

INDEPENDENT BANK CORP /MI/

Form 10-Q

August 07, 2008

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**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2008**

Commission file number 0-7818

INDEPENDENT BANK CORPORATION

(Exact name of registrant as specified in its charter)

Michigan

38-2032782

(State or jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification
Number)

230 West Main Street, P.O. Box 491, Ionia, Michigan 48846

(Address of principal executive offices)

(616) 527-9450

(Registrant's telephone number, including area code)

NONE

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

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

Common stock, par value \$1

23,014,262

Class

Outstanding at August 7, 2008

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
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Any statements in this document that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Words such as expect, believe, intend, estimate, project, may and similar expressions are intended to identify forward-looking statements. These forward-looking statements are predicated on management's beliefs and assumptions based on information known to Independent Bank Corporation's management as of the date of this document and do not purport to speak as of any other date. Forward-looking statements may include descriptions of plans and objectives of Independent Bank Corporation's management for future or past operations, products or services, and forecasts of the Company's revenue, earnings or other measures of economic performance, including statements of profitability, business segments and subsidiaries, and estimates of credit quality trends. Such statements reflect the view of Independent Bank Corporation's management as of this date with respect to future events and are not guarantees of future performance; involve assumptions and are subject to substantial risks and uncertainties, such as the changes in Independent Bank Corporation's plans, objectives, expectations and intentions. Should one or more of these risks materialize or should underlying beliefs or assumptions prove incorrect, the Company's actual results could differ materially from those discussed. Factors that could cause or contribute to such differences are changes in interest rates, changes in the accounting treatment of any particular item, the results of regulatory examinations, changes in industries where the Company has a concentration of loans, changes in the level of fee income, changes in general economic conditions and related credit and market conditions, and the impact of regulatory responses to any of the foregoing. Forward-looking statements speak only as of the date they are made. Independent Bank Corporation does not undertake to update forward-looking statements to reflect facts, circumstances, assumptions or events that occur after the date the forward-looking statements are made. For any forward-looking statements made in this document, Independent Bank Corporation claims the protection of the safe harbor for forward-looking statements contained in

the Private Securities Litigation Reform Act of 1995.

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Item 1.INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Condition

	June 30, 2008	December 31, 2007
	(unaudited)	
	(in thousands)	
Assets		
Cash and due from banks	\$ 69,441	\$ 79,289
Trading securities	12,963	
Securities available for sale	308,757	364,194
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	28,063	21,839
Loans held for sale, carried at fair value, at June 30, 2008	26,188	33,960
Loans		
Commercial	1,060,216	1,066,276
Mortgage	861,886	873,945
Installment	366,786	368,478
Finance receivables	276,535	238,197
Total Loans	2,565,423	2,546,896
Allowance for loan losses	(51,104)	(45,294)
Net Loans	2,514,319	2,501,602
Property and equipment, net	72,413	73,558
Bank owned life insurance	43,897	42,934
Goodwill	66,754	66,754
Other intangibles	13,708	15,262
Capitalized mortgage loan servicing rights	16,551	15,780
Accrued income and other assets	65,981	60,910
Total Assets	\$ 3,239,035	\$ 3,276,082
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	\$ 306,506	\$ 294,332
Savings and NOW	978,894	987,299
Retail time	682,199	707,419
Brokered time	112,539	516,077
Total Deposits	2,080,138	2,505,127
Federal funds purchased	40,671	54,452
Other borrowings	702,059	302,539
Subordinated debentures	92,888	92,888
Financed premiums payable	53,931	44,911
Liabilities of discontinued operations		34
Accrued expenses and other liabilities	31,078	35,629

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Total Liabilities	3,000,765	3,035,580
Shareholders' Equity		
Preferred stock, no par value 200,000 shares authorized; none outstanding		
Common stock, \$1.00 par value 40,000,000 shares authorized; issued and outstanding: 23,014,262 shares at June 30, 2008 and 22,647,511 shares at December 31, 2007	22,773	22,601
Capital surplus	196,819	195,302
Retained earnings	22,178	22,770
Accumulated other comprehensive income (loss)	(3,500)	(171)
Total Shareholders' Equity	238,270	240,502
Total Liabilities and Shareholders' Equity	\$ 3,239,035	\$ 3,276,082

See notes to interim consolidated financial statements

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(unaudited)			
	(in thousands)			
Interest Income				
Interest and fees on loans	\$ 46,750	\$ 50,576	\$ 94,876	\$ 100,529
Interest on securities				
Taxable	2,176	2,592	4,480	5,069
Tax-exempt	2,099	2,535	4,346	5,135
Other investments	362	464	719	778
Total Interest Income	51,387	56,167	104,421	111,511
Interest Expense				
Deposits	11,191	23,378	27,403	45,786
Other borrowings	6,975	2,313	13,412	5,617
Total Interest Expense	18,166	25,691	40,815	51,403
Net Interest Income	33,221	30,476	63,606	60,108
Provision for loan losses	12,352	14,893	23,668	23,032
Net Interest Income After Provision for Loan Losses	20,869	15,583	39,938	37,076
Non-interest Income				
Service charges on deposit accounts	6,164	6,380	11,811	11,268
Net gains (losses) on assets				
Mortgage loans	1,141	1,238	3,008	2,319
Securities	837	128	(1,326)	207
VISA check card interchange income	1,495	1,292	2,866	2,242
Mortgage loan servicing	1,528	712	1,205	1,239
Title insurance fees	384	430	801	844
Other income	2,588	2,593	5,264	5,324
Total Non-interest Income	14,137	12,773	23,629	23,443
Non-interest Expense				
Compensation and employee benefits	13,808	14,784	27,992	28,752
Occupancy, net	2,813	2,735	5,927	5,349
Loan and collection	2,031	1,221	3,887	2,227
Furniture, fixtures and equipment	1,825	1,991	3,642	3,891
Data processing	1,712	1,912	3,437	3,350
Loss on other real estate and repossessed assets	1,560	68	1,666	92
Advertising	1,168	1,341	2,268	2,493
Branch acquisition and conversion costs		(92)		330

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Goodwill impairment				343
Other expenses	6,274	5,841	12,623	10,940
Total Non-interest Expense	31,191	29,801	61,442	57,767
Income (Loss) From Continuing Operations Before				
Income Tax	3,815	(1,445)	2,125	2,752
Income tax expense (benefit)	469	(1,553)	(1,562)	(1,248)
Income From Continuing Operations	3,346	108	3,687	4,000
Discontinued operations, net of tax		(151)		200
Net Income (Loss)	\$ 3,346	\$ (43)	\$ 3,687	\$ 4,200
Income Per Share From Continuing Operations				
Basic	\$.15	.00	.16	.18
Diluted	.15	.00	.16	.17
Net Income Per Share				
Basic	\$.15	.00	.16	.18
Diluted	.15	.00	.16	.18
Dividends Per Common Share				
Declared	\$.01	.21	.12	.42
Paid	.11	.21	.32	.41
See notes to interim consolidated financial statements				

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Six months ended June 30,	
	2008	2007
	(unaudited)	
	(in thousands)	
Net Income	\$ 3,687	\$ 4,200
Adjustments to Reconcile Net Income to Net Cash from Operating Activities		
Proceeds from sales of loans held for sale	167,463	149,444
Disbursements for loans held for sale	(156,683)	(151,044)
Provision for loan losses	23,668	23,334
Depreciation and amortization of premiums and accretion of discounts on securities and loans	(9,809)	(5,208)
Net gains on mortgage loans	(3,008)	(2,319)
Net (gains) losses on securities	1,326	(207)
Goodwill impairment		343
Deferred loan fees	(193)	(206)
Share based compensation	296	
Increase in accrued income and other assets	(2,881)	(7,603)
Increase (decrease) in accrued expenses and other liabilities	1,283	(6,425)
	21,462	109
Net Cash from Operating Activities	25,149	4,309
Cash Flow from Investing Activities		
Proceeds from the sale of securities available for sale	28,659	15,491
Proceeds from the maturity of securities available for sale	12,822	28,802
Principal payments received on securities available for sale	11,636	16,823
Purchases of securities available for sale	(20,777)	(47,102)
Purchase of Federal Home Loan Bank stock	(6,224)	
Increase in portfolio loans originated, net of principal payments	(20,229)	(9,704)
Acquisition of business offices, less cash paid		210,053
Proceeds from sale of insurance premium finance business		175,901
Capital expenditures	(3,214)	(4,600)
Net Cash from Investing Activities	2,673	385,664
Cash Flow (used in) Financing Activities		
Net decrease in total deposits	(425,173)	(216,302)
Net increase (decrease) in other borrowings and federal funds purchased	252,322	(156,944)
Proceeds from Federal Home Loan Bank advances	464,101	32,000
Payments of Federal Home Loan Bank advances	(327,684)	(49,073)
Repayment of long-term debt	(3,000)	(1,000)
Net increase in financed premiums payable	9,020	1,537
Dividends paid	(7,307)	(9,338)

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Proceeds from issuance of common stock	51	186
Repurchase of common stock		(5,989)
Proceeds from issuance of subordinated debt		12,372
Redemption of subordinated debt		(4,300)
Net Cash (used in) Financing Activities	(37,670)	(396,851)
Net Decrease in Cash and Cash Equivalents	(9,848)	(6,878)
Change in cash and cash equivalents of discontinued operations		167
Cash and Cash Equivalents at Beginning of Period	79,289	73,142
Cash and Cash Equivalents at End of Period	\$ 69,441	\$ 66,431
Cash paid during the period for		
Interest	\$ 46,932	\$ 53,102
Income taxes	272	7,283
Transfer of loans to other real estate	5,112	3,892
Transfer of loans held for sale		3,300
Adoption of fair value option securities transferred from available for sale to trading	15,018	
See notes to interim consolidated financial statements		

Table of ContentsINDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity

	Six months ended June 30,	
	2008	2007
	(unaudited)	
	(in thousands)	
Balance at beginning of period	\$ 240,502	\$ 258,167
Net income	3,687	4,200
Cash dividends declared	(2,761)	(9,481)
Issuance of common stock	1,393	364
Share based compensation	296	118
Repurchase of common stock		(5,989)
Net change in accumulated other comprehensive income, net of reclassification adjustment pursuant to the adoption of SFAS #159 and related tax effect	(4,847)	(3,345)
Balance at end of period	\$ 238,270	\$ 244,034

See notes to interim consolidated financial statements.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. In our opinion, the accompanying unaudited consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of June 30, 2008 and December 31, 2007, and the results of operations for the three and six-month periods ended June 30, 2008 and 2007. Certain reclassifications have been made in the prior year financial statements to conform to the current year presentation. Our critical accounting policies include the assessment for other than temporary impairment on investment securities, the determination of the allowance for loan losses, the valuation of derivative financial instruments, the valuation of originated mortgage loan servicing rights, the valuation of deferred tax assets and the valuation of goodwill. Refer to our 2007 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements , (SFAS #157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157 . This FSP delays the effective date of SFAS #157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this statement on January 1, 2008 did not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities , (SFAS #159). This statement provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. This new standard is effective for us on January 1, 2008. We elected the fair value option for certain securities available for sale that existed at January 1, 2008 and for loans held for sale originated on or after January 1, 2008. The cumulative effect adjustment to retained earnings resulting from the adoption of SFAS #159 was an after tax decrease of \$1.5 million. This amount was reclassified from accumulated other comprehensive income.

In November, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value through Earnings (SAB 109). Previously, Staff Accounting Bulletin No. 105, Application of Accounting Principles to Loan Commitments (SAB 105) stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 was effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. As a result of adoption of SAB 109, gains on mortgage loans increased by approximately \$0.1 million, before tax during the first six months of 2008.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

3. Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors. Loans on non-accrual status, past due more than 90 days, or restructured amounted to \$111.4 million at

June 30, 2008, and \$77.2 million at December 31, 2007.

Impaired loans totaled approximately \$95.9 million, \$61.3 million and \$37.7 million at June 30, 2008, December 31, 2007 and June 30, 2007, respectively. At those same dates, certain impaired loans with balances of approximately \$81.6 million, \$53.4 million and \$31.2 million, respectively had specific allocations of the allowance for loan losses, which totaled approximately \$15.9 million, \$10.7 million and \$8.9 million, respectively. Our average investment in impaired loans was approximately \$80.7 million and \$30.2 million for the six-month periods ended June 30, 2008 and 2007, respectively. Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance. Interest income recognized on impaired loans during the second quarters of 2008 and 2007 was approximately \$0.5 million and \$0.2 million, respectively, the majority of which were received in cash.

An analysis of the allowance for loan losses is as follows:

	Six months ended June 30,			
	2008	2007		2007
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(in thousands)			
Balance at beginning of period	\$ 45,294	\$ 1,936	\$ 26,879	\$ 1,881
Additions (deduction)				
Provision charged to operating expense	23,875	(207)	22,658	374
Recoveries credited to allowance	1,099		1,140	
Loans charged against the allowance	(19,164)		(12,464)	
Balance at end of period	\$ 51,104	\$ 1,729	\$ 38,213	\$ 2,255

4. Comprehensive income for the three- and six-month periods ended June 30 follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(in thousands)			
Net income (loss)	\$ 3,346	\$ (43)	\$ 3,687	\$ 4,200
Net change in unrealized gain (loss) on securities available for sale, net of related tax effect	(5,740)	(3,489)	(5,568)	(3,099)
Net change in unrealized gain (loss) on derivative instruments, net of related tax effect	2,202	431	721	(92)
Reclassification adjustment for accretion on settled derivative financial instruments		(53)		(154)
Comprehensive income (loss)	\$ (192)	\$ (3,154)	\$ (1,160)	\$ 855

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

The net change in unrealized gain (loss) on securities available for sale reflect net gains and losses reclassified into earnings as follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(in thousands)			
Gain reclassified into earnings	\$723	\$128	\$723	\$207
Federal income tax expense as a result of the reclassification of these amounts from comprehensive income	253	44	253	72

5. Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank (IB) and Mepco Finance Corporation (Mepco). We evaluate performance based principally on net income of the respective reportable segments. In September 2007 we consolidated our four existing bank charters into one. Prior to this consolidation we reported each of the four banks as separate segments. Prior period information for the four banks has been consolidated under our current IB segment.

A summary of selected financial information for our reportable segments as of or for the three-month and six-month periods ended June 30, follows:

As of or for the three months ended June 30,

	IB	Mepco	Other ⁽¹⁾ (in thousands)	Elimination	Total
2008					
Total assets	\$2,927,747	\$303,088	\$334,621	\$(326,421)	\$3,239,035
Interest income	43,410	7,977			51,387
Net interest income	28,617	6,378	(1,774)		33,221
Provision for loan losses	12,409	(57)			12,352
Income (loss) before income tax	1,441	4,351	(1,953)	(24)	3,815
Net income (loss)	1,892	2,702	(1,232)	(16)	3,346
2007					
Total assets	\$3,058,809	\$230,261	\$331,763	\$(359,576)	\$3,261,257
Interest income	51,159	5,658	5	(655)	56,167
Net interest income	28,438	3,666	(1,586)	(42)	30,476
Provision for loan losses	14,851	42			14,893
Income (loss) from continuing operations before income tax	(1,478)	1,869	(2,021)	185	(1,445)
Discontinued operations, net of tax		(151)			(151)
Net income (loss)	206	1,015	(1,350)	86	(43)

(1) Includes amounts relating to our parent company and certain

insignificant
operations.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

As of or for the six months ended June 30,

	IB	Mepco	Other ⁽¹⁾ (in thousands)	Elimination	Total
2008					
Total assets	\$2,927,747	\$303,088	\$334,621	\$(326,421)	\$3,239,035
Interest income	89,270	15,151			104,421
Net interest income	55,356	11,893	(3,643)		63,606
Provision for loan losses	23,651	17			23,668
Income (loss) before income tax	(1,590)	8,172	(4,409)	(48)	2,125
Net income (loss)	1,395	5,075	(2,752)	(31)	3,687
2007					
Total assets	\$3,058,809	\$230,261	\$331,763	\$(359,576)	\$3,261,257
Interest income	101,461	10,856	10	(816)	111,511
Net interest income	56,407	6,934	(3,149)	(84)	60,108
Provision for loan losses	22,861	171			23,032
Income (loss) from continuing operations before income tax	3,498	3,257	(4,358)	355	2,752
Discontinued operations, net of tax		200			200
Net income (loss)	4,536	2,235	(2,743)	172	4,200

(1) Includes amounts relating to our parent company and certain insignificant operations.

6. Basic income per share is based on weighted average common shares outstanding during the period. Diluted income per share includes the dilutive effect of additional potential common shares to be issued upon the exercise of stock options, stock units for a deferred compensation plan for non-employee directors and restricted stock awards.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

A reconciliation of basic and diluted earnings per share for the three-month and the six-month periods ended June 30 follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(in thousands, except per share amounts)			
Income from continuing operations	\$ 3,346	\$ 108	\$ 3,687	\$ 4,000
Net income (loss)	\$ 3,346	\$ (43)	\$ 3,687	\$ 4,200
Shares outstanding	22,767	22,585	22,703	22,706
Effect of stock options	7	156	20	208
Stock units for deferred compensation plan for non employee directors	58	60	62	59
Restricted stock awards	2		21	
Shares outstanding for calculation of diluted earnings per share	22,834	22,801	22,806	22,973
Income (loss) per share from continuing operations				
Basic	\$.15	\$.00	\$.16	\$.18
Diluted ⁽¹⁾	.15	.00	.16	.17
Net income (loss) per share				
Basic	\$.15	\$.00	\$.16	\$.18
Diluted ⁽¹⁾	.15	.00	.16	.18

(1) For any period in which a loss is recorded, the assumed exercise of stock options and stock units for deferred compensation plan for non-employee directors would have an anti-dilutive impact on the loss per share and thus are ignored in the

diluted per share
calculation.

Weighted average stock options outstanding that were anti-dilutive totaled 1.5 million and 1.0 million for the three-months ended June 30, 2008 and 2007, respectively. During the six-month periods ended June 30, 2008 and 2007, weighted-average anti-dilutive stock options totaled 1.5 million and 0.9 million respectively.

7. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS #133) which was subsequently amended by SFAS #138, requires companies to record derivatives on the balance sheet 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.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

Our derivative financial instruments according to the type of hedge in which they are designated under SFAS #133 follows:

	Notional Amount	June 30, 2008 Average Maturity (years)	Fair Value
	(dollars in thousands)		
Fair Value Hedges			
pay variable interest-rate swap agreements	\$ 11,159	0.5	\$ 6
Cash Flow Hedges			
Pay fixed interest-rate swap agreements	\$ 127,000	2.6	\$ 519
Interest-rate cap agreements	203,500	1.1	273
	\$ 330,500	1.7	\$ 792
No hedge designation			
Pay fixed interest-rate swap agreements	\$ 2,000	0.9	\$ (8)
Interest-rate cap agreements	92,000	1.5	113
Rate-lock mortgage loan commitments	8,630	0.1	145
Mandatory commitments to sell mortgage loans	35,956	0.1	130
Total	\$ 138,586	1.0	\$ 380

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.

We use variable-rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our balance sheet, which exposes us to variability in interest rates. To meet our 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 currently include certain pay-fixed interest-rate swaps and interest-rate cap agreements.

Through certain special purposes entities we issue trust preferred securities as part of our capital management strategy. Certain of these trust preferred securities are variable rate which exposes us to variability in cash flows . To mitigate our exposure to fluctuations in cash flows resulting from changes in interest rates, on approximately \$20.0 million of variable rate trust preferred securities, we entered into a pay-fixed interest-rate swap agreement in September, 2007. 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 pay an upfront premium on interest rate caps which is recognized in earnings in the same period in which the hedged item affects earnings. Unrecognized premiums from interest rate caps aggregated to \$0.9 million and \$1.2 million at June 30, 2008 and December 31, 2007, respectively.

We record the fair value of Cash Flow Hedges in accrued income and other assets and accrued expenses and other liabilities. On an ongoing basis, we adjust our balance sheet to reflect the then current fair value of Cash Flow Hedges.

The related gains or losses are reported in other comprehensive income and are subsequently reclassified into earnings, as a yield adjustment in the same period in which the related interest on the hedged items (primarily variable-rate debt

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)
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obligations) affect earnings. It is anticipated that approximately \$0.4 million, net of tax, of unrealized losses on Cash Flow Hedges at June 30, 2008 will be reclassified to earnings over the next twelve months. To the extent that the Cash Flow Hedges are not effective, the ineffective portion of the Cash Flow Hedges are immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at June 30, 2008 is 6.5 years.

We also use long-term, fixed-rate brokered CDs to fund a portion of our balance sheet. These instruments expose us to variability in fair value due to changes in interest rates. To meet our objectives, we may enter into derivative financial instruments to mitigate exposure to fluctuations in fair values of such fixed-rate debt instruments (Fair Value Hedges). Fair Value Hedges currently include pay-variable interest-rate swaps.

Also, we record Fair Value Hedges at fair value in accrued income and other assets and accrued expenses and other liabilities. The hedged items (primarily fixed-rate debt obligations) are also recorded at fair value through the statement of operations, which offsets the adjustment to Fair Value Hedges. On an ongoing basis, we will adjust our balance sheet to reflect the then current fair value of both the Fair Value Hedges and the respective hedged items. To the extent that the change in value of the Fair Value Hedges do not offset the change in the value of the hedged items, the ineffective portion is immediately recognized as interest expense.

Certain financial derivative instruments are not designated as hedges. The fair value of these derivative financial instruments have been recorded on our balance sheet and are adjusted on an ongoing basis to reflect their then current fair value. The changes in the fair value of derivative financial instruments not designated as hedges, are recognized currently 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 gains on the sale of mortgage loans. We obtain market prices on Mandatory Commitments and Rate Lock Commitments. Net gains on the sale of mortgage loans, as well as net income may be more volatile as a result of these derivative instruments, which are not designated as hedges.

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The impact of SFAS #133 on net income and other comprehensive income for the three-month and six-month periods ended June 30, 2008 and 2007 is as follows:

	Net Income	Income (Expense) Other Comprehensive Income (in thousands)	Total
Change in fair value during the three month period ended June 30, 2008			
Interest-rate swap agreements not designated as hedges	\$ (8)		\$ (8)
Interest-rate cap agreements not designated as hedges	91		91
Rate Lock Commitments	(194)		(194)
Mandatory Commitments	159		159
Ineffectiveness of Fair value hedges	(4)		(4)
Ineffectiveness of Cash flow hedges	1		1
Cash flow hedges		\$ 3,764	3,764
Reclassification adjustment		(377)	(377)
Total	45	3,387	3,432
Income tax	16	1,185	1,201
Net	\$ 29	\$ 2,202	\$ 2,231

	Net Income	Income (Expense) Other Comprehensive Income (in thousands)	Total
Change in fair value during the six month period ended June 30, 2008			
Interest-rate swap agreements not designated as hedges	\$ (8)		\$ (8)
Interest-rate cap agreements not designated as hedges	(3)		(3)
Rate Lock Commitments	193		193
Mandatory Commitments	193		193
Ineffectiveness of Fair value hedges	6		6
Ineffectiveness of Cash flow hedges	1		1
Cash flow hedges		\$ 1,579	1,579
Reclassification adjustment		(471)	(471)
Total	382	1,108	1,490
Income tax	134	387	521

Net \$ 248 \$ 721 \$ 969

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)
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	Net	Income (Expense) Other Comprehensive	
	Income	Income	Total
		(in thousands)	
Change in fair value during the three month period ended June 30, 2007			
Interest-rate swap agreements not designated as hedges	\$ 12		\$ 12
Interest-rate cap agreements not designated as hedges	64		64
Rate Lock Commitments	(169)		(169)
Mandatory Commitments	176		176
Ineffectiveness of Fair value hedges	(14)		(14)
Ineffectiveness of Cash flow hedges	(1)		(1)
Cash flow hedges		\$ 349	349
Reclassification adjustment		232	232
Total	68	581	649
Income tax	23	203	226
Net	\$ 45	\$ 378	\$ 423

	Net	Income (Expense) Other Comprehensive	
	Income	Income	Total
		(in thousands)	
Change in fair value during the six month period ended June 30, 2007			
Interest-rate swap agreements not designated as hedges	\$ 29		\$ 29
Interest-rate cap agreements not designated as hedges	26		26
Rate Lock Commitments	(119)		(119)
Mandatory Commitments	101		101
Ineffectiveness of Fair value hedges	(9)		(9)
Ineffectiveness of Cash flow hedges	2		2
Cash flow hedges		\$ (1,076)	(1,076)
Reclassification adjustment		698	698
Total	30	(378)	(348)
Income tax	10	(132)	(122)
Net	\$ 20	\$ (246)	\$ (226)

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8. SFAS No. 141, Business Combinations, (SFAS #141) and SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS #142) effects how organizations account for business combinations and for the goodwill and intangible assets that arise from those combinations or are acquired otherwise.

Intangible assets, net of amortization, were comprised of the following at June 30, 2008 and December 31, 2007:

	June 30, 2008		December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(dollars in thousands)			
Amortized intangible assets				
Core deposit	\$ 31,326	\$ 18,026	\$ 31,326	\$ 16,648
Customer relationship	1,302	1,132	1,302	1,099
Covenants not to compete	1,520	1,282	1,520	1,139
Total	\$ 34,148	\$ 20,440	\$ 34,148	\$ 18,886
Unamortized intangible assets				
Goodwill	\$ 66,754		\$ 66,754	

Amortization of intangibles has been estimated through 2013 and thereafter in the following table, and does not take into consideration any potential future acquisitions or branch purchases.

	(dollars in thousands)
Six months ended December 31, 2008	\$ 1,518
Year ending December 31:	
2009	1,838
2010	1,310
2011	1,398
2012	1,115
2013 and thereafter	6,529
Total	\$ 13,708

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Changes in the carrying amount of goodwill by reporting segment for the periods presented were as follows:

	IB	Mepco	Other ⁽¹⁾	Total
		(dollars in thousands)		
Goodwill				
Balance, December 31, 2007	\$ 49,676	\$ 16,735	\$ 343	\$ 66,754
Acquired during period				
Impairment during period				
Balance, June 30, 2008	\$ 49,676	\$ 16,735	\$ 343	\$ 66,754
Balance, December 31, 2006	\$ 31,631	\$ 16,735	\$ 343	\$ 48,709
Acquired during period ⁽²⁾	18,388			18,388
Impairment	(343)			(343)
Balance, June 30, 2007	\$ 49,676	\$ 16,735	\$ 343	\$ 66,754

(1) Includes items relating to the Registrant and certain insignificant operations.

(2) Goodwill associated with the acquisition of 10 branches.

During the first quarter of 2007 we recorded a goodwill impairment charge of \$0.3 million at First Home Financial (FHF) which was acquired in 1998. We test goodwill for impairment and based on the fair value of FHF the goodwill associated with FHF was reduced to zero at March 31, 2007. This amount is included in Goodwill impairment in the Consolidated Statements of Operations. FHF was a loan origination company based in Grand Rapids, Michigan that specialized in the financing of manufactured homes located in mobile home parks or communities and was a subsidiary of our IB segment above. Revenues and profits had declined at FHF over the last few years and a result of these declines, the operations of FHF ceased effective June 15, 2007 and this entity was dissolved on June 30, 2007. During the second quarter of 2008, our common stock began to trade on the NASDAQ market at levels consistently below book value. As a result, we conducted a goodwill impairment analysis. This analysis included valuations based on: a comparable merger and acquisition transaction method; a guideline publicly traded company method, and; a discounted earnings method. Based on these valuations, management concluded that goodwill was not impaired. We intend to continue to closely monitor market conditions and the assumptions that we utilized for this most recent valuation analysis. We may incur additional impairment charges related to our goodwill in the future due to changes in business prospects or other matters that could affect our valuation assumptions.

9. We maintain performance-based compensation plans that include a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. This plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.1 million shares of common stock

as of June 30, 2008. We believe that such awards better align the interests of our officers with our shareholders. Share based compensation awards, 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. Pursuant to our performance-based compensation plans we granted 0.2 million shares of non-vested common stock to our officers on January, 16, 2008. The non-vested common stock cliff vests in five years. We use the market value of the common stock on date of grant to measure compensation cost for these non-vested share awards. We also estimate expected forfeitures over the vesting period.

During the first quarter of 2008 we modified 0.1 million stock options originally issued in prior years for one former officer. These modified options vested immediately and the expense associated with this modification of \$0.01 million was included in compensation and benefits expense during the three month period ended March 31, 2008. The modification consisted of

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extending the date of exercise subsequent to resignation of the officer from 3 months to 12 months. During the second quarter of 2007 we modified 0.1 million stock options originally issued in prior years for one former officer. These modified options vested immediately and the expense associated with this modification of \$0.1 million was included in compensation and benefits expense during the three month period ended June 30, 2007. The modification consisted of extending the date of exercise subsequent to resignation of the officer from 3 months to 18 months.

A summary of outstanding stock option grants and transactions at June 30, follows:

		Six-months Ended June 30, 2008		
	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregated Intrinsic Value (in thousands)
Outstanding at January 1, Granted	1,658,861	\$ 19.55		
Exercised	8,228	6.17		
Forfeited	(36,675)	23.17		
Outstanding at June 30,	1,613,958	\$ 19.54	4.95	\$ 0
Vested and expected to vest at June 30, 2008	1,584,471	\$ 19.59	4.88	\$ 0
Exercisable at June 30, 2008	1,472,969	\$ 19.81	4.58	\$ 0

A summary of non-vested restricted stock and transactions for the six month period ended June 30, follows:

	2008		2007	
Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value	