99,534	113,432
Total closed loans	$96,268	$97,195	$184,305	$164,711

The Company sold $48.2 million and $62.1 million in residential loans during the three months ended June 30, 2017 and 2016, respectively, and $97.8 million and $106.6 million during the six months ended June 30, 2017 and 2016, respectively. All loans sold during these periods were sold with servicing rights released.

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Currently, the Bank sells the servicing of sold loans for a servicing release premium, simultaneous with the sale of the loan. In the past, the Bank may have opted to sell loans and retain the servicing. In the event of a sale with servicing rights retained, a mortgage servicing asset is established, which represents the then current estimated fair value based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Servicing rights are recorded in other assets in the consolidated balance sheets, are amortized in proportion to and over the period of estimated net servicing income, and are assessed for impairment based on fair value at each reporting date. Impairment is determined by stratifying the rights based on predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance, to the extent that fair value is less than the capitalized amount. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance may be recorded as an increase to income. The principal balance of loans serviced by the Bank on behalf of investors amounted to $303.7 million, $311.3 million and $345.9 million at June 30, 2017, December 31, 2016, and June 30, 2016, respectively. The following table shows the adjusted cost of the servicing rights associated with these loans and the changes for the periods indicated:

Table 2 - Mortgage Servicing Asset

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
	(Dollars in thousands)			
Balance at beginning of period	$1,958	$2,418	$2,048	$2,581
Acquired portfolio	28	—	28	—
Amortization	(108)	(141)	(209)	(279)
Change in valuation allowance	(2)	(156)	9	(181)
Balance at end of period	$1,876	$2,121	$1,876	$2,121

Forward sale contracts of mortgage loans, considered derivative instruments for accounting purposes, may be utilized by the Company in its efforts to manage risk of loss associated with its mortgage loan commitments and mortgage loans held for sale. Prior to closing and funding certain one-to-four family residential mortgage loans, an interest rate lock commitment is generally extended to the borrower. During the period from commitment date to closing date, the Company is subject to the risk that market rates of interest may change. If market rates rise, investors generally will pay less to purchase such loans, resulting in a reduction in the gain on sale of the loans or, possibly, a loss. In an effort to mitigate such risk, forward delivery sales commitments are executed, under which the Company agrees to deliver whole mortgage loans to investors which economically hedges this market risk. See Note 10, “Derivative and Hedging Activities” within Condensed Notes to Consolidated Financial Statements included in Item 1 hereof for more information on mortgage activity and mortgage related derivatives.

Loan Portfolio Management continues to focus on growth in the commercial and home equity lending categories. Management believes this emphasis is prudent, given the prevailing interest rate and economic environment, as well as strategic priorities. The Company’s loan portfolio increased by $270.1 million during the first six months of 2017, due in part to the acquired loan portfolio related to the Island Bancorp acquisition.

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Excluding the effects of the Island Bancorp acquisition, the Company has experienced organic loan growth across all major loan categories. The following table summarizes loan growth during the periods indicated:

Table 3 - Components of Loan Growth/(Decline)

	June 30 2017	December 31 2016	Island Bancorp Acquisition	Organic Growth/(Loss)	Organic Growth/ (Loss) %
	(Dollars in thousands)				
Commercial and industrial	$910,936	$902,053	$ 4,271	$ 4,612	0.51 %
Commercial real estate	3,083,020	3,010,798	44,510	27,712	0.92 %
Commercial construction	340,757	320,391	106	20,260	6.32 %
Small business	131,663	122,726	57	8,880	7.24 %
Total commercial	4,466,376	4,355,968	48,944	61,464	1.41 %
Residential real estate	749,392	644,426	87,450	17,516	2.72 %
Home equity	1,043,459	988,147	18,921	36,391	3.68 %
Total consumer real estate	1,792,851	1,632,573	106,371	53,907	3.30 %
Total other consumer	10,469	11,064	236	(831)	(7.51)%
Total loans	$6,269,696	$5,999,605	$ 155,551	$ 114,540	1.91 %

Management considers the Company’s commercial and industrial portfolio to be well-diversified with loans to various types of industries. The following pie chart shows the diversification of the commercial and industrial portfolio as of June 30, 2017:

	(Dollars in thousands)
Average loan size	$233
Largest individual commercial and industrial loan outstanding	$21,000
Commercial and industrial nonperforming loans/commercial and industrial loans	3.69 %

The Company’s commercial real estate portfolio, inclusive of commercial construction, is the Company’s largest loan type concentration. The Company believes that this portfolio is also well-diversified with loans secured by a variety of property types, such as owner-occupied and nonowner-occupied commercial, retail, office, industrial, warehouse, industrial development bonds,

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and other special purpose properties, such as hotels, motels, nursing homes, restaurants, churches, recreational facilities, marinas, and golf courses. Commercial real estate also includes loans secured by certain residential-related property types including multi-family apartment buildings, residential development tracts and condominiums. The following pie chart shows the diversification of the commercial real estate portfolio as of June 30, 2017:

	(Dollars in thousands)	
Average loan size	$ 831	
Largest individual commercial real estate mortgage outstanding	$ 27,649	
Commercial real estate nonperforming loans/commercial real estate loans	0.14	%
Owner occupied commercial real estate loans/commercial real estate loans	16.1	%

In addition to the commercial portfolios, the Company also originates both fixed-rate and adjustable-rate residential real estate loans as well as residential construction lending related to single-home residential development within the Company's market area. The Company also provides home equity loans and lines that may be made as a fixed rate term loan or under a variable rate revolving line of credit secured by a first or junior mortgage on the borrower's residence or second home. Additionally, the Company makes loans for a wide variety of other personal needs. Consumer loans primarily consist of installment loans and overdraft protections. The residential, home equity and other consumer portfolios totaled $1.8 billion at June 30, 2017.

Asset Quality   The Company continually monitors the asset quality of the loan portfolio using all available information. Based on this assessment, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower’s ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring ("TDR").

Delinquency   The Company’s philosophy toward managing its loan portfolios is predicated upon careful monitoring, which stresses early detection and response to delinquent and default situations. The Company seeks to make arrangements to resolve any delinquent or default situation over the shortest possible time frame. Generally, the Company requires that a delinquency notice be mailed to a borrower upon expiration of a grace period (typically no longer than 15 days beyond the due date). Reminder notices may be sent and telephone calls may be made prior to the expiration of the grace period. If the delinquent status is not resolved within a reasonable time frame following the mailing of a delinquency notice, the Bank’s personnel charged with managing its loan portfolios contacts the borrower to ascertain the reasons for delinquency and the prospects for payment. Any subsequent actions taken to resolve the delinquency will depend upon the nature of the loan and the length of time that the loan has been delinquent. The borrower’s needs are considered as much as reasonably possible without jeopardizing the Bank’s position. A late charge is usually assessed on loans upon expiration of the grace period.

Nonaccrual Loans   As a general rule, loans more than 90 days past due with respect to principal or interest are classified as nonaccrual loans. However, certain loans that are more than 90 days past due may be kept on an accruing status if the loans are well secured and/or in the process of collection. The Company may also put a junior lien mortgage on nonaccrual status as a result of delinquency with respect to the first position, which is held by another financial institution, while the junior lien is currently performing. Income accruals are suspended on all nonaccrual loans and all previously accrued and uncollected interest is reversed against current income. A loan remains on nonaccrual status until it becomes current with respect to principal and interest (and in certain instances remains current for up to six months), the loan is liquidated, or when the loan is determined to be uncollectible and is charged-off against the allowance for loan losses.

Troubled Debt Restructurings   In the course of resolving problem loans, the Company may choose to restructure the contractual terms of certain loans. The Company attempts to work out an alternative payment schedule with the borrower in order to avoid or cure a default. Loans that are modified are reviewed by the Company to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower’s financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include adjustments to interest rates, extensions of maturity, consumer loans where the borrower's obligations have been effectively discharged through Chapter 7 Bankruptcy and the borrower has not reaffirmed the debt to the Bank, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. If such efforts by the Bank do not result in satisfactory performance, the loan is referred to legal counsel, at which time foreclosure proceedings are initiated. At any time prior to a sale of the property at foreclosure, the Bank may terminate foreclosure proceedings if the borrower is able to work out a satisfactory payment plan.

It is the Company’s policy to have any restructured loans which are on nonaccrual status prior to being modified remain on nonaccrual status for six months, subsequent to being modified, before management considers its return to accrual status. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. Loans that are considered TDRs are classified as performing, unless they are on nonaccrual status or greater than 90 days delinquent. Loans classified as TDRs remain classified as such for the life of the loan, except in limited circumstances, when it may be determined that the borrower is performing under modified terms and the restructuring agreement specified an interest rate greater than or equal to an acceptable market rate for a comparable new loan at the time of the restructuring.

Purchased Credit Impaired Loans   Purchased Credit Impaired (“PCI”) loans are acquired loans which had evidence of deterioration in credit quality at the purchase date and for which it is probable that all contractually required payments will not be collected. PCI loans are recorded at fair value without any carryover of the allowance for loan losses. The excess cash flows expected to be collected over the carrying amount of the loans, referred to as the "accretable yield," is accreted into interest income over the life of the loans using the effective yield method. Accordingly, PCI loans are not subject to classification as nonaccrual in the same manner as originated loans, rather they are generally considered to be accruing loans because their interest income recognized relates to the accretable yield and not to contractual interest payments. See Note 5, "Loans, Allowance for Loan Losses, and Credit Quality" within Condensed Notes to Consolidated Financial Statements included in Item 1 hereof for more information.

Nonperforming Assets   Nonperforming assets are comprised of nonperforming loans and other real estate owned (“OREO”). Nonperforming loans consist of nonaccrual loans and loans that are more than 90 days past due but still accruing interest.

OREO consists of real estate properties, which have primarily served as collateral to secure loans, that are controlled or owned by the Bank. These properties are recorded at fair value less estimated costs to sell at the date control is established, resulting in a new cost basis. The amount by which the recorded investment in the loan exceeds the fair value (net of estimated costs to sell) of the foreclosed asset is charged to the allowance for loan losses. Subsequent declines in the fair value of the foreclosed asset below the new cost basis are recorded through the use of a valuation allowance. Subsequent increases in the fair value are recorded as reductions in the valuation allowance, but not below zero. All costs incurred thereafter in maintaining the property are generally charged to noninterest expense. In the event the real estate is utilized as a rental property, net rental income and expenses are recorded as incurred within noninterest expense.

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The following table sets forth information regarding nonperforming assets held by the Company at the dates indicated:
Table 4 - Nonperforming Assets

	June 30, 2017	December 31, 2016	June 30, 2016
	(Dollars in thousands)		
Loans accounted for on a nonaccrual basis			
Commercial and industrial (1)	$33,630	$ 37,455	$3,177
Commercial real estate	4,679	6,266	8,220
Small business	453	302	349
Residential real estate	7,683	7,782	7,116
Home equity	5,240	5,553	6,684
Other consumer	90	47	81
Total (2)	$51,775	$ 57,405	$25,627
Loans past due 90 days or more but still accruing			
Other consumer	8	2	1
Total	$8	$ 2	$1
Total nonperforming loans	$51,783	$ 57,407	$25,628
Other real estate owned	3,029	4,173	1,845
Total nonperforming assets	$54,812	$ 61,580	$27,473
Nonperforming loans as a percent of gross loans	0.83 %	0.96 %	0.45 %
Nonperforming assets as a percent of total assets	0.68 %	0.80 %	0.37 %

(1) Included in the June 30, 2017 amount is loans related to one large relationship that was place on nonaccrual status.
(2) Inclusive of TDRs on nonaccrual status of $5.7 million, $5.2 million, and $5.1 million at June 30, 2017, December 31, 2016, and June 30, 2016, respectively.

The following table summarizes the changes in nonperforming assets for the periods indicated:
Table 5 - Activity in Nonperforming Assets

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
	(Dollars in thousands)			
Nonperforming assets beginning balance	$58,456	$27,219	$61,580	$29,849
New to nonperforming	3,619	3,943	7,567	7,102
Loans charged-off	(4,198)	(576)	(4,706)	(1,113)
Loans paid-off	(1,124)	(1,955)	(5,869)	(5,649)
Loans transferred to other real estate owned and foreclosed assets	—	(291)	(457)	(377)
Loans restored to performing status	(1,642)	(1,058)	(2,271)	(2,162)
New to other real estate owned	—	291	457	377
Valuation write down	(95)	(153)	(95)	(153)
Sale of other real estate owned	(279)	(45)	(1,505)	(683)
Capital improvements to other real estate owned	—	31	—	144
Other	75	67	111	138
Nonperforming assets ending balance	$54,812	$27,473	$54,812	$27,473

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The following table sets forth information regarding troubled debt restructured loans as of the dates indicated:
Table 6 - Troubled Debt Restructurings

	June 30, 2017	December 31, 2016	June 30, 2016
	(Dollars in thousands)		
Performing troubled debt restructurings	$26,908	$ 27,093	$28,319
Nonaccrual troubled debt restructurings	5,728	5,199	5,121
Total	$32,636	$ 32,292	$33,440
Performing troubled debt restructurings as a % of total loans	0.43 %	0.45 %	0.50 %
Nonaccrual troubled debt restructurings as a % of total loans	0.09 %	0.09 %	0.09 %
Total troubled debt restructurings as a % of total loans	0.52 %	0.54 %	0.59 %

The following table summarizes changes in TDRs for the periods indicated:
Table 7 - Activity in Troubled Debt Restructurings

	Three Months Ended		Six Months Ended	
	June 30 2017	June 30 2016	June 30 2017	June 30 2016
	(Dollars in thousands)			
TDRs beginning balance	$31,014	$36,550	$32,292	$38,074
New to TDR status	2,976	1,187	3,207	2,031
Transfer to OREO	—	—	(215)	—
Paydowns	(1,352)	(4,282)	(2,629)	(6,650)
Charge-offs	(2)	(15)	(19)	(15)
TDRs ending balance	$32,636	$33,440	$32,636	$33,440

Income accruals are suspended on all nonaccrual loans and all previously accrued and uncollected interest is reversed against current income. The table below shows interest income that was recognized or collected on all nonaccrual loans and TDRs as of the dates indicated:
Table 8 - Interest Income - Nonaccrual Loans and Troubled Debt Restructurings

	Three Months Ended		Six Months Ended	
	2017	2016	2017	2016
	(Dollars in thousands)			
The amount of incremental gross interest income that would have been recorded if nonaccrual loans had been current in accordance with their original terms	$529	$289	$1,100	$577
The amount of interest income on nonaccrual loans and performing TDRs that was included in net income	$395	$537	$764	$995

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment

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shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impaired loans include all commercial and industrial loans, commercial real estate loans, commercial construction and small business loans that are on nonaccrual status, TDRs, and other loans that have been categorized as impaired. Impairment is measured on a loan by loan basis by comparing the loan's value to either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. For impaired loans deemed collateral dependent, where impairment is measured using the fair value of the collateral, the Bank will either order a new appraisal or use another available source of collateral assessment such as a broker's opinion of value to determine a reasonable estimate of the fair value of the collateral.

Total impaired loans at June 30, 2017 and December 31, 2016 were $74.6 million and $77.3 million, respectively. For additional information regarding the Company's asset quality, including delinquent loans, nonaccruals, TDRs, and impaired loans, see Note 5, "Loans, Allowance for Loan Losses, and Credit Quality" within Condensed Notes to Consolidated Financial Statements included in Item 1 hereof.

Potential problem loans are any loans which are not included in nonaccrual or nonperforming loans, where known information about possible credit problems of the borrowers causes management to have concerns as to the ability of such borrowers to comply with present loan repayment terms. At June 30, 2017, there were 59 relationships, with an aggregate balance of $92.0 million, deemed to be potential problem loans. These potential problem loans continued to perform with respect to payments. Management actively monitors these loans and strives to minimize any possible adverse impact to the Company.

Allowance for Loan Losses The allowance for loan losses is maintained at a level that management considers appropriate to provide for probable loan losses based upon evaluation of known and inherent risks in the loan portfolio. The allowance is increased by providing for loan losses through a charge to expense and by credits for recoveries of loans previously charged-off and is reduced by loans being charged-off.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on increases in nonperforming loans, changes in economic conditions, or for other reasons. Additionally, various regulatory agencies, as an integral part of the Bank's examination process, periodically assess the adequacy of the allowance for loan losses to ensure its accordance with GAAP and applicable guidance.

The allowance for loan losses is allocated to loan types using both a formula-based approach applied to groups of loans and an analysis of certain individual loans for impairment. The formula-based approach emphasizes loss factors derived from actual historical portfolio loss rates, which are combined with an assessment of certain qualitative factors to determine the allowance amounts allocated to the various loan categories. Allowance amounts are determined based on an estimate of the historical average annual percentage rate of loan loss for each loan category, an estimate of the incurred loss emergence and confirmation period for each loan category, and certain qualitative risk factors considered in the computation of the allowance for loan losses. Additionally, the Company reviews numerous credit quality indicators when assessing the risk in its loan portfolio. For the commercial portfolio, the Company utilizes a 10-point commercial risk-rating system, which assigns a risk-grade to each borrower based on a number of quantitative and qualitative factors associated with a commercial loan transaction. Factors considered include industry and market conditions, position within the industry, earnings trends, operating cash flow, asset/liability values, debt capacity, guarantor strength, management and controls, financial reporting, collateral and other considerations.

As of June 30, 2017, the allowance for loan losses totaled $59.5 million, or 0.95% of total loans, as compared to $61.6 million, or 1.03% of total loans, at December 31, 2016.

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The following table summarizes changes in the allowance for loan losses and other selected statistics for the periods presented:

Table 9 - Summary of Changes in the Allowance for Loan Losses

	Three Months Ended				
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
	(Dollars in thousands)				
Average total loans	$6,158,997	$6,017,713	$5,841,546	$5,660,271	$5,629,745
Allowance for loan losses, beginning of period	$62,318	$61,566	$58,205	$57,727	$56,432
Charged-off loans					
Commercial and industrial	3,591	—	562	27	2
Commercial real estate	—	—	49	341	25
Small business	24	70	37	98	30
Residential real estate	116	23	1	—	8
Home equity	122	14	111	154	190
Other consumer	345	401	455	523	322
Total charged-off loans	4,198	508	1,215	1,143	577
Recoveries on loans previously charged-off					
Commercial and industrial	13	187	9	63	649
Commercial real estate	26	31	29	124	223
Small business	13	66	73	28	73
Residential real estate	2	12	117	130	51
Home equity	26	76	64	24	26
Other consumer	229	288	284	302	250
Total recoveries	309	660	576	671	1,272
Net loans charged-off (recovered)					
Commercial and industrial	3,578	(187)	553	(36)	(647)
Commercial real estate	(26)	(31)	20	217	(198)
Small business	11	4	(36)	70	(43)
Residential real estate	114	11	(116)	(130)	(43)
Home equity	96	(62)	47	130	164
Other consumer	116	113	171	221	72
Total net loans charged-off (recovered)	3,889	(152)	639	472	(695)
Provision for loan losses	1,050	600	4,000	950	600
Total allowance for loan losses, end of period	$59,479	$62,318	$61,566	$58,205	