

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

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2020 or
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____
Commission file number _____ 0-7818

INDEPENDENT BANK CORPORATION

(Exact name of Registrant as specified in its charter)

Michigan

(State or other jurisdiction of incorporation)

38-2032782

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

4200 East Beltline, Grand Rapids, Michigan

(Address of principal executive offices)

49525

(Zip Code)

Registrant's telephone number, including area code

(616) 527-5820

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

Common Stock, No Par Value

(Title of class)

IBCP

(Trading Symbol(s))

NASDAQ

(Name of Exchange)

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

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

Yes No

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

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. Yes No

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

Yes No

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2020, was \$318,683,270.

The number of shares outstanding of the registrant's common stock as of March 4, 2021 was 21,772,847.

Documents incorporated by reference: Portions of our definitive proxy statement and annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, are incorporated by reference into Part I, Part II, Part III, and Part IV of this Form 10-K.

The Exhibit Index appears on Pages 35-36

FORWARD-LOOKING STATEMENTS

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

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business including the impact of the ongoing COVID-19 pandemic on each of these items;
- economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our bank operates including the economic impact of the ongoing COVID-19 pandemic in each of these areas;
- the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;
- increased competition in the financial services industry, either nationally or regionally;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- the continued services of our management team; and
- implementation of new legislation, which may have significant effects on us and the financial services industry.

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

ITEM 1. BUSINESS

Independent Bank Corporation was incorporated under the laws of the State of Michigan on September 17, 1973, for the purpose of becoming a bank holding company. We are registered under the Bank Holding Company Act of 1956, as amended, and own all of the outstanding stock of Independent Bank (the "bank"), which is also organized under the laws of the State of Michigan. The bank was founded as First National Bank in Ionia in 1864. Over the years, we have grown both organically and as the result of acquisitions of community banks, bank branches, and other organizations within the financial services industry. Our most recent acquisition was our acquisition of Traverse City State Bank in April 2018.

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

Our bank transacts business in the single industry of commercial banking. It offers a broad range of banking services to individuals and businesses, including checking and savings accounts, commercial lending, direct and indirect consumer financing, mortgage lending, and safe deposit box services. Our bank does not offer trust services. Our principal markets are the rural and suburban communities across Lower Michigan, which are served by the bank's main office in Grand Rapids, Michigan, and a total of 59 branches, two drive-thru facilities, and nine Michigan based loan production offices. We also have two loan production offices in Ohio (Columbus and Fairlawn). Most of our bank's branches provide full-service lobby and drive-thru services, as well as automatic teller machines (ATMs). In addition, we provide internet and mobile banking capabilities to our customers. We continue to see customer transaction volume declining at our bank offices and increasing through our electronic channels.

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

As of December 31, 2020, our bank had total loans (excluding loans held for sale) of \$2.734 billion and total deposits of \$3.637 billion.

As of December 31, 2020, we had 854 full-time employees and 129 part-time employees. We compete for talent and human resources with other financial services organizations within our geographic market, which is largely the lower peninsula of Michigan. The market for residential mortgage loan officers and support staff is particularly competitive given the competitive nature of those products, especially in the historically low interest rate environment we have been experiencing recently. We strive to be an employer of choice by offering competitive compensation and benefits as well as fostering strong employee relations through our culture, training and growth opportunities and similar measures. As a community-oriented bank, we believe it is especially important for our employees to engage with the communities in our market areas, and we encourage and provide opportunities for our employees to volunteer with local organizations in the markets served by our bank branches.

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

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

	2020	2019	2018
Interest and fees on loans	55.8%	68.1%	66.6%
Other interest income	7.6	7.7	7.9
Non-interest income	36.6	24.2	25.5
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Supervision and Regulation

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

General

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

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

Independent Bank Corporation

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

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

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

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

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

ITEM 1. BUSINESS (continued)

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

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

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

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

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

Under current federal regulations, our holding company is required to maintain the following minimum capital ratios: (1) a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%, (2) a minimum ratio of Tier 1 capital to risk-weighted assets of 6%, (3) a minimum ratio of total capital to total risk-weighted assets of 8%, and (4) a minimum leverage ratio of 4%. A 2.5% common equity Tier 1 capital conservation buffer is also required. We believe our holding company currently exceeds all of the minimum capital ratio requirements applicable to it.

It is important to note that these regulatory capital rules provide minimum requirements, and higher capital levels may be required if warranted by the particular circumstances or risk profiles of individual banking organizations. In addition, the federal bank regulatory agencies are required biennially to review risk-based capital standards to ensure that they adequately address interest rate risk, concentration of credit risk and risks from non-traditional activities.

Our Tier 1 capital as of December 31, 2020, includes \$38.3 million of trust preferred securities (classified on our Consolidated Statements of Financial Condition as "Subordinated debentures"). The Federal Reserve has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities and certain other capital elements is limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit could be included in the Tier 2 capital, subject to restrictions. The provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act adopted in 2010 (the "Dodd-Frank Act") imposed additional limitations on the ability to include trust preferred securities as Tier 1 capital; however, these additional limitations do not apply to our outstanding trust preferred securities. Our Tier 2 capital as of December 31, 2020 includes \$40.0 million of subordinated debentures that were issued during 2020 and mature May, 2030. Generally, for subordinated debt with a minimum maturity of five years, there is no limit on the amount of subordinated debt that can be included in Tier 2 capital.

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

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

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

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

Independent Bank

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

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

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

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

Capital Requirements. The Federal Reserve has established the following minimum capital standards for state-chartered, FDIC-insured member banks, such as our bank: (1) a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%, (2) a minimum ratio of Tier 1 capital to risk-weighted assets of 6%, (3) a minimum ratio of total capital to total risk-weighted assets of 8%, and (4) a minimum leverage ratio of 4%. A 2.5% common equity Tier 1 capital conservation buffer is also required. It is important to note that these regulatory capital rules provide minimum requirements, and higher capital levels may be required if warranted by the particular circumstances or risk profiles of individual banking organizations. In addition, the federal bank regulatory agencies are required biennially to review risk-based capital standards to ensure that they adequately address interest rate risk, concentration of credit risk and risks from non-traditional activities.

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

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

At December 31, 2020, our bank's ratios exceeded minimum requirements for the well-capitalized category.

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

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

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

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

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

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

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

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

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

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

A number of consumer protection laws were implemented following the 2008 recession, including the Dodd-Frank Act, adopted in 2010. The Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB), which was given the power to issue and enforce certain consumer protection laws. The CFPB has issued a number of consumer protection regulations over the last decade, including regulations that impact residential mortgage lending and servicing.

We have experienced, and expect to continue to experience, increased costs and expenses related to compliance with these consumer protection regulations as well as new regulations that may be implemented in the future.

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

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

The 2018 Act also includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, and risk weights for certain high-risk commercial real estate loans. However, it remains difficult to predict the full extent to which the 2018 Act or the implementing rules and regulations will affect our business in the future.

CARES Act. On March 27, 2020, the Coronavirus Aid, Relief and Economic Security ("CARES") Act of 2020 was signed into law. Among other things, the CARES Act temporarily lowered the community bank leverage ratio to 8%. The federal bank regulators subsequently issued a rule implementing the lower ratio effective April 23, 2020. The rule also established a two-quarter grace period for a qualifying institution whose leverage ratio falls below the 8% community bank leverage ratio requirement so long as the bank maintains a leverage ratio of 7% or greater. Another rule was issued to transition back to the 9% community bank leverage ratio by increasing the ratio to 8.5% for calendar year 2021 and 9% thereafter. In addition, the CARES Act allows banks to elect to suspend requirements under U.S. GAAP for loan modifications related to the COVID-19 pandemic (for loans that were not more than 30 days past due as of December 31, 2019) that would otherwise be categorized as a TDR, including impairment for accounting purposes. The passage of the Bipartisan-Bicameral Omnibus COVID Relief Deal in December 2020 permitted further suspension of these requirements until the earlier of 60 days after the termination date of the national emergency or January 1, 2022. Finally, as discussed below, the CARES Act and this December 2020 legislation delayed the required implementation of the Current Expected Credit Loss (CECL) accounting standard.

Anti-Money Laundering Act of 2020. The National Defense Authorization Act for Fiscal Year 2021 (the "NDAA") enacted January 1, 2021 over a presidential veto, includes a number of significant new requirements intended to enhance U.S. anti-money laundering efforts. These provisions, many of which are contained within a section of the NDAA known as the Anti-Money Laundering Act of 2020 (the "AMLA"), include establishment of a beneficial ownership registration database, the creation of two new criminal offenses regarding money laundering, new penalties for Bank Secrecy Act violations, and increased whistleblower rewards and protections. Under these new laws, various government agencies will also be tasked with identification of policy priorities, establishment of streamlined processes, creation of information sharing programs, and regular reporting to Congress in an effort to modernize anti-money laundering enforcement. The development of rules and regulations implementing the AMLA are currently in the very early stages and future impacts are difficult to predict at this time.

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

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

Current Expected Credit Loss ("CECL"). In June 2016, the Financial Accounting Standards Board ("FASB") adopted a new accounting standard that was expected to be effective for the Bank for the calendar year beginning on January 1, 2020. This standard, referred to as Current Expected Credit Loss, or CECL, requires financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This represents a change from the previous method of providing allowances for loan losses that are probable and the implementation of the new standard may require us to increase our allowance for loan losses. It may also greatly increase the data we will need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses, or expenses incurred to determine the appropriate level of the allowance for loan losses, may have a material adverse effect on our financial condition and results of operations. However, pursuant to the CARES Act passed on March 27, 2020 and subsequent legislation passed in December 2020, the required implementation of CECL was permitted to be delayed until the earlier of January 1, 2022 or the first day of the fiscal year that begins after the termination of the COVID-related national emergency. Early adoption is allowed on either January 1, 2020 or January 1, 2021. In addition, on March 27, 2020, the Federal Reserve and other federal bank regulatory agencies released a joint regulatory capital rule providing a new option for phasing CECL impacts into regulatory capital over the next five years.

London Interbank Offered Rate ("LIBOR"). In 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calibration of LIBOR after 2021. The Federal Reserve and the Alternative Reference Rates Committee ("ARRC"), a steering committee comprised primarily of large U.S. financial institutions, have identified the Secured Overnight Financing Rate ("SOFR"), a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as a potential alternative to LIBOR, and the Federal Reserve announced final plans for the production of SOFR. Whether SOFR will become a LIBOR replacement and the ultimate future of LIBOR remain uncertain. However, both Fannie Mae and Freddie Mac announced in 2020 that they would cease purchasing and issuing LIBOR-based products by the end of 2020 and have begun accepting mortgages based on SOFR. The language in our LIBOR-based contracts and financial instruments has developed over time and may specify various events that will trigger when a successor rate would be selected. Some contracts and financial instruments may give the calculation agent discretion over the substitute index or indices for the calculation of interest rates. Furthermore, implementation of successor indices may lead to additional documentation requirements, compliance measures, and financial impacts, as well as potential disputes or litigation with customers and creditors.

Future Legislation

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

Available Information

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

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE

- I. (A) DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
(B) INTEREST RATES AND INTEREST DIFFERENTIAL
(C) INTEREST RATES AND DIFFERENTIAL

The information set forth in the tables captioned "Average Balances and Rates" and "Change in Net Interest Income" of our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

II. INVESTMENT PORTFOLIO

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
		(in thousands)	
Equity securities at fair value	\$ -	\$ -	\$ 393
<u>Available for sale</u>			
U.S. agency residential mortgage-backed	\$ 344,582	\$ 227,762	\$ 123,751
Obligations of states and political subdivisions	324,293	96,102	127,555
Other asset backed	254,181	93,886	83,319
Corporate	86,017	33,195	34,309
Private label mortgage-backed	42,829	39,693	29,419
U.S. agency	10,748	14,661	20,014
U.S. agency commercial mortgage-backed	7,195	10,756	5,726
Trust preferred	1,798	1,843	1,819
Foreign government	516	502	2,014
Total	<u>\$ 1,072,159</u>	<u>\$ 518,400</u>	<u>\$ 427,926</u>

(B) The following table sets forth contractual maturities of securities at December 31, 2020 and the weighted average yield of such securities:

	Maturing Within One Year		Maturing After One But Within Five Years		Maturing After Five But Within Ten Years		Maturing After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
(dollars in thousands)								
<u>Available for sale</u>								
U.S. agency residential mortgage-backed	\$ 207	1.33%	\$ 106,560	1.43%	\$ 19,658	1.99%	\$ 218,157	2.30%
Obligations of states and political subdivisions	10,406	1.99	40,872	2.64	34,714	3.16	238,301	2.82
Other asset backed	117,474	2.80	93,313	1.56	38,621	1.23	4,773	1.65
Corporate	10,439	1.98	34,505	3.13	41,073	3.56	-	
Private label mortgage-backed	149	1.77	29,642	2.81	11,993	3.13	1,045	4.51
U.S. agency	567	1.96	6,832	1.67	3,349	2.80	-	
U.S. agency commercial mortgage-backed	1,301	2.31	1,072	2.52	-	-	4,822	3.27
Trust preferred	-	-	-	-	924	3.25	874	3.20
Foreign government	-	-	516	2.03	-	-	-	
Total	<u>\$ 140,543</u>	<u>2.67%</u>	<u>\$ 313,312</u>	<u>1.95%</u>	<u>\$ 150,332</u>	<u>2.61%</u>	<u>\$ 467,972</u>	<u>2.57%</u>
Tax equivalent adjustment for calculation of yield	<u>\$ 42</u>		<u>\$ 161</u>		<u>\$ 136</u>		<u>\$ 1,200</u>	

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

<u>Available for sale</u>	Tax-Exempt Rate	Adjustment	Rate on Tax Equivalent Basis (1)
Under 1 year	1.57%	0.42%	1.99%
1-5 years	2.28	0.61	2.89
5-10 years	2.54	0.67	3.21
After 10 years	2.25	0.60	2.85

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

III. LOAN PORTFOLIO

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

	2020	2019	2018	2017	2016
	(in thousands)				
Loans held for sale(a)	\$ 92,434	\$ 69,800	\$ 86,224	\$ 39,436	\$ 67,380
Mortgage	1,015,926	1,098,911	1,042,890	849,530	538,615
Commercial	1,242,415	1,166,695	1,144,481	853,260	804,017
Installment	475,337	459,417	395,149	316,027	265,616
Total Loans	<u>\$ 2,826,112</u>	<u>\$ 2,794,823</u>	<u>\$ 2,668,744</u>	<u>\$ 2,058,253</u>	<u>\$ 1,675,628</u>

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

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

(B) The following table sets forth scheduled loan repayments (excluding 1-4 family residential mortgages and installment loans) at December 31, 2020:

	Due Within One Year	Due After One But Within Five Years	Due After Five Years	Total
	(in thousands)			
Mortgage	\$ -	\$ 72	\$ 150,163	\$ 150,235
Commercial	93,679	449,956	698,780	1,242,415
Total	<u>\$ 93,679</u>	<u>\$ 450,028</u>	<u>\$ 848,943</u>	<u>\$ 1,392,650</u>

The following table sets forth loans due after one year which have predetermined (fixed) interest rates and/or adjustable (variable) interest rates at December 31, 2020:

	Fixed Rate	Variable Rate	Total
	(in thousands)		
Due after one but within five years	\$ 295,122	\$ 154,906	\$ 450,028
Due after five years	532,941	316,002	848,943
Total	<u>\$ 828,063</u>	<u>\$ 470,908</u>	<u>\$ 1,298,971</u>

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
			(in thousands)		
(a) Loans accounted for on a non-accrual basis (1, 2)	\$ 8,312	\$ 10,178	\$ 9,029	\$ 8,184	\$ 13,364
(b) Aggregate amount of loans ninety days or more past due (excludes loans in (a) above)	-	-	5	-	-
(c) Loans not included above which are "troubled debt restructurings" as defined by accounting guidance	<u>44,341</u>	<u>47,575</u>	<u>53,087</u>	<u>60,115</u>	<u>70,286</u>
Total	<u>\$ 52,653</u>	<u>\$ 57,753</u>	<u>\$ 62,121</u>	<u>\$ 68,299</u>	<u>\$ 83,650</u>

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

(2) Interest in the amount of \$3.25 million would have been earned in 2020 had loans in categories (a) and (c) remained at their original terms; however, only \$2.74 million was included in interest income for the year with respect to these loans.

Potential problem loans identified by the loan review department which are not included as non-performing in the table above were zero at December 31, 2020.

At December 31, 2020, there was no concentration of loans exceeding 10% of total loans which is not already disclosed as a category of loans in this section "Loan Portfolio" (Item III(A)).

There were no other interest-bearing assets at December 31, 2020, that would be required to be disclosed above (Item III(C)), if such assets were loans.

There were no foreign loans at December 31, 2020, 2019, 2018, 2017 and 2016.

IV. SUMMARY OF LOAN LOSS EXPERIENCE

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

	2020		2019		2018	
	(dollars in thousands)					
Total loans outstanding at the end of the year (net of unearned fees)	\$ 2,826,112		\$ 2,794,823		\$ 2,668,744	
Average total loans outstanding for the year (net of unearned fees)	\$ 2,870,991		\$ 2,721,627		\$ 2,424,539	
	Allowance for Loan Losses	Unfunded Commitments	Allowance for Loan Losses	Unfunded Commitments	Allowance for Loan Losses	Unfunded Commitments
Balance at beginning of year	\$ 26,148	\$ 1,542	\$ 24,888	\$ 1,296	\$ 22,587	\$ 1,125
Loans charged-off						
Mortgage	816		1,221		1,946	
Commercial	4,076		682		448	
Installment	1,359		1,622		1,430	
Total loans charged-off	6,251		3,525		3,824	
Recoveries of loans previously charged-off						
Mortgage	513		933		734	
Commercial	1,804		2,165		2,889	
Installment	752		863		999	
Total recoveries	3,069		3,961		4,622	
Net loans charged-off (recovered)	3,182		(436)		(798)	
Additions included in operations	12,463	263	824	246	1,503	171
Balance at end of year	\$ 35,429	\$ 1,805	\$ 26,148	\$ 1,542	\$ 24,888	\$ 1,296
Net loans charged-off (recovered) as a percent of average loans outstanding (includes loans held for sale) for the year	0.11%		(0.02)%		(0.03)%	
Allowance for loan losses as a percent of loans outstanding (includes loans held for sale) at the end of the year	1.25		0.94		0.93	

	2017		2016	
	(dollars in thousands)			
Total loans outstanding at the end of the year (net of unearned fees)	\$ 2,058,253		\$ 1,675,628	
Average total loans outstanding for the year (net of unearned fees)	\$ 1,848,860		\$ 1,599,899	
	Allowance for Loan Losses	Unfunded Commit- ments	Allowance for Loan Losses	Unfunded Commit- ments
Balance at beginning of year	\$ 20,234	\$ 650	\$ 22,570	\$ 652
Loans charged-off				
Mortgage	1,122		2,599	
Commercial	455		1,317	
Installment	1,474		1,671	
Total loans charged-off	3,051		5,587	
Recoveries of loans previously charged-off				
Mortgage	1,741		1,047	
Commercial	1,497		2,472	
Installment	967		1,100	
Total recoveries	4,205		4,619	
Net loans charged-off (recovered)	(1,154)		968	
Reclassification to loans held for sale	-		59	
Additions (deductions) included in operations	1,199	475	(1,309)	(2)
Balance at end of year	\$ 22,587	\$ 1,125	\$ 20,234	\$ 650
Net loans charged-off as a percent of average loans outstanding (includes loans held for sale) for the year	(0.06)%		0.06%	
Allowance for loan losses as a percent of loans outstanding (includes loans held for sale) at the end of the year	1.10		1.21	

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

Further discussion of the provision and allowance for loan losses (a critical accounting policy) as well as non-performing loans, is presented in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference.

IV. SUMMARY OF LOAN LOSS EXPERIENCE (Continued)

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

	2020		2019		2018	
	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans
	(dollars in thousands)					
Commercial	\$ 7,401	44.0%	\$ 7,922	41.7%	\$ 7,090	42.9%
Mortgage	6,998	39.2	8,216	41.8	7,978	42.3
Installment	1,112	16.8	1,283	16.5	895	14.8
Payment plan receivables	-	-	-	-	-	-
Subjective allocation	19,918	-	8,727	-	8,925	-
Total	\$ 35,429	100.0%	\$ 26,148	100.0%	\$ 24,888	100.0%

	2017		2016	
	Allowance for Loan Losses Amount	Percent of Loans to Total Loans	Allowance for Loan Losses Amount	Percent of Loans to Total Loans
	(dollars in thousands)			
Commercial	\$ 5,595	41.5%	\$ 4,880	48.0%
Mortgage	8,733	43.2	8,681	34.3
Installment	864	15.3	1,011	15.9
Payment plan receivables(a)	-	-	-	1.8
Subjective allocation	7,395	-	5,662	-
Total	\$ 22,587	100.0%	\$ 20,234	100.0%

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

V. DEPOSITS

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

	2020		2019		2018	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
	(dollars in thousands)					
Non-interest bearing deposits	\$ 1,054,230		\$ 867,314		\$ 846,718	
Savings and interest-bearing checking	1,821,115	0.21%	1,453,061	0.70%	1,218,243	0.39%
Time deposits	516,306	1.70	655,718	2.01	632,330	1.55
Total	<u>\$ 3,391,651</u>	<u>0.37%</u>	<u>\$ 2,976,093</u>	<u>0.79%</u>	<u>\$ 2,697,291</u>	<u>0.54%</u>

The following table summarizes time deposits in amounts of 0.10 million or more by time remaining until maturity at December 31, 2020:

(in thousands)	
Three months or less	\$ 62,343
Over three through six months	28,928
Over six months through one year	41,619
Over one year	26,331
Total	<u>\$ 159,221</u>

VI. RETURN ON EQUITY AND ASSETS

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

	2020	2019	2018	2017	2016
Net income as a percent of					
Average shareholders' equity	15.68%	13.63%	12.38%	7.82%	9.21%
Average assets	1.43	1.35	1.27	0.77	0.92
Dividends declared per share as a percent of diluted net income per share	31.62	36.00	35.71	44.21	32.38
Average shareholders' equity as a percent of average assets	9.10	9.90	10.27	9.88	9.98

Additional performance ratios are set forth in Selected Consolidated Financial Data in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference. Any significant changes in the current trend of the above ratios are reviewed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and is incorporated herein by reference.

VII. SHORT-TERM BORROWINGS

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

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

Risk Factors Relating to the COVID-19 Pandemic

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

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

The Governor of Michigan issued her first "stay home, stay safe" executive order effective March 24, 2020. In general, that order and subsequent modifications required individuals in Michigan to stay at home or their place of residence, except for certain specified activities that were deemed necessary to sustain or protect life. That original executive order was amended several times and was later rescinded and replaced entirely by a series of "Safer at Home" executive orders, which generally extended certain social distancing restrictions, but lifted the requirement that individuals remain in their homes. The series of "Safer at Home" orders, along with all other executive orders relating to the pandemic issued by Michigan's Governor after April 30, 2020, were then deemed unconstitutional by the Michigan Supreme Court on October 2, 2020. On October 4, 2020, Michigan's Attorney General announced her office would no longer enforce the Governor's executive orders that were ruled unconstitutional, effective immediately. Since then, the Michigan Department of Health and Human Services (MDHHS) and the Michigan Occupational Safety and Health Administration (MIOSHA) have issued orders imposing restrictions similar to the Governor's former executive orders under authority granted to the MDHHS by the Michigan Public Health Code and to MIOSHA under the Michigan Occupational Safety and Health Act – different statutes than the law on which the Governor based her executive orders. Under the MDHHS and MIOSHA orders, social distancing and gathering restrictions remain in place; however, certain retail operations, restaurants and bars, and other businesses are permitted to conduct in-person operations, subject to capacity limitations and other workplace safety requirements. The degree to which businesses may resume operations varies based on the type of business operations being conducted. It is currently expected that various forms of state and local government restrictions similar to those described above will continue for the foreseeable future. As a result of these events, Michigan has experienced a significant increase in unemployment.

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

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

These factors may continue for a significant period of time.

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

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

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

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), was signed into law which included a \$349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. PPP loans are eligible for forgiveness, subject to numerous limitations. The Bank is participating as a lender in the PPP. The PPP opened on April 3, 2020; however, because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there is some ambiguity in the laws, rules and guidance regarding the operation of the PPP, which exposes us to potential risks relating to noncompliance with the PPP. Since then, the SBA and U.S. Department of Treasury have provided additional guidance and clarity on the PPP through the issuance of over 20 interim final rules implementing the PPP. On or about April 16, 2020, the SBA notified lenders that the \$349 billion earmarked for the PPP was exhausted. The PPP was then expanded by the Paycheck Protection Program and Health Care Enhancement Act in late April 2020, adding an additional \$310 billion in funding while the Paycheck Protection Program Flexibility Act made certain changes to the PPP by allowing for more time to spend the funds and making it easier to get a loan fully forgiven. The PPP initially closed on August 8, 2020. On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (“Economic Aid Act”) was signed into law which allocates an additional \$284 billion in funding for the PPP. The Economic Aid Act reopens the PPP through March 31, 2021 with generally the same terms and conditions as originally enacted under the CARES Act while clarifying eligibility and ineligibility for certain entities and expanding the permitted uses of PPP funds. In addition, the Economic Aid Act simplifies the loan forgiveness process for PPP loans of \$150,000 or less. The Economic Aid Act also establishes second draw loans for entities that have already used the initial PPP funds, subject to numerous limitations and eligibility criteria. PPP second draw loans are eligible for forgiveness similar to initial PPP loans, subject to limitations set forth in the Economic Aid Act.

As of December 31, 2020, we had 1,483 initial PPP loans outstanding with a total balance of \$169.8 million. As of December 31, 2020, we had 808 forgiveness applications for initial PPP loans totaling \$123.0 million that remained pending. We had no PPP second draw loans outstanding as of December 31, 2020.

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

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

Risk Factors Relating to the Financial Services Industry

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

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

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

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

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

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

The soundness of other financial institutions could adversely affect us.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Methods of reducing risk exposures might not be effective.

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

Risk Factors More Specific to Our Business

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

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

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

Our loan customers may not repay their loans according to their respective terms, and the collateral securing the payment of these loans may be insufficient to cover any losses we may incur. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. Non-performing loans amounted to \$7.9 million and \$9.5 million at December 31, 2020 and December 31, 2019, respectively. Our allowance for loan losses coverage ratio of non-performing loans was 450.01% and 274.32% at December 31, 2020 and December 31, 2019, respectively. In determining the size of the allowance for loan losses, we rely on our experience and our evaluation of current economic conditions. If our assumptions or judgments prove to be incorrect, our current allowance for loan losses may not be sufficient to cover certain loan losses inherent in our loan portfolio, and adjustments may be necessary to account for different economic conditions or adverse developments in our loan portfolio. Material additions to our allowance for loan losses would adversely impact our operating results.

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

We have credit risk in our securities portfolio.

We maintain diversified securities portfolios, which include obligations of the Treasury and government-sponsored agencies as well as securities issued by states and political subdivisions, mortgage-backed securities, corporate securities and asset-backed securities. We seek to limit credit losses in our securities portfolios by principally purchasing highly rated securities (generally rated "AA" or higher by a major debt rating agency) and by conducting due diligence on the issuer. However, gross unrealized losses on securities available for sale in our portfolio totaled approximately \$1.4 million as of December 31, 2020 (compared to approximately \$1.1 million as of December 31, 2019). We believe these unrealized losses are temporary in nature and are expected to be recovered within a reasonable time period as we believe we have the ability to hold the securities to maturity or until such time as the unrealized losses reverse. However, we evaluate securities available for sale for other than temporary impairment (OTTI) at least quarterly and more frequently when economic or market concerns warrant such evaluation. Those evaluations may result in OTTI charges to our earnings. In addition to these impairment charges, we may, in the future, experience additional losses in our securities portfolio which may result in charges that could materially adversely affect our results of operations.

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

A portion of our revenues are derived from net gains on mortgage loans. These net gains primarily depend on the volume of loans we sell, which in turn depends on our ability to originate real estate mortgage loans and the demand for fixed-rate obligations and other loans that are outside of our established interest-rate risk parameters. Net gains on mortgage loans are also dependent upon economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates. Consequently, they can often be a volatile part of our overall revenues. We realized net gains of \$62.6 million on mortgage loans during 2020 compared to \$20.0 million during 2019 and \$10.6 million during 2018.

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

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

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

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

Compliance with new capital requirements may adversely affect us.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our ability to retain key officers and employees may change.

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

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

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

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

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

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

We have identified certain accounting policies as being critical because they require us to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. We have established detailed policies and control procedures that are intended to ensure these critical accounting estimates and judgments are subject to internal controls and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding management's judgments and the estimates pertaining to these matters, we cannot guarantee that we will not be required to adjust accounting policies or restate prior period financial statements. See note #1, "Accounting Policies" in the Notes to Consolidated Financial Statements in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K).

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We and our bank operate a total of 84 facilities in Michigan and three leased facilities in Ohio. We own 61 and lease 23 of the facilities in Michigan.

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

ITEM 3. LEGAL PROCEEDINGS

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

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ADDITIONAL ITEM - EXECUTIVE OFFICERS

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

The following sets forth certain information with respect to our executive officers at February 19, 2021.

Name (Age)	Position	First elected as an executive officer
William B. Kessel (56)	President, Chief Executive Officer and Director	2004
Gavin A. Mohr (37)	Executive Vice President and Chief Financial Officer(1)	2020
Stefanie M. Kimball (61)	Executive Vice President and Chief Risk Officer	2007
Joel Rahn (54)	Executive Vice President and Chief Lending Officer(2)	2021
Larry R. Daniel (57)	Executive Vice President, Operations and Digital Banking (3)	2017
Patrick J. Ervin (55)	Executive Vice President, Mortgage Banking (4)	2017
James J. Twarozynski (55)	Senior Vice President, Controller	2002

- (1) Mr. Mohr joined Independent Bank in September 2020, as Executive Vice President and Chief Financial Officer. Prior to joining Independent Bank, Mr. Mohr served as the Chief Financial Officer of STAR Financial Bank, (“STAR”), a \$2.1 billion bank, located in Fort Wayne, Indiana. Prior to joining STAR, Mr. Mohr served as Treasurer of Yadkin Bank and Trust (Statesville, North Carolina) from 2013 to 2014.
- (2) Mr. Rahn joined Independent Bank in April of 2018 as Senior Vice President Commercial Lending. He was promoted to Executive Vice President and Chief Lending Officer in January, 2021. He has 33 years of commercial banking experience and has served in senior leadership positions for the past 16 years.
- (3) Mr. Daniel joined Independent Bank over 20 years ago as a commercial lender. Prior to being named Executive Vice President – Operations and Digital Banking in November 2017, he served as Senior Vice President of Retail and Mortgage Lending at Independent Bank, a position he held since 2012.
- (4) Mr. Ervin joined Independent Bank in August 2016, as Senior Vice President – Mortgage Banking. He was promoted to Executive Vice President – Mortgage Banking in November 2017. Prior to joining Independent Bank, Mr. Ervin served as Executive Managing Director Mortgage Banking and Servicing at Talmer Bank and Trust, a position he held since 2009.

PART II.

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

The information set forth under the caption "Quarterly Summary" in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

We maintain a Deferred Compensation and Stock Purchase Plan for Non-Employee Directors (the "Plan") pursuant to which non-employee directors can elect to receive shares of our common stock in lieu of fees otherwise payable to the director for his or her service as a director. A director can elect to receive shares on a current basis or to defer receipt of the shares, in which case the shares are issued to a trust to be held for the account of the director and then generally distributed to the director after his or her retirement from the Board. Pursuant to this Plan, during the fourth quarter of 2020, we issued 656 shares of common stock to non-employee directors on a current basis and 6,717 shares of common stock to the trust for distribution to directors on a deferred basis. These shares were issued on October 1, 2020 and November 20, 2020 representing aggregate fees of \$0.09 million. The shares on a current basis were issued at a price of \$12.57 per share and the shares on a deferred basis were issued at a price of \$11.61 per share, representing 90% of the fair value of the shares on the credit date. The price per share was the consolidated closing bid price per share of our common stock as of the date of issuance, as determined in accordance with NASDAQ Marketplace Rules. We issued the shares pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the issuance of the shares was made on a private basis pursuant to the Plan.

ISSUER PURCHASES OF EQUITY SECURITIES

The following table shows certain information relating to purchases of common stock for the three-months ended December 31, 2020:

Period	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan(2)	Remaining Number of Shares Authorized for Purchase Under the Plan
October 2020	1,885	\$ 14.19	-	441,071
November 2020	32,459	\$ 15.02	30,027	411,044
December 2020	1,588	\$ 18.80	-	-
Total	35,932	\$ 15.15	30,027	-

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

(2) These shares were repurchased pursuant to a share repurchase plan announced on December 17, 2019, which authorized the repurchase of up to 1,120,000 shares of our outstanding common stock during 2020.

The share repurchase plan we had in place for 2020 expired on December 31, 2020. On December 15, 2020, we announced the adoption by our Board of Directors of a 2021 share repurchase plan that authorizes the repurchase during 2021 of up to 1,100,000 shares of our outstanding common stock.

ITEM 6. SELECTED FINANCIAL DATA

The information set forth under the caption "Selected Consolidated Financial Data" in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

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

The information set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Asset/liability management" in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements and the independent auditor's report are set forth in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), and are incorporated herein by reference.

Management's Annual Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition at December 31, 2020 and 2019

Consolidated Statements of Operations for the years ended December 31, 2020, 2019 and 2018

Consolidated Statements of Comprehensive Income for the years ended December 31, 2020, 2019 and 2018

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2020, 2019 and 2018

Consolidated Statements of Cash Flows for the years ended December 31, 2020, 2019 and 2018

Notes to Consolidated Financial Statements

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (continued)

The supplementary data required by this item set forth under the caption "Quarterly Financial Data (Unaudited)" in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

The portions of our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), which are not specifically incorporated by reference as part of this Form 10-K are not deemed to be a part of this report.

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

None

ITEM 9A. CONTROLS AND PROCEDURES

1. Evaluation of Disclosure Controls and Procedures. With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15e and 15d – 15e) as of the year ended December 31, 2020 (the "Evaluation Date"), have concluded that, as of such date, our disclosure controls and procedures were effective.
2. Internal Control Over Financial Reporting. "Management's Annual Report on Internal Control Over Financial Reporting" and our independent registered public accounting firm's audit of internal control over financial reporting as of December 31, 2020 included within the "Report of Independent Registered Public Accounting Firm," each as set forth in our annual report, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K) are incorporated herein by reference.

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

DIRECTORS - The information with respect to our directors set forth under the caption "Proposal I Submitted for Your Vote -- Election of Directors" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

BENEFICIAL OWNERSHIP REPORTING – The information set forth under the caption "Delinquent Section 16(a) Reports" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

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

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

CORPORATE GOVERNANCE – Information relating to our audit committee, set forth under the caption "Board Committees and Functions" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information set forth under the captions "Executive Compensation," "Director Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

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

The information set forth under the captions "Voting Securities and Record Date", "Proposal I Submitted for Your Vote -- Election of Directors" and "Securities Ownership of Management" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

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

The following sets forth certain information regarding our equity compensation plans as of December 31, 2020.

<u>Plan Category</u>	<u>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>(b) Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
Equity compensation plans approved by security holders	<u>121,189</u>	<u>\$ 4.81</u>	<u>435,526</u>
Equity compensation plan not approved by security holders	None	N/A	<u>147,992</u>

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

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

The information set forth under the captions "Transactions Involving Management" and "Determination of Independence of Board Members" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information set forth under the caption "Disclosure of Fees Paid to our Independent Auditors" in our definitive proxy statement, to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders, is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Financial Statements

All of our financial statements are incorporated herein by reference as set forth in the annual report to be delivered to shareholders in connection with the April 20, 2021 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K.)

2. Exhibits (Numbered in accordance with Item 601 of Regulation S-K)

The Exhibit Index is located below.

EXHIBIT INDEX

Exhibit number and description

EXHIBITS FILED HEREWITH

13	Annual report, relating to the April 20, 2021 Annual Meeting of Shareholders. This annual report will be delivered to our shareholders in compliance with Rule 14(a)-3 of the Securities Exchange Act of 1934, as amended.
21	List of Subsidiaries.
23	Consent of Independent Registered Public Accounting Firm (Crowe LLP).
24	Power of Attorney (included on page 37).
31.1	Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover page interactive data file (formatted as inline XBRL and contained in Exhibit 101)

EXHIBITS INCORPORATED BY REFERENCE

3.1	Restated Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to our quarterly report on Form 10-Q filed November 3, 2017).
3.2	Amended and Restated Bylaws (incorporated here by reference to Exhibit 3.2 to our annual report on Form 10-K filed March 7, 2017).
4.1	Description of Registrant's Common Stock (incorporated here by reference to Exhibit 4 to our annual report on Form 10-K filed March 6, 2020).
4.2	Form of 5.95% Fixed-to-Floating Rate Subordinated Note due 2030 (included as Exhibit A to the Form of Subordinated Note Purchase Agreement filed as Exhibit 10.8 to this Annual Report on Form 10-K).
10.1*	The form of Indemnity Agreement, as executed with all of the directors of the registrant (incorporated herein by reference to Exhibit 10.3 to the Form S-4 we filed on December 29, 2017).
10.2*	The form of Management Continuity Agreement as executed with executive officers and certain senior managers (incorporated herein by reference to Exhibit 10.4 to the Form S-4 we filed on December 29, 2017).
10.3*	Long-Term Incentive Plan, as amended through January 24, 2017 (incorporated herein by reference to Appendix A to our proxy statement filed on Schedule 14A on March 7, 2017).

- [10.4*](#) Amended and Restated Deferred Compensation and Stock Purchase Plan for Nonemployee Directors, as amended through March 19, 2019 (incorporated herein by reference to Exhibit 10.1 to our quarterly report on Form 10-Q filed May 3, 2019).
- [10.5*](#) Form of Restricted Stock Unit Grant Agreement as executed with certain executive officers (incorporated herein by reference to Exhibit 10.2 to our quarterly report on Form 10-Q filed May 9, 2011).
- [10.6*](#) Form of TSR Performance Share Award Agreement as executed with certain executive officers (incorporated herein by reference to Exhibit 10.12 to our annual report on Form 10-K filed March 7, 2014).
- [10.7*](#) Summary of Independent Bank Corporation Management Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.10 to our annual report on Form 10-K filed March 6, 2015).
- [10.8](#) Form of Subordinated Note Purchase Agreement dated May 27, 2020, by and among Independent Bank Corporation and the Purchasers (incorporated here by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on May 27, 2020).

* Represents a compensation plan.

ITEM 16. FORM 10-K SUMMARY

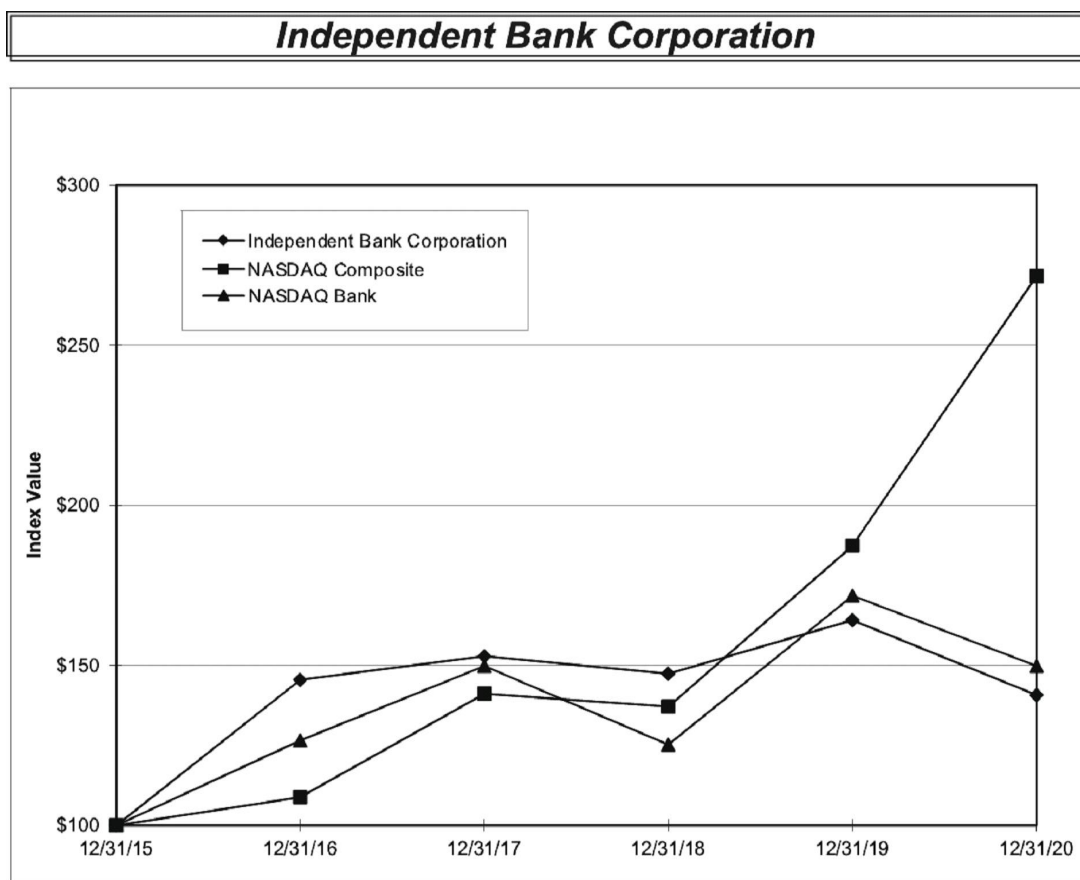
Not applicable.



Performance Graph	10
Selected Consolidated Financial Data	11
Management’s Discussion and Analysis of Financial Condition and Results of Operations	12
Management’s Annual Report on Internal Control Over Financial Reporting	36
Report of Independent Registered Public Accounting Firm	37
Consolidated Financial Statements	39
Notes to Consolidated Financial Statements.	44
Quarterly Data	104

PERFORMANCE GRAPH

The graph below compares the total returns (assuming reinvestment of dividends) of Independent Bank Corporation common stock, the NASDAQ Composite Index and the NASDAQ Bank Stock Index. The graph assumes \$100 invested in Independent Bank Corporation common stock (returns based on stock prices per the NASDAQ) and each of the indices on December 31, 2015, and the reinvestment of all dividends during the periods presented. The performance shown on the graph is not necessarily indicative of future performance.



Index	Period ending					
	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20
Independent Bank Corporation	100.00	145.53	152.84	147.40	164.21	140.76
NASDAQ Composite	100.00	108.87	141.13	137.12	187.44	271.64
NASDAQ Bank	100.00	126.54	149.82	125.25	171.82	149.83

SELECTED CONSOLIDATED FINANCIAL DATA

	Year Ended December 31,				
	2020	2019	2018	2017	2016
	(Dollars in thousands, except per share amounts)				
SUMMARY OF OPERATIONS					
Interest income	\$ 139,829	\$ 148,928	\$ 130,773	\$ 98,309	\$ 86,523
Interest expense	16,217	26,347	17,491	9,123	6,882
Net interest income	123,612	122,581	113,282	89,186	79,641
Provision for loan losses	12,463	824	1,503	1,199	(1,309)
Net gains on securities	267	307	138	260	563
Other non-interest income	80,478	47,429	44,677	42,273	41,735
Non-interest expense	122,413	111,733	107,461	92,082	90,347
Income before income tax	69,481	57,760	49,133	38,438	32,901
Income tax expense	13,329	11,325	9,294	17,963	10,135
Net income	<u>\$ 56,152</u>	<u>\$ 46,435</u>	<u>\$ 39,839</u>	<u>\$ 20,475</u>	<u>\$ 22,766</u>
PER COMMON SHARE DATA					
Net income per common share					
Basic	\$ 2.56	\$ 2.03	\$ 1.70	\$ 0.96	\$ 1.06
Diluted	2.53	2.00	1.68	0.95	1.05
Cash dividends declared and paid	0.80	0.72	0.60	0.42	0.34
Book Value	17.82	15.58	14.38	12.42	11.71
SELECTED BALANCES					
Assets	\$ 4,204,013	\$ 3,564,694	\$ 3,353,281	\$ 2,789,355	\$ 2,548,950
Loans	2,733,678	2,725,023	2,582,520	2,018,817	1,608,248
Allowance for loan losses	35,429	26,148	24,888	22,587	20,234
Deposits	3,637,355	3,036,727	2,913,428	2,400,534	2,225,719
Shareholders' equity	389,522	350,169	338,994	264,933	248,980
Other borrowings	30,012	88,646	25,700	54,600	9,433
Subordinated debt	39,281	—	—	—	—
Subordinated debentures	39,524	39,456	39,388	35,569	35,569
SELECTED RATIOS					
Net interest income to average interest earning assets	3.34%	3.80%	3.88%	3.65%	3.52%
Net income to					
Average shareholders' equity	15.68	13.63	12.38	7.82	9.21
Average assets	1.43	1.35	1.27	0.77	0.92
Average shareholders' equity to average assets	9.10	9.90	10.27	9.88	9.98
Tier 1 capital to average assets	9.15	10.11	10.47	10.57	10.50
Non-performing loans to Portfolio Loans	0.29	0.35	0.33	0.39	0.75

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

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

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business including the impact of the ongoing COVID-19 pandemic on each of these items;
- economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our bank operates including the economic impact of the ongoing COVID-19 pandemic in each of these areas;
- the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;
- increased competition in the financial services industry, either nationally or regionally;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- the continued services of our management team; and
- implementation of new legislation, which may have significant effects on us and the financial services industry.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report, but the list is not intended to be all-inclusive. The risk factors disclosed in Part I – Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2020, as updated by any new or modified risk factors disclosed in Part II – Item 1A of any subsequently filed Quarterly Report on Form 10-Q, include the primary risks our management believes could materially affect the results described by forward-looking statements in this report. However, those risks are not the only risks we face. Our results of operations, cash flows, financial position, and prospects could also be materially and adversely affected by additional factors that are not presently known to us, that we currently consider to be immaterial, or that develop after the date of this report. We cannot assure you that our future results will meet expectations. While we believe the forward-looking statements in this report are reasonable, you should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. We do not undertake, and expressly disclaim, any obligation to update or alter any statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

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

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

Significant Developments. On April 1, 2018, TCSB was merged with and into IBCP, with IBCP as the surviving corporation (the “Merger”). In connection with the Merger, on April 1, 2018, IBCP consolidated Traverse City State Bank, TCSB’s wholly-owned subsidiary bank, with and into Independent Bank (with Independent Bank as the surviving institution). See note #26 to the Consolidated Financial Statements.

On March 11, 2020, the World Health Organization declared COVID-19, the disease caused by the novel coronavirus, a pandemic as a result of the global spread of the coronavirus illness. In response to the outbreak, federal and state authorities in the U.S. introduced various measures to try to limit or slow the spread of the virus, including travel restrictions, nonessential business closures, stay-at-home orders, and strict social distancing. The Governor of Michigan issued her first “stay home, stay safe” executive order effective March 24, 2020. In general, that order and subsequent modifications required individuals in Michigan to stay at home or their place of residence, except for certain specified activities that were deemed necessary to sustain or protect life. That original executive order was amended several times and was later rescinded and replaced entirely by a series of “Safer at Home” executive orders, which generally extended certain social distancing restrictions, but lifted the requirement that individuals remain in their homes. The series of “Safer at Home” orders, along with all other executive orders relating to the pandemic issued by Michigan’s Governor after April 30, 2020, were then deemed unconstitutional by the Michigan Supreme Court on October 2, 2020. On October 4, 2020, Michigan’s Attorney General announced her office would no longer enforce the Governor’s executive orders that were ruled unconstitutional, effective immediately. Since then, the Michigan Department of Health and Human Services (MDHHS) and the Michigan Occupational Safety and Health Administration (MIOSHA) have issued orders imposing restrictions similar to the Governor’s former executive orders under authority granted to the MDHHS by the Michigan Public Health Code and to MIOSHA under the Michigan Occupational Safety and Health Act – different statutes than the law on which the Governor based her executive orders. Under the MDHHS and MIOSHA orders, social distancing and gathering restrictions remain in place; however, certain retail operations, restaurants and bars, and other businesses are permitted to conduct in-person operations, subject to capacity limitations and other workplace safety requirements. The degree to which businesses may resume operations varies based on the type of business operations being conducted. It is currently expected that various forms of state and local government restrictions similar to those described above will continue for the foreseeable future. As a result of these events, Michigan has experienced a significant increase in unemployment.

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

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

These factors may continue for a significant period of time.

The spread of COVID-19 has caused us to modify many of our business practices. Currently, approximately 40% of our total employees are working remotely. We have also expanded sick and vacation time for certain employees. We may take further actions as may be required or as we determine to be prudent. There is no certainty that such measures will be sufficient to mitigate the risks posed by COVID-19.

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

It is against this backdrop that we discuss our results of operations and financial condition in 2020 as compared to earlier periods.

RESULTS OF OPERATIONS

Summary. We recorded net income of \$56.2 million, or \$2.53 per diluted share, in 2020, net income of \$46.4 million, or \$2.00 per diluted share, in 2019, and net income of \$39.8 million, or \$1.68 per diluted share, in 2018.

KEY PERFORMANCE RATIOS

	Year Ended December 31,		
	2020	2019	2018
Net income to			
Average shareholders' equity	15.68%	13.63%	12.38%
Average assets	1.43	1.35	1.27
Net income per common share			
Basic	\$ 2.56	\$ 2.03	\$ 1.70
Diluted	2.53	2.00	1.68

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

Net interest income totaled \$123.6 million during 2020, compared to \$122.6 million and \$113.3 million during 2019 and 2018, respectively. The increase in net interest income in 2020 compared to 2019 primarily reflects a \$483.8 million increase in average interest-earning assets that was partially offset by a 46 basis point decrease in our tax equivalent net interest income as a percent of average interest-earning assets (the "net interest margin").

The increase in net interest income in 2019 compared to 2018 primarily reflects a \$302.1 million increase in average interest-earning assets that was partially offset by an eight basis point decrease in our net interest margin.

The increase in average interest-earning assets during 2020 primarily reflects an increase in securities available for sale and interest bearing deposits. The significant increases in these balances is primarily due to the deployment of funds from a substantial increase in deposits. The decrease in the net interest margin during 2020 as compared to 2019 primarily reflects reductions in short-term interest rates as well a flattening of the yield curve.

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

Interest and fees on loans in 2020 include \$5.6 million of accretion of net loan fees on Payroll Protection Program ("PPP") loans. No such accretion is included in the comparable prior year periods.

Interest expense in 2020 included \$1.6 million of accelerated amortization of deferred loss on certain derivative financial instruments that were de-designated. No such amortization is included in the comparable prior year periods. See note #16 to the Consolidated Financial Statements for discussion regarding these derivative financial instruments.

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

2020, 2019 and 2018 interest income on loans includes \$1.1 million, \$1.5 million and \$1.7 million, respectively, of accretion of the discount recorded on the TCSB loans acquired in the Merger.

Our net interest income is also impacted by our level of non-accrual loans. Average non-accrual loans totaled \$11.2 million, \$8.1 million and \$8.4 million in 2020, 2019 and 2018, respectively.

AVERAGE BALANCES AND RATES

	2020			2019			2018		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
(Dollars in thousands)									
ASSETS									
Taxable loans	\$ 2,863,846	\$ 122,875	4.29%	\$ 2,713,690	\$ 133,574	4.92%	\$ 2,418,421	\$ 116,634	4.82%
Tax-exempt loans ⁽¹⁾	7,145	360	5.04	7,937	391	4.93	6,118	292	4.77
Taxable securities	635,914	12,655	1.99	397,598	11,842	2.98	394,160	10,874	2.76
Tax-exempt securities ⁽¹⁾	137,330	3,673	2.67	52,324	1,683	3.22	67,574	2,192	3.24
Interest bearing cash	59,056	184	0.31	48,023	818	1.70	32,593	371	1.14
Other investments	18,410	905	4.92	18,359	1,043	5.68	16,936	920	5.43
Interest earning assets	3,721,701	140,652	3.78	3,237,931	149,351	4.61	2,935,802	131,283	4.48
Cash and due from banks	49,886			37,575			33,384		
Other assets, net	162,068			164,726			162,750		
Total assets	\$ 3,933,655			\$ 3,440,232			\$ 3,131,936		
LIABILITIES									
Savings and interest-bearing checking	\$ 1,821,115	3,882	0.21	\$ 1,453,061	10,228	0.70	\$ 1,218,243	4,696	0.39
Time deposits	516,306	8,784	1.70	655,718	13,197	2.01	632,330	9,782	1.55
Other borrowings	117,904	3,551	3.01	77,254	2,922	3.78	79,519	3,013	3.79
Interest bearing liabilities	2,455,325	16,217	0.66	2,186,033	26,347	1.21	1,930,092	17,491	0.91
Non-interest bearing deposits	1,054,230			867,314			846,718		
Other liabilities	65,943			46,153			33,354		
Shareholders' equity	358,157			340,732			321,772		
Total liabilities and shareholders' equity	\$ 3,933,655			\$ 3,440,232			\$ 3,131,936		
Net interest income		\$ 124,435			\$ 123,004			\$ 113,792	
Net interest income as a percent of average interest earning assets			3.34%			3.80%			3.88%

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

RECONCILIATION OF NET INTEREST MARGIN, FULLY TAXABLE EQUIVALENT (“FTE”)

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Net interest income	\$ 123,612	\$ 122,581	\$ 113,792
Add: taxable equivalent adjustment	823	423	510
Net interest income - taxable equivalent	\$ 124,435	\$ 123,004	\$ 113,792
Net interest margin (GAAP)	3.32%	3.79%	3.85%
Net interest margin (FTE)	3.34%	3.80%	3.88%

CHANGE IN NET INTEREST INCOME

	2020 compared to 2019			2019 compared to 2018		
	Volume	Rate	Net	Volume	Rate	Net
	(In thousands)					
Increase (decrease) in interest income ⁽¹⁾						
Taxable loans	\$ 7,105	\$ (17,804)	\$ (10,699)	\$ 14,491	\$ 2,449	\$ 16,940
Tax-exempt loans ⁽²⁾	(40)	9	(31)	89	10	99
Taxable securities	5,582	(4,769)	813	96	872	968
Tax-exempt securities ⁽²⁾	2,318	(328)	1,990	(491)	(18)	(509)
Interest bearing cash	154	(788)	(634)	218	229	447
Other investments	3	(141)	(138)	80	43	123
Total interest income	15,122	(23,821)	(8,699)	14,483	3,585	18,068
Increase (decrease) in interest expense ⁽¹⁾						
Savings and interest bearing checking	2,109	(8,455)	(6,346)	1,047	4,485	5,532
Time deposits	(2,555)	(1,858)	(4,413)	374	3,041	3,415
Other borrowings	1,311	(682)	629	(86)	(5)	(91)
Total interest expense	865	(10,995)	(10,130)	1,335	7,521	8,856
Net interest income	\$ 14,257	\$ (12,826)	\$ 1,431	\$ 13,148	\$ (3,936)	\$ 9,212

(1) The change in interest due to changes in both balance and rate has been allocated to change due to balance and change due to rate in proportion to the relationship of the absolute dollar amounts of change in each.

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

COMPOSITION OF AVERAGE INTEREST EARNING ASSETS AND INTEREST BEARING LIABILITIES

	Year Ended December 31,		
	2020	2019	2018
As a percent of average interest earning assets			
Loans	77.1%	84.1%	82.6%
Other interest earning assets	22.9	15.9	17.4
Average interest earning assets	100.0%	100.0%	100.0%
Savings and interest-bearing checking	48.9%	44.9%	41.5%
Time deposits	13.9	20.3	21.5
Other borrowings	3.2	2.3	2.7
Average interest bearing liabilities	66.0%	67.5%	65.7%
Earning asset ratio	94.6%	94.1%	93.7%
Free-funds ratio ⁽¹⁾	34.0	32.5	34.3

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

Provision for loan losses. We have elected to delay the adoption of the Current Expected Credit Losses (“CECL”) accounting standard as permitted by Section 4014 of the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, as amended and continue to utilize the existing incurred loss impairment methodology to calculate our allowance for loan losses (“AFL”) and our provision for loan losses. See note #1 to the Consolidated Financial Statements for our discussion on CECL implementation.

The provision for loan losses was an expense of \$12.5 million, \$0.8 million and \$1.5 million in 2020, 2019 and 2018, respectively. The provision reflects our assessment of the AFL) taking into consideration factors such as loan growth, loan mix, levels of non-performing and classified loans and loan net charge-offs. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors. In particular, the credit impact of the COVID-19 pandemic, and more specifically the periodic closing of various segments of the economy in order to contain it, may have a negative impact on our level of non-performing loans and assets in the future, but as of yet, the magnitude of that impact is uncertain. As a result of this potential adverse impact, we have increased the subjective portion of our AFL) by \$11.2 million (or 128.3%) in 2020 compared to 2019. See “Portfolio Loans and asset quality” for a discussion of the various components of the AFL) and their impact on the provision for loan losses in 2020.

Non-interest income. Non-interest income is a significant element in assessing our results of operations. Non-interest income totaled \$80.7 million during 2020 compared to \$47.7 million and \$44.8 million during 2019 and 2018, respectively.

NON-INTEREST INCOME

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Interchange income	\$ 11,230	\$ 10,297	\$ 9,905
Service charges on deposit accounts	8,517	11,208	12,258
Net gains on assets			
Mortgage loans	62,560	19,978	10,597
Securities	267	307	138
Mortgage loan servicing, net	(9,350)	(3,336)	3,157
Investment and insurance commissions	1,971	1,658	1,971
Bank owned life insurance	910	1,111	970
Other	4,640	6,513	5,819
Total non-interest income	\$ 80,745	\$ 47,736	\$ 44,815

Interchange income totaled \$11.2 million in 2020 compared to \$10.3 million in 2019 and \$9.9 million in 2018. The increases in interchange income is primarily due to increased transaction volume.

Service charges on deposit accounts totaled \$8.5 million in 2020, as compared to \$11.2 million in 2019 and \$12.3 million during 2018. These yearly variations primarily reflect declines in non-sufficient funds fees. During 2020, non-sufficient funds fees were also impacted by contracted consumer spending and government stimulus payments related to COVID-19.

We realized net gains of \$62.6 million on mortgage loans during 2020, compared to \$20.0 million and \$10.6 million during 2019 and 2018 respectively. Mortgage loan activity is summarized as follows:

MORTGAGE LOAN ACTIVITY

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Mortgage loans originated	\$ 1,820,697	\$ 1,011,141	\$ 807,408
Mortgage loans sold ⁽¹⁾	1,447,031	738,910	491,798
Net gains on mortgage loans	62,560	19,978	10,597
Net gains as a percent of mortgage loans sold (“Loan Sales Margin”)	4.32%	2.70%	2.15%
Fair value adjustments included in the Loan Sales Margin	0.47	0.22	(0.02)

(1) 2020 includes the securitization of \$26.3 million of portfolio residential fixed rate loans and the sale of \$2.4 million of portfolio residential fixed rate mortgage loans. 2019 includes the sale of \$50.5 million of portfolio residential fixed and adjustable rate mortgage loans to other institutions and securitization of \$65.1 million of portfolio residential fixed rate loans. 2018 includes the sale of \$27.6 million of portfolio residential fixed and adjustable rate portfolio mortgage loans to another financial institution and securitization of \$10.9 million of portfolio residential fixed rate loans.

The increase in mortgage loan originations, sales and net gains in 2020 as compared to 2019 and 2018 is due primarily to lower interest rates in 2020 that have spurred a significant increase in refinance volumes. Mortgage loans sold also increased in 2020 compared to 2019 and 2018 due to a higher mix of salable loans in our origination volumes. Net gains on mortgage loans also increased in 2020 as compared to 2019 and 2018 due to fair value adjustments as discussed below.

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

Our Loan Sales Margin is impacted by several factors including competition and the manner in which the loan is sold. Net gains on mortgage loans are also impacted by recording fair value accounting adjustments. Excluding these fair value accounting adjustments, the Loan Sales Margin would have been 3.85% in 2020, 2.48% in 2019 and 2.17% in 2018. The increase in the Loan Sales Margin (excluding fair value adjustments) in 2020 was generally due to a substantial widening of primary-to-secondary market pricing spreads as market interest rates fell during 2020 and mortgage loan refinance volumes dramatically increased. Once mortgage loan refinance volumes abate, we would expect our Loan Sales Margin to decline to more normal levels. The changes in the fair value accounting adjustments are primarily due to changes in the amount of commitments to originate mortgage loans for sale during each year. In addition, in 2018, we recorded a loss on mortgage loans of \$0.25 million in the fourth quarter on the pending sale of approximately \$41.5 million of portfolio mortgage loans. This sale closed on January 30, 2019.

We generated net gains on securities of \$0.27 million, \$0.31 million and \$0.14 million in 2020, 2019 and 2018, respectively. These net gains were due to the sales of securities and changes in the fair value of equity/trading securities as outlined in the table below. We recorded no net impairment losses in 2020, 2019 or 2018 for other than temporary impairment of securities available for sale.

GAINS AND LOSSES ON SECURITIES

	Year Ended December 31,			
	Proceeds	Gains⁽¹⁾	Losses⁽²⁾	Net
	(In thousands)			
2020	\$ 38,095	\$ 271	\$ 4	\$ 267
2019	68,716	415	108	307
2018	48,736	336	198	138

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

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

Mortgage loan servicing, net, generated a loss of \$9.4 million and \$3.3 million in 2020 and 2019 respectively. Mortgage loan servicing, net, generated earnings of \$3.2 million in 2018. The significant variances in mortgage loan servicing, net are primarily due to changes in the fair value of capitalized mortgage loan servicing rights associated with changes in mortgage loan interest rates and expected future prepayment levels. Mortgage loan servicing, net activity is summarized in the following table:

MORTGAGE LOAN SERVICING ACTIVITY

	<u>2020</u>	<u>2019</u> (In thousands)	<u>2018</u>
Mortgage loan servicing:			
Revenue, net	\$ 6,874	\$ 6,196	\$ 5,480
Fair value change due to price	(10,833)	(6,408)	191
Fair value change due to pay-downs	(5,391)	(3,124)	(2,514)
Total	<u>\$ (9,350)</u>	<u>\$ (3,336)</u>	<u>\$ 3,157</u>

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

CAPITALIZED MORTGAGE LOAN SERVICING RIGHTS

	<u>2020</u>	<u>2019</u> (In thousands)	<u>2018</u>
Balance at January 1,	\$ 19,171	\$ 21,400	\$ 15,699
Originated servicing rights capitalized	13,957	7,303	4,977
Servicing rights acquired	—	—	3,047
Change in fair value	(16,224)	(9,532)	(2,323)
Balance at December 31,	<u>\$ 16,904</u>	<u>\$ 19,171</u>	<u>\$ 21,400</u>

At December 31, 2020, we were servicing approximately \$3.0 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of 3.77% and a weighted average service fee of approximately 25.7 basis points. Remaining capitalized mortgage loan servicing rights at December 31, 2020 totaled \$16.9 million, representing approximately 56.7 basis points on the related amount of mortgage loans serviced for others.

Investment and insurance commissions totaled \$2.0 million in 2020 as compared to \$1.7 million and \$2.0 million in 2019 and 2018. The increase in revenue in 2020 as compared to 2019 was primarily due to higher sales volume and an increase in fee based revenue. The lower level of revenue in 2019 as compared to the prior year was due primarily to lower sales volumes reflecting, in part, changes in and newer personnel in certain markets.

We earned \$0.9 million, \$1.1 million and \$1.0 million in 2020, 2019 and 2018, respectively, on our separate account bank owned life insurance principally as a result of increases in the cash surrender value. Our separate account is primarily invested in agency mortgage-backed securities and managed by a fixed income investment manager. The crediting rate (on which the earnings are based) reflects the performance of the separate account. The total cash surrender value of our bank owned life insurance was \$55.2 million and \$55.7 million at December 31, 2020 and 2019, respectively. The decrease in earnings in 2020 compared to 2019 is due to a decrease in the crediting rate.

Other non-interest income totaled \$4.6 million, \$6.5 million and \$5.8 million in 2020, 2019 and 2018, respectively. Several categories of fees have been reduced in 2020 due to the impact of the COVID-19 pandemic on transaction volumes, including ATM fees. In addition, we have elected to suspend certain electronic banking fees because of the COVID-19 pandemic and the increased need for our customers to access these channels. Fees related to interest rate swaps for commercial loan customers is also lower in 2020 as customers have not felt the need to execute such transactions given the low interest rate environment. The increase in 2019 as compared to 2018 is due primarily to growth in fees related to interest rate swaps for commercial loan customers.

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

Non-interest expense totaled \$122.4 million in 2020, \$111.7 million in 2019, and \$107.5 million in 2018. Performance based compensation and expense related to the core data processing conversion are primarily responsible for the increase in 2020 compared to 2019. Many of the components of non-interest expense increased in 2019 and 2018 due to the Merger. The components of non-interest expense are as follows:

NON-INTEREST EXPENSE

	Year ended December 31,		
	2020	2019	2018
	(In thousands)		
Compensation	\$ 41,517	\$ 41,719	\$ 37,878
Performance-based compensation	19,725	12,066	11,942
Payroll taxes and employee benefits	13,539	13,716	12,258
Compensation and employee benefits	74,781	67,501	62,078
Occupancy, net	8,938	9,013	8,912
Data processing	8,534	8,905	8,262
Furniture, fixtures and equipment	4,089	4,113	4,080
Interchange expense	3,342	3,215	2,702
Communications	3,194	2,947	2,848
Loan and collection	3,037	2,685	2,682
Conversion related expenses	2,586	—	—
Advertising	2,230	2,450	2,155
Legal and professional	2,027	1,814	1,839
FDIC deposit insurance	1,596	685	1,081
Amortization of intangible assets	1,020	1,089	969
Supplies	680	638	689
Branch closure costs	417	—	—
Correspondent bank service fees	395	411	414
Costs related to unfunded lending commitments	263	246	171
Provision for loss reimbursement on sold loans	200	229	10
Net (gains) losses on other real estate and repossessed assets	64	(90)	(672)
Merger related expenses	—	—	3,465
Other	5,020	5,882	5,776
Total non-interest expense	<u>\$ 122,413</u>	<u>\$ 111,733</u>	<u>\$ 107,461</u>

Compensation expense, which is primarily salaries, totaled \$41.5 million, \$41.7 million and \$37.9 million in 2020, 2019 and 2018, respectively. The comparative decrease in 2020 to 2019 is primarily due to an increased level of compensation that was deferred as direct loan origination costs (due to higher loan origination volumes) that was partially offset by salary increases that were predominantly effective on January 1, 2020. The increase in 2019 is primarily due to annual merit based salary increases, the Merger and additional staffing particularly in commercial lending and information technology (including data analytics).

Performance-based compensation expense totaled \$19.7 million, \$12.1 million and \$11.9 million in 2020, 2019 and 2018, respectively. The increase in 2020 as compared to 2019 was due to actual performance relative to the established incentive plan targets as well as \$0.4 million in bonuses paid during the second quarter of 2020 to front-line personnel due to their extraordinary efforts during the COVID-19 pandemic. The increase in 2019 as compared to 2018 was primarily due to an increase in the employee stock ownership plan (“ESOP”) contribution accrual reflecting the aforementioned higher salaries.

We maintain performance-based compensation plans. In addition to commissions and cash incentive awards, such plans include an ESOP and a long-term equity based incentive plan. The amount of expense recognized in 2020, 2019 and 2018 for share-based awards under our long-term equity based incentive plan was \$1.6 million, \$1.6 million and \$1.5 million, respectively. In each of those three years, the Board and Compensation Committee of the Board authorized the grant of restricted stock and performance share awards under the plan.

Payroll taxes and employee benefits expense totaled \$13.5 million, \$13.7 million and \$12.3 million in 2020, 2019 and 2018, respectively. The decrease in 2020 compared to 2019 is due primarily to a decline in health care costs (due to decreased claims in 2020) as well as a \$0.3 million prescription drug rebate received and recorded in the second quarter of 2020 that related to our 2019 plan year. The decrease in 2020 health care claims is due in part to the COVID-19 pandemic that resulted in the closing of many medical and dental facilities except for emergency care during Michigan's "stay home, stay safe" period. The increase in 2019 as compared to 2018 was primarily due to a \$0.3 million increase in payroll taxes, a \$0.5 million increase in health care insurance, a \$0.2 million increase in 401(k) plan employer contributions and a \$0.4 million increase in employee education and employee relations costs. A portion of the increases in 2019 and 2018 was due to the Merger. However, we maintain a self-insured health care plan (with an individual claim stop loss limit) and we experienced a significant rise in claims in 2019 and 2018.

Data processing expenses totaled \$8.5 million, \$8.9 million, and \$8.3 million in 2020, 2019 and 2018, respectively. The comparative decrease in 2020 is primarily due to a cost savings agreement related to core data processing services that was executed in the second quarter of 2020. This expense reduction was partially offset by new software product additions and increased mobile banking costs. The increase in 2019 as compared to 2018 was primarily due to higher mobile banking activity and software costs for new applications in several departments.

Interchange expense, which totaled \$3.3 million, \$3.2 million, and \$2.7 million in 2020, 2019 and 2018, respectively, primarily represents fees paid to our core information systems processor and debit card licensor related to debit card and ATM transactions. The increase in 2020 compared to 2019 was primarily due to increased debit card transaction volume. Increased debit card transaction volumes in 2019 compared to 2018 also contributed to the rise in this expense as well as the addition of a fraud detection service in early 2019.

Communications expense totaled \$3.2 million, \$2.9 million and \$2.8 million in 2020, 2019 and 2018, respectively. The increase in 2020 relative to 2019 is primarily due to mailing costs related to the issuance of new contactless debit cards. The increase in 2019 as compared to 2018 was primarily due to the Merger.

Loan and collection expenses reflect costs related to new lending activity as well as the management and collection of non-performing loans and other problem credits. These expenses totaled \$3.0 million, \$2.7 million and \$2.7 million in 2020, 2019 and 2018, respectively. These costs increased in 2020 due primarily to higher loan origination activity.

Conversion related expenses totaled \$2.6 million in 2020. We are in the process of converting our core data processing system to a new system hosted by a different vendor. These 2020 expenses represent costs incurred for assistance from our existing vendor and fees from consultants who are assisting us in this conversion. We expect to continue to incur these costs through at least the second quarter of 2021. Also see Part II, Item 1A. Risk Factors of our Annual report on Form 10-K.

Advertising expense totaled \$2.2 million, \$2.5 million, and \$2.2 million in 2020, 2019 and 2018, respectively. The decrease in 2020 compared to 2019 is due primarily to the receipt of a \$0.2 million reimbursement from our debit card provider for certain eligible marketing costs that we incurred. The increase in 2019 as compared to 2018 was primarily due to increased outdoor advertising (billboards).

Legal and professional fees totaled \$2.0 million, \$1.8 million, and \$1.8 million in 2020, 2019 and 2018, respectively. The increase in 2020 is due primarily to an increase in title search fees and bank examination fees (due to an increase in our asset size).

The amortization of intangible assets primarily relates to the Merger and branch acquisitions and the related amortization of the deposit customer relationship value, including core deposit value, which was acquired in connection with those transactions. We had remaining unamortized intangible assets of \$4.3 million and \$5.3 million at December 31, 2020 and 2019 respectively. See note #7 to the Consolidated Financial Statements for a schedule of future amortization of intangible assets.

FDIC deposit insurance expense totaled \$1.6 million, \$0.7 million, and \$1.1 million in 2020, 2019 and 2018, respectively. FDIC deposit insurance expense increased in 2020 compared to 2019 due primarily due to the use of our FDIC Small Bank Assessment Credit ("the Assessment Credit") in 2019 as well as an increase in our assessment rate and growth in our total assets. The decrease in 2019 as compared to 2018 was primarily due to the use of the Assessment Credit of approximately \$0.7 million in 2019. We did not have any remaining Assessment Credit to apply against our 2020 FDIC deposit insurance expense.

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

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

The provision for loss reimbursement on sold loans was an expense of \$0.20 million, \$0.23 million and \$0.01 million in 2020, 2019 and 2018, respectively. This provision represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Bank of Indianapolis). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. The reserve for loss reimbursements on sold mortgage loans totaled \$1.0 million and \$0.9 million at December 31, 2020 and 2019, respectively. This reserve is included in accrued expenses and other liabilities in our Consolidated Statements of Financial Condition. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate based upon our prior experience and other assumptions. However, future losses could exceed our current estimate.

Net gains (losses) on other real estate and repossessed assets represent the gain or loss on the sale or additional write downs on these assets subsequent to the transfer of the asset from our loan portfolio. This transfer occurs at the time we acquire the collateral that secured the loan. At the time of acquisition, the other real estate or repossessed asset is valued at fair value, less estimated costs to sell, which becomes the new basis for the asset. Any write-downs at the time of acquisition are charged to the allowance for loan losses. Net loss was \$0.1 million in 2020 compared to net gain of \$0.1 million and \$0.7 million in 2019 and 2018 respectively. The net gain of \$0.7 million in 2018 was primarily due to the sale of a commercial property in the fourth quarter of that year.

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

Other non-interest expenses totaled \$5.0 million, \$5.9 million, and \$5.8 million in 2020, 2019 and 2018, respectively. The decrease in 2020 is primarily due to a decline in travel and entertainment costs due to COVID-19 pandemic related travel restrictions as well as a reduction in deposit account and debit card related fraud costs. The increase in 2019 as compared to 2018 was due to an increase in debit card and check fraud losses.

Income tax expense. We recorded an income tax expense of \$13.3 million, \$11.3 million and \$9.3 million in 2020, 2019 and 2018, respectively. The 2020 increase in tax expense compared to 2019 and 2018 is due to higher taxable income.

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

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

FINANCIAL CONDITION

Summary. Our total assets increased to \$4.20 billion at December 31, 2020, compared to \$3.56 billion at December 31, 2019, primarily due to growth in interest bearing deposits and securities available for sale. Loans, excluding loans held for sale (“Portfolio Loans”), totaled \$2.73 billion at December 31, 2020 and December 31, 2019. Growth in commercial loans of \$75.7 million and installment loans of \$15.9 million were partially offset by a decline in mortgage loans of \$83.0 million. The decline in mortgage loans was due in part to a securitization and/or sale of \$28.7 million of portfolio mortgage loans during the first quarter of 2020 as well as a higher mix of salable loans in our origination volumes. (See “Portfolio Loans and asset quality.”)

Deposits totaled \$3.64 billion at December 31, 2020, compared to \$3.04 billion at December 31, 2019. The \$600.6 million increase in deposits is primarily due to growth in non-interest bearing deposits, savings and interest bearing checking deposits and reciprocal deposits that were partially offset by a decline in time and brokered time deposits.

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

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

Securities. We maintain diversified securities portfolios, which include obligations of U.S. government- sponsored agencies, securities issued by states and political subdivisions, residential and commercial mortgage-backed securities, asset-backed securities, corporate securities, trust preferred securities and foreign government securities (that are denominated in U.S. dollars). We regularly evaluate asset/liability management needs and attempt to maintain a portfolio structure that provides sufficient liquidity and cash flow. Except as discussed below, we believe that the unrealized losses on securities available for sale are temporary in nature and are expected to be recovered within a reasonable time period. We believe that we have the ability to hold securities with unrealized losses to maturity or until such time as the unrealized losses reverse. (See “Asset/liability management.”) Securities available for sale increased by \$553.8 million during 2020, reflecting the deployment of a portion of the funds generated from the growth in deposits.

Our portfolio of securities available for sale is reviewed quarterly for impairment in value. In performing this review, management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates on the market value of the security, and (4) an assessment of whether we intend to sell, or it is more likely than not that we will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. For securities that do not meet these recovery criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income (loss). We recorded no net impairment losses related to other than temporary impairment on securities available for sale in 2020, 2019 or 2018.

SECURITIES

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
	(In thousands)			
Securities available for sale				
December 31, 2020	\$ 1,052,147	\$ 21,416	\$ 1,404	\$ 1,072,159
December 31, 2019	\$ 513,668	5,782	1,050	518,400

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

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

We generally retain loans that may be profitably funded within established risk parameters. (See “Asset/liability management.”) As a result, we may hold adjustable-rate conventional and fixed rate jumbo mortgage loans as Portfolio Loans, while 15- and 30-year fixed-rate non-jumbo mortgage loans are generally sold to mitigate exposure to changes in interest rates. (See “Non-interest income.”) Due primarily to the expansion of our mortgage-banking activities and a change in mix in our mortgage loan originations, we are now originating and putting into Portfolio Loans more fixed rate mortgage loans compared to past periods. These fixed rate mortgage loans generally have terms from 15 to 30 years, do not have prepayment penalties and expose us to more interest rate risk. To date, our interest rate risk profile has not changed significantly. However, we are carefully monitoring this change in the composition of our Portfolio Loans and the impact of potential future changes in interest rates on our changes in market value of portfolio equity and changes in net interest income. (See “Asset/liability management.”). As a result, we may utilize derivatives (interest rate swaps and interest rate caps) to manage interest rate risk and may continue to sell certain fixed rate and adjustable rate jumbo or other mortgage loans in the future.

In 2020 we sold or securitized \$28.7 million of fixed and adjustable rate portfolio mortgage loans. In 2019, we sold or securitized \$75.0 million (excludes the \$40.6 million discussed below) of fixed and adjustable rate portfolio mortgage loans. In 2018, we sold \$27.6 million of fixed and adjustable rate portfolio mortgage loans. In addition, in the fourth quarter of 2018 we reclassified \$41.7 million (fair value of \$41.5 million) of adjustable rate portfolio mortgage loans to held for sale. These loans (which totaled \$40.6 million at the time of sale) were sold to another financial institution on a servicing released basis on January 30, 2019. All of these loan sales/securitizations were non-recourse (other than standard representations and warranties) and were executed primarily for asset/liability management purposes.

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

A short summary of the PPP is as follows:

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

A summary of our participation in the PPP follows:

Paycheck Protection Program Volume

	As of December 31, 2020	
	Amount (#)	Amount
	(Dollars in thousands)	
Closed and outstanding	1,483	\$ 169,782
Loans \$50,000 and under	921	16,878
Forgiveness applications submitted to the SBA	808	122,962
Fees accreted into interest income during the year	n/a	5,557
Unaccreted net fees remaining at year-end	n/a	3,216
Average loan yield for the year	n/a	4.31%

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

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

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

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

A summary of accommodations as of December 31, 2020 follows:

Commercial and Retail Loan COVID-19 Accommodations

Loan Category	Covid-19 Accommodations			% of Total Loans
	Loans (#)	Loans (\$)	Total Loans	
	(Dollars in thousands)			
Commercial	2	\$ 163	\$ 1,242,415	0.0%
Mortgage	134	19,830	1,015,926	2.0
Installment	48	1,412	475,337	0.3
Total	184	\$ 21,405	\$ 2,733,678	0.8%
Mortgage loans serviced for others ⁽¹⁾	288	\$ 42,897	\$ 2,984,088	1.4%

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

Certain industries (such as hotels and restaurants) have been more adversely impacted by the COVID-19 pandemic and related periodic shut downs of our economy. We believe that the following industry concentrations within our commercial loan portfolio represent greater potential risk in the current economic environment. The balances below are as of December 31, 2020.

Commercial and industrial portfolio segment:

- Retail - \$93 million
- Food service - \$55 million
- Hotel - \$44 million

Commercial real estate portfolio segment:

- Retail - \$97 million
- Office - \$67 million
- Multifamily - \$58 million

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

LOAN PORTFOLIO COMPOSITION

	December 31,	
	2020	2019
	(In thousands)	
Real estate ⁽¹⁾		
Residential first mortgages	\$ 792,762	\$ 843,746
Residential home equity and other junior mortgages	138,128	166,735
Construction and land development	232,693	249,747
Other ⁽²⁾	669,150	693,580
Consumer	468,090	448,297
Commercial	429,011	318,504
Agricultural	3,844	4,414
Total loans	<u>\$ 2,733,678</u>	<u>\$ 2,725,023</u>

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

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

NON-PERFORMING ASSETS⁽¹⁾

	December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Non-accrual loans	\$ 8,312	\$ 10,178	\$ 9,029
Loans 90 days or more past due and still accruing interest	—	—	5
Sub total	8,312	10,178	9,034
Less: Government guaranteed loans	439	646	460
Total non-performing loans	7,873	9,532	8,574
Other real estate and repossessed assets	766	1,865	1,299
Total non-performing assets	<u>\$ 8,639</u>	<u>\$ 11,397</u>	<u>\$ 9,873</u>

As a percent of Portfolio Loans

Non-performing loans	0.29%	0.35%	0.33%
Allowance for loan losses	1.30	0.96	0.96
Non-performing assets to total assets	0.21	0.32	0.29
Allowance for loan losses as a percent of non-performing loans	450.01	274.32	290.27

(1) Excludes loans classified as “troubled debt restructured” that are performing.

TROUBLED DEBT RESTRUCTURINGS

	December 31, 2020		
	Commercial	Retail ⁽¹⁾	Total
	(In thousands)		
Performing TDR's	\$ 7,956	\$ 36,385	\$ 44,341
Non-performing TDR's ⁽²⁾	1,148	1,584 ⁽³⁾	2,732
Total	<u>\$ 9,104</u>	<u>\$ 37,969</u>	<u>\$ 47,073</u>

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

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

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

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

Non-performing loans totaled \$7.9 million, \$9.5 million and \$8.6 million at December 31, 2020, 2019 and 2018, respectively. The decrease in 2020 compared to 2019 was primarily due to a \$1.5 million decrease in the residential mortgage loan portfolio segment compared to year-end 2019. Our collection and resolution efforts have generally resulted in a stable trend in non-performing loans. However, the credit impact of the COVID-19 pandemic, and more specifically the periodic, government-mandated closing of various segments of the economy in order to contain it, may have a negative impact on the level of non-performing loans and assets in the future, but as yet, the magnitude of that impact is undeterminable. As a result of this potential adverse impact, we have increased the subjective portion of our allowance for loan losses ("AFL") by \$11.2 million (or 128.2%) during 2020. (See the further discussion of our AFL below.) The increase in non-performing loans in 2019 as compared to 2018 was primarily in the residential mortgage loan portfolio segment that was partially offset by the pay-off or liquidation of non-performing commercial loans.

Non-performing loans exclude performing loans that are classified as troubled debt restructurings ("TDRs"). Performing TDRs totaled \$44.3 million, or 1.6% of total Portfolio Loans, and \$47.6 million, or 1.7% of total Portfolio Loans, at December 31, 2020 and 2019, respectively. The decrease in the amount of performing TDRs during 2020 reflects a decline in mortgage loan TDRs due primarily to payoffs and paydowns.

ORE and repossessed assets totaled \$0.8 million at December 31, 2020, compared to \$1.9 million at December 31, 2019. The decrease in ORE during 2020 reflects the sale of a \$0.6 million commercial property as well as certain other retail properties.

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

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

	December 31,		
	2020	2019	2018
	(In thousands)		
Specific allocations	\$ 5,581	\$ 6,155	\$ 6,310
Other adversely rated commercial loans	1,716	2,502	1,861
Historical loss allocations	8,214	8,764	7,792
Additional allocations based on subjective factors	19,918	8,727	8,925
Total	<u>\$ 35,429</u>	<u>\$ 26,148</u>	<u>\$ 24,888</u>

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

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

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

The AFL increased \$9.28 million to \$35.43 million at December 31, 2020 from \$26.15 million at December 31, 2019 and was equal to 1.30% and 0.96% of total Portfolio Loans at December 31, 2020 and 2019, respectively.

Three of the four components of the AFL outlined above decreased in 2020 compared to 2019. The AFL related to specific loans decreased \$0.6 million in 2020 due primarily to a \$5.3 million decline in the amount such loans. The AFL related to other adversely rated commercial loans decreased \$0.8 million in 2020, primarily due to a decrease in the balance of such loans included in this component to \$37.6 million from \$54.4 million at December 31, 2019. The AFL related to historical losses decreased \$0.6 million in 2020 primarily due to a decrease in the balance of such loans included in this component. The AFL related to subjective factors increased \$11.2 million in 2020. The significant increase in the AFL related to subjective factors is due principally to the economic shock of COVID-19 and various executive orders suspending or restricting certain businesses and operations, the significant increase in unemployment claims, especially in the State of Michigan, and elevated requests for payment relief from our borrowers.

During the first quarter of 2019, we deployed a third-party software solution (we previously used spreadsheet software) to assist in the determination of our AFL. This new third-party software has also assisted us in moving to the expected loss framework that we implemented on January 1, 2021. Although the use of this new third-party software did not have any material impact on our overall AFL, it did result in some classification shifts from the AFL related to subjective factors into the AFL related to historical losses as the new software model allowed us to capture longer historical look-back periods (previously this was being captured in the subjective portion of the AFL).

Two of the four components of the AFLL outlined above increased during 2019. The AFLL related to specific loans decreased \$0.2 million during 2019 due primarily to a \$2.6 million decline in the amount of such loans. The AFLL related to other adversely rated commercial loans increased \$0.6 million during 2019, primarily due to an increase in the balance of such loans included in this component to \$54.4 million at December 31, 2019 from \$44.7 million at December 31, 2018. The increase in other adversely rated commercial loans was primarily in early watch credit categories and these loans are largely performing. The AFLL related to historical losses increased \$1.0 million during 2019, and the AFLL related to subjective factors decreased \$0.2 million during 2019, due in part to the classification shifts discussed above, as well as loan growth, for the AFLL related to historical losses.

ALLOWANCE FOR LOSSES ON LOANS AND UNFUNDED COMMITMENTS

	2020		2019		2018	
	<u>Loan Losses</u>	<u>Unfunded Commitments</u>	<u>Loan Losses</u>	<u>Unfunded Commitments</u>	<u>Loan Losses</u>	<u>Unfunded Commitments</u>
	(Dollars in thousands)					
Balance at beginning of year	\$ 26,148	\$ 1,542	\$ 24,888	\$ 1,296	\$ 22,587	\$ 1,125
Additions (deductions)						
Provision for loan losses	12,463	—	824	—	1,503	—
Recoveries credited to allowance	3,069	—	3,961	—	4,622	—
Loans charged against the allowance	(6,251)	—	(3,525)	—	(3,824)	—
Additions included in non-interest expense	—	263	—	246	—	171
Balance at end of year	<u>\$ 35,429</u>	<u>\$ 1,805</u>	<u>\$ 26,148</u>	<u>\$ 1,542</u>	<u>\$ 24,888</u>	<u>\$ 1,296</u>
Net loans charged against the allowance to average Portfolio Loans		0.11%		(0.02)%		(0.03)%

In 2020, we recorded loan net charge offs of \$3.2 million compared to loan net recoveries in 2019 and 2018 of \$0.4 million and \$0.8 million, respectively. The increase in net charge-offs in 2020 was attributed to a \$4.0 million charge down of one specific commercial loan relationship whose balance was zero at December 31, 2020. The net recoveries in 2019 and 2018 primarily reflect reduced levels of non-performing loans, improvement in collateral liquidation values and on-going collection efforts on previously charged-off loans.

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

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

Deposits totaled \$3.64 billion and \$3.04 billion at December 31, 2020 and 2019, respectively. The \$600.6 million increase in deposits during 2020 is due to growth in non-interest bearing deposits, savings and interest bearing checking deposits and reciprocal deposits. Reciprocal deposits totaled \$556.2 million and \$431.0 million at December 31, 2020 and 2019, respectively. These deposits represent demand, money market and time deposits from our customers that have been placed through IntraFi Network (formerly Promontory Interfinancial Network's Insured Cash Sweep[®] service and Certificate of Deposit Account Registry Service[®]). This service allows our customers to access multi-million dollar FDIC deposit insurance on deposit balances greater than the standard FDIC insurance maximum. The significant increase in reciprocal deposits is due in part to an automated sweep capability we introduced in mid-2018 as well as the marketing and sales efforts of our treasury management team.

We cannot be sure that we will be able to maintain our current level of core deposits. In particular, those deposits that are uninsured may be susceptible to outflow. At December 31, 2020, we had an estimated \$755.7 million of uninsured deposits. A reduction in core deposits would likely increase our need to rely on wholesale funding sources.

We have also implemented strategies that incorporate using federal funds purchased, other borrowings and Brokered CDs to fund a portion of our interest-earning assets. The use of such alternate sources of funds supplements our core deposits and is also a part of our asset/liability management efforts. Other borrowings, comprised primarily of federal funds purchased and advances from the Federal Home Loan Bank (the "FHLB"), totaled \$30.0 million and \$88.6 million at December 31, 2020 and 2019, respectively.

As described above, we utilize wholesale funding, including federal funds purchased, FHLB borrowings and Brokered CDs to augment our core deposits and fund a portion of our assets. At December 31, 2020, our use of such wholesale funding sources (including reciprocal deposits) amounted to approximately \$700.0 million, or 19.1% of total funding (deposits and total borrowings, excluding subordinated debt and debentures). Because wholesale funding sources are affected by general market conditions, the availability of such funding may be dependent on the confidence these sources have in our financial condition and operations. The continued availability to us of these funding sources is not certain, and Brokered CDs may be difficult for us to retain or replace at attractive rates as they mature. Our liquidity may be constrained if we are unable to renew our wholesale funding sources or if adequate financing is not available in the future at acceptable rates of interest or at all. Our financial performance could also be affected if we are unable to maintain our access to funding sources or if we are required to rely more heavily on more expensive funding sources. In such case, our net interest income and results of operations could be adversely affected.

We have historically employed derivative financial instruments to manage our exposure to changes in interest rates. During 2020, 2019 and 2018, we entered into \$16.7 million, \$74.5 million and \$23.9 million (original aggregate notional amounts), respectively, of interest rate swaps with commercial loan customers, which were offset with interest rate swaps that the Bank entered into with a broker-dealer. We recorded \$0.26 million, \$0.94 million and \$0.46 million of fee income related to these transactions during 2020, 2019 and 2018, respectively. In 2020 we entered into \$42.0 million (notional amount) of pay fixed interest rate swaps to hedge the fair value of municipal bond securities. In 2019 we entered into a \$7.1 million (notional amount) pay fixed interest rate swap to hedge the fair value of a fixed rate commercial loan. In 2018, we entered into (notional amounts): \$10.0 million of pay fixed interest rate swaps and \$105.0 million of interest rate caps. These swaps and caps were hedging short-term wholesale funding. See note #16 to our Consolidated Financial Statements.

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

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

At December 31, 2020, we had \$370.5 million of time deposits (see note #8 to the Consolidated Financial Statements) that mature in the next 12 months. Historically, a majority of these maturing time deposits are renewed by our customers. Additionally, \$3.20 billion of our deposits at December 31, 2020, were in account types from which the customer could withdraw the funds on demand. Changes in the balances of deposits that can be withdrawn upon demand are usually predictable and the total balances of these accounts have generally grown or have been stable over time as a result of our marketing and promotional activities. However, there can be no assurance that historical patterns of renewing time deposits or overall growth or stability in deposits will continue in the future.

We have developed contingency funding plans that stress test our liquidity needs that may arise from certain events such as an adverse change in our financial metrics (for example, credit quality or regulatory capital ratios). Our liquidity management also includes periodic monitoring that measures quick assets (defined generally as highly

liquid or short-term assets) to total assets, short-term liability dependence and basic surplus (defined as quick assets less volatile liabilities to total assets). Policy limits have been established for our various liquidity measurements and are monitored on a quarterly basis. In addition, we also prepare cash flow forecasts that include a variety of different scenarios.

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

We also believe that the available cash on hand at the parent company (including time deposits) of approximately \$50.5 million as of December 31, 2020, provides sufficient liquidity resources at the parent company to meet operating expenses, to make interest payments on the subordinated debt and debentures and to pay a cash dividend on our common stock for the foreseeable future.

In the normal course of business we enter into certain contractual obligations. Such obligations include requirements to make future payments on debt and lease arrangements, contractual commitments for capital expenditures, and service contracts. The table below summarizes our significant contractual obligations at December 31, 2020.

CONTRACTUAL COMMITMENTS⁽¹⁾

	<u>1 Year or Less</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>After 5 Years</u>	<u>Total</u>
	<u>(In thousands)</u>				
Time deposit maturities	\$ 370,497	\$ 57,388	\$ 10,529	\$ 603	\$ 439,017
FHLB advances	—	—	—	30,000	30,000
Subordinated debt	—	—	—	39,281	39,281
Subordinated debentures	—	—	—	39,524	39,524
Operating lease obligations	1,669	2,711	1,624	2,525	8,529
Purchase obligations ⁽²⁾	4,332	10,680	10,680	17,800	43,492
Total	\$ 376,498	\$ 70,779	\$ 22,833	\$ 129,733	\$ 599,843

(1) Excludes approximately \$0.2 million of accrued tax and interest relative to uncertain tax benefits due to the high degree of uncertainty as to when, or if, those amounts would be paid.

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

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

CAPITALIZATION

	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Subordinated debt	\$ 39,281	\$ —
Subordinated debentures	39,524	39,456
Amount not qualifying as regulatory capital	(505)	(1,224)
Amount qualifying as regulatory capital	78,300	38,232
Shareholders' equity		
Common stock	339,353	352,344
Retained earnings	40,145	1,611
Accumulated other comprehensive income (loss)	10,024	(3,786)
Total shareholders' equity	389,522	350,169
Total capitalization	\$ 467,822	\$ 388,401

In May 2020, we issued \$40.0 million of fixed to floating subordinated notes with a ten year maturity and a five year call option. The initial coupon rate is 5.95% fixed for five years and then floats at the Secured Overnight

Financing Rate (“SOFR”) plus 5.825%. These notes are presented in the Consolidated Statement of Financial Condition under the caption “Subordinated debt” and the December 31, 2020 balance of \$39.3 million is net of remaining unamortized deferred issuance costs of approximately \$0.7 million that are being amortized through the maturity date into interest expense on other borrowings and subordinated debt and debentures in our Consolidated Statement of Operations.

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

The FRB has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities (and certain other capital elements) is limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital, subject to restrictions. Although the Dodd-Frank Act further limited Tier 1 treatment for trust preferred securities, those new limits did not apply to our outstanding trust preferred securities. Further, the new capital rules that went into effect in 2015 grandfathered the treatment of our trust preferred securities as qualifying regulatory capital.

Common shareholders’ equity increased to \$389.5 million at December 31, 2020 from \$350.2 million at December 31, 2019, due primarily to our net income and the change in our accumulated other comprehensive income (loss) that were partially offset by share repurchases and by dividends that we paid. Our tangible common equity (“TCE”) totaled \$356.9 million and \$316.5 million, respectively, at those same dates. Our ratio of TCE to tangible assets was 8.56% and 8.96% at December 31, 2020 and 2019, respectively. TCE and the ratio of TCE to tangible assets are non-GAAP measures. TCE represents total common equity less intangible assets.

In December 2019, our Board of Directors authorized a 2020 share repurchase plan. Under the terms of the 2020 share repurchase plan, we were authorized to buy back 1,120,000 shares, or approximately 5%, of our outstanding common stock. During the first three months of 2020, we repurchased 678,929 shares at a weighted average purchase price of \$20.30 per share. Due primarily to the economic uncertainty brought on by the COVID-19 pandemic, we suspended share repurchase activity on March 16, 2020. However, primarily as a result of our strong financial performance and improved economic conditions, we reactivated the share repurchase plan in the fourth quarter of 2020 and acquired 30,027 shares at a weighted average price of \$14.90. We repurchased a total of 708,956 shares at a weighted average price of \$20.07 in 2020.

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

In December 2020, our Board of Directors authorized the 2021 share repurchase plan. Under the terms of the 2021 share repurchase plan, we are authorized to buy back up to 1,100,000 shares, or approximately 5%, of our outstanding common stock. This repurchase plan commenced on January 1, 2021, and is expected to last through December 31, 2021.

We currently pay a quarterly cash dividend on our common stock. The annual total dividends paid were \$0.80, \$0.72 and \$0.60 per share for 2020, 2019 and 2018, respectively. We currently favor a dividend payout ratio between 30% and 50% of net income.

As of December 31, 2020 and 2019, our Bank (and holding company) continued to meet the requirements to be considered “well-capitalized” under federal regulatory standards (also see note #20 to the Consolidated Financial Statements).

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

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

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

CHANGES IN MARKET VALUE OF PORTFOLIO EQUITY AND NET INTEREST INCOME

<u>Change in Interest Rates</u>	Market Value of Portfolio Equity⁽¹⁾	Percent Change	Net Interest Income⁽²⁾	Percent Change
(Dollars in thousands)				
December 31, 2020				
200 basis point rise	\$ 494,600	15.02%	\$ 125,200	4.16%
100 basis point rise	483,200	12.37	123,700	2.91
Base-rate scenario	430,000	—	120,200	—
100 basis point decline	395,500	(8.02)	114,900	(4.41)
December 31, 2019				
200 basis point rise	\$ 472,500	1.13%	\$ 123,900	1.23%
100 basis point rise	478,800	2.48	123,300	0.74
Base-rate scenario	467,200	—	122,400	—
100 basis point decline	412,100	(11.79)	118,100	(3.51)

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

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

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

FAIR VALUATION OF FINANCIAL INSTRUMENTS

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

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

LITIGATION MATTERS

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

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

CRITICAL ACCOUNTING POLICIES

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

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

At December 31, 2020 and 2019, we had approximately \$16.9 million and \$19.2 million, respectively, of mortgage loan servicing rights capitalized on our Consolidated Statements of Financial Condition. There are several critical assumptions involved in establishing the value of this asset including estimated future prepayment speeds on the underlying mortgage loans, the interest rate used to discount the net cash flows from the mortgage loan servicing, the estimated amount of ancillary income that will be received in the future (such as late fees) and the estimated cost to service the mortgage loans. We believe the assumptions that we utilize in our valuation are reasonable based upon accepted industry practices for valuing mortgage loan servicing rights and represent neither the most conservative or aggressive assumptions.

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

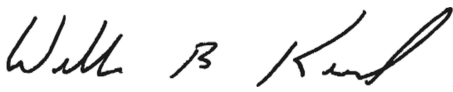
The management of Independent Bank Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to us and the board of directors regarding the preparation and fair presentation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

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

We assessed the effectiveness of our internal control over financial reporting as of December 31, 2020. In making this assessment, we used the criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management has concluded that as of December 31, 2020, the Company's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2020, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Our independent registered public accounting firm has issued an audit report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2020. Their report immediately follows our report.



William B. Kessel
President and
Chief Executive Officer



Gavin A. Mohr
Executive Vice President
and Chief Financial Officer

Independent Bank Corporation
March 5, 2021

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statements of financial condition of Independent Bank Corporation (the “Corporation”) as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income, shareholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively referred to as the “financial statements”). We also have audited the Corporation’s internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

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

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

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – Subjective Factors

As described in Notes 1 and 4 to the consolidated financial statements, the Corporation's allowance for loan losses is a valuation account that reflects the Corporation's estimation of probable incurred losses in its loan portfolio. The allowance for loan losses was \$35,429,000 at December 31, 2020, which consists of two components: the valuation allowance for loans individually evaluated for impairment ("specific component"), representing \$5,581,000, and the valuation allowance for loans collectively evaluated for impairment ("general component"), representing \$29,848,000. The general component includes allocations using historical analysis based on probability of default and loss given default methodologies and additional allocations based on subjective factors.

The subjective factors include consideration of the following: local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and the general terms of the overall loan portfolio. Due to the significant judgment applied by management to determine the effect of the subjective factors, we identified the effect of the subjective factors on the allowance for loan losses as a critical audit matter as it involved especially subjective auditor judgment to audit management's determination of the subjective factors and also required the use of senior level audit personnel.

The primary procedures we performed to address this critical audit matter included:

- Testing the effectiveness of controls over the evaluation of the items used to estimate the subjective factors, including controls addressing:
 - Management's review of the completeness and accuracy of data inputs used as the basis for the allowance allocations resulting from the subjective factors.
 - Management's review of the reasonableness of the judgments and assumptions used to develop the subjective factors for the general component of the allowance for loan losses and the relevance to the loan segment in which it is applied.
- Substantively testing management's process, including evaluating their judgments and assumptions, for developing the subjective factors, which included:
 - Evaluation of the completeness and accuracy of data inputs used as a basis for the subjective factors.
 - Evaluation of the reasonableness of management's judgments related to the qualitative and quantitative assessment of the data used in the determination of the subjective factors and the resulting allocation to the allowance. Among other procedures, our evaluation considered, evidence from internal and external sources, loan portfolio performance and whether such assumptions were applied consistently from period to period, including the relevance of the factors to the loan segment in which it is applied.
 - Evaluating the subjective factors year over year for directional consistency, testing for reasonableness, and obtaining evidence for significant changes.



Crowe LLP

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

Grand Rapids, Michigan
March 5, 2021

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2020	2019
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	\$ 56,006	\$ 53,295
Interest bearing deposits	62,699	12,009
	Cash and Cash Equivalents	65,304
Interest bearing deposits - time	-	350
Securities available for sale	1,072,159	518,400
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	18,427	18,359
Loans held for sale, carried at fair value	92,434	69,800
Loans		
Commercial	1,242,415	1,166,695
Mortgage	1,015,926	1,098,911
Installment	475,337	459,417
	Total Loans	2,725,023
Allowance for loan losses	(35,429)	(26,148)
	Net Loans	2,698,875
Other real estate and repossessed assets, net	766	1,865
Property and equipment, net	36,127	38,411
Bank-owned life insurance	55,180	55,710
Capitalized mortgage loan servicing rights, carried at fair value	16,904	19,171
Other intangibles	4,306	5,326
Goodwill	28,300	28,300
Accrued income and other assets	62,456	44,823
	Total Assets	\$ 4,204,013
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	\$ 1,153,473	\$ 852,076
Savings and interest-bearing checking	1,526,465	1,186,745
Reciprocal	556,185	431,027
Time	287,402	376,877
Brokered time	113,830	190,002
	Total Deposits	3,036,727
Other borrowings	30,012	88,646
Subordinated debt	39,281	-
Subordinated debentures	39,524	39,456
Accrued expenses and other liabilities	68,319	49,696
	Total Liabilities	3,214,525
Commitments and contingent liabilities		
Shareholders' Equity		
Preferred stock, no par value, 200,000 shares authorized; none issued or outstanding	-	-
Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 21,853,800 shares at December 31, 2020 and 22,481,643 shares at December 31, 2019	339,353	352,344
Retained earnings	40,145	1,611
Accumulated other comprehensive income (loss)	10,024	(3,786)
	Total Shareholders' Equity	350,169
	Total Liabilities and Shareholders' Equity	\$ 4,204,013

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2020	2019	2018
	(In thousands, except per share amounts)		
INTEREST INCOME			
Interest and fees on loans	\$ 123,159	\$ 133,883	\$ 116,865
Interest on securities available for sale			
Taxable	12,655	11,842	10,874
Tax-exempt	2,926	1,342	1,743
Other investments	1,089	1,861	1,291
Total Interest Income	<u>139,829</u>	<u>148,928</u>	<u>130,773</u>
INTEREST EXPENSE			
Deposits	12,666	23,425	14,478
Other borrowings and subordinated debt and debentures	3,551	2,922	3,013
Total Interest Expense	<u>16,217</u>	<u>26,347</u>	<u>17,491</u>
Net Interest Income	<u>123,612</u>	<u>122,581</u>	<u>113,282</u>
Provision for loan losses	12,463	824	1,503
Net Interest Income After Provision for Loan Losses	<u>111,149</u>	<u>121,757</u>	<u>111,779</u>
NON-INTEREST INCOME			
Interchange income	11,230	10,297	9,905
Service charges on deposit accounts	8,517	11,208	12,258
Net gains on assets			
Mortgage loans	62,560	19,978	10,597
Securities available for sale	267	307	138
Mortgage loan servicing, net	(9,350)	(3,336)	3,157
Other	7,521	9,282	8,760
Total Non-interest Income	<u>80,745</u>	<u>47,736</u>	<u>44,815</u>
NON-INTEREST EXPENSE			
Compensation and employee benefits	74,781	67,501	62,078
Occupancy, net	8,938	9,013	8,912
Data processing	8,534	8,905	8,262
Furniture, fixtures and equipment	4,089	4,113	4,080
Interchange expense	3,342	3,215	2,702
Communications	3,194	2,947	2,848
Loan and collection	3,037	2,685	2,682
Conversion related expense	2,586	-	-
Advertising	2,230	2,450	2,155
Legal and professional	2,027	1,814	1,839
FDIC deposit insurance	1,596	685	1,081
Net (gains) losses on other real estate and repossessed assets	64	(90)	(672)
Merger related expense	-	-	3,465
Other	7,995	8,495	8,029
Total Non-interest Expense	<u>122,413</u>	<u>111,733</u>	<u>107,461</u>
Income Before Income Tax	<u>69,481</u>	<u>57,760</u>	<u>49,133</u>
Income tax expense	13,329	11,325	9,294
Net Income	<u>\$ 56,152</u>	<u>\$ 46,435</u>	<u>\$ 39,839</u>
Net income per common share			
Basic	<u>\$ 2.56</u>	<u>\$ 2.03</u>	<u>\$ 1.70</u>
Diluted	<u>\$ 2.53</u>	<u>\$ 2.00</u>	<u>\$ 1.68</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Net income	\$ 56,152	\$ 46,435	\$ 39,839
Other comprehensive income (loss)			
Securities available for sale			
Unrealized gain (loss) arising during period	15,611	10,235	(4,594)
Change in unrealized gains and losses for which a portion of other than temporary impairment has been recognized in earnings	(49)	(65)	(53)
Reclassification adjustments for gains included in earnings	(267)	(140)	(56)
Unrealized gains (losses) recognized in other comprehensive income (loss) on securities available for sale	15,295	10,030	(4,703)
Income tax expense (benefit)	3,212	2,106	(988)
Unrealized gains (losses) recognized in other comprehensive income (loss) on securities available for sale, net of tax	12,083	7,924	(3,715)
Derivative instruments			
Unrealized losses arising during period	(354)	(1,603)	(262)
Reclassification adjustment for (income) expense recognized in earnings	2,539	(425)	(237)
Unrealized gains (losses) recognized in other comprehensive income (loss) on derivative instruments	2,185	(2,028)	(499)
Income tax expense (benefit)	458	(426)	(105)
Unrealized gains (losses) recognized in other comprehensive income (loss) on derivative instruments, net of tax	1,727	(1,602)	(394)
Other comprehensive income (loss)	13,810	6,322	(4,109)
Comprehensive income	\$ 69,962	\$ 52,757	\$ 35,730

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	(Dollars in thousands, except per share amounts)			
Balances at January 1, 2018	\$ 324,986	\$ (54,054)	\$ (5,999)	\$ 264,933
Net income for 2018	-	39,839	-	39,839
Cash dividends declared, \$0.60 per share	-	(14,055)	-	(14,055)
Repurchase of 587,969 shares of common stock	(12,681)	-	-	(12,681)
Acquisition of TCSB Bancorp, Inc.	64,536	-	-	64,536
Issuance of 152,549 shares of common stock	267	-	-	267
Share based compensation (issuance of 80,028 shares of common stock)	1,731	-	-	1,731
Share based compensation withholding obligation (withholding of 108,185 shares of common stock)	(1,467)	-	-	(1,467)
Other comprehensive loss	-	-	(4,109)	(4,109)
Balances at December 31, 2018	<u>377,372</u>	<u>(28,270)</u>	<u>(10,108)</u>	<u>338,994</u>
Net income for 2019	-	46,435	-	46,435
Cash dividends declared, \$0.72 per share	-	(16,554)	-	(16,554)
Repurchase of 1,204,688 shares of common stock	(26,284)	-	-	(26,284)
Issuance of 71,799 shares of common stock	284	-	-	284
Share based compensation (issuance of 92,275 shares of common stock)	1,854	-	-	1,854
Share based compensation withholding obligation (withholding of 57,468 shares of common stock)	(882)	-	-	(882)
Other comprehensive income	-	-	6,322	6,322
Balances at December 31, 2019	<u>352,344</u>	<u>1,611</u>	<u>(3,786)</u>	<u>350,169</u>
Net income for 2020	-	56,152	-	56,152
Cash dividends declared, \$0.80 per share	-	(17,618)	-	(17,618)
Repurchase of 708,956 shares of common stock	(14,231)	-	-	(14,231)
Issuance of 17,317 shares of common stock	15	-	-	15
Share based compensation (issuance of 103,429 shares of common stock)	1,980	-	-	1,980
Share based compensation withholding obligation (withholding of 39,633 shares of common stock)	(755)	-	-	(755)
Other comprehensive income	-	-	13,810	13,810
Balances at December 31, 2020	<u>\$ 339,353</u>	<u>\$ 40,145</u>	<u>\$ 10,024</u>	<u>\$ 389,522</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Net Income	\$ 56,152	\$ 46,435	\$ 39,839
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH FROM OPERATING ACTIVITIES			
Proceeds from the sale of equity securities at fair value	-	560	-
Proceeds from sales of loans held for sale	1,478,908	642,537	463,699
Disbursements for loans held for sale	(1,438,982)	(647,606)	(457,077)
Provision for loan losses	12,463	824	1,503
Deferred income tax (benefit) expense	(2,130)	1,088	9,294
Net deferred loan fees (costs)	1,686	(2,936)	(4,044)
Net depreciation, amortization of intangible assets and premiums and accretion of discounts on securities, loans and interest bearing deposits - time	9,161	6,059	6,033
Net gains on mortgage loans	(62,560)	(19,978)	(10,597)
Net gains on securities available for sale	(267)	(307)	(138)
Net (gains) losses on other real estate and repossessed assets	64	(90)	(672)
Share based compensation	1,980	1,854	1,731
Increase in accrued income and other assets	(8,477)	(6,573)	(4,890)
Increase in accrued expenses and other liabilities	10,175	12,113	240
Total Adjustments	2,021	(12,455)	5,082
Net Cash From Operating Activities	58,173	33,980	44,921
CASH FLOW USED IN INVESTING ACTIVITIES			
Proceeds from the sale of securities available for sale	38,095	68,716	48,736
Proceeds from maturities, prepayments and calls of securities available for sale	306,691	153,938	160,627
Purchases of securities available for sale	(859,068)	(237,672)	(103,493)
Proceeds from the sale of interest bearing deposits - time	-	-	2,474
Proceeds from the maturity of interest bearing deposits - time	350	250	3,728
Purchase of Federal Home Loan Bank stock	(68)	-	-
Purchase of Federal Reserve Bank stock	-	-	(2,038)
Net increase in portfolio loans (loans originated, net of principal payments)	(41,861)	(215,276)	(344,330)
Proceeds from the sale of portfolio loans	2,395	50,516	27,658
Cash received in the acquisition of TCSB Bancorp Inc.	-	-	23,516
Proceeds from the collection of vehicle service contract counterparty receivables	511	512	511
Proceeds from the sale of other real estate and repossessed assets	1,367	1,766	2,526
Proceeds from bank-owned life insurance	1,441	470	474
Proceeds from the sale of property and equipment	1,133	74	106
Capital expenditures	(4,383)	(4,936)	(3,862)
Net Cash Used in Investing Activities	(553,397)	(181,642)	(183,367)
CASH FLOW FROM FINANCING ACTIVITIES			
Net increase in total deposits	600,628	123,299	225,185
Net increase (decrease) in other borrowings	(24,994)	25,002	(6,600)
Proceeds from Federal Home Loan Bank advances	239,254	111,000	1,272,000
Payments of Federal Home Loan Bank advances	(272,910)	(73,143)	(1,308,697)
Proceeds from issuance of subordinated debt, net of issuance costs	39,236	-	-
Dividends paid	(17,618)	(16,554)	(14,055)
Proceeds from issuance of common stock	15	284	267
Repurchase of common stock	(14,231)	(26,284)	(12,681)
Share based compensation withholding obligation	(755)	(882)	(1,467)
Net Cash From Financing Activities	548,625	142,722	153,952
Net Increase (Decrease) in Cash and Cash Equivalents	53,401	(4,940)	15,506
Cash and Cash Equivalents at Beginning of Year	65,304	70,244	54,738
Cash and Cash Equivalents at End of Year	\$ 118,705	\$ 65,304	\$ 70,244
Cash paid during the year for			
Interest	\$ 16,912	\$ 26,697	\$ 16,737
Income taxes	15,500	9,534	120
Operating leases	1,785	2,201	-
Transfers to other real estate and repossessed assets	332	2,242	1,510
Transfer of mortgage loans to held for sale	-	36,622	41,471
Securitization of portfolio loans	26,324	65,070	10,869
Right of use assets obtained in exchange for lease obligations	1,587	9,906	-
Purchase of securities available for sale not yet settled	1,000	-	-
Common stock and stock options issued in TCSB Bancorp, Inc. acquisition	-	-	64,536

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ACCOUNTING POLICIES

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

Our subsidiary, Independent Bank (“Bank”), transacts business in the single industry of commercial banking. Our Bank’s activities cover traditional phases of commercial banking, including checking and savings accounts, commercial lending, direct and indirect consumer financing and mortgage lending. Our principal markets are the rural and suburban communities across Lower Michigan that are served by our Bank’s branches and loan production offices as well as two loan production offices we have in Ohio. At December 31, 2020, 67.0% of our Bank’s loan portfolio was secured by real estate.

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

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

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

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

LOANS HELD FOR SALE — Mortgage loans originated and intended for sale in the secondary market are carried at fair value. Fair value adjustments, as well as realized gains and losses, are recorded in current earnings.

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

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

Mortgage loan servicing income is recorded for fees earned for servicing loans previously sold. The fees are generally based on a contractual percentage of the outstanding principal and are recorded as income when earned. Mortgage loan servicing fees, excluding fair value changes of capitalized mortgage loan servicing rights, totaled \$6.9 million, \$6.2 million and \$5.5 million for the years ended December 31, 2020, 2019 and 2018, respectively. Late fees and ancillary fees related to loan servicing are not material.

TRANSFERS OF FINANCIAL ASSETS — Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

have been isolated from us, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and we do not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

SECURITIES — We classify our securities as equity, trading, held to maturity or available for sale. Equity securities are investments in certain equity stocks and are reported at fair value with realized and unrealized gains and losses included in earnings. Trading securities are bought and held principally for the purpose of selling them in the near term and are reported at fair value with realized and unrealized gains and losses included in earnings. Securities held to maturity represent those securities for which we have the positive intent and ability to hold until maturity and are reported at cost, adjusted for amortization of premiums and accretion of discounts computed on the level-yield method. We did not have any equity securities, trading securities or securities held to maturity at December 31, 2020 and 2019. Securities available for sale represent those securities not classified as equity, trading or held to maturity and are reported at fair value with unrealized gains and losses, net of applicable income taxes reported in other comprehensive income (loss).

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

Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis.

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

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

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

Certain loan fees and direct loan origination costs are deferred and recognized as an adjustment of yield generally over the contractual life of the related loan. Fees received in connection with loan commitments are

deferred until the loan is advanced and are then recognized generally over the contractual life of the loan as an adjustment of yield. Fees on commitments that expire unused are recognized at expiration. Fees received for letters of credit are recognized as revenue over the life of the commitment.

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

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

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

During the first quarter of 2019, we deployed a third-party software solution (we previously used spreadsheet software) to assist in the determination of our AFL. This new third-party software also has assisted us in moving to the expected loss framework that we plan to adopt on January 1, 2021. Although the use of this new third-party software did not have any material impact on our overall AFL, it did result in some classification shifts from the AFL related to subjective factors into the AFL related to historical losses as the new software model allowed us to capture longer historical look-back periods (previously this was being captured in the subjective portion of the AFL).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

At the inception of the derivative we designate the derivative as one of three types based on our intention and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (“Fair Value Hedge”), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (“Cash Flow Hedge”), or (3) an instrument with no hedging designation. For a Fair Value Hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in interest income in our Consolidated Statements of Operations. For a Cash Flow Hedge, the gain or loss on the derivative is reported in other comprehensive income (loss) and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For instruments with no hedging designation, the gain or loss on the derivative is reported in earnings. These free standing instruments currently consist of (i) mortgage banking related derivatives and include rate-lock loan commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and mandatory forward commitments for the future delivery of these mortgage loans, (ii) certain pay-fixed and pay-variable interest rate swap agreements related to commercial loan customers and (iii) certain purchased and written options related to a time deposit product. The fair value of rate-lock mortgage loan commitments is based on agency cash window loan pricing for comparable assets and the fair value of mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets. We enter into mandatory forward commitments for the future delivery of mortgage loans generally when interest rate locks are entered into in order to hedge the change in interest rates resulting from our commitments to fund the loans. Changes in the fair values of these derivatives are included in net gains on mortgage loans in the Consolidated Statements of Operations. Fair values of the pay-fixed and pay-variable interest rate swap agreements are derived from proprietary models which utilize current market data and are included in net interest income in the Consolidated Statements of Operations. Fair values of the purchased and written options are based on prices of financial instruments with similar characteristics and are included in net interest income in the Consolidated Statements of Operations.

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

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

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

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

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

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

COMMON STOCK — At December 31, 2020, 0.1 million shares of common stock were reserved for issuance under the dividend reinvestment plan and 0.6 million shares of common stock were reserved for issuance under our long-term incentive plans.

RECLASSIFICATION — Certain amounts in the 2019 and 2018 consolidated financial statements have been reclassified to conform to the 2020 presentation.

ADOPTION OF NEW ACCOUNTING STANDARDS — In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2018-13, “Fair Value Measurement (Topic 820), Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement”. This new ASU amends disclosure requirements in Topic 820 to eliminate, add and modify certain disclosure requirements for fair value measurements as part of its disclosure framework project. The amended guidance eliminates the requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the entity’s policy for the timing of transfers between levels of the fair value hierarchy and the entity’s valuation processes for Level 3 fair value measurements. The amended guidance adds the requirements to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements of instruments held at the end of the reporting period and for recurring and nonrecurring Level 3 fair value

measurements, the range and weighted average used to develop significant unobservable inputs and how the weighted average was calculated, with certain exceptions. This amended guidance was effective for us on January 1, 2020, and did not have a material impact on our consolidated operating results or financial condition.

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

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

We began evaluating this ASU in 2016 and established a company-wide, cross-discipline governance structure, which provides implementation oversight. We continued to test and refine our current expected credit loss models that satisfied the requirements of this ASU. Oversight and testing, as well as efforts to meet expanded disclosure requirements, extended through the end of 2020. We currently expect to estimate losses over approximately a one year forecast period using external economic forecast sources, including the Federal Open Market Committee median economic projections, and then revert to longer term historical loss experience to estimate losses over more extended periods. We were originally required to adopt this ASU on January 1, 2020 but section 4014 of the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act allowed for temporary relief from applying this ASU. Under the amended CARES Act we were allowed to delay the adoption of this ASU until the earlier of the termination of the national emergency that was declared on March 13, 2020, or January 1, 2022. Early adoption is also allowed on either January 1, 2020 or January 1, 2021. As such, we chose to delay the adoption of this ASU during 2020 and continue to utilize the existing incurred loss impairment methodology to calculate our allowance for loan losses and our provision for loan losses as required under Accounting Standards Codification 310 (Receivables). We plan to adopt this ASU as allowed under the amended CARES Act on January 1, 2021.

We expect to recognize a one-time cumulative effect adjustment to beginning retained earnings at January 1, 2021 increasing the allowance for loan losses. We are estimating an increase to the allowance for loan losses at that time to be in the range of \$10.5 million to \$12.5 million primarily driven by the longer contractual maturities of our mortgage and consumer installment loan portfolio segments. In addition, we currently expect this ASU to increase the allowance for losses related to unfunded loan commitments between \$0.5 million and \$1.5 million. The ultimate impact of adopting this ASU, and at each subsequent reporting period, is highly dependent on credit quality, economic forecasts and conditions, composition of our loan portfolios and securities available for sale, along with other management judgments. The transition adjustment to record the allowance for credit losses may fall outside of our estimated increase based on the finalization of assumptions including qualitative adjustments and the economic forecast used in calculating the allowance for credit losses upon the adoption of CECL.

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

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

NOTE 2 – RESTRICTIONS ON CASH AND DUE FROM BANKS

During March 2020 the FRB, in response to the COVID-19 pandemic, reduced our Bank’s reserve balance requirements to zero. Prior to that time our Bank was required to maintain reserve balances in the form of vault cash and balances with the FRB. The average reserve balances to be maintained during 2020 and 2019 were \$9.2 million and \$26.6 million, respectively. We do not maintain compensating balances with correspondent banks. We are also required to maintain reserve balances related to certain mortgage banking related derivatives not classified as hedges and to our merchant payment processing operations and for certain investment security transactions. These balances are held at unrelated financial institutions and totaled \$0.74 million and \$0.01 million at December 31, 2020 and 2019, respectively.

NOTE 3 – SECURITIES

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

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
(In thousands)				
2020				
U.S. agency	\$ 10,456	\$ 305	\$ 13	\$ 10,748
U.S. agency residential mortgage-backed	340,224	4,951	593	344,582
U.S. agency commercial mortgage-backed	6,869	326	-	7,195
Private label mortgage-backed	41,429	1,539	139	42,829
Other asset backed	252,596	1,796	211	254,181
Obligations of states and political subdivisions	315,795	8,676	178	324,293
Corporate	82,307	3,807	97	86,017
Trust preferred	1,971	-	173	1,798
Foreign government	500	16	-	516
Total	<u>\$ 1,052,147</u>	<u>\$ 21,416</u>	<u>\$ 1,404</u>	<u>\$ 1,072,159</u>
2019				
U.S. agency	\$ 14,591	\$ 89	\$ 19	\$ 14,661
U.S. agency residential mortgage-backed	226,130	1,910	278	227,762
U.S. agency commercial mortgage-backed	10,671	113	28	10,756
Private label mortgage-backed	39,248	544	99	39,693
Other asset backed	94,158	103	375	93,886
Obligations of states and political subdivisions	94,499	1,724	121	96,102
Corporate	31,904	1,296	5	33,195
Trust preferred	1,968	-	125	1,843
Foreign government	499	3	-	502
Total	<u>\$ 513,668</u>	<u>\$ 5,782</u>	<u>\$ 1,050</u>	<u>\$ 518,400</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At December 31, 2020 we have entered into a pay-fixed interest rate swap to protect a portion of the fair value of certain securities available for sale. The fair value adjustment to securities available for sale was an unrealized loss of \$0.015 million at December 31, 2020. See note 16 - Derivative Financial Instruments.

Total OTTI recognized in accumulated other comprehensive income (loss) for securities available for sale was zero at both December 31, 2020 and 2019, respectively.

Our investments' gross unrealized losses and fair values aggregated by investment type and length of time that individual securities have been at a continuous unrealized loss position, at December 31 follows:

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
2020						
U.S. agency	\$ 1,469	\$ 3	\$ 2,329	\$ 10	\$ 3,798	\$ 13
U.S. agency residential mortgage-backed	96,839	592	83	1	96,922	593
Private label mortgage-backed	11,838	95	2,050	44	13,888	139
Other asset backed	7,142	25	21,197	186	28,339	211
Obligations of states and political subdivisions	28,957	177	800	1	29,757	178
Corporate	1,924	97	-	-	1,924	97
Trust preferred	-	-	1,798	173	1,798	173
Total	<u>\$ 148,169</u>	<u>\$ 989</u>	<u>\$ 28,257</u>	<u>\$ 415</u>	<u>\$ 176,426</u>	<u>\$ 1,404</u>
2019						
U.S. agency	\$ 2,782	\$ 8	\$ 2,712	\$ 11	\$ 5,494	\$ 19
U.S. agency residential mortgage-backed	56,377	126	13,551	152	69,928	278
U.S. agency commercial mortgage-backed	3,284	24	659	4	3,943	28
Private label mortgage-backed	16,387	55	343	44	16,730	99
Other asset backed	34,027	233	13,839	142	47,866	375
Obligations of states and political subdivisions	15,666	84	5,396	37	21,062	121
Corporate	2,125	5	-	-	2,125	5
Trust preferred	-	-	1,843	125	1,843	125
Total	<u>\$ 130,648</u>	<u>\$ 535</u>	<u>\$ 38,343</u>	<u>\$ 515</u>	<u>\$ 168,991</u>	<u>\$ 1,050</u>

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

U.S. agency, U.S. agency residential mortgage-backed securities and U.S. agency commercial mortgage backed securities — at December 31, 2020, we had 25 U.S. agency, and 37 U.S. agency residential mortgage-backed securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to widening spreads to Treasury bond since acquisition.

Private label mortgage backed, other asset backed and corporate securities — at December 31, 2020, we had 20 private label mortgage backed, 33 other asset backed and four corporate securities whose fair value is less than amortized cost. Unrealized losses are primarily due to credit spread since their acquisition.

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

Obligations of states and political subdivisions — at December 31, 2020, we had 27 municipal securities whose fair value is less than amortized cost. The unrealized losses are primarily due to wider benchmark pricing spreads since acquisition.

Trust preferred securities — at December 31, 2020, we had two trust preferred securities whose fair value is less than amortized cost. Both of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities has suffered from credit spread widening. One of the securities is rated by a major rating agency as investment grade while the other one is non-rated. The non-rated issue is a relatively small bank and was never rated. The issuer of this non-rated trust preferred security, which had a total amortized cost of \$1.0 million and total fair value of \$0.87 million as of December 31, 2020, continues to have satisfactory credit metrics and make interest payments.

As management does not intend to liquidate any of the securities discussed above and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines discussed above (other than certain declines related to the two private label mortgage-backed securities currently being reviewed for OTTI) are deemed to be other than temporary.

We recorded zero credit related OTTI charges in the Consolidated Statements of Operations on securities available for sale during 2020, 2019, and 2018.

At December 31, 2020, two private label mortgage-backed securities had credit related OTTI and are summarized as follows:

	<u>Senior Security</u>	<u>Super Senior Security</u>	<u>Total</u>
	(In thousands)		
As of December 31, 2020			
Fair value	\$ 373	\$ 505	\$ 878
Amortized cost	350	326	676
Non-credit unrealized loss	-	-	-
Unrealized gain	23	179	202
Cumulative credit related OTTI	757	457	1,214

Both of these securities are receiving principal and interest payments similar to principal reductions in the underlying collateral and have unrealized gains at December 31, 2020. The original amortized cost (current amortized cost excluding cumulative credit related OTTI) for each of these securities has been permanently adjusted downward for previously recorded credit related OTTI. The unrealized loss (based on original amortized cost) for these securities is now less than previously recorded credit related OTTI amounts.

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(In thousands)		
	\$ 1,214	\$ 1,594	\$ 1,594
Additions to credit losses on securities for which no previous OTTI was recognized	-	-	-
Increases to credit losses on securities for which OTTI was previously recognized	-	-	-
Reduction(1)	-	(380)	-
Total	<u>\$ 1,214</u>	<u>\$ 1,214</u>	<u>\$ 1,594</u>

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

The amortized cost and fair value of securities available for sale at December 31, 2020, by contractual maturity, follow:

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	\$ 21,244	\$ 21,412
Maturing after one year but within five years	79,837	82,725
Maturing after five years but within ten years	76,454	80,060
Maturing after ten years	233,494	239,175
	411,029	423,372
U.S. agency residential mortgage-backed	340,224	344,582
U.S. agency commercial mortgage-backed	6,869	7,195
Private label mortgage-backed	41,429	42,829
Other asset backed	252,596	254,181
Total	\$ 1,052,147	\$ 1,072,159

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

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

	Proceeds	Realized	
		Gains (1)	Losses
	(In thousands)		
2020	\$ 38,095	\$ 271	\$ 4
2019	68,716	248	108
2018	48,736	192	136

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

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

Securities available for sale with a book value of \$14.0 million and \$8.7 million at December 31, 2020 and 2019, respectively, were pledged to secure borrowings, derivatives, public deposits and for other purposes as required by law. There were no investment obligations of state and political subdivisions that were payable from or secured by the same source of revenue or taxing authority that exceeded 10% of consolidated total shareholders' equity at December 31, 2020 or 2019.

NOTE 4 – LOANS

Our loan portfolios at December 31 follow:

	2020	2019
	(In thousands)	
Real estate (1)		
Residential first mortgages	\$ 792,762	\$ 843,746
Residential home equity and other junior mortgages	138,128	166,735
Construction and land development	232,693	249,747
Other (2)	669,150	693,580
Consumer	468,090	448,297
Commercial	429,011	318,504
Agricultural	3,844	4,414
Total loans	\$ 2,733,678	\$ 2,725,023

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

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

Loans include net deferred loan costs of \$14.6 million and \$16.3 million at December 31, 2020 and 2019, respectively.

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

During 2019, we sold \$40.6 million of residential adjustable rate mortgage loans servicing released (classified on the Consolidated Statements of Financial Condition as held for sale, carried at the lower of cost or fair value at December 31, 2018) to another financial institution and recognized a gain on sale of \$0.01 million. We also securitized \$65.1 million of portfolio residential fixed rate mortgage loans servicing retained with Freddie Mac and recognized a gain on sale of \$1.7 million. In addition, we sold \$9.9 million of residential fixed and adjustable rate portfolio mortgage loans servicing retained to another financial institution and recognized a gain on sale of \$0.07 million. These transactions were done primarily for asset/liability management purposes.

During 2018, we sold \$27.6 million of residential fixed and adjustable rate portfolio mortgage loans servicing retained to another financial institution and recognized a gain on sale of \$0.04 million. We also securitized \$10.9 million of portfolio residential fixed rate mortgage loans servicing retained with Freddie Mac recognizing a loss on sale of approximately \$0.1 million. These transactions were done primarily for asset/liability management purposes.

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

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u> (In thousands)	<u>Subjective</u> <u>Allocation</u>	<u>Total</u>
2020					
Balance at beginning of period	\$ 7,922	\$ 8,216	\$ 1,283	\$ 8,727	\$ 26,148
Additions (deductions)					
Provision for loan losses	1,751	(915)	436	11,191	12,463
Recoveries credited to allowance	1,804	513	752	-	3,069
Loans charged against the allowance	(4,076)	(816)	(1,359)	-	(6,251)
Balance at end of period	<u>\$ 7,401</u>	<u>\$ 6,998</u>	<u>\$ 1,112</u>	<u>\$ 19,918</u>	<u>\$ 35,429</u>
2019					
Balance at beginning of period		\$7,090	\$7,978	\$895	\$8,925
Additions (deductions)					
Provision for loan losses		(651)	526	1,147	(198)
Recoveries credited to allowance		2,165	933	863	-
Loans charged against the allowance		(682)	(1,221)	(1,622)	-
Balance at end of period		<u>\$7,922</u>	<u>\$8,216</u>	<u>\$1,283</u>	<u>\$8,727</u>
2018					
Balance at beginning of period		\$5,595	\$8,733	\$864	\$7,395
Additions (deductions)					
Provision for loan losses		(946)	457	462	1,530
Recoveries credited to allowance		2,889	734	999	-
Loans charged against the allowance		(448)	(1,946)	(1,430)	-
Balance at end of period		<u>\$7,090</u>	<u>\$7,978</u>	<u>\$895</u>	<u>\$8,925</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	<u>Commercial</u>	<u>Mortgage</u>	<u>Installment</u> (In thousands)	<u>Subjective Allocation</u>	<u>Total</u>	
2020						
Allowance for loan losses:						
Individually evaluated for impairment	\$ 1,266	\$ 4,124	\$ 191	\$ -	\$ 5,581	
Collectively evaluated for impairment	6,135	2,874	921	19,918	29,848	
Loans acquired with deteriorated credit quality	-	-	-	-	-	
Total ending allowance for loan losses balance	<u>\$ 7,401</u>	<u>\$ 6,998</u>	<u>\$ 1,112</u>	<u>\$ 19,918</u>	<u>\$ 35,429</u>	
Loans						
Individually evaluated for impairment	\$ 9,431	\$ 39,245	\$ 1,996		\$ 50,672	
Collectively evaluated for impairment	1,236,052	980,449	474,379		2,690,880	
Loans acquired with deteriorated credit quality	468	410	147		1,025	
Total loans recorded investment	<u>1,245,951</u>	<u>1,020,104</u>	<u>476,522</u>		<u>2,742,577</u>	
Accrued interest included in recorded investment	3,536	4,178	1,185		8,899	
Total loans	<u>\$ 1,242,415</u>	<u>\$ 1,015,926</u>	<u>\$ 475,337</u>		<u>\$ 2,733,678</u>	
2019						
Allowance for loan losses:						
Individually evaluated for impairment		\$1,031	\$4,863	\$261	\$-	\$6,155
Collectively evaluated for impairment		6,891	3,353	1,022	8,727	19,993
Loans acquired with deteriorated credit quality		-	-	-	-	-
Total ending allowance for loan losses balance		<u>\$7,922</u>	<u>\$8,216</u>	<u>\$1,283</u>	<u>\$8,727</u>	<u>\$26,148</u>
Loans						
Individually evaluated for impairment		\$9,393	\$43,574	\$2,925		\$55,892
Collectively evaluated for impairment		1,158,906	1,058,917	457,370		2,675,193
Loans acquired with deteriorated credit quality		1,394	575	316		2,285
Total loans recorded investment		<u>1,169,693</u>	<u>1,103,066</u>	<u>460,611</u>		<u>2,733,370</u>
Accrued interest included in recorded investment		2,998	4,155	1,194		8,347
Total loans		<u>\$1,166,695</u>	<u>\$1,098,911</u>	<u>\$459,417</u>		<u>\$2,725,023</u>

Non-performing loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. If these loans had continued to accrue interest in accordance with their original terms, approximately \$0.5 million, \$0.4 million and \$0.4 million of interest income would have been recognized in each of the years ended 2020, 2019 and 2018, respectively. Interest income recorded on these loans was approximately zero during each of the years ended 2020, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	<u>90+ and Still Accruing</u>	<u>Non- Accrual</u> (In thousands)	<u>Total Non- Performing Loans</u>
2020			
Commercial			
Commercial and industrial (2)	\$ -	\$ 1,387	\$ 1,387
Commercial real estate	-	-	-
Mortgage			
1-4 family owner occupied - jumbo	-	623	623
1-4 family owner occupied - non-jumbo (3)	-	2,281	2,281
1-4 family non-owner occupied	-	1,112	1,112
1-4 family - 2nd lien	-	1,344	1,344
Resort lending	-	607	607
Installment			
Boat lending	-	52	52
Recreational vehicle lending	-	74	74
Other	-	393	393
Total recorded investment	<u>\$ -</u>	<u>\$ 7,873</u>	<u>\$ 7,873</u>
Accrued interest included in recorded investment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
2019			
Commercial			
Commercial and industrial (2)	\$ -	\$ 565	\$ 565
Commercial real estate	-	735	735
Mortgage			
1-4 family owner occupied - jumbo	-	1,179	1,179
1-4 family owner occupied - non-jumbo (3)	-	3,540	3,540
1-4 family non-owner occupied	-	1,039	1,039
1-4 family - 2nd lien	-	979	979
Resort lending	-	690	690
Installment			
Boat lending	-	332	332
Recreational vehicle lending	-	3	3
Other	-	470	470
Total recorded investment	<u>\$ -</u>	<u>\$ 9,532</u>	<u>\$ 9,532</u>
Accrued interest included in recorded investment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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

(2) Non-performing commercial and industrial loans exclude \$0.053 million and \$0.077 million of government guaranteed loans at December 31, 2020 and 2019, respectively.

(3) Non-performing 1-4 family owner occupied – non jumbo loans exclude \$0.386 million and \$0.569 million of government guaranteed loans at December 31, 2020 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	Loans Past Due				Loans not Past Due	Total Loans
	30-59 days	60-89 days	90+ days	Total		
	(In thousands)					
2020						
Commercial						
Commercial and industrial	\$ 5,003	\$ 131	\$ 70	\$ 5,204	\$ 671,115	\$ 676,319
Commercial real estate	2,600	-	-	2,600	567,032	569,632
Mortgage						
1-4 family owner occupied - jumbo	761	-	623	1,384	438,794	440,178
1-4 family owner occupied - non-jumbo	1,888	453	502	2,843	264,730	267,573
1-4 family non-owner occupied	1,184	139	476	1,799	157,977	159,776
1-4 family - 2nd lien	710	228	732	1,670	92,860	94,530
Resort lending	32	195	358	585	57,462	58,047
Installment						
Boat lending	95	101	-	196	207,317	207,513
Recreational vehicle lending	207	37	48	292	169,282	169,574
Other	337	162	199	698	98,737	99,435
Total recorded investment	<u>\$ 12,817</u>	<u>\$ 1,446</u>	<u>\$ 3,008</u>	<u>\$ 17,271</u>	<u>\$ 2,725,306</u>	<u>\$ 2,742,577</u>
Accrued interest included in recorded investment	<u>\$ 147</u>	<u>\$ 22</u>	<u>\$ -</u>	<u>\$ 169</u>	<u>\$ 8,730</u>	<u>\$ 8,899</u>
2019						
Commercial						
Commercial and industrial	\$ -	\$ 289	\$ 102	\$ 391	\$ 564,480	\$ 564,871
Commercial real estate	177	-	735	912	603,910	604,822
Mortgage						
1-4 family owner occupied - jumbo	1,757	1,037	-	2,794	398,759	401,553
1-4 family owner occupied - non-jumbo	2,672	852	1,387	4,911	342,349	347,260
1-4 family non-owner occupied	695	136	623	1,454	168,083	169,537
1-4 family - 2nd lien	909	90	386	1,385	115,157	116,542
Resort lending	364	53	565	982	67,192	68,174
Installment						
Boat lending	337	107	88	532	202,750	203,282
Recreational vehicle lending	161	97	3	261	153,184	153,445
Other	377	275	202	854	103,030	103,884
Total recorded investment	<u>\$ 7,449</u>	<u>\$ 2,936</u>	<u>\$ 4,091</u>	<u>\$ 14,476</u>	<u>\$ 2,718,894</u>	<u>\$ 2,733,370</u>
Accrued interest included in recorded investment	<u>\$ 74</u>	<u>\$ 34</u>	<u>\$ -</u>	<u>\$ 108</u>	<u>\$ 8,239</u>	<u>\$ 8,347</u>

Impaired loans are as follows:

	December 31,	
	2020	2019
	(In thousands)	
Impaired loans with no allocated allowance for loan losses		
TDR	\$ 93	\$ 337
Non - TDR	1,367	1,550
Impaired loans with an allocated allowance for loan losses		
TDR - allowance based on collateral	9,027	1,587
TDR - allowance based on present value cash flow	37,953	48,798
Non - TDR - allowance based on collateral	1,873	3,365
Total impaired loans	<u>\$ 50,313</u>	<u>\$ 55,637</u>

Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	\$ 1,058	\$ 542
TDR - allowance based on present value cash flow	3,755	4,641
Non - TDR - allowance based on collateral	768	972
Total amount of allowance for loan losses allocated	<u>\$ 5,581</u>	<u>\$ 6,155</u>

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

	2020			2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
	(In thousands)					
With no related allowance for loan losses recorded:						
Commercial						
Commercial and industrial	\$ 77	\$ 80	\$ -	\$ 257	\$ 257	\$ -
Commercial real estate	-	-	-	796	796	-
Mortgage						
1-4 family owner occupied - jumbo	623	629	-	-	-	-
1-4 family owner occupied - non-jumbo	-	-	-	212	217	-
1-4 family non-owner occupied	305	473	-	214	366	-
1-4 family - 2nd lien	301	304	-	407	438	-
Resort lending	154	379	-	-	-	-
Installment						
Boat lending	-	-	-	-	-	-
Recreational vehicle lending	-	-	-	-	-	-
Other	-	-	-	1	41	-
	<u>1,460</u>	<u>1,865</u>	<u>-</u>	<u>1,887</u>	<u>2,115</u>	<u>-</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	2020			2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
(In thousands)						
With an allowance for loan losses recorded:						
Commercial						
Commercial and industrial	2,227	2,370	756	1,655	1,706	453
Commercial real estate	7,127	7,096	510	6,685	6,661	578
Mortgage						
1-4 family owner occupied - jumbo	506	880	50	1,447	1,445	91
1-4 family owner occupied - non-jumbo	21,655	22,311	2,300	10,163	10,695	1,031
1-4 family non-owner occupied	4,335	4,704	495	4,962	5,542	572
1-4 family - 2nd lien	811	829	200	14,059	15,243	1,695
Resort lending	10,555	10,764	1,079	12,110	12,263	1,474
Installment						
Boat lending	7	11	2	-	-	-
Recreational vehicle lending	87	100	19	-	-	-
Other	1,902	2,040	170	2,924	3,153	261
	<u>49,212</u>	<u>51,105</u>	<u>5,581</u>	<u>54,005</u>	<u>56,708</u>	<u>6,155</u>
Total						
Commercial						
Commercial and industrial	2,304	2,450	756	1,912	1,963	453
Commercial real estate	7,127	7,096	510	7,481	7,457	578
Mortgage						
1-4 family owner occupied - jumbo	1,129	1,509	50	1,447	1,445	91
1-4 family owner occupied - non-jumbo	21,655	22,311	2,300	10,375	10,912	1,031
1-4 family non-owner occupied	4,640	5,177	495	5,176	5,908	572
1-4 family - 2nd lien	1,112	1,133	200	14,466	15,681	1,695
Resort lending	10,709	11,143	1,079	12,110	12,263	1,474
Installment						
Boat lending	7	11	2	-	-	-
Recreational vehicle lending	87	100	19	-	-	-
Other	1,902	2,040	170	2,925	3,194	261
Total	<u>\$50,672</u>	<u>\$52,970</u>	<u>\$5,581</u>	<u>\$55,892</u>	<u>\$58,823</u>	<u>\$6,155</u>
Accrued interest included in recorded investment	<u>\$359</u>			<u>\$255</u>		

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	2020		2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)					
With no related allowance for loan losses recorded:						
Commercial						
Commercial and industrial	\$ 125	\$ 9	\$ 51	\$ -	\$ 378	\$ 20
Commercial real estate	159	-	278	5	961	-
Mortgage						
1-4 family owner occupied - jumbo	408	-	-	-	41	-
1-4 family owner occupied - non-jumbo	252	4	201	-	15	27
1-4 family non-owner occupied	308	10	123	-	-	-
1-4 family - 2nd lien	380	-	136	7	-	-
Resort lending	92	-	-	-	-	-
Installment						
Boat lending	-	-	-	-	-	-
Recreational vehicle lending	-	-	-	-	-	-
Other	-	-	-	1	1	11
	<u>1,724</u>	<u>23</u>	<u>789</u>	<u>13</u>	<u>1,396</u>	<u>58</u>
With an allowance for loan losses recorded:						
Commercial						
Commercial and industrial	2,230	242	2,256	72	2,641	127
Commercial real estate	10,751	1,043	5,778	315	5,199	288
Mortgage						
1-4 family owner occupied - jumbo	1,083	84	995	39	1,335	69
1-4 family owner occupied - non-jumbo	19,624	2,033	15,183	594	28,183	1,408
1-4 family non-owner occupied	4,664	375	2,874	291	5,475	314
1-4 family - 2nd lien	3,376	22	13,383	809	284	12
Resort lending	11,316	799	11,697	669	14,687	606
Installment						
Boat lending	59	1	54	-	1	-
Recreational vehicle lending	81	4	22	-	84	4
Other	2,416	225	3,186	189	3,640	224
	<u>55,600</u>	<u>4,828</u>	<u>55,428</u>	<u>2,978</u>	<u>61,529</u>	<u>3,052</u>
Total						
Commercial						
Commercial and industrial	2,355	251	2,307	72	3,019	147
Commercial real estate	10,910	1,043	6,056	320	6,160	288
Mortgage						
1-4 family owner occupied - jumbo	1,491	84	995	39	1,376	69
1-4 family owner occupied - non-jumbo	19,876	2,037	15,384	594	28,198	1,435
1-4 family non-owner occupied	4,972	385	2,997	291	5,475	314
1-4 family - 2nd lien	3,756	22	13,519	816	284	12
Resort lending	11,408	799	11,697	669	14,687	606
Installment						
Boat lending	59	1	54	-	1	-
Recreational vehicle lending	81	4	22	-	84	4
Other	2,416	225	3,186	190	3,641	235
Total	<u>\$ 57,324</u>	<u>\$ 4,851</u>	<u>\$ 56,217</u>	<u>\$ 2,991</u>	<u>\$ 62,925</u>	<u>\$ 3,110</u>

Troubled debt restructurings at December 31 follow:

	2020		
	Commercial	Retail (1)	Total
	(In thousands)		
Performing TDR's	\$ 7,956	\$ 36,385	\$ 44,341
Non-performing TDR's (2)	1,148	1,584 ⁽³⁾	2,732
Total	\$ 9,104	\$ 37,969	\$ 47,073

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

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

We have allocated \$4.8 million and \$5.2 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2020 and 2019, respectively. We have committed to lend additional amounts totaling up to \$0.07 million and \$0.05 million at December 31, 2020 and 2019, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The terms of certain loans were modified as troubled debt restructurings and generally included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for a new loan with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan have generally been for periods ranging from 9 months to 36 months but have extended to as much as 480 months in certain circumstances. Modifications involving an extension of the maturity date have generally been for periods ranging from 1 month to 60 months but have extended to as much as 230 months in certain circumstances.

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

	Number of Contracts	Pre- modification Recorded Balance	Post- modification Recorded Balance
	(Dollars in thousands)		
2020			
Commercial			
Commercial and industrial	7	\$ 1,207	\$ 1,207
Commercial real estate	4	7,012	7,012
Mortgage			
1-4 family owner occupied - jumbo	-	-	-
1-4 family owner occupied - non-jumbo	5	357	374
1-4 family non-owner occupied	2	111	116
1-4 family - 2nd lien	2	44	46
Resort lending	-	-	-
Installment			
Boat lending	-	-	-
Recreational vehicle lending	-	-	-
Other	4	91	93
Total	24	\$ 8,822	\$ 8,848

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

The troubled debt restructurings described above increased (decreased) the AFLL by \$0.04 million, \$0.50 million and \$(0.19) million during the years ended December 31, 2020, 2019 and 2018, respectively and resulted in charge offs of zero during each of the years ended December 31, 2020, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
2020		
Commercial		
Commercial and industrial	-	\$ -
Commercial real estate	-	-
Mortgage		
1-4 family owner occupied - jumbo	-	-
1-4 family owner occupied - non-jumbo	-	-
1-4 family non-owner occupied	-	-
1-4 family - 2nd lien	-	-
Resort lending	-	-
Installment		
Boat lending	-	-
Recreational vehicle lending	-	-
Other	-	-
Total	-	\$ -
2019		
Commercial		
Commercial and industrial	1	\$ 19
Commercial real estate	-	-
Mortgage		
1-4 family owner occupied - jumbo	-	-
1-4 family owner occupied - non-jumbo	1	12
1-4 family non-owner occupied	-	-
1-4 family - 2nd lien	-	-
Resort lending	-	-
Installment		
Boat lending	-	-
Recreational vehicle lending	-	-
Other	-	-
Total	2	\$ 31
2018		
Commercial		
Commercial and industrial	-	\$ -
Commercial real estate	-	-
Mortgage		
1-4 family owner occupied - jumbo	-	-
1-4 family owner occupied - non-jumbo	-	-
1-4 family non-owner occupied	-	-
1-4 family - 2nd lien	-	-
Resort lending	-	-
Installment		
Boat lending	-	-
Recreational vehicle lending	-	-
Other	1	13
Total	1	\$ 13

Information on subsequent accommodation extensions for portfolio loans follows:

Commercial and Retail Loan COVID-19 Subsequent Accomodations (1)

Loan Category	Loans (#)	Loans (\$)
	(Dollars in thousands)	
Commercial	2	\$ 163
Mortgage	100	15,004
Installment	35	1,045
Total	137	\$ 16,212

(1) Subsequent accommodations are extensions of the original accommodations that were given as summarized in the paragraph above.

The CARES Act also included an initial \$349 billion loan program administered through the U.S. Small Business Administration (“SBA”) referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. We are participating as a lender in the PPP. The PPP opened on April 3, 2020 intending to provide American small businesses with eight weeks of cash-flow assistance through 100 percent federally guaranteed loans through the SBA. In late April 2020 the Paycheck Protection Program and Health Care Enhancement Act, added another \$310 billion in funding while the Paycheck Protection Program Flexibility Act made certain changes to the program, by allowing for more time to spend the funds, and making it easier to get a loan fully forgiven. The PPP initially closed on August 8, 2020. On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (“Economic Aid Act”) was signed into law which allocates an additional \$284 billion in funding for the PPP. The Economic Aid Act reopens the PPP through March 31, 2021 with generally the same terms and conditions as originally enacted under the CARES Act while clarifying eligibility and ineligibility for certain entities and expanding the permitted uses of PPP funds. In addition, the Economic Aid Act simplifies the loan forgiveness process for PPP loans of \$150,000 or less. The Economic Aid Act also establishes second draw loans for entities that have already used the initial PPP funds, subject to numerous limitations and eligibility criteria. PPP second draw loans are eligible for forgiveness similar to initial PPP loans, subject to limitations set forth in the Economic Aid Act. As of December 31, 2020, we had 1,483 initial PPP loans outstanding with a total balance of \$169.8 million. PPP loans are included in the commercial and industrial class of the commercial loan portfolio segment. As these loans are 100% guaranteed through the SBA the allowance for loan losses recorded on these loans is zero. As of December 31, 2020, 755 forgiveness applications had been processed and approved for initial PPP loans totaling \$92.0 million (we expect to receive these forgiveness proceeds during the first quarter of 2021). Interest and fees on loans in our consolidated statement of operations includes \$5.6 million for the twelve month period of 2020, related to the accretion of net loan fees on initial PPP loans. No such accretion is included in the comparable prior year periods. At December 31, 2020 we had \$3.2 million of remaining unaccreted net fees related to initial PPP loans. We had no PPP second draw loans outstanding as of December 31, 2020.

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

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

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

Rating 7 and 8: These loans are generally referred to as our “watch” commercial credits. These ratings include loans to borrowers that exhibit potential credit weakness or downward trends. If not checked or cured these trends could weaken our asset or credit position. While potentially weak, no loss of principal or interest is envisioned with these ratings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Rating 9: These loans are generally referred to as our “substandard accruing” commercial credits. This rating includes loans to borrowers that exhibit a well-defined weakness where payment default is probable and loss is possible if deficiencies are not corrected. Generally, loans with this rating are considered collectible as to both principal and interest primarily due to collateral coverage.

Rating 10 and 11: These loans are generally referred to as our “substandard - non-accrual” and “doubtful” commercial credits. These ratings include loans to borrowers with weaknesses that make collection of debt in full, on the basis of current facts, conditions and values at best questionable and at worst improbable. All of these loans are placed in non-accrual.

Rating 12: These loans are generally referred to as our “loss” commercial credits. This rating includes loans to borrowers that are deemed incapable of repayment and are charged-off.

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

	Commercial				Total
	Non-watch 1-6	Watch 7-8	Substandard Accrual 9	Non- Accrual 10-11	
	(In thousands)				
2020					
Commercial and industrial	\$ 637,826	\$ 32,765	\$ 4,341	\$ 1,387	\$ 676,319
Commercial real estate	561,382	5,978	2,272	-	569,632
Total	\$ 1,199,208	\$ 38,743	\$ 6,613	\$ 1,387	\$ 1,245,951
Accrued interest included in total	\$ 3,408	\$ 105	\$ 23	\$ -	\$ 3,536
2019					
Commercial and industrial	\$ 515,955	\$ 44,384	\$ 3,967	\$ 565	\$ 564,871
Commercial real estate	580,516	23,036	535	735	604,822
Total	\$ 1,096,471	\$ 67,420	\$ 4,502	\$ 1,300	\$ 1,169,693
Accrued interest included in total	\$ 2,763	\$ 205	\$ 30	\$ -	\$ 2,998

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

	Mortgage (1)					Total
	1-4 Family Owner Occupied - Jumbo	1-4 Family Owner Occupied - Non-jumbo	1-4 Family Non-owner Occupied	1-4 Family 2nd Lien	Resort Lending	
	(In thousands)					
2020						
800 and above	\$ 61,077	\$ 40,187	\$ 25,468	\$ 12,490	\$ 9,546	\$ 148,768
750-799	223,177	70,642	82,124	42,138	27,530	445,611
700-749	101,086	75,489	30,326	22,962	11,726	241,589
650-699	40,296	44,344	13,182	11,269	6,393	115,484
600-649	11,146	18,519	4,303	2,703	1,670	38,341
550-599	-	11,021	2,388	1,608	917	15,934
500-549	3,396	5,129	1,580	1,012	192	11,309
Under 500	-	2,242	405	348	73	3,068
Unknown	-	-	-	-	-	-
Total	\$ 440,178	\$ 267,573	\$ 159,776	\$ 94,530	\$ 58,047	\$ 1,020,104
Accrued interest included in total	\$ 1,301	\$ 1,641	\$ 587	\$ 373	\$ 276	\$ 4,178

	Mortgage (1)					Total
	1-4 Family Owner Occupied - Jumbo	1-4 Family Owner Occupied - Non-jumbo	1-4 Family Non-owner Occupied	1-4 Family 2nd Lien	Resort Lending	
(In thousands)						
2019						
800 and above	\$48,486	\$43,848	\$24,315	\$13,905	\$11,076	\$141,630
750-799	198,491	111,521	84,656	50,012	29,364	474,044
700-749	106,609	95,064	34,839	30,697	14,626	281,835
650-699	31,553	51,174	13,995	14,267	8,063	119,052
600-649	13,230	21,938	5,897	4,097	2,074	47,236
550-599	514	12,308	1,863	1,703	673	17,061
500-549	1,519	7,940	1,870	1,281	889	13,499
Under 500	641	2,208	533	511	79	3,972
Unknown	510	1,259	1,569	69	1,330	4,737
Total	\$401,553	\$347,260	\$169,537	\$116,542	\$68,174	\$1,103,066
Accrued interest included in total	\$1,139	\$1,662	\$586	\$502	\$266	\$4,155

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

	Installment (1)			
	Boat Lending	Recreational Vehicle Lending	Other	Total
(In thousands)				
2020				
800 and above	\$ 32,231	\$ 29,223	\$ 9,154	\$ 70,608
750-799	123,689	95,890	37,512	257,091
700-749	38,223	33,476	25,262	96,961
650-699	10,189	8,794	21,138	40,121
600-649	2,083	1,305	3,730	7,118
550-599	661	551	1,299	2,511
500-549	342	283	767	1,392
Under 500	95	52	63	210
Unknown	-	-	510	510
Total	\$ 207,513	\$ 169,574	\$ 99,435	\$ 476,522
Accrued interest included in total	\$ 572	\$ 457	\$ 156	\$ 1,185
2019				
800 and above	\$ 28,041	\$ 24,470	\$ 7,611	\$ 60,122
750-799	118,380	88,164	37,583	244,127
700-749	41,490	31,055	27,204	99,749
650-699	11,485	7,267	22,517	41,269
600-649	2,254	1,411	4,470	8,135
550-599	946	592	1,884	3,422
500-549	377	464	1,127	1,968
Under 500	309	22	284	615
Unknown	-	-	1,204	1,204
Total	\$ 203,282	\$ 153,445	\$ 103,884	\$ 460,611
Accrued interest included in total	\$ 490	\$ 378	\$ 326	\$ 1,194

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

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

	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Mortgage loans serviced for :		
Fannie Mae	\$ 1,656,060	\$ 1,449,935
Freddie Mac	1,095,877	852,123
Ginnie Mae	181,615	180,941
FHLB	39,294	69,149
Other	11,242	29,018
Total	<u>\$ 2,984,088</u>	<u>\$ 2,581,166</u>

Custodial deposit accounts maintained in connection with mortgage loans serviced for others totaled \$40.5 million and \$29.9 million, at December 31, 2020 and 2019, respectively.

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

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	<u>(In thousands)</u>		
Balance at beginning of period	\$ 19,171	\$ 21,400	\$ 15,699
Originated servicing rights capitalized	13,957	7,303	4,977
Servicing rights acquired	-	-	3,047
Change in fair value due to price	(10,833)	(6,408)	191
Change in fair value due to pay downs	(5,391)	(3,124)	(2,514)
Balance at end of year	<u>\$ 16,904</u>	<u>\$ 19,171</u>	<u>\$ 21,400</u>
Loans sold and serviced that have had servicing rights capitalized	<u>\$ 2,982,833</u>	<u>\$ 2,580,705</u>	<u>\$ 2,333,081</u>

Fair value of capitalized mortgage loan servicing rights was determined using an average coupon rate of 3.77%, average servicing fee of 0.257%, average discount rate of 10.09% and an average Public Securities Association (“PSA”) prepayment rate of 348 for December 31, 2020; and average coupon rate of 4.22%, average servicing fee of 0.258%, average discount rate of 10.14% and an average PSA prepayment rate of 250 for December 31, 2019.

Purchase Credit Impaired (“PCI”) Loans

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income.

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

	December 31,	
	2020	2019
	(In thousands)	
Commercial	\$ 468	\$ 1,394
Mortgage	410	575
Installment	147	316
Total carrying amount	1,025	2,285
Allowance for loan losses	-	-
Carrying amount, net of allowance for loan losses	\$ 1,025	\$ 2,285

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

	Year ended December 31,	
	2020	2019
	(In thousands)	
Balance at beginning of period	\$ 640	\$ 462
New loans purchased	-	-
Accretion of income	(280)	(187)
Reclassification from (to) nonaccretable difference	-	365
Disposals/other adjustments	-	-
Balance at end of period	\$ 360	\$ 640

NOTE 5 – OTHER REAL ESTATE

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

	2020	2019	2018
	(In thousands)		
Balance at beginning of year, net of valuation allowance	\$ 1,715	\$ 1,178	\$ 1,628
Loans transferred to other real estate	332	2,242	1,510
Sales of other real estate	(1,161)	(1,438)	(1,822)
Additions to valuation allowance charged to expense	(148)	(267)	(138)
Balance at end of year, net of valuation allowance	\$ 738	\$ 1,715	\$ 1,178

(1) Table excludes other repossessed assets totaling \$0.03 million and \$0.15 million at December 31, 2020 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
		(In thousands)	
Balance at beginning of year	\$ 92	\$ 144	\$ 123
Additions charged to expense	148	267	138
Direct write-downs upon sale	(150)	(319)	(117)
Balance at end of year	<u>\$ 90</u>	<u>\$ 92</u>	<u>\$ 144</u>

At December 31, 2020 and 2019, the balance of other real estate includes \$0.7 million and \$1.2 million, respectively of foreclosed residential real estate properties. Retail mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements totaled \$0.3 million and \$0.7 million at December 31, 2020 and 2019, respectively.

Other real estate and repossessed assets totaling \$0.8 million and \$1.9 million at December 31, 2020 and 2019, respectively, are presented net of the valuation allowance on the Consolidated Statements of Financial Condition.

NOTE 6 – PROPERTY AND EQUIPMENT

A summary of property and equipment at December 31 follows:

	<u>2020</u>	<u>2019</u>
	(In thousands)	
Land and land improvements	\$ 17,083	\$ 17,478
Buildings	57,208	57,363
Equipment	72,542	71,194
	<u>146,833</u>	<u>146,035</u>
Accumulated depreciation and amortization	(110,706)	(107,624)
Property and equipment, net	<u>\$ 36,127</u>	<u>\$ 38,411</u>

Depreciation expense was \$5.3 million, \$5.2 million and \$5.1 million in 2020, 2019 and 2018, respectively.

NOTE 7 – GOODWILL AND OTHER INTANGIBLES

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

	<u>2020</u>	<u>2019</u>		
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets - core deposits	\$ 11,916	\$ 7,610	\$ 11,916	\$ 6,590
Unamortized intangible assets - goodwill	<u>\$ 28,300</u>		<u>\$ 28,300</u>	

At December 31, 2020, the Bank (our reporting unit) had positive equity and we elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the Bank exceeds its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the Bank exceeded its carrying value, resulting in no impairment.

Intangible amortization expense was \$1.0 million, \$1.1 million and \$1.0 million during the years ended 2020, 2019 and 2018, respectively.

A summary of estimated core deposit intangible amortization at December 31, 2020, follows:

	(In thousands)
2021	\$ 970
2022	785
2023	547
2024	516
2025	487
2026 and thereafter	1,001
Total	<u>\$ 4,306</u>

NOTE 8 – DEPOSITS

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

	2020	2019	2018
	(In thousands)		
Savings and interest-bearing checking	\$ 2,264	\$ 5,371	\$ 4,146
Reciprocal	2,158	6,024	1,292
Time	7,073	7,148	5,343
Brokered time	1,171	4,882	3,697
Total	<u>\$ 12,666</u>	<u>\$ 23,425</u>	<u>\$ 14,478</u>

Aggregate time deposits in denominations of \$0.25 million or more amounted to \$50.0 million and \$71.5 million at December 31, 2020 and 2019, respectively.

A summary of the maturity of time deposits at December 31, 2020, follows:

	(In thousands)
2021	\$ 370,497
2022	40,671
2023	16,717
2024	5,072
2025	5,457
2026 and thereafter	603
Total	<u>\$ 439,017</u>

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

A summary of reciprocal deposits at December 31 follows:

	2020	2019
	(In thousands)	
Demand	\$ 515,092	\$ 383,953
Money market	3,308	4,416
Time	37,785	42,658
Total	<u>\$ 556,185</u>	<u>\$ 431,027</u>

NOTE 9 – OTHER BORROWINGS

A summary of other borrowings at December 31 follows:

	<u>2020</u>	<u>2019</u>
	(In thousands)	
Advances from the FHLB	\$ 30,000	\$ 63,640
Federal funds purchased	-	25,000
Other	12	6
Total	<u>\$ 30,012</u>	<u>\$ 88,646</u>

Advances from the FHLB are secured by unencumbered qualifying mortgage and home equity loans with a market value equal to at least 132% to 165%, respectively, of outstanding advances. Advances are also secured by FHLB stock that we own, which totaled \$8.6 million at December 31, 2020. Unused borrowing capacity with the FHLB (subject to the FHLB’s credit requirements and policies) was \$772.8 million at December 31, 2020. Interest expense on advances amounted to \$0.5 million, \$0.7 million and \$1.0 million for the years ended December 31, 2020, 2019 and 2018, respectively. No FHLB advances were prepaid during 2020, 2019 or 2018.

As a member of the FHLB, we must own FHLB stock equal to the greater of 0.75% of the unpaid principal balance of residential mortgage assets or 4.5% of our outstanding advances. At December 31, 2020, we were in compliance with the FHLB stock ownership requirements.

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

	<u>2020</u>		<u>2019</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
	(Dollars in thousands)			
Fixed-rate advances				
2020			\$ 28,645	2.19%
2022	\$ -	-%	4,995	1.69
2026 and thereafter	30,000	0.74	30,000	0.74
Total advances	<u>\$ 30,000</u>	0.74%	<u>\$ 63,640</u>	1.47%

Borrowings with the FRB at December 31, 2020 and 2019 were zero. Average borrowings with the FRB during the years ended December 31, 2020, 2019 and 2018 totaled \$1.546 million, \$0.305 million and \$0.003 million. We had unused borrowing capacity with the FRB (subject to the FRB’s credit requirements and policies) of \$492.0 million at December 31, 2020. Collateral for FRB borrowings are certain commercial and installment loans.

Interest expense on federal funds purchased totaled \$0.01 million, \$0.08 million and \$0.10 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Assets, consisting of FHLB stock and loans, pledged to secure other borrowings and unused borrowing capacity totaled \$1.9 billion at December 31, 2020.

NOTE 10 – SUBORDINATED DEBT AND DEBENTURES

Subordinated Debt

In May 2020, we issued \$40.0 million of fixed to floating subordinated notes with a ten year maturity (May 31, 2030 maturity date) and a five year call option. The initial coupon rate is 5.95% fixed for five years and then floats at the Secured Overnight Financing Rate (“SOFR”) plus 5.825%. These notes are presented in the Consolidated Statement of Financial Condition under the caption “Subordinated debt” and the December 31, 2020 balance of \$39.3 million is net of remaining unamortized deferred issuance costs of approximately \$0.7 million that are being amortized through the maturity date into interest expense on other borrowings and subordinated debt and debentures in our Consolidated Statement of Operations. We may redeem the notes, in whole or in part, on or after May 31, 2025, and redeem the notes at any time in whole upon certain other events. Any redemption of the notes will be subject to prior regulatory approval to the extent required.

Subordinated Debentures

We have formed various special purpose entities (the “trusts”) for the purpose of issuing trust preferred securities in either public or pooled offerings or in private placements. Independent Bank Corporation owns all of the common stock of each trust and has issued subordinated debentures to each trust in exchange for all of the proceeds from the issuance of the common stock and the trust preferred securities. Trust preferred securities totaling \$38.3 million and \$38.2 million at December 31, 2020 and 2019, respectively qualified as Tier 1 regulatory capital.

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

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

Summary information regarding subordinated debentures as of December 31 follows:

2020				
Entity Name	Issue Date	Subordinated Debentures	Trust Preferred Securities Issued	Common Stock Issued
		(In thousands)		
IBC Capital Finance III	May 2007	\$ 12,372	\$ 12,000	\$ 372
IBC Capital Finance IV	September 2007	15,465	15,000	465
Midwest Guaranty Trust I	November 2002	7,732	7,500	232
TCSB Statutory Trust I	March 2005	5,155	5,000	155
Discount on TCSB Statutory Trust I		(1,200)	(1,200)	-
		<u>\$ 39,524</u>	<u>\$ 38,300</u>	<u>\$ 1,224</u>

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

Other key terms for the subordinated debentures and trust preferred securities that were outstanding at December 31, 2020 and 2019 follow:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The subordinated debentures and trust preferred securities are cumulative and have a feature that permits us to defer distributions (payment of interest) from time to time for a period not to exceed 20 consecutive quarters. Interest is payable quarterly on each of the subordinated debentures and trust preferred securities and no distributions were deferred at December 31, 2020 and 2019.

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

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

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business, we enter into financial instruments with off-balance sheet risk to meet the financing needs of customers or to reduce exposure to fluctuations in interest rates. These financial instruments may include commitments to extend credit and standby letters of credit. Financial instruments involve varying degrees of credit and interest-rate risk in excess of amounts reflected in the Consolidated Statements of Financial Condition. Exposure to credit risk in the event of non-performance by the counterparties to the financial instruments for loan commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments.

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

	<u>2020</u>		<u>2019</u>
	(In thousands)		
Financial instruments whose risk is represented by contract amounts			
Commitments to extend credit	\$ 644,815	\$	582,457
Standby letters of credit	9,361		7,207

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and generally require payment of a fee. Since commitments may expire without being drawn upon, the commitment amounts do not represent future cash requirements. Commitments are issued subject to similar underwriting standards, including collateral requirements, as are generally involved in the extension of credit facilities.

Standby letters of credit are written conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in such transactions is essentially the same as that involved in extending loan facilities and, accordingly, standby letters of credit are issued subject to similar underwriting standards, including collateral requirements, as are generally involved in the extension of credit facilities. The majority of the standby letters of credit are on-demand with no stated maturity date and have variable rates that range from 2.50% to 12.00%.

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared COVID-19, the disease caused by the novel coronavirus, a pandemic as a result of the global spread of the coronavirus illness. In response to the outbreak, federal and state authorities in the U.S. introduced various measures to try to limit or slow the spread of the virus, including travel restrictions, nonessential business closures, stay-at-home orders, and strict social distancing. The degree to which businesses may resume operations varies based on the type of business operations being conducted. It is currently expected that various forms of state and local government restrictions similar to those described above will continue for the foreseeable future. As a result of these events, Michigan has experienced a significant increase in unemployment.

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

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

These factors may continue for a significant period of time.

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

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

Litigation

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

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

Loss Reimbursement Obligations

The provision for loss reimbursement on sold loans represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae, Freddie Mac, Ginnie Mae and the FHLB). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have

breached a representation or warranty or other contractual requirement related to the loan sale. The provision for loss reimbursement on sold loans was an expense of \$0.20 million, \$0.23 million and \$0.01 million for the years ended December 31, 2020, 2019 and 2018, respectively. The reserve for loss reimbursements on sold mortgage loans totaled \$1.0 million and \$0.9 million at December 31, 2020 and 2019, respectively. This reserve is included in accrued expenses and other liabilities in our Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. We believe that the amounts that we have accrued for incurred losses on sold mortgage loans are appropriate given our analyses. However, future losses could exceed our current estimate.

Visa Stock

We own 12,566 shares of VISA Class B common stock. At the present time, these shares can only be sold to other Class B shareholders. As a result, there has generally been limited transfer activity in private transactions between buyers and sellers. Given the limited activity that we have become aware of and the continuing uncertainty regarding the likelihood, ultimate timing and eventual exchange rate for Class B shares into Class A shares, we continue to carry these shares at zero, representing cost basis less impairment. However, given the current conversion ratio of 1.6228 Class A shares for every 1 Class B share and the closing price of VISA Class A shares on February 26, 2021 of \$212.39 per share, our 12,566 Class B shares would have a current “value” of approximately \$4.3 million. We continue to monitor Class B trading activity and the status of the resolution of certain litigation matters at VISA that would trigger the conversion of Class B common shares into Class A common shares, which would not have any trading restrictions.

NOTE 12 – SHAREHOLDERS’ EQUITY AND INCOME PER COMMON SHARE

Our Board of Directors authorized share repurchase plans to buy back up to 5% of our outstanding common stock during 2020, 2019 and 2018. In addition, in June, 2019 our Board of Directors authorized a 300,000 share expansion of the 2019 repurchase plan. During 2020, 2019 and 2018 repurchases were made through open market and negotiated transactions and totaled 708,956, 1,204,688 and 587,969 shares of common stock, respectively for an aggregate purchase price of \$14.2 million, \$26.3 million and \$12.7 million, respectively.

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(In thousands, except per share amounts)		
Net income	\$ 56,152	\$ 46,435	\$ 39,839
Weighted average shares outstanding (1)	21,977	22,894	23,412
Stock units for deferred compensation plan for non-employee directors	121	132	128
Effect of stock options	90	115	176
Performance share units	33	42	53
Weighted average shares outstanding for calculation of diluted earnings per share	<u>22,221</u>	<u>23,183</u>	<u>23,769</u>
Net income per common share			
Basic (1)	\$ 2.56	\$ 2.03	\$ 1.70
Diluted	<u>\$ 2.53</u>	<u>\$ 2.00</u>	<u>\$ 1.68</u>

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

Weighted average stock options outstanding that were not considered in computing diluted net income per common share because they were anti-dilutive were zero for each year ended 2020, 2019 and 2018, respectively.

NOTE 13 – INCOME TAX

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
		(In thousands)	
Current expense	\$ 15,459	\$ 10,237	\$ -
Deferred expense (benefit)	(2,130)	1,088	9,294
Income tax expense	<u>\$ 13,329</u>	<u>\$ 11,325</u>	<u>\$ 9,294</u>

The deferred income tax benefit of \$2.1 million in 2020 can be primarily attributed to the increase in our allowance for loan losses while the deferred income tax expense of \$1.1 million during 2019 can be primarily attributed to the utilization of our net operating loss (“NOL”) carryforward and alternative minimum tax credit carryforward while the deferred income tax expense of \$9.3 million during 2018 can be primarily attributed to the utilization of our NOL carryforward.

A reconciliation of income tax expense to the amount computed by applying the statutory federal income tax rate of 21% for 2020, 2019 and 2018 to the income before income tax for the years ended December 31 follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
		(In thousands)	
Statutory rate applied to income before income tax	\$ 14,591	\$ 12,130	\$ 10,318
Tax-exempt income	(690)	(375)	(383)
Unrecognized tax benefit	(206)	(134)	(162)
Share-based compensation	(204)	(204)	(367)
Bank owned life insurance	(196)	(233)	(229)
Non-deductible meals, entertainment and memberships	57	86	85
Other, net	(23)	55	32
Income tax expense	<u>\$ 13,329</u>	<u>\$ 11,325</u>	<u>\$ 9,294</u>

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

	<u>2020</u>	<u>2019</u>
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	\$ 7,363	\$ 5,355
Lease liabilities	1,652	1,744
Property and equipment	1,047	1,528
Share-based compensation	742	808
Reserve for unfunded lending commitments	379	324
Deferred compensation	321	285
Loss reimbursement on sold loans reserve	214	185
Non accrual loan interest income	203	173
Other than temporary impairment charge on securities available for sale	144	147
Vehicle service contract counterparty contingency reserve	26	38
Unrealized loss on derivative financial instruments	-	459
Gross deferred tax assets	<u>12,091</u>	<u>11,046</u>
Deferred tax liabilities		
Capitalized mortgage loan servicing rights	3,550	4,026
Deferred loan fees	1,901	1,852
Lease right of use asset	1,606	1,739
Unrealized gain on securities available for sale	4,206	994
Purchase premiums, net	509	293
Federal Home Loan Bank stock	27	27
Other	17	43
Gross deferred tax liabilities	<u>11,816</u>	<u>8,974</u>
Deferred tax assets, net	<u>\$ 275</u>	<u>\$ 2,072</u>

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

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(In thousands)		
Balance at beginning of year	\$ 438	\$ 588	\$ 724
Additions based on tax positions related to the current year	15	20	26
Reductions due to the statute of limitations	(273)	(170)	(162)
Reductions due to settlements	-	-	-
Balance at end of year	<u>\$ 180</u>	<u>\$ 438</u>	<u>\$ 588</u>

If recognized, the entire amount of unrecognized tax benefits, net of \$0.04 million of federal tax on state benefits, would affect our effective tax rate. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. No amounts were expensed for interest and penalties for the years ended December 31, 2020, 2019 and 2018. No amounts were accrued for interest and penalties at December 31, 2020, 2019 and 2018. At December 31, 2020, U.S. Federal tax years 2017 through the present remain open to examination.

NOTE 14 – SHARE BASED COMPENSATION AND BENEFIT PLANS

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.4 million shares of common stock as of December 31, 2020. The non-employee director stock purchase plan permits the grant of additional share based payments for up to 0.1 million shares of common stock as of December 31, 2020. Share based awards and payments are measured at fair value at the date of grant and are expensed over the requisite service period. Common shares issued upon exercise of stock options come from currently authorized but unissued shares.

During 2020, 2019 and 2018 pursuant to our long-term incentive plan, we granted 0.06 million, 0.06 million and 0.05 million shares, respectively of restricted stock and 0.02 million during each year of performance stock units (“PSUs”), to certain officers. Except for 0.010 million shares and 0.002 million shares of restricted stock issued in 2019 and 2018, respectively that vest ratably over three years, all shares of restricted stock and PSUs cliff vest after a period of three years. The performance feature of the PSUs is based on a comparison of our total shareholder return over the vesting period starting on the grant date to the total shareholder return over that period for a banking index of our peers. We have not issued stock options since 2013, other than in connection with the Merger (see note #26).

Our directors may elect to receive all or a portion of their cash retainer fees in the form of common stock (either on a current basis or on a deferred basis) pursuant to the non-employee director stock purchase plan referenced above. Shares equal in value to that portion of each director’s fees that he or she has elected to receive in stock on a current basis are issued each quarter and vest immediately. Shares issued on a deferred basis are credited at the rate of 90% of the current fair value of our common stock and vest immediately. We issued 0.02 million, 0.01 million and 0.01 million shares to directors pursuant to this plan during the years ending 2020, 2019 and 2018, respectively and expensed their value during those same periods.

Total compensation expense recognized for grants pursuant to our long-term incentive plan was \$1.6 million, \$1.6 million and \$1.5 million in 2020, 2019 and 2018, respectively. The corresponding tax benefit relating to this expense was \$0.3 million during each year. Total expense recognized for non-employee director share based payments was \$0.4 million, \$0.3 million and \$0.2 million in 2020, 2019 and 2018, respectively. The corresponding tax benefit relating to this expense was \$0.07 million, \$0.05 million and \$0.04 million in 2020, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At December 31, 2020, the total expected compensation cost related to non-vested restricted stock and PSUs not yet recognized was \$1.7 million. The weighted-average period over which this amount will be recognized is 1.7 years.

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

	<u>Number of Shares</u>	<u>Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term (Years)</u>	<u>Aggregated Intrinsic Value (In thousands)</u>
Outstanding at January 1, 2020	138,506	\$ 4.62		
Granted	-			
Exercised	(17,317)	3.27		
Forfeited	-			
Expired	-			
Outstanding at December 31, 2020	<u>121,189</u>	<u>\$ 4.81</u>	<u>2.1</u>	<u>\$ 1,658</u>
Vested and expected to vest at December 31, 2020	<u>121,189</u>	<u>\$ 4.81</u>	<u>2.1</u>	<u>\$ 1,658</u>
Exercisable at December 31, 2020	<u>121,189</u>	<u>\$ 4.81</u>	<u>2.1</u>	<u>\$ 1,658</u>

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

	<u>Number of Shares</u>	<u>Weighted- Average Grant Date Fair Value</u>
Outstanding at January 1, 2020	245,726	\$ 21.72
Granted	76,893	22.46
Vested	(94,342)	19.96
Forfeited	(21,160)	22.63
Outstanding at December 31, 2020	<u>207,117</u>	<u>\$ 22.70</u>

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	<u>(In thousands)</u>		
Intrinsic value	<u>\$ 293</u>	<u>\$ 897</u>	<u>\$ 2,333</u>
Cash proceeds received	<u>\$ 57</u>	<u>\$ 706</u>	<u>\$ 1,420</u>
Tax benefit realized	<u>\$ 61</u>	<u>\$ 188</u>	<u>\$ 490</u>

We maintain 401(k) and employee stock ownership plans covering substantially all of our full-time employees. We matched 50% of employee contributions to the 401(k) plan up to a maximum of 8% of participating employees' eligible wages for 2020, 2019 and 2018. Contributions to the employee stock ownership plan are determined annually and require approval of our Board of Directors. The maximum contribution is 6% of employees' eligible wages. Contributions to the employee stock ownership plan were 2% for 2020, 2019 and 2018. Amounts expensed for these retirement plans were \$3.2 million, \$2.6 million and \$2.3 million in 2020, 2019 and 2018, respectively.

Our employees participate in various performance-based compensation plans. Amounts expensed for all incentive plans totaled \$15.7 million, \$9.5 million and \$9.8 million in 2020, 2019 and 2018, respectively.

We also provide certain health care and life insurance programs to substantially all full-time employees. Amounts expensed for these programs totaled \$4.8 million, \$5.7 million and \$5.2 million in 2020, 2019 and 2018 respectively.

These insurance programs are also available to retired employees at their own expense.

NOTE 15 – OTHER NON-INTEREST INCOME

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(In thousands)		
Investment and insurance commissions	\$ 1,971	\$ 1,658	\$ 1,971
ATM fees	1,197	1,403	1,457
Bank owned life insurance	910	1,111	970
Other	3,443	5,110	4,362
Total other non-interest income	<u>\$ 7,521</u>	<u>\$ 9,282</u>	<u>\$ 8,760</u>

NOTE 16 – DERIVATIVE FINANCIAL INSTRUMENTS

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

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

	<u>2020</u>		
	<u>Notional</u>	<u>Average</u>	<u>Fair</u>
	Amount	Maturity	Value
	(Dollars in thousands)		
Fair value hedge designation			
Pay-fixed interest rate swap agreements - commercial	\$ 7,088	8.4	\$ (776)
Pay-fixed interest rate swap agreements - securities available for sale	41,950	7.1	15
Total	<u>\$ 49,038</u>	7.3	<u>\$ (761)</u>
No hedge designation			
Rate-lock mortgage loan commitments	\$ 168,816	0.1	\$ 7,020
Mandatory commitments to sell mortgage loans	186,092	0.1	(941)
Pay-fixed interest rate swap agreements - commercial	147,456	4.5	(9,700)
Pay-variable interest rate swap agreements - commercial	147,456	4.5	9,700
Pay-fixed interest rate swap agreements	25,000	0.6	(295)
Interest rate cap agreements	135,000	1.8	5
Purchased options	2,908	0.5	42
Written options	2,848	0.5	(42)
Total	<u>\$ 815,576</u>	2.0	<u>\$ 5,789</u>

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

We have established management objectives and strategies that include interest-rate risk parameters for maximum fluctuations in net interest income and market value of portfolio equity. We monitor our interest rate risk position via simulation modeling reports. The goal of our asset/liability management efforts is to maintain profitable financial leverage within established risk parameters.

To meet our asset/liability management objectives, we may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates (“Cash Flow Hedges”). Cash Flow Hedges included certain pay-fixed interest rate swaps and interest rate cap agreements. Pay-fixed interest rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates. Under interest-rate cap agreements, we will receive cash if interest rates rise above a predetermined level. As a result, we effectively have variable-rate debt with an established maximum rate. We paid an upfront premium on interest rate caps which was recognized in earnings in the same period in which the hedged item affected earnings. During the first and third quarters of 2020 we transferred all of our Cash Flow Hedge interest rate cap agreements and pay-fixed interest rate swaps, respectively to a no hedge designation. The \$2.0 million and \$0.5 million unrealized loss on our Cash Flow Hedge interest rate cap agreements and pay-fixed interest rate swaps, respectively which were included as a component of accumulated other comprehensive income (loss) at the time of the transfers were being reclassified into earnings over the remaining life of the interest rate cap agreements and pay-fixed interest rate swap agreements. In the fourth quarter of 2020 it became probable that the forecasted transactions being hedged by these interest rate cap agreements and pay-fixed interest rate swap agreements would not occur by the end of the originally specified time period. As a result, all remaining unrealized losses included as a component of accumulated other comprehensive income (loss) were reclassified into earnings. The interest rate cap agreements and pay-fixed interest rate swaps are now classified as a no hedge designation at December 31, 2020 and any changes in fair value since the transfers to the no hedge designation are recorded in earnings.

We have entered into a pay-fixed interest rate swap to protect a portion of the fair value of a certain fixed rate commercial loan (“Fair Value Hedge – Commercial Loan”). As a result, changes in the fair value of the pay-fixed interest rate swap is expected to offset changes in the fair value of the fixed rate commercial loan due to fluctuations in interest rates. We record the fair value of Fair Value Hedge – Commercial Loan in accrued income and other assets and accrued expenses and other liabilities on our Consolidated Statements of Financial Condition. The hedged item (fixed rate commercial loan) is also recorded at fair value which offsets the adjustment to the Fair Value Hedge –

Commercial Loan. On an ongoing basis, we adjust our Consolidated Statements of Financial Condition to reflect the then current fair value of both the Fair Value Hedge – Commercial Loan and the hedged item. The related gains or losses are reported in interest income – interest and fees on loans in our Consolidated Statements of Operations.

During 2020 we entered into pay-fixed interest rate swaps to protect a portion of the fair value of certain securities available for sale (“Fair Value Hedge – AFS Securities”). As a result, the change in the fair value of the pay-fixed interest rate swaps is expected to offset a portion of the change in the fair value of the fixed rate securities available for sale due to fluctuations in interest rates. We record the fair value of Fair Value Hedge – AFS Securities in accrued income and other assets and accrued expenses and other liabilities on our Consolidated Statements of Financial Condition. The hedged item (fixed rate securities available for sale) is also recorded at fair value which offsets the adjustment to the Fair Value Hedge – AFS Securities. On an ongoing basis, we adjust our Consolidated Statements of Financial Condition to reflect the then current fair value of both the Fair Value Hedge – AFS Securities and the hedged item. The related gains or losses are reported in interest income – interest on securities available for sale – tax-exempt in our Consolidated Statements of Operations.

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	December 31,				December 31,			
	2020		2019		2020		2019	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
								(In thousands)
Derivatives designated as hedging instruments								
Pay-fixed interest rate swap agreements	Other assets	\$ 15	Other assets	\$ -	Other liabilities	\$ 776	Other liabilities	\$ 416
Interest rate cap agreements	Other assets	-	Other assets	214	Other liabilities	-	Other liabilities	-
		<u>15</u>		<u>214</u>		<u>776</u>		<u>416</u>
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	7,020	Other assets	1,412	Other liabilities	\$ -	Other liabilities	-
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	-	Other liabilities	941	Other liabilities	150
Pay-fixed interest rate swap agreements - commercial	Other assets	-	Other assets	28	Other liabilities	9,700	Other liabilities	3,669
Pay-variable interest rate swap agreements - commercial	Other assets	9,700	Other assets	3,669	Other liabilities	-	Other liabilities	28
Pay-fixed interest rate swap agreements	Other assets	-	Other assets	-	Other liabilities	295	Other liabilities	-
Interest rate cap agreements	Other assets	5	Other assets	-	Other liabilities	-	Other liabilities	-
Purchased options	Other assets	42	Other assets	141	Other liabilities	-	Other liabilities	-
Written options	Other assets	-	Other assets	-	Other liabilities	42	Other liabilities	139
		<u>16,767</u>		<u>5,250</u>		<u>10,978</u>		<u>3,986</u>
Total derivatives		<u>\$ 16,782</u>		<u>\$ 5,464</u>		<u>\$ 11,754</u>		<u>\$ 4,402</u>

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

Year Ended December 31,											
Gain (loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)			Location Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)			Location of Gain (Loss) Recognized in Income(1)	Gain (Loss) Recognized in Income(1)			
				2020	2019	2018		2020	2019	2018	2020
(In thousands)											
Fair Value Hedges											
Pay-fixed interest rate swap agreement - Commercial loan							Interest and fees on loans	\$ (534)	\$ (242)	\$ -	
Pay-fixed interest rate swap agreements - Securities available for sale							Interest on securities available for sale - tax-exempt	15	-	-	
Total								<u>\$ (519)</u>	<u>\$ (242)</u>	<u>\$ -</u>	
Cash Flow Hedges											
Interest rate cap agreements	\$ 125	\$ (1,211)	\$ (340)	Interest expense	\$ (1,885)	\$ 363	\$ 206	Interest expense	\$ -	\$ -	\$ -
Pay-fixed interest rate swap agreements	(479)	(392)	78	Interest expense	(654)	62	31	Interest expense	-	-	(12)
Total	<u>\$ (354)</u>	<u>\$ (1,603)</u>	<u>\$ (262)</u>		<u>\$ (2,539)</u>	<u>\$ 425</u>	<u>\$ 237</u>		<u>\$ -</u>	<u>\$ -</u>	<u>\$ (12)</u>
No hedge designation											
Rate-lock mortgage loan commitments							Net gains on mortgage loans	\$ 5,608	\$ 725	\$ 157	
Mandatory commitments to sell mortgage loans							Net gains on mortgage loans	(791)	233	(420)	
Pay-fixed interest rate swap agreements - commercial							Interest income	(6,059)	(4,046)	113	
Pay-variable interest rate swap agreements -commercial							Interest income	6,059	4,046	(113)	
Pay-fixed interest rate swap agreements							Interest expense	231	-	-	
Interest rate cap agreements							Interest expense	(57)	-	-	
Purchased options							Interest expense	(99)	25	(206)	
Written options							Interest expense	97	(23)	206	
Total								<u>\$ 4,989</u>	<u>\$ 960</u>	<u>\$ (263)</u>	

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

NOTE 17 – RELATED PARTY TRANSACTIONS

Certain of our directors and executive officers, including companies in which they are officers or have significant ownership, were loan and deposit customers during 2020 and 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Balance at beginning of year	\$ 13,077	\$ 14,205
New loans and advances	417	713
Repayments	(11,078)	(1,841)
Balance at end of year	<u>\$ 2,416</u>	<u>\$ 13,077</u>

Deposits held by us for directors and executive officers totaled \$2.0 million at both December 31, 2020 and 2019.

NOTE 18 – LEASES

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

Leases are classified as operating or finance leases at the lease commencement date (we did not have any finance leases as of December 31, 2020). Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. The ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of the lease payment over the lease term.

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

The cost components of our operating leases follows:

	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Operating lease cost	\$ 1,780	\$ 2,217
Variable lease cost	69	142
Short-term lease cost	36	19
Total	<u>\$ 1,885</u>	<u>\$ 2,378</u>

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

Supplemental balance sheet information related to our operating leases follows:

	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Lease right of use asset (1)	<u>\$ 7,646</u>	<u>\$ 8,282</u>
Lease liabilities (2)	<u>\$ 7,868</u>	<u>\$ 8,304</u>
Weighted average remaining lease term (years)	<u>7.12</u>	<u>7.47</u>
Weighted average discount rate	<u>2.4%</u>	<u>2.8%</u>

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

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

Maturity analysis of our lease liabilities at December 31, 2020 based on required contractual payments follows:

	<u>(In thousands)</u>
2021	\$ 1,669
2022	1,489
2023	1,222
2024	815
2025	809
2026 and thereafter	2,525
Total lease payments	<u>8,529</u>
Less imputed interest	<u>(661)</u>
Total	<u>\$ 7,868</u>

NOTE 19 – CONCENTRATIONS OF CREDIT RISK

Credit risk is the risk to earnings and capital arising from an obligor’s failure to meet the terms of any contract with our organization or otherwise failing to perform as agreed. Credit risk can occur outside of our traditional lending activities and can exist in any activity where success depends on counterparty, issuer or borrower performance. Concentrations of credit risk (whether on- or off-balance sheet) arising from financial instruments can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries or certain geographic regions. Credit risk associated with these concentrations could arise when a significant amount of loans or other financial instruments, related by similar characteristics, are simultaneously impacted by changes in economic or other conditions that cause their probability of repayment or other type of settlement to be adversely affected. Our major concentrations of credit risk arise by collateral type and by industry. The significant concentrations by collateral type at December 31, 2020, include \$930.9 million of loans secured by residential real estate and \$232.7 million of construction and development loans.

Additionally, within our commercial real estate and commercial loan portfolio, we had significant standard industry classification concentrations in the following categories as of December 31, 2020: Lessors of Nonresidential Real Estate (\$301.8 million); Lessors of Residential Real Estate (\$119.6 million); Construction (\$130.4 million); Manufacturing (\$99.4 million); Accommodation and Food Services (\$99.1 million) and Health Care and Social Assistance (\$87.2 million). A geographic concentration arises because we primarily conduct our lending activities in the State of Michigan.

NOTE 20 – REGULATORY MATTERS

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank’s current year net profits, combined with the retained net profits of the preceding two years. Further, the Bank cannot pay a dividend at any time that it has negative undivided profits. As of December 31, 2020, the Bank had positive undivided profits of \$77.8 million. It is not our intent to have dividends paid in amounts that would reduce the capital of our Bank to levels below those which we consider prudent or that would not be in accordance with guidelines of regulatory authorities.

We are also subject to various regulatory capital requirements. The prompt corrective action regulations establish quantitative measures to ensure capital adequacy and require minimum amounts and ratios of total, Tier 1, and common equity Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can result in certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. In addition, capital adequacy rules include a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets that applies to all supervised financial institutions. To avoid limits on capital distributions and certain discretionary bonus payments we must meet the minimum ratio for adequately capitalized institutions plus the buffer. Under capital adequacy guidelines, we must meet specific capital requirements that involve quantitative measures as well as qualitative judgments by the regulators. The most recent regulatory filings as of December 31, 2020 and 2019, categorized our Bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent Federal Deposit Insurance Corporation (“FDIC”) categorization.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Our actual capital amounts and ratios at December 31 follow⁽¹⁾:

	Actual		Minimum for Adequately Capitalized Institutions		Minimum for Well-Capitalized Institutions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
2020						
Total capital to risk-weighted assets						
Consolidated	\$ 455,072	15.95%	\$ 228,214	8.00%	NA	NA
Independent Bank	401,005	14.06	228,111	8.00	\$ 285,139	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 379,395	13.30%	\$ 171,161	6.00%	NA	NA
Independent Bank	365,343	12.81	171,083	6.00	\$ 228,111	8.00%
Common equity tier 1 capital to risk-weighted assets						
Consolidated	\$ 341,095	11.96%	\$ 128,370	4.50%	NA	NA
Independent Bank	365,343	12.81	128,312	4.50	\$ 185,340	6.50%
Tier 1 capital to average assets						
Consolidated	\$ 379,395	9.15%	\$ 165,825	4.00%	NA	NA
Independent Bank	365,343	8.81	165,828	4.00	\$ 207,285	5.00%
2019						
Total capital to risk-weighted assets						
Consolidated	\$ 380,454	13.74%	\$ 221,562	8.00%	NA	NA
Independent Bank	358,914	12.96	221,482	8.00	\$ 276,852	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 352,764	12.74%	\$ 166,171	6.00%	NA	NA
Independent Bank	331,224	11.96	166,111	6.00	\$ 221,482	8.00%
Common equity tier 1 capital to risk-weighted assets						
Consolidated	\$ 314,532	11.36%	\$ 124,628	4.50%	NA	NA
Independent Bank	331,224	11.96	124,583	4.50	\$ 179,954	6.50%
Tier 1 capital to average assets						
Consolidated	\$ 352,764	10.11%	\$ 139,632	4.00%	NA	NA
Independent Bank	331,224	9.49	139,615	4.00	\$ 174,519	5.00%

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

NA - Not applicable

The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	December 31,		December 31,	
	2020	2019	2020	2019
	(In thousands)			
Total shareholders' equity	\$ 389,522	\$ 350,169	\$ 413,770	\$ 366,861
Add (deduct)				
Accumulated other comprehensive loss for regulatory purposes	(15,821)	(2,011)	(15,821)	(2,011)
Goodwill and other intangibles	(32,606)	(33,626)	(32,606)	(33,626)
Common equity tier 1 capital	341,095	314,532	365,343	331,224
Qualifying trust preferred securities	38,300	38,232	-	-
Tier 1 capital	379,395	352,764	365,343	331,224
Subordinated debt	40,000	-	-	-
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	35,677	27,690	35,662	27,690
Total risk-based capital	<u>\$ 455,072</u>	<u>\$ 380,454</u>	<u>\$ 401,005</u>	<u>\$ 358,914</u>

NOTE 21 – FAIR VALUE DISCLOSURES

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

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

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

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

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

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

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

Loans held for sale: The fair value of mortgage loans held for sale, carried at fair value is based on agency cash window loan pricing for comparable assets (recurring Level 2).

Impaired loans with specific loss allocations based on collateral value: From time to time, certain loans are considered impaired and an AFL is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. We measure our investment in an impaired loan based on one of three methods: the loan's observable market price, the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2020 and 2019, all of our total impaired loans were evaluated based on either the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. When the fair value of the collateral is based on an appraised value we record the impaired loan as nonrecurring Level 3. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and thus will typically result in a Level 3 classification of the inputs for determining fair value.

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

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

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

Derivatives: The fair value of rate-lock mortgage loan commitments is based on agency cash window loan pricing for comparable assets and the fair value of mandatory commitments to sell mortgage loans is based on mortgage backed security pricing for comparable assets (recurring Level 2). The fair value of interest rate swap and interest rate cap agreements are derived from proprietary models which utilize current market data. The significant fair value inputs can generally be observed in the market place and do not typically involve judgment by management (recurring Level 2). The fair value of purchased and written options is based on prices of financial instruments with similar characteristics and do not typically involve judgment by management (recurring Level 2).

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

	Fair Value Measurements	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
(In thousands)				
December 31, 2020:				
Measured at Fair Value on a Recurring Basis				
Assets				
Securities available for sale				
U.S. agency	\$ 10,748	\$ -	\$ 10,748	\$ -
U.S. agency residential mortgage-backed	344,582	-	344,582	-
U.S. agency commercial mortgage-backed	7,195	-	7,195	-
Private label mortgage-backed	42,829	-	42,829	-
Other asset backed	254,181	-	254,181	-
Obligations of states and political subdivisions	324,293	-	324,293	-
Corporate	86,017	-	86,017	-
Trust preferred	1,798	-	1,798	-
Foreign government	516	-	516	-
Loans held for sale, carried at fair value	92,434	-	92,434	-
Capitalized mortgage loan servicing rights	16,904	-	-	16,904
Derivatives (1)	16,782	-	16,782	-
Liabilities				
Derivatives (2)	11,754	-	11,754	-
Measured at Fair Value on a Non-recurring Basis:				
Assets				
Impaired loans (3)				
Commercial				
Commercial and industrial	1,468	-	-	1,468
Commercial real estate	6,586	-	-	6,586
Mortgage				
1-4 family owner occupied - jumbo	-	-	-	-
1-4 family owner occupied - non-jumbo	321	-	-	321
1-4 family non-owner occupied	155	-	-	155
1-4 family - 2nd lien	324	-	-	324
Resort lending	61	-	-	61
Installment				
Boat lending	4	-	-	4
Recreational vehicle lending	31	-	-	31
Other	124	-	-	124
Other real estate (4)				
1-4 family owner occupied - non-jumbo	102	-	-	102

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

(2) Included in accrued expenses and other liabilities in the Consolidated Statements of Financial Condition.

(3) Only includes impaired loans with specific loss allocations based on collateral value.

(4) Only includes other real estate with subsequent write downs to fair value.

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

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

(2) Included in accrued expenses and other liabilities in the Consolidated Statements of Financial Condition.

(3) Only includes impaired loans with specific loss allocations based on collateral value.

(4) Only includes other real estate with subsequent write downs to fair value.

Changes in fair values of financial assets for which we have elected the fair value option for the years ended December 31 were as follows:

	Net Gains (Losses) on Assets			Mortgage Loan Servicing, net	Total Change in Fair Values Included in Current Period Earnings
	Securities Available For Sale	Mortgage Loans			
(In thousands)					
2020					
Loans held for sale	\$ -	\$ 1,962	\$ -	\$ 1,962	
Capitalized mortgage loan servicing rights	-	-	(16,224)	(16,224)	
2019					
Equity securities at fair value	\$ 167	\$ -	\$ -	\$ 167	
Loans held for sale	-	637	-	637	
Capitalized mortgage loan servicing rights	-	-	(9,532)	(9,532)	
2018					
Trading securities	\$ (62)	\$ -	\$ -	\$ (62)	
Loans held for sale	-	413	-	413	
Capitalized mortgage loan servicing rights	-	-	(2,323)	(2,323)	

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

The following represent impairment charges recognized during the years ended December 31, 2020, 2019 and 2018 relating to assets measured at fair value on a non-recurring basis:

- Loans which are measured for impairment using the fair value of collateral for collateral dependent loans had a carrying amount of \$9.1 million, which is net of a valuation allowance of \$1.8 million at December 31, 2020, and had a carrying amount of \$3.4 million, which is net of a valuation allowance of \$1.5 million at December 31, 2019. An additional provision for loan losses relating to these impaired loans of \$0.7 million, \$1.3 million and \$1.3 million was included in our results of operations for the years ending December 31, 2020, 2019 and 2018, respectively.
- Other real estate, which is measured using the fair value of the property, had a carrying amount of \$0.10 million which is net of a valuation allowance of \$0.09 million at December 31, 2020, and a carrying amount of \$0.06 million which is net of a valuation allowance of \$0.09 million, at December 31, 2019. An additional charge relating to other real estate measured at fair value of \$0.03 million, \$0.03 million and \$0.09 million was included in our results of operations during the years ended December 31, 2020, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

A reconciliation for all assets and (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31 follows:

	Capitalized Mortgage Loan Servicing Rights		
	2020	2019	2018
	(In thousands)		
Beginning balance	\$ 19,171	\$ 21,400	\$ 15,699
Total losses realized and unrealized:			
Included in results of operations	(16,224)	(9,532)	(2,323)
Included in other comprehensive income (loss)	-	-	-
Purchases, issuances, settlements, maturities and calls	13,957	7,303	8,024
Transfers in and/or out of Level 3	-	-	-
Ending balance	<u>\$ 16,904</u>	<u>\$ 19,171</u>	<u>\$ 21,400</u>
Amount of total losses for the period included in earnings attributable to the change in unrealized losses relating to assets and liabilities still held at December 31	<u>\$ (16,224)</u>	<u>\$ (9,532)</u>	<u>\$ (2,323)</u>

The fair value of our capitalized mortgage loan servicing rights has been determined based on a valuation model used by an independent third party as discussed above. The significant unobservable inputs used in the fair value measurement of the capitalized mortgage loan servicing rights are discount rate, cost to service, ancillary income, float rate and prepayment rate. Significant changes in all five of these assumptions in isolation would result in significant changes to the value of our capitalized mortgage loan servicing rights. Quantitative information about our Level 3 fair value measurements measured on a recurring basis follows:

	Asset Fair Value (In thousands)	Valuation Technique	Unobservable Inputs	Range	Weighted Average
2020					
Capitalized mortgage loan servicing rights	\$ 16,904	Present value of net servicing revenue	Discount rate	10.00% to 13.00%	10.09%
			Cost to service	\$ 69 to \$289	\$ 79
			Ancillary income	20 to 37	22
			Float rate	0.43%	0.43%
			Prepayment rate	7.92% to 64.70%	20.85
2019					
Capitalized mortgage loan servicing rights	\$ 19,171	Present value of net servicing revenue	Discount rate	10.00% to 13.00%	10.14%
			Cost to service	\$ 66 to \$316	\$ 81
			Ancillary income	20 to 37	22
			Float rate	1.73%	1.73%
			Prepayment rate	7.01% to 69.34%	14.96

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	<u>Asset Fair Value</u> (In thousands)	<u>Valuation Technique</u>	<u>Unobservable Inputs</u>	<u>Range</u>	<u>Weighted Average</u>
2020					
Impaired loans					
Commercial	\$ 8,054	Sales comparison	Adjustment for differences between comparable sales	(40.0)% to 75.0%	3.8%
Mortgage and Installment (1)	1,020	Sales comparison approach	Adjustment for differences between comparable sales	(73.3) to 104.6	(1.5)
Other real estate					
Mortgage	102	Sales comparison approach	Adjustment for differences between comparable sales	(13.1) to 2.4	(3.6)
2019					
Impaired loans					
Commercial	\$ 971	Sales comparison	Adjustment for differences between comparable sales	(48.0)% to 19.2%	(5.6)%
Mortgage and Installment (1)	2,467	Sales comparison approach	Adjustment for differences between comparable sales	(25.2) to 49.2	11.5
Other real estate					
Mortgage and Installment	59	Sales comparison approach	Adjustment for differences between comparable sales	(11.6) to 5.0	(5.1)

(1) In addition to the valuation techniques and unobservable inputs discussed above, at December 31, 2020 and 2019 certain impaired collateral dependent installment loans totaling approximately \$0.16 million and \$0.14 million are secured by collateral other than real estate. For the majority of these loans, we apply internal discount rates to industry valuation guides.

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding for loans held for sale for which the fair value option has been elected at December 31:

	<u>Aggregate Fair Value</u>	<u>Difference</u> (In thousands)	<u>Contractual Principal</u>
Loans held for sale			
2020	\$ 92,434	\$ 3,856	\$ 88,578
2019	69,800	1,894	67,906
2018	44,753	1,257	43,496

NOTE 22 – FAIR VALUES OF FINANCIAL INSTRUMENTS

Most of our assets and liabilities are considered financial instruments. Many of these financial instruments lack an available trading market and it is our general practice and intent to hold the majority of our financial instruments to maturity. Significant estimates and assumptions were used to determine the fair value of financial instruments. These estimates are subjective in nature, involving uncertainties and matters of judgment, and therefore, fair values may not be a precise estimate. Changes in assumptions could significantly affect the estimates.

Estimated fair values have been determined using available data and methodologies that are considered suitable for each category of financial instrument. For instruments with adjustable interest rates which reprice frequently and without significant credit risk, it is presumed that estimated fair values approximate the recorded book balances.

The estimated recorded book balances and fair values at December 31 follow:

	Recorded Book Balance	Fair Value	Fair Value Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un- observable Inputs (Level 3)
(In thousands)					
2020					
Assets					
Cash and due from banks	\$ 56,006	\$ 56,006	\$ 56,006	\$ -	\$ -
Interest bearing deposits	62,699	62,699	62,699	-	-
Securities available for sale	1,072,159	1,072,159	-	1,072,159	-
Federal Home Loan Bank and Federal Reserve Bank					
Stock	18,427	NA	NA	NA	NA
Net loans and loans held for sale	2,790,683	2,794,058	-	92,434	2,701,624
Accrued interest receivable	12,315	12,315	3	3,414	8,898
Derivative financial instruments	16,782	16,782	-	16,782	-
Liabilities					
Deposits with no stated maturity (1)	\$ 3,198,338	\$ 3,198,338	\$ 3,198,338	\$ -	\$ -
Deposits with stated maturity (1)	439,017	441,457	-	441,457	-
Other borrowings	30,012	30,844	-	30,844	-
Subordinated debt	39,281	41,417	-	41,417	-
Subordinated debentures	39,524	30,265	-	30,265	-
Accrued interest payable	601	601	59	542	-
Derivative financial instruments	11,754	11,754	-	11,754	-
2019					
Assets					
Cash and due from banks	\$ 53,295	\$ 53,295	\$ 53,295	\$ -	\$ -
Interest bearing deposits	12,009	12,009	12,009	-	-
Interest bearing deposits - time	350	350	-	350	-
Securities available for sale	518,400	518,400	-	518,400	-
Federal Home Loan Bank and Federal Reserve Bank					
Stock	18,359	NA	NA	NA	NA
Net loans and loans held for sale	2,768,675	2,768,817	-	69,800	2,699,017
Accrued interest receivable	10,108	10,108	8	1,752	8,348
Derivative financial instruments	5,464	5,464	-	5,464	-
Liabilities					
Deposits with no stated maturity (1)	\$ 2,427,190	\$ 2,427,190	\$ 2,427,190	\$ -	\$ -
Deposits with stated maturity (1)	609,537	610,235	-	610,235	-
Other borrowings	88,646	88,680	-	88,680	-
Subordinated debentures	39,456	33,149	-	33,149	-
Accrued interest payable	1,296	1,296	97	1,199	-
Derivative financial instruments	4,402	4,402	-	4,402	-

NA – Not applicable

(1) Deposits with no stated maturity include reciprocal deposits with a recorded book balance of \$518.400 million and \$388.369 million at December 31, 2020 and 2019, respectively. Deposits with a stated maturity include reciprocal deposits with a recorded book balance of \$37.785 million and \$42.658 million at December 31, 2020 and 2019, respectively.

The fair values for commitments to extend credit and standby letters of credit are estimated to approximate their aggregate book balance, which is nominal, and therefore are not disclosed.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale the entire holdings of a particular financial instrument.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business, the value of future earnings attributable to off-balance sheet activities and the value of assets and liabilities that are not considered financial instruments.

Fair value estimates for deposit accounts do not include the value of the core deposit intangible asset resulting from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

NOTE 23 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

A summary of changes in accumulated other comprehensive income (loss) (“AOCIL”), net of tax during the years ended December 31 follows:

	Unrealized Gains (Losses) on Securities Available for Sale	Dispropor- tionate Tax Effects from Securities Available for Sale	Unrealized Gains (Losses) on Cash Flow Hedges	Total
	(In thousands)			
2020				
Balances at beginning of period	\$ 3,739	\$ (5,798)	\$ (1,727)	\$ (3,786)
Other comprehensive income (loss) before reclassifications	12,294	-	(279)	12,015
Amounts reclassified from AOCIL	(211)	-	2,006	1,795
Net current period other comprehensive income	12,083	-	1,727	13,810
Balances at end of period	<u>\$ 15,822</u>	<u>\$ (5,798)</u>	<u>\$ -</u>	<u>\$ 10,024</u>
2019				
Balances at beginning of period	\$ (4,185)	\$ (5,798)	\$ (125)	\$ (10,108)
Other comprehensive income (loss) before reclassifications	8,035	-	(1,266)	6,769
Amounts reclassified from AOCIL	(111)	-	(336)	(447)
Net current period other comprehensive income (loss)	7,924	-	(1,602)	6,322
Balances at end of period	<u>\$ 3,739</u>	<u>\$ (5,798)</u>	<u>\$ (1,727)</u>	<u>\$ (3,786)</u>
2018				
Balances at beginning of period	\$ (470)	\$ (5,798)	\$ 269	\$ (5,999)
Other comprehensive loss before reclassifications	(3,671)	-	(207)	(3,878)
Amounts reclassified from AOCIL	(44)	-	(187)	(231)
Net current period other comprehensive loss	(3,715)	-	(394)	(4,109)
Balances at end of period	<u>\$ (4,185)</u>	<u>\$ (5,798)</u>	<u>\$ (125)</u>	<u>\$ (10,108)</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

A summary of reclassifications out of each component of AOCIL for the years ended December 31 follows:

AOCIL Component	Reclassified From AOCIL (In thousands)	Affected Line Item in Consolidated Statements of Operations
2020		
Unrealized gains (losses) on securities available for sale	\$ 267	Net gains on securities
	-	Net impairment loss recognized in earnings
	<u>267</u>	Total reclassifications before tax
	56	Income tax expense
	<u>\$ 211</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ 2,539	Interest expense
	533	Income tax expense
	<u>\$ 2,006</u>	Reclassification, net of tax
	<u>\$ (1,795)</u>	Total reclassifications for the period, net of tax
2019		
Unrealized gains (losses) on securities available for sale	\$ 140	Net gains on securities
	-	Net impairment loss recognized in earnings
	<u>140</u>	Total reclassifications before tax
	29	Income tax expense
	<u>\$ 111</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ (425)	Interest expense
	(89)	Income tax expense
	<u>\$ (336)</u>	Reclassification, net of tax
	<u>\$ 447</u>	Total reclassifications for the period, net of tax
2018		
Unrealized gains (losses) on securities available for sale	\$ 56	Net gains on securities
	-	Net impairment loss recognized in earnings
	<u>56</u>	Total reclassifications before tax
	12	Income tax expense
	<u>\$ 44</u>	Reclassifications, net of tax
Unrealized gains (losses) on cash flow hedges	\$ (237)	Interest expense
	(50)	Income tax expense
	<u>\$ (187)</u>	Reclassification, net of tax
	<u>\$ 231</u>	Total reclassifications for the period, net of tax

NOTE 24 – INDEPENDENT BANK CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION

Presented below are condensed financial statements for our parent company.

CONDENSED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2020	2019
	(In thousands)	
ASSETS		
Cash and due from banks	\$ 10,466	\$ 10,505
Interest bearing deposits - time	40,000	10,000
Investment in subsidiaries	418,465	369,861
Accrued income and other assets	805	463
Total Assets	\$ 469,736	\$ 390,829
LIABILITIES AND SHAREHOLDERS' EQUITY		
Subordinated debt	\$ 39,281	\$ -
Subordinated debentures	39,524	39,456
Accrued expenses and other liabilities	684	575
Shareholders' equity	390,247	350,798
Total Liabilities and Shareholders' Equity	\$ 469,736	\$ 390,829

CONDENSED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
OPERATING INCOME			
Dividends from subsidiary	\$ 24,000	\$ 29,000	\$ 33,500
Interest income	99	230	160
Other income	42	61	56
Total Operating Income	24,141	29,291	33,716
OPERATING EXPENSES			
Interest expense	2,893	2,104	1,924
Administrative and other expenses	733	655	748
Total Operating Expenses	3,626	2,759	2,672
Income Before Income Tax and Equity in Undistributed Net Income of Subsidiaries	20,515	26,532	31,044
Income tax benefit	(937)	(423)	(515)
Income Before Equity in Undistributed Net Income of Subsidiaries	21,452	26,955	31,559
Equity in undistributed net income of subsidiaries	34,700	19,480	8,280
Net Income	\$ 56,152	\$ 46,435	\$ 39,839

CONDENSED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Net Income	\$ 56,152	\$ 46,435	\$ 39,839
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH FROM OPERATING ACTIVITIES			
Deferred income tax (benefit) expense	(34)	1,503	6,620
Share based compensation	89	65	53
Accretion of discount on subordinated debt and debentures	113	68	51
(Increase) decrease in accrued income and other assets	(307)	891	(1,307)
Increase in accrued expenses and other liabilities	109	45	21
Equity in undistributed net income of subsidiaries	(34,700)	(19,480)	(8,280)
Total Adjustments	(34,730)	(16,908)	(2,842)
Net Cash From Operating Activities	21,422	29,527	36,997
CASH FLOW FROM (USED IN) INVESTING ACTIVITIES			
Purchases of interest bearing deposits - time	(85,000)	(20,000)	(30,000)
Maturity of interest bearing deposits - time	55,000	35,000	10,000
Acquisition of business, less cash received	-	-	431
Net Cash From (Used In) Investing Activities	(30,000)	15,000	(19,569)
CASH FLOW FROM (USED IN) FINANCING ACTIVITIES			
Proceeds from issuance of subordinated debt, net of issuance costs	39,236	-	-
Dividends paid	(17,618)	(16,554)	(14,055)
Proceeds from issuance of common stock	1,907	2,074	1,945
Share based compensation withholding obligation	(755)	(882)	(1,467)
Repurchase of common stock	(14,231)	(26,284)	(12,681)
Net Cash From (Used In) Financing Activities	8,539	(41,646)	(26,258)
Net Increase (Decrease) in Cash and Cash Equivalents	(39)	2,881	(8,830)
Cash and Cash Equivalents at Beginning of Year	10,505	7,624	16,454
Cash and Cash Equivalents at End of Year	\$ 10,466	\$ 10,505	\$ 7,624

NOTE 25 – REVENUE FROM CONTRACTS WITH CUSTOMERS

We account for revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers. We derive the majority of our revenue from financial instruments and their related contractual rights and obligations which for the most part are excluded from the scope of this topic. These sources of revenue that are excluded from the scope of this topic include interest income, net gains on mortgage loans, net gains on securities, mortgage loan servicing, net and bank owned life insurance and were approximately 88.1% and 84.9% of total revenues at December 31, 2020 and 2019, respectively.

Material sources of revenue that are included in the scope of ASC Topic 606 include service charges on deposits, other deposit related income, interchange income and investment and insurance commissions and are discussed in the following paragraphs. Generally these sources of revenue are earned at the time the service is delivered or over the course of a monthly period and do not result in any contract asset or liability balance at any given period end. As a result, there were no contract assets or liabilities recorded as of December 31, 2020.

Service charges on deposit accounts and other deposit related income: Revenues are earned on depository accounts for commercial and retail customers and include fees for transaction-based, account maintenance and overdraft services. Transaction-based fees, which includes services such as ATM use fees, stop payment charges and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

ACH fees are recognized at the time the transaction is executed as that is the time we fulfill our customer’s request. Account maintenance fees, which includes monthly maintenance services are earned over the course of a month representing the period over which the performance obligation is satisfied. Our obligation for overdraft services is satisfied at the time of the overdraft.

Interchange income: Interchange income primarily includes debit card interchange and network revenues. Debit card interchange and network revenues are earned on debit card transactions conducted through payment networks such as MasterCard and NYCE. Interchange income is recognized concurrently with the delivery of services on a daily basis. Interchange and network revenues are presented gross of interchange expenses, which are presented separately as a component of non-interest expense.

Investment and insurance commissions: Investment and insurance commissions include fees and commissions from asset management, custody, recordkeeping, investment advisory and other services provided to our customers. Revenue is recognized on an accrual basis at the time the services are performed and are generally based on either the market value of the assets managed or the services provided. We have an agent relationship with a third party provider of these services and net certain direct costs charged by the third party provider associated with providing these services to our customers.

Net gains on other real estate and repossessed assets: We record a gain or loss from the sale of other real estate when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. If we were to finance the sale of other real estate to the buyer, we would assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction is probable. Once these criteria are met, the other real estate asset would be derecognized and the gain or loss on sale would be recorded upon the transfer of control of the property to the buyer. There were no other real estate properties sold during 2020 that were financed by us.

Disaggregation of our revenue sources by attribute for the years ended December 31 follow:

2020

	<u>Service Charges on Deposit Accounts</u>	<u>Other Deposit Related Income</u>	<u>Interchange Income</u> (In thousands)	<u>Investment and Insurance Commissions</u>	<u>Total</u>
Retail					
Overdraft fees	\$ 5,627	\$ -	\$ -	\$ -	\$ 5,627
Account service charges	2,017	-	-	-	2,017
ATM fees	-	1,173	-	-	1,173
Other	-	769	-	-	769
Business					
Overdraft fees	873	-	-	-	873
ATM fees	-	24	-	-	24
Other	-	342	-	-	342
Interchange income	-	-	11,230	-	11,230
Asset management revenue	-	-	-	1,283	1,283
Transaction based revenue	-	-	-	688	688
Total	<u>\$ 8,517</u>	<u>\$ 2,308</u>	<u>\$ 11,230</u>	<u>\$ 1,971</u>	<u>\$ 24,026</u>

Reconciliation to Consolidated Statement of Operations:

Non-interest income - other:	
Other deposit related income	\$ 2,308
Investment and insurance commissions	1,971
Bank owned life insurance	910
Other	2,332
Total	<u>\$ 7,521</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

2019

	<u>Service Charges on Deposit Accounts</u>	<u>Other Deposit Related Income</u>	<u>Interchange Income</u>	<u>Investment and Insurance Commissions</u>	<u>Total</u>
	(In thousands)				
Retail					
Overdraft fees	\$ 7,590	\$ -	\$ -	\$ -	\$ 7,590
Account service charges	2,103	-	-	-	2,103
ATM fees	-	1,368	-	-	1,368
Other	-	965	-	-	965
Business					
Overdraft fees	1,515	-	-	-	1,515
ATM fees	-	35	-	-	35
Other	-	422	-	-	422
Interchange income	-	-	10,297	-	10,297
Asset management revenue	-	-	-	1,123	1,123
Transaction based revenue	-	-	-	535	535
Total	<u>\$ 11,208</u>	<u>\$ 2,790</u>	<u>\$ 10,297</u>	<u>\$ 1,658</u>	<u>\$ 25,953</u>

Reconciliation to Consolidated Statement of Operations:

Non-interest income - other:					
Other deposit related income					\$ 2,790
Investment and insurance commissions					1,658
Bank owned life insurance					1,111
Other					3,723
Total					<u>\$ 9,282</u>

2018

	<u>Service Charges on Deposit Accounts</u>	<u>Other Deposit Related Income</u>	<u>Interchange Income</u>	<u>Investment and Insurance Commissions</u>	<u>Total</u>
	(In thousands)				
Retail					
Overdraft fees	\$ 8,285	\$ -	\$ -	\$ -	\$ 8,285
Account service charges	2,406	-	-	-	2,406
ATM fees	-	1,423	-	-	1,423
Other	-	941	-	-	941
Business					
Overdraft fees	1,567	-	-	-	1,567
ATM fees	-	34	-	-	34
Other	-	594	-	-	594
Interchange income	-	-	9,905	-	9,905
Asset management revenue	-	-	-	1,100	1,100
Transaction based revenue	-	-	-	871	871
Total	<u>\$ 12,258</u>	<u>\$ 2,992</u>	<u>\$ 9,905</u>	<u>\$ 1,971</u>	<u>\$ 27,126</u>

Reconciliation to Consolidated Statement of Operations:

Non-interest income - other:					
Other deposit related income					\$ 2,992
Investment and insurance commissions					1,971
Bank owned life insurance					970
Other					2,827
Total					<u>\$ 8,760</u>

NOTE 26 – RECENT ACQUISITION

Effective April 1, 2018, we completed the acquisition of all of the issued and outstanding shares of common stock of TCSB through a merger of TCSB into Independent Bank Corporation (“IBCP”), with IBCP as the surviving corporation (the “Merger”). On that same date we also consolidated Traverse City State Bank, TCSB’s wholly-owned subsidiary bank, into Independent Bank (with Independent Bank as the surviving institution). Under the terms of the merger agreement each holder of TCSB common stock received 1.1166 shares of IBCP common stock plus cash in lieu of fractional shares totaling \$0.005 million. TCSB option holders had their options converted into IBCP stock options. As a result we issued 2.71 million shares of common stock and 0.19 million stock options with a fair value of approximately \$64.5 million to the shareholders and option holders of TCSB. The fair value of common stock and stock options issued as the consideration paid for TCSB was determined using the closing price of our common stock on the acquisition date. This acquisition was accounted for under the acquisition method of accounting. Accordingly, we recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values. TCSB results of operations are included in our results beginning April 1, 2018. Non-interest expense includes zero, zero and \$3.5 million of costs incurred during the years ended December 31, 2020, 2019 and 2018, respectively related to the Merger.

QUARTERLY FINANCIAL DATA (UNAUDITED)

A summary of selected quarterly results of operations for the years ended December 31 follows:

	Three Months Ended			
	March 31,	June 30,	September 30,	December 31,
	(In thousands, except per share amounts)			
2020				
Interest income	\$ 35,579	\$ 33,754	\$ 35,034	\$ 35,462
Net interest income	30,191	30,462	31,966	30,993
Provision for loan losses	6,721	5,188	975	(421)
Income before income tax	5,755	18,295	24,361	21,070
Net income	4,810	14,772	19,584	16,986
Net income per common share				
Basic	0.22	0.67	0.90	0.78
Diluted	0.21	0.67	0.89	0.77
2019				
Interest income	\$ 36,636	\$ 37,573	\$ 37,811	\$ 36,908
Net interest income	30,243	30,756	30,872	30,710
Provision for loan losses	664	652	(271)	(221)
Income before income tax	11,548	13,417	15,570	17,225
Net income	9,381	10,730	12,445	13,879
Net income per common share				
Basic	0.40	0.47	0.55	0.62
Diluted	0.39	0.46	0.55	0.61

During the fourth quarter of 2020, we recognized \$1.6 million of losses in interest expense relating to cash flow hedges that had been transferred to a no hedge designation (see note #16), \$1.5 million of core data processing conversion related expenses and a negative fair value adjustment due to price on our capitalized mortgage loan servicing rights of \$0.9 million (see note #4). During the fourth quarter of 2019, we recognized a positive fair value adjustment due to price on our capitalized mortgage loan servicing rights of \$0.6 million (see note #4).

QUARTERLY SUMMARY (UNAUDITED)

	Reported Sales Prices of Common Shares						Cash Dividends Declared	
	2020			2019			2020	2019
	High	Low	Close	High	Low	Close		
First quarter	\$ 22.98	\$ 9.19	\$ 12.87	\$ 23.64	\$ 20.40	\$ 21.50	\$ 0.20	\$ 0.18
Second quarter	16.92	10.91	14.85	22.42	20.60	21.79	0.20	0.18
Third quarter	16.20	12.14	12.57	22.25	18.94	21.32	0.20	0.18
Fourth quarter	19.28	12.42	18.47	23.93	20.40	22.65	0.20	0.18

We have approximately 1,400 holders of record of our common stock. Our common stock trades on the NASDAQ Global Select Market System under the symbol "IBCP." The prices shown above are supplied by NASDAQ and reflect the inter-dealer prices and may not include retail markups, markdowns or commissions. There may have been transactions or quotations at higher or lower prices of which we are not aware.

In addition to limitations imposed by the provisions of the Michigan Business Corporation Act (which, among other things, limits us from paying dividends to the extent we are insolvent), our ability to pay dividends is limited by our ability to obtain funds from our Bank and by regulatory capital guidelines applicable to us (see note #20).

INDEPENDENT BANK CORPORATION

Subsidiaries of the Registrant

	<u>State of Incorporation</u>
IBC Capital Finance III Grand Rapids, Michigan	Delaware
IBC Capital Finance IV Grand Rapids, Michigan	Delaware
Midwest Guaranty Trust I Grand Rapids, Michigan	Delaware
TCSB Statutory Trust I Grand Rapids, Michigan	Delaware
Independent Bank Grand Rapids, Michigan	Michigan
IB Wealth Management, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan
IB Insurance Services, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan
Independent Title Services, Inc., Grand Rapids, Michigan (a subsidiary of Independent Bank Corporation)	Michigan
Independent Life Insurance Trust, Grand Rapids, Michigan (a subsidiary of Independent Bank)	Michigan

Note: Table excludes insignificant subsidiaries, such as single-member limited liability companies formed solely to hold other real estate.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Nos. 333-89072, 333-125484, 333-189437, and 333-221177) on Forms S-8 of Independent Bank Corporation of our report dated March 5, 2021 with respect to the consolidated financial statements and effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K for the year ended December 31, 2020.

/s/ Crowe LLP

Grand Rapids, Michigan
March 5, 2021

CERTIFICATION

I, William B. Kessel, certify that:

1. I have reviewed this annual report on Form 10-K of Independent Bank Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15.15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 5, 2021

/s/ William B. Kessel
William B. Kessel
President and Chief Executive Officer

CERTIFICATION

I, Gavin A. Mohr, certify that:

1. I have reviewed this annual report on Form 10-K of Independent Bank Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15.15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 5, 2021

/s/ Gavin A. Mohr
Gavin A. Mohr
Chief Financial Officer

CERTIFICATE OF THE
CHIEF EXECUTIVE OFFICER OF
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

I, William B. Kessel, President and Chief Executive Officer of Independent Bank Corporation, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- (1) The annual report on Form 10-K for the annual period ended December 31, 2020, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;
- (2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2020, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

Date: March 5, 2021

/s/ William B. Kessel
William B. Kessel
President and Chief Executive Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Independent Bank Corporation and will be retained by Independent Bank Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE OF THE
CHIEF FINANCIAL OFFICER OF
INDEPENDENT BANK CORPORATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

I, Gavin A. Mohr, Chief Financial Officer of Independent Bank Corporation, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- (1) The annual report on Form 10-K for the annual period ended December 31, 2020, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;
- (2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2020, fairly presents, in all material respects, the financial condition and results of operations of Independent Bank Corporation.

Date: March 5, 2021

/s/ Gavin A. Mohr
Gavin A. Mohr
Chief Financial Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Independent Bank Corporation and will be retained by Independent Bank Corporation and furnished to the Securities and Exchange Commission or its staff upon request.
