INDEPENDENT BANK CORP /MI/
Form 424B3
August 21, 2012

Filed Pursuant to Rule 424(b)(3)
File No. 333-169200

PROSPECTUS SUPPLEMENT NO. 2
TO PROSPECTUS DATED MAY 23, 2012

Common Stock

This Prospectus Supplement No. 2 supplements and amends the prospectus dated May 23, 2012, as amended and supplemented by the Prospectus Supplement No. 1 dated May 30, 2012, which we collectively refer to as the Prospectus, which forms part of our Post-Effective Amendment No. 2 to Registration Statement on Form S-1 (Registration Statement No. 333-169200). The Prospectus relates to the disposition from time to time of up to 1,502,468 shares of our common stock that we may issue to Dutchess Opportunity Fund, II, LP ("Dutchess"), pursuant to an Investment Agreement between us and Dutchess, dated July 7, 2010. We are not selling any common stock under the Prospectus or this Prospectus Supplement No. 2, and will not receive any of the proceeds from the sale of shares by the selling stockholder.

We are filing this Prospectus Supplement No. 2 to update, amend and supplement the information included or incorporated by reference in the Prospectus with the information contained in the quarterly report and the current reports described below.

This Prospectus Supplement No. 2 includes our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on August 9, 2012, and our four Current Reports on Form 8-K, filed with the Securities and Exchange Commission on July 19, 2012, July 30, 2012, August 8, 2012 and August 15, 2012, respectively.

This Prospectus Supplement No. 2 should be read in conjunction with, and may not be delivered or utilized without, the Prospectus, including any amendments or supplements thereto. This Prospectus Supplement No. 2 is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 2 supersedes the information contained in the Prospectus. All references in the Prospectus to "this prospectus" are hereby amended to read "this prospectus (as supplemented and amended)."

Our common stock is listed on the Nasdaq Global Select Market under the symbol "IBCP." As of August 20, 2012, the closing sale price for our common stock on the Nasdaq Global Select Market was $2.90 per share.

Investing in our common stock involves risks. These risks are described under the caption "Risk Factors" beginning on page 7 of the Prospectus, as the same may be updated in prospectus supplements.

The shares of common stock offered are not savings accounts, deposits, or other obligations of any of our bank or non-bank subsidiaries and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.

Neither the Securities and Exchange Commission, any state securities commission, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, nor any other regulatory body has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is August 21, 2012.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2012

Commission file number 0-7818

INDEPENDENT BANK CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or smaller reporting company.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company x

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

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

Common stock, no par value	8,773,629
Class	Outstanding at August 9, 2012

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

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

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

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

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

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

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Part I - Item 1.
INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition

	June 30, 2012	December 31, 2011
	(unaudited)	
	(In thousands, except share amounts)	
Assets		
Cash and due from banks	$ 60,838	$ 62,777
Interest bearing deposits	358,920	278,331
Cash and Cash Equivalents	419,758	341,108
Trading securities	86	77
Securities available for sale	247,047	157,444
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	20,494	20,828
Loans held for sale, carried at fair value	43,386	44,801
Loans held for sale relating to branch sale, carried at lower of cost or fair value	53,180	-
Loans		
Commercial	612,044	651,155
Mortgage	547,210	590,876
Installment	199,190	219,559
Payment plan receivables	98,946	115,018
Total Loans	1,457,390	1,576,608
Allowance for loan losses	(51,346)	(58,884)
Net Loans	1,406,044	1,517,724
Other real estate and repossessed assets	29,504	34,042
Property and equipment, net	50,802	62,548
Bank-owned life insurance	50,094	49,271
Other intangibles	7,065	7,609
Capitalized mortgage loan servicing rights	10,651	11,229
Prepaid FDIC deposit insurance assessment	11,008	12,609
Vehicle service contract counterparty receivables, net	28,879	29,298
Fixed assets held for sale relating to branch sale	8,491	-
Accrued income and other assets	16,976	18,818
Total Assets	$ 2,403,465	$ 2,307,406
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	$ 471,718	$ 497,718
Savings and interest-bearing checking	852,214	1,019,603
Retail time	392,544	526,525
Brokered time	48,860	42,279
Total Deposits	1,765,336	2,086,125
Deposits held for sale relating to branch sale	417,521	-
Other borrowings	17,929	33,387
Subordinated debentures	50,175	50,175
Vehicle service contract counterparty payables	7,118	6,633
Accrued expenses and other liabilities	32,214	28,459
Total Liabilities	2,290,293	2,204,779
Shareholders' Equity		

Convertible preferred stock, no par value, 200,000 shares authorized; 74,426 shares issued and outstanding at June 30, 2012 and December 31, 2011; liquidation preference: $83,061 at June 30, 2012 and $81,023 at December 31, 2011	82,004	79,857
Common stock, no par value, 500,000,000 shares authorized; issued and outstanding: 8,749,220 shares at June 30, 2012 and 8,491,526 shares at December 31, 2011	249,751	248,950
Accumulated deficit	(208,569)	(214,259)
Accumulated other comprehensive loss	(10,014)	(11,921)
Total Shareholders' Equity	113,172	102,627
Total Liabilities and Shareholders' Equity	$ 2,403,465	$ 2,307,406

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited) (In thousands)			
Interest Income				
Interest and fees on loans	$ 23,696	$ 28,102	$ 48,042	$ 57,586
Interest on securities				
Taxable	933	344	1,591	811
Tax-exempt	244	298	540	630
Other investments	382	383	778	818
Total Interest Income	25,255	29,127	50,951	59,845
Interest Expense				
Deposits	2,305	4,511	4,729	9,456
Other borrowings	1,120	1,232	2,292	2,555
Total Interest Expense	3,425	5,743	7,021	12,011
Net Interest Income	21,830	23,384	43,930	47,834
Provision for loan losses	1,056	4,156	6,187	14,858
Net Interest Income After Provision for Loan Losses	20,774	19,228	37,743	32,976
Non-interest Income				
Service charges on deposit accounts	4,552	4,784	8,753	9,066
Interchange income	2,407	2,308	4,729	4,476
Net gains (losses) on assets				
Mortgage loans	3,579	1,793	7,439	3,728
Securities	169	115	853	328
Other than temporary impairment loss on securities				
Total impairment loss	(85)	327	(262)	(142)
Loss recognized in other comprehensive loss	-	(327)	-	-
Net impairment loss recognized in earnings	(85)	-	(262)	(142)
Mortgage loan servicing	(1,088)	(126)	(352)	770
Title insurance fees	489	318	997	791
(Increase) decrease in fair value of U.S. Treasury warrant	(25)	642	(179)	996
Other	3,044	2,622	5,648	5,154
Total Non-interest Income	13,042	12,456	27,626	25,167
Non-interest Expense				
Compensation and employee benefits	13,506	13,029	25,988	25,378
Loan and collection	2,407	3,580	5,297	7,447
Occupancy, net	2,490	2,663	5,206	5,764
Data processing	2,450	2,415	4,789	4,725
Furniture, fixtures and equipment	1,307	1,502	2,601	2,920
Legal and professional	1,268	801	2,165	1,579
Communications	826	889	1,701	1,837

FDIC deposit insurance	816	652	1,673	1,887
Net losses on other real estate and repossessed assets	633	777	1,620	2,183
Credit card and bank service fees	624	1,013	1,275	2,060
Advertising	639	670	1,195	1,224
Vehicle service contract counterparty contingencies	326	1,311	797	3,657
Provision for loss reimbursement on sold loans	126	363	558	769
Costs (recoveries) related to unfunded lending commitments	(12)	89	(59)	184
Other	2,077	2,151	2,726	4,159
Total Non-interest Expense	29,483	31,905	57,532	65,773
Income (Loss) Before Income Tax	4,333	(221)	7,837	(7,630)
Income tax benefit	-	(258)	-	(266)
Net Income (Loss)	$ 4,333	$ 37	$ 7,837	$ (7,364)
Convertible preferred stock dividends and discount accretion	1,092	1,051	2,148	2,059
Net Income (Loss) Applicable to Common Stock	$ 3,241	$ (1,014)	5,689	$ (9,423)
Net Income (Loss) Per Common Share				
Basic	$ .38	$ (.12)	$ .66	$ (1.16)
Diluted	.11	(.12)	.19	(1.16)
Dividends Per Common Share				
Declared	$ .00	$ .00	$ .00	$ .00
Paid	.00	.00	.00	.00

See notes to interim condensed consolidated financial statements (unaudited)

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

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(unaudited) (In thousands)		(unaudited) (In thousands)	
Net income (loss)	$4,333	$37	$7,837	$(7,364)
Other comprehensive income (loss), before tax				
Unrealized losses on available for sale securities				
Unrealized gain (loss) arising during period	2,756	394	1,896	715
Change in unrealized losses for which a portion of other than temporary impairment has been recognized in earnings	204	738	333	411
Reclassification adjustments for (gains) losses included in earnings	(151)	(64)	(843)	(204)
Unrealized losses on available for sale securities, net	2,809	1,068	1,386	922
Unrealized losses on derivative instruments				
Unrealized loss arising during period	(24)	(240)	(75)	(263)
Reclassification adjustment for expense recognized in earnings	120	201	305	403
Reclassfication adjustment for accretion on settled derivatives	146	147	291	369
Unrealized gains on derivative instruments	242	108	521	509
Other comprehensive income (loss), before tax	3,051	1,176	1,907	1,431
Income tax expense related to components of other comprehesive income (loss)	-	501	-	501
Other comprehensive income	3,051	675	1,907	930
Comprehensive income (loss)	$7,384	$712	$9,744	$(6,434)

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Six months ended June 30, 2012	2011
	(unaudited - In thousands)	
Net Income (Loss)	$ 7,837	$ (7,364)
Adjustments to Reconcile Net Income (Loss) to Net Cash from Operating Activities		
Proceeds from sales of loans held for sale	246,587	187,558
Disbursements for loans held for sale	(237,733)	(160,040)
Provision for loan losses	6,187	14,858
Deferred loan fees	(404)	(214)
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	(2,351)	(6,442)
Net gains on sales of mortgage loans	(7,439)	(3,728)
Net gains on securities	(853)	(328)
Securities impairment recognized in earnings	262	142
Net losses on other real estate and repossessed assets	1,620	2,183
Vehicle service contract counterparty contingencies	797	3,657
Share based compensation	304	455
Decrease in accrued income and other assets	3,288	4,346
Increase in accrued expenses and other liabilities	4,262	2,632
Total Adjustments	14,527	45,079
Net Cash from Operating Activities	22,364	37,715
Cash Flow from (used in) Investing Activities		
Proceeds from the sale of securities available for sale	18,999	70,322
Proceeds from the maturity or call of securities available for sale	60,728	295
Principal payments received on securities available for sale	11,220	3,872
Purchases of securities available for sale	(179,262)	(83,906)
Redemption of Federal Home Loan Bank stock	-	2,397
Redemption of Federal Reserve Bank stock	334	228
Net decrease in portfolio loans (loans originated, net of principal payments)	53,220	108,369
Proceeds from the collection of vehicle service contract counterparty receivables	396	671
Proceeds from the sale of other real estate and repossessed assets	8,912	10,084
Capital expenditures	(3,257)	(1,554)
Net Cash from (used in) Investing Activities	(28,710)	110,778
Cash Flow from (used in) Financing Activities		
Net increase (decrease) in total deposits	99,472	(187,153)
Net increase (decrease) in other borrowings	9	(8)
Proceeds from Federal Home Loan Bank advances	12,000	7,000
Payments of Federal Home Loan Bank advances	(27,467)	(37,115)
Net increase in vehicle service contract counterparty payables	485	2,858
Proceeds from issuance of common stock	497	1,335
Net Cash from (used in) Financing Activities	84,996	(213,083)
Net Increase (Decrease) in Cash and Cash Equivalents	78,650	(64,590)
Cash and Cash Equivalents at Beginning of Period	341,108	385,374
Cash and Cash Equivalents at End of Period	$ 419,758	$ 320,784

Cash paid during the period for				
Interest	$	5,914	$	11,361
Income taxes		186		26
Transfers to other real estate and repossessed assets		5,994		10,462
Transfer of payment plan receivables to vehicle service contract counterparty receivables		849		8,010
Transfers to loans held for sale		54,127		-
Transfers to fixed assets held for sale		11,065		-
Transfers to deposits held for sale		420,261		-

See notes to interim condensed consolidated financial statements (unaudited)

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

	Six months ended June 30,	
	2012	2011
	(unaudited) (In thousands)	
Balance at beginning of period	$102,627	$119,085
Net income (loss)	7,837	(7,364)
Issuance of common stock	497	1,335
Share based compensation	304	455
Net change in accumulated other comprehensive loss, net of related tax effect	1,907	930
Balance at end of period	$113,172	$114,441

See notes to interim condensed consolidated financial statements (unaudited)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Preparation of Financial Statements

The interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2011 included in our Annual Report on Form 10-K.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of June 30, 2012 and December 31, 2011, and the results of operations for the three and six-month periods ended June 30, 2012 and 2011. The results of operations for the three and six-month periods ended June 30, 2012, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the assessment for other than temporary impairment ("OTTI") on investment securities, the determination of the allowance for loan losses, the determination of vehicle service contract counterparty contingencies, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2011 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. New Accounting Standards

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

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

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220)". This ASU amended guidance on the presentation requirements for comprehensive income. The amended guidance requires an entity to present total comprehensive income, the components of net income and the components of other comprehensive income on the face of the financial statements, either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amended guidance did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This amended guidance became effective for us at January 1, 2012 and was applied retrospectively. The effect of adopting this standard did not have a material impact on our consolidated operating results or financial condition, but we have included separate Condensed Consolidated Statements of Comprehensive Income (Loss) immediately following our Condensed Consolidated Statements of Operations in our Condensed Consolidated Financial Statements.

3. Securities

Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
		(In thousands)		
June 30, 2012				
U.S. agency	$38,039	$124	$20	$38,143
U.S. agency residential mortgage-backed	156,231	994	61	157,164
Private label residential mortgage-backed	9,887	-	2,208	7,679
Obligations of states and political subdivisions	40,383	643	62	40,964
Trust preferred	4,700	-	1,603	3,097
Total	$249,240	$1,761	$3,954	$247,047
December 31, 2011				
U.S. agency	$24,980	$58	$21	$25,017
U.S. agency residential mortgage-backed	93,415	1,007	216	94,206
Private label residential mortgage-backed	11,066	-	2,798	8,268
Obligations of states and political subdivisions	26,865	510	58	27,317
Trust preferred	4,697	-	2,061	2,636
Total	$161,023	$1,575	$5,154	$157,444

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

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

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
June 30, 2012						
U.S. agency	$7,507	$20	$-	$-	$7,507	$20
U.S. agency residential mortgage-backed	30,497	44	10,097	17	40,594	61
Private label residential mortgage-backed	-	-	7,677	2,208	7,677	2,208
Obligations of states and political subdivisions	8,202	62	-	-	8,202	62
Trust preferred	-	-	3,097	1,603	3,097	1,603
Total	$46,206	$126	$20,871	$3,828	$67,077	$3,954
December 31, 2011						
U.S. agency	$9,974	$21	$-	$-	$9,974	$21
U.S. agency residential mortgage-backed	42,500	216	-	-	42,500	216
Private label residential mortgage-backed	163	90	8,102	2,708	8,265	2,798
Obligations of states and political subdivisions	-	-	1,729	58	1,729	58
Trust preferred	591	1,218	2,045	843	2,636	2,061
Total	$53,228	$1,545	$11,876	$3,609	$65,104	$5,154

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

U.S. Agency and U.S. Agency residential mortgage-backed securities — at June 30, 2012 we had two U.S. Agency and eight U.S. Agency residential mortgage-backed securities whose fair market value is less than amortized cost. The unrealized losses on U.S. Agency residential mortgage-backed securities are largely attributed to widening discount margins. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Private label residential mortgage backed securities — at June 30, 2012 we had eight securities whose fair value is less than amortized cost. Two of the issues are rated by a major rating agency as investment grade while four are below investment grade and two are split rated. Six of these bonds have impairment in excess of 10% and all of these holdings have been impaired for more than 12 months.

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

The unrealized losses are largely attributable to credit spread widening on these securities since their acquisition. The underlying loans within these securities include Jumbo (75%) and Alt A (25%) at June 30, 2012.

	June 30, 2012		December 31, 2011	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Private label residential mortgage-backed				
Jumbo	$5,738	$(1,602)	$6,454	$(1,937)
Alt-A	1,941	(606)	1,814	(861)

Seven of the private label residential mortgage-backed transactions have geographic concentrations in California, ranging from 22% to 58% of the collateral pool. Typical exposure levels to California (median exposure is 47%) are consistent with overall market collateral characteristics. Three transactions have modest exposure to Florida, ranging from 5% to 7% and one transaction has modest exposure to Nevada (5%). The underlying collateral pools do not have meaningful exposure to Arizona, Michigan or Ohio. None of the issues involve subprime mortgage collateral. Thus the impact of this market segment is only indirect, in that it has impacted liquidity and pricing in general for private label residential mortgage-backed securities. The majority of transactions are backed by fully amortizing loans. However, six transactions have concentrations in loans that pay interest only for a specified period of time and will fully amortize thereafter ranging from 31% to 94% (at origination date). The structure of the residential mortgage securities portfolio provides protection to credit losses. The portfolio primarily consists of senior securities as demonstrated by the following: super senior (22%), senior (43%), senior support (25%) and mezzanine (10%). The mezzanine class is from a seasoned transaction (94 months) with a significant level of subordination (8.60%). Except for the additional discussion below relating to other than temporary impairment, each private label residential mortgage-backed security has sufficient credit enhancement via subordination to reasonably assure full realization of book value. This assertion is based on a transaction level review of the portfolio.

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

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

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

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

At June 30, 2012 three below investment grade private label residential mortgage-backed securities with fair values of $3.3 million, $1.7 million and $0.1 million, respectively and unrealized losses of $1.0 million, $0.3 million and $0.03 million, respectively (amortized cost of $4.3 million, $2.0 million and $0.1 million, respectively) had losses that were considered other than temporary.

The underlying loans in the first transaction are 30 year fixed rate jumbos with an average FICO of 744 and an average loan-to-value ratio of 72%. The loans backing this transaction were originated in 2007 and this is our only security backed by 2007 vintage loans. We believe that this vintage is a key differentiating factor between this security and the others in our portfolio that do not have unrealized losses that are considered OTTI. The bond is a senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.645 million of cumulative credit related OTTI as of June 30, 2012 on this security. $0.085 million and zero of this credit related OTTI was recognized in our Condensed Consolidated Statements of Operations during the three months ended June 30, 2012 and 2011, respectively and $0.170 million and $0.052 million of this credit related OTTI was recognized during the six months ended June 30, 2012 and 2011, respectively, with the balance being recognized in previous periods. The remaining non-credit related unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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The underlying loans in the second transaction are 30 year hybrid ARM Alt-A with an average FICO of 717 and an average loan-to-value ratio of 78%. The loans backing this transaction were originated in 2005. The bond is a super senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.457 million of cumulative credit related OTTI as of June 30, 2012 on this security. There was no credit related OTTI recognized in our Condensed Consolidated Statements of Operations during the three months ended June 30, 2012 and 2011 while $0.032 million and zero of this credit related OTTI was recognized during the six months ended June 30, 2012 and 2011, respectively, with the balance being recognized in previous periods. The remaining non-credit related unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

The underlying loans in the third transaction are 30 year hybrid ARM jumbos with an average FICO of 738 and an average loan-to-value ratio of 57%. The loans backing this transaction were originated in 2005. The bond is a senior support security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated $0.380 million of cumulative credit related OTTI as of June 30, 2012 on this security. There was no credit related OTTI recognized in our Condensed Consolidated Statements of Operations during the three months ended June 30, 2012 and 2011, while $0.060 million and $0.090 million of this credit related OTTI was recognized during the six months ended June 30, 2012 and 2011, respectively, with the balance being recognized in previous periods. The remaining non-credit related unrealized loss was attributed to other factors and is reflected in other comprehensive income (loss) during those same periods.

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

Obligations of states and political subdivisions — at June 30, 2012 we had nine municipal securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to widening of market spreads. Seven of the impaired securities are rated by a major rating agency as investment grade. The non rated securities have a periodic internal credit review according to established procedures. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Trust preferred securities — at June 30, 2012 we had four securities whose fair value is less than amortized cost. All of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities over the past several years has suffered from significant credit spread widening fueled by uncertainty regarding potential losses of financial companies, the absence of a liquid functioning secondary market and potential supply concerns from financial companies issuing new debt to recapitalize themselves.

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One of the four securities is rated by two major rating agencies as investment grade, while one is rated one grade below investment grade by two major rating agencies and the other two are non-rated. The non-rated issues are relatively small banks and were never rated. The issuers of these non-rated trust preferred securities, which had a total amortized cost of $2.8 million and total fair value of $1.5 million as of June 30, 2012, continue to have satisfactory credit metrics and one continues to make interest payments. One non-rated issue began deferring dividend payments in the third quarter of 2011 apparently due to an increase in non-performing assets. Nevertheless, this issuer continues to have satisfactory capital measures and interim profitability.

The following table breaks out our trust preferred securities in further detail as of June 30, 2012 and December 31, 2011:

	June 30, 2012		December 31, 2011	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Trust preferred securities				
Rated issues	$1,564	$(329)	$1,405	$(484)
Unrated issues - no OTTI	1,533	(1,274)	1,231	(1,577)

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

We recorded credit related OTTI charges in earnings on securities available for sale of $0.085 million and zero during the three month periods ended June 30, 2012 and 2011, respectively and $0.262 million and $0.142 million during the six month periods ended June 30, 2012 and 2011, respectively (see discussion above).

A roll forward of credit losses recognized in earnings on securities available for sale for the three and six month periods ending June 30, follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Balance at beginning of period	$1,647	$852	$1,470	$710
Additions to credit losses on securities for which no previous OTTI was recognized	-	-	-	-
Increases to credit losses on securities for which OTTI was previously recognized	85	-	262	142
Balance at end of period	$1,732	$852	$1,732	$852

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The amortized cost and fair value of securities available for sale at June 30, 2012, by contractual maturity, follow. The actual maturity may differ from the contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$1,323	$1,341
Maturing after one year but within five years	6,491	6,711
Maturing after five years but within ten years	15,318	15,531
Maturing after ten years	59,990	58,621
	83,122	82,204
U.S. agency residential mortgage-backed	156,231	157,164
Private label residential mortgage-backed	9,887	7,679
Total	$249,240	$247,047

Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the six month periods ending June 30, follows:

	Proceeds	Realized Gains	Losses(1)
		(In thousands)	
2012	$ 18,999	$ 843	$ -
2011	70,322	279	75

(1) Losses in 2012 and 2011 exclude $0.262 million and $0.142 million, respectively of credit related OTTI recognized in earnings.

During 2012 and 2011 our trading securities consisted of various preferred stocks. During the first six months of 2012 and 2011 we recognized gains on trading securities of $0.010 million and $0.124 million, respectively, that are included in net gains (losses) on securities in the Condensed Consolidated Statements of Operations. Both of these amounts, relate to gains recognized on trading securities still held at each respective period end.

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4. Loans

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

An analysis of the allowance for loan losses by portfolio segment for the three months ended June 30, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
2012						
Balance at beginning of period	$16,441	$23,271	$5,534	$206	$10,554	$56,006
Additions (deductions)						
Provision for loan losses	1,194	570	229	(7)	(930)	1,056
Recoveries credited to allowance	390	572	389	-	-	1,351
Loans charged against the allowance	(2,379)	(2,950)	(953)	(4)	-	(6,286)
Reclassification to loans held for sale	(170)	(192)	(218)	-	(201)	(781)
Balance at end of period	$15,476	$21,271	$4,981	$195	$9,423	$51,346
2011						
Balance at beginning of period	$21,279	$23,771	$6,719	$333	$13,659	$65,761
Additions (deductions)						
Provision for loan losses	1,333	2,964	446	37	(624)	4,156
Recoveries credited to allowance	512	385	348	2	-	1,247
Loans charged against the allowance	(5,427)	(3,968)	(1,224)	(26)	-	(10,645)
Balance at end of period	$17,697	$23,152	$6,289	$346	$13,035	$60,519

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An analysis of the allowance for loan losses by portfolio segment for the six months ended June 30, follows:

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
2012						
Balance at beginning of period	$18,183	$22,885	$6,146	$197	$11,473	$58,884
Additions (deductions)						
Provision for loan losses	2,690	4,805	518	23	(1,849)	6,187
Recoveries credited to allowance	1,396	1,120	715	-	-	3,231
Loans charged against the allowance	(6,623)	(7,347)	(2,180)	(25)	-	(16,175)
Reclassification to loans held for sale	(170)	(192)	(218)	-	(201)	(781)
Balance at end of period	$15,476	$21,271	$4,981	$195	$9,423	$51,346
2011						
Balance at beginning of period	$23,836	$22,642	$6,769	$389	$14,279	$67,915
Additions (deductions)						
Provision for loan losses	6,043	8,333	1,681	45	(1,244)	14,858
Recoveries credited to allowance	731	740	707	4	-	2,182
Loans charged against the allowance	(12,913)	(8,563)	(2,868)	(92)	-	(24,436)
Balance at end of period	$17,697	$23,152	$6,289	$346	$13,035	$60,519

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

	Commercial	Mortgage	Installment	Payment Plan Receivables	Unallocated	Total
			(In thousands)			
June 30, 2012						
Allowance for loan losses:						
Individually evaluated for impairment	$9,855	$10,201	$1,674	$-	$-	$21,730
Collectively evaluated for impairment	5,621	11,070	3,307	195	9,423	29,616
Total ending allowance balance	$15,476	$21,271	$4,981	$195	$9,423	$51,346
Loans						
Individually evaluated for impairment	$66,703	$91,494	$7,717	$-		$165,914
Collectively evaluated for impairment	547,014	458,274	192,249	98,946		1,296,483
Total loans recorded investment	613,717	549,768	199,966	98,946		1,462,397
Accrued interest included in recorded investment	1,673	2,558	776	-		5,007
Total loans	$612,044	$547,210	$199,190	$98,946		$1,457,390
December 31, 2011						
Allowance for loan losses:						
Individually evaluated for impairment	$10,252	$10,285	$1,762	$-	$-	$22,299
Collectively evaluated for impairment	7,931	12,600	4,384	197	11,473	36,585
Total ending allowance balance	$18,183	$22,885	$6,146	$197	$11,473	$58,884
Loans						
Individually evaluated for impairment	$58,674	$93,702	$7,554	$-		$159,930
Collectively evaluated for impairment	594,665	499,919	212,907	115,018		1,422,509
Total loans recorded investment	653,339	593,621	220,461	115,018		1,582,439
Accrued interest included in recorded investment	2,184	2,745	902	-		5,831
Total loans	$651,155	$590,876	$219,559	$115,018		$1,576,608

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

	90+ and Still Accruing	Non-Accrual (In thousands)	Total Non-Performing Loans
June 30, 2012			
Commercial			
Income producing - real estate	$ 280	$ 8,277	$ 8,557
Land, land development and construction - real estate	125	4,804	4,929
Commercial and industrial	338	8,932	9,270
Mortgage			
1-4 family	-	11,593	11,593
Resort lending	-	6,475	6,475
Home equity line of credit - 1st lien	-	592	592
Home equity line of credit - 2nd lien	-	690	690
Installment			
Home equity installment - 1st lien	-	1,079	1,079
Home equity installment - 2nd lien	-	710	710
Loans not secured by real estate	-	883	883
Other	-	1	1
Payment plan receivables			
Full refund	-	126	126
Partial refund	-	137	137
Other	-	15	15
Total recorded investment	$ 743	$ 44,314	$ 45,057
Accrued interest included in recorded investment	$ 4	$ -	$ 4
December 31, 2011			
Commercial			
Income producing - real estate	$ 490	$ 13,788	$ 14,278
Land, land development and construction - real estate	43	6,990	7,033
Commercial and industrial	-	7,984	7,984
Mortgage			
1-4 family	54	15,929	15,983
Resort lending	-	8,819	8,819
Home equity line of credit - 1st lien	-	523	523
Home equity line of credit - 2nd lien	-	889	889
Installment			
Home equity installment - 1st lien	-	1,542	1,542
Home equity installment - 2nd lien	-	1,023	1,023
Loans not secured by real estate	-	880	880
Other	-	4	4
Payment plan receivables			
Full refund	-	491	491

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

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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An aging analysis of loans by class follows:

	Loans Past Due				Loans not	Total
	30-59 days	60-89 days	90+ days	Total	Past Due	Loans
			(In thousands)			
June 30, 2012						
Commercial						
Income producing - real estate	$2,280	$1,887	$3,823	$7,990	$210,777	$218,767
Land, land development and construction - real estate	191	-	1,555	1,746	42,605	44,351
Commercial and industrial	2,820	999	4,498	8,317	342,282	350,599
Mortgage						
1-4 family	2,501	1,003	11,593	15,097	285,035	300,132
Resort lending	169	383	6,475	7,027	174,069	181,096
Home equity line of credit - 1st lien	334	101	592	1,027	19,395	20,422
Home equity line of credit - 2nd lien	372	55	690	1,117	47,001	48,118
Installment						
Home equity installment - 1st lien	498	162	1,079	1,739	33,405	35,144
Home equity installment - 2nd lien	542	145	710	1,397	42,147	43,544
Loans not secured by real estate	872	297	883	2,052	116,454	118,506
Other	13	3	1	17	2,755	2,772
Payment plan receivables						
Full refund	2,075	659	126	2,860	87,987	90,847
Partial refund	208	94	137	439	7,220	7,659
Other	10	8	15	33	407	440
Total recorded investment	$12,885	$5,796	$32,177	$50,858	$1,411,539	$1,462,397
Accrued interest included in recorded investment	$111	$78	$4	$193	$4,814	$5,007
December 31, 2011						
Commercial						
Income producing - real estate	$1,701	$937	$6,408	$9,046	$264,620	$273,666
Land, land development and construction - real estate	487	66	2,720	3,273	51,453	54,726
Commercial and industrial	1,861	1,132	3,516	6,509	318,438	324,947
Mortgage						
1-4 family	3,507	1,418	15,983	20,908	294,771	315,679
Resort lending	2,129	932	8,819	11,880	184,943	196,823
Home equity line of credit - 1st lien	96	196	523	815	24,705	25,520
Home equity line of credit - 2nd lien	506	159	889	1,554	54,045	55,599

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

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Impaired loans are as follows :

	June 30, 2012	December 31, 2011
Impaired loans with no allocated allowance		
TDR	$ 26,170	$ 26,945
Non - TDR	235	423
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	17,137	20,142
TDR - allowance based on present value cash flow	111,396	98,130
Non - TDR - allowance based on collateral	10,479	13,773
Non - TDR - allowance based on present value cash flow	-	-
Total impaired loans	$ 165,417	$ 159,413
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$ 4,860	$ 6,004
TDR - allowance based on present value cash flow	13,384	12,048
Non - TDR - allowance based on collateral	3,486	4,247
Non - TDR - allowance based on present value cash flow	-	-
Total amount of allowance for loan losses allocated	$ 21,730	$ 22,299

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Impaired loans by class are as follows (1):

	June 30, 2012			December 31, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			(In thousands)			
Commercial						
Income producing - real estate	$1,848	$2,692	$-	$4,626	$6,386	$-
Land, land development & construction-real estate	2,794	2,787	-	219	243	-
Commercial and industrial	3,332	3,657	-	3,593	3,677	-
Mortgage						
1-4 family	7,651	10,350	-	6,975	9,242	-
Resort lending	5,913	6,375	-	7,156	7,680	-
Home equity line of credit - 1st lien	22	40	-	-	-	-
Home equity line of credit - 2nd lien	45	118	-	134	211	-
Installment						
Home equity installment - 1st lien	2,100	2,204	-	2,100	2,196	-
Home equity installment - 2nd lien	2,239	2,238	-	1,987	1,987	-
Loans not secured by real estate	529	600	-	637	688	-
Other	22	22	-	24	24	-
	26,495	31,083	-	27,451	32,334	-
With an allowance recorded:						
Commercial						
Income producing - real estate	26,935	30,985	3,094	22,781	29,400	3,642
Land, land development & construction-real estate	10,203	12,703	2,945	12,362	14,055	3,633
Commercial and industrial	21,591	25,376	3,816	15,093	18,357	2,977
Mortgage						
1-4 family	59,255	60,826	6,980	61,214	63,464	7,716
Resort lending	18,561	18,926	3,190	18,159	19,351	2,534
Home equity line of credit - 1st lien	47	47	31	64	73	35
Home equity line of credit - 2nd lien	-	-	-	-	-	-
Installment						
Home equity installment - 1st lien	1,397	1,430	673	1,232	1,293	660
Home equity installment - 2nd lien	1,151	1,220	921	1,421	1,458	1,062
Loans not secured by real estate	279	287	80	153	156	40

Other	-	-	-	-	-	-
	139,419	151,800	21,730	132,479	147,607	22,299
Total						
Commercial						
Income producing - real estate	28,783	33,677	3,094	27,407	35,786	3,642
Land, land development & construction-real estate	12,997	15,490	2,945	12,581	14,298	3,633
Commercial and industrial	24,923	29,033	3,816	18,686	22,034	2,977
Mortgage						
1-4 family	66,906	71,176	6,980	68,189	72,706	7,716
Resort lending	24,474	25,301	3,190	25,315	27,031	2,534
Home equity line of credit - 1st lien	69	87	31	64	73	35
Home equity line of credit - 2nd lien	45	118	-	134	211	-
Installment						
Home equity installment - 1st lien	3,497	3,634	673	3,332	3,489	660
Home equity installment - 2nd lien	3,390	3,458	921	3,408	3,445	1,062
Loans not secured by real estate	808	887	80	790	844	40
Other	22	22	-	24	24	-
Total	$165,914	$182,883	$21,730	$159,930	$179,941	$22,299
Accrued interest included in recorded investment	$497			$517		

(1) There were no impaired payment plan receivables at June 30, 2012 or December 31, 2011.

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Average recorded investment in and interest income earned on impaired loans by class for the three month periods ending June 30, follows:

	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$2,211	$13	$1,922	$12
Land, land development & construction-real estate	2,877	36	514	14
Commercial and industrial	3,896	44	1,800	17
Mortgage				
1-4 family	7,615	75	9,258	102
Resort lending	6,134	60	8,543	125
Home equity line of credit - 1st lien	11	-	-	-
Home equity line of credit - 2nd lien	46	1	116	1
Installment				
Home equity installment - 1st lien	1,827	32	1,919	28
Home equity installment - 2nd lien	1,987	30	1,999	28
Loans not secured by real estate	473	7	705	10
Other	23	-	14	1
	27,100	298	26,790	338
With an allowance recorded:				
Commercial				
Income producing - real estate	24,300	120	16,824	33
Land, land development & construction-real estate	10,495	52	8,133	37
Commercial and industrial	18,954	156	9,253	92
Mortgage				
1-4 family	59,285	650	63,492	668
Resort lending	18,499	192	22,469	152
Home equity line of credit - 1st lien	59	-	24	1
Home equity line of credit - 2nd lien	47	-	10	-
Installment				
Home equity installment - 1st lien	1,709	9	1,521	14
Home equity installment - 2nd lien	1,469	6	1,561	14
Loans not secured by real estate	241	3	150	-
Other	-	-	-	-
	135,058	1,188	123,437	1,011
Total				
Commercial				
Income producing - real estate	26,511	133	18,746	45
Land, land development & construction-real estate	13,372	88	8,647	51
Commercial and industrial	22,850	200	11,053	109
Mortgage				
1-4 family	66,900	725	72,750	770
Resort lending	24,633	252	31,012	277

Home equity line of credit - 1st lien	70	-	24	1
Home equity line of credit - 2nd lien	93	1	126	1
Installment				
Home equity installment - 1st lien	3,536	41	3,440	42
Home equity installment - 2nd lien	3,456	36	3,560	42
Loans not secured by real estate	714	10	855	10
Other	23	-	14	1
Total	$162,158	$1,486	$150,227	$1,349

(1) There were no impaired payment plan receivables during the three month periods ending June 30, 2012 and 2011.

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

Average recorded investment in and interest income earned on impaired loans by class for the six month periods ending June 30, follows:

	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	(In thousands)			
Commercial				
Income producing - real estate	$3,016	$30	$2,796	$30
Land, land development & construction-real estate	1,991	36	876	27
Commercial and industrial	3,795	46	3,143	17
Mortgage				
1-4 family	7,401	149	9,095	214
Resort lending	6,474	126	7,584	223
Home equity line of credit - 1st lien	7	-	-	-
Home equity line of credit - 2nd lien	75	2	108	2
Installment				
Home equity installment - 1st lien	1,918	52	1,870	48
Home equity installment - 2nd lien	1,987	51	1,963	49
Loans not secured by real estate	528	13	540	16
Other	23	1	9	1
	27,215	506	27,984	627
With an allowance recorded:				
Commercial				
Income producing - real estate	23,793	267	16,618	122
Land, land development & construction-real estate	11,117	105	9,667	69
Commercial and industrial	17,667	270	10,335	141
Mortgage				
1-4 family	59,928	1,300	63,714	1,351
Resort lending	18,386	370	24,417	396
Home equity line of credit - 1st lien	60	1	16	1
Home equity line of credit - 2nd lien	31	-	15	-
Installment				
Home equity installment - 1st lien	1,550	30	1,467	28
Home equity installment - 2nd lien	1,453	25	1,511	30
Loans not secured by real estate	211	5	185	1
Other	-	-	-	-
	134,196	2,373	127,945	2,139
Total				
Commercial				
Income producing - real estate	26,809	297	19,414	152
Land, land development & construction-real estate	13,108	141	10,543	96
Commercial and industrial	21,462	316	13,478	158
Mortgage				
1-4 family	67,329	1,449	72,809	1,565

Resort lending	24,860	496	32,001	619
Home equity line of credit - 1st lien	67	1	16	1
Home equity line of credit - 2nd lien	106	2	123	2
Installment				
Home equity installment - 1st lien	3,468	82	3,337	76
Home equity installment - 2nd lien	3,440	76	3,474	79
Loans not secured by real estate	739	18	725	17
Other	23	1	9	1
Total	$161,411	$2,879	$155,929	$2,766

(1) There were no impaired payment plan receivables during the six month periods ending June 30, 2012 and 2011.

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

Our average investment in impaired loans was approximately $162.2 million and $150.2 million for the three-month periods ended June 30, 2012 and 2011, respectively and $161.4 million and $155.9 million for the six-month periods ended June 30, 2012 and 2011, 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 three months ending June 30, 2012 and 2011 was approximately $1.5 million and $1.3 million, respectively and was approximately $2.9 million and $2.8 million during the six months ending June 30, 2012 and 2011, respectively .

Troubled debt restructurings follow:

	June 30, 2012			
	Commercial	Retail		Total
		(In thousands)		
Performing TDR's	$ 44,573	$ 87,294		$ 131,867
Non-performing TDR's(1)	11,298	11,538	(2)	22,836
Total	$ 55,871	$ 98,832		$ 154,703

	December 31, 2011			
	Commercial	Retail		Total
		(In thousands)		
Performing TDR's	$ 29,799	$ 86,770		$ 116,569
Non-performing TDR's(1)	14,567	14,081	(2)	28,648
Total	$ 44,366	$ 100,851		$ 145,217

(1) Included in non-performing loans table above.
(2) Also includes loans on non-accrual at the time of modification until six payments are received on a timely basis.

The Company has allocated $18.2 million and $18.1 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2012 and December 31, 2011, respectively.

During the three and six months ending June 30, 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans 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 new debt 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 60 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 472 months in certain circumstances.

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

Loans that have been classified as troubled debt restructurings during the three-month period ended June 30, 2012 follows:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
		(Dollars in thousands)	
Commercial			
Income producing - real estate	12	$ 8,045	$ 7,974
Land, land development & construction-real estate	1	49	77
Commercial and industrial	19	4,286	4,001
Mortgage			
1-4 family	28	3,504	3,372
Resort lending	11	3,031	2,917
Home equity line of credit - 1st lien	-	-	-
Home equity line of credit - 2nd lien	-	-	-
Installment			
Home equity installment - 1st lien	6	118	115
Home equity installment - 2nd lien	6	317	313
Loans not secured by real estate	9	252	233
Other	-	-	-
Total	92	$ 19,602	$ 19,002

Loans that have been classified as troubled debt restructurings during the six-month period ended June 30, 2012 follows:

	Number of Contracts	Pre-modification Recorded Balance	Post-modification Recorded Balance
		(Dollars in thousands)	
Commercial			
Income producing - real estate	14	$ 8,268	$ 8,191
Land, land development & construction-real estate	3	2,887	2,913
Commercial and industrial	33	8,196	7,895
Mortgage			
1-4 family	43	4,802	4,639
Resort lending	18	5,206	5,072
Home equity line of credit - 1st lien	1	15	6
Home equity line of credit - 2nd lien	-	-	-
Installment			
Home equity installment - 1st lien	10	426	426
Home equity installment - 2nd lien	13	511	507
Loans not secured by real estate	10	277	258
Other	-	-	-
Total	145	$ 30,588	$ 29,907

The troubled debt restructurings described above increased the allowance for loan losses by $0.4 million and resulted in $0.3 million charge offs during the three months ending June 30, 2012 and increased the allowance by $0.6 million and resulted in $0.3 million charge offs during the six months ending June 30, 2012.

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

Loans that have been classified as troubled debt restructurings during the past twelve months and that have subsequently defaulted during the three-month period ended June 30, 2012 follows:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
Commercial		
Income producing - real estate	-	$-
Land, land development & construction-real estate	-	-
Commercial and industrial	1	41
Mortgage		
1-4 family	2	148
Resort lending	-	-
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	-	-
Home equity installment - 2nd lien	1	20
Loans not secured by real estate	-	-
Other	-	-
	4	$209

Loans that have been classified as troubled debt restructurings during the past twelve months and that have subsequently defaulted during the six-month period ended June 30, 2012 follows:

	Number of Contracts	Recorded Balance
	(Dollars in thousands)	
Commercial		
Income producing - real estate	2	$434
Land, land development & construction-real estate	1	136
Commercial and industrial	8	914
Mortgage		
1-4 family	2	148
Resort lending	1	117
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	1	26
Home equity installment - 2nd lien	1	20
Loans not secured by real estate	-	-
Other	-	-
	16	$1,795

A loan is considered to be in payment default generally once it is 90 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above decreased the allowance for loan losses by $0.1 million as a result of charge offs of $0.2 million during the three months ending June 30, 2012 and decreased the allowance for loan losses by $0.3 million as a result of charge offs of $0.6 million during the six months ending June 30, 2012.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The terms of certain other loans were modified during the three months ending June 30, 2012 that did not meet the definition of a troubled debt restructuring. The modification of these loans could have included modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, we perform an evaluation of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under our internal underwriting policy.

Credit Quality Indicators – As part of our on on-going monitoring of the credit quality of our loan portfolios, we track certain credit quality indicators including (a) weighted-average risk grade of commercial loans, (b) the level of classified commercial loans (c) credit scores of mortgage and installment loan borrowers (d) investment grade of certain counterparties for payment plan receivables and (e) 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. This rating includes 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 principle or interest is envisioned with these ratings.

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. This rating includes 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.

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

The following table summarizes loan ratings by loan class for our commercial loan segment:

	Non-watch 1-6	Watch 7-8	Commercial Substandard Accrual 9	Non-Accrual 10-11	Total
			(In thousands)		
June 30, 2012					
Income producing - real estate	$173,267	$34,030	$3,193	$8,277	$218,767
Land, land development and construction - real estate	28,353	8,409	2,785	4,804	44,351
Commercial and industrial	294,234	31,843	15,590	8,932	350,599
Total	$495,854	$74,282	$21,568	$22,013	$613,717
Accrued interest included in total	$1,386	$212	$75	$-	$1,673
December 31, 2011					
Income producing - real estate	$201,655	$52,438	$5,785	$13,788	$273,666
Land, land development and construction - real estate	33,515	9,421	4,800	6,990	54,726
Commercial and industrial	275,245	27,783	13,935	7,984	324,947
Total	$510,415	$89,642	$24,520	$28,762	$653,339
Accrued interest included in total	$1,677	$381	$126	$-	$2,184

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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For each of our mortgage and consumer segment classes we generally monitor credit quality based on the credit scores of the borrowers. These credit scores are generally updated at least annually.

The following table summarizes credit scores by loan class for our mortgage and installment loan segments:

	Mortgage (1)				
	1-4 Family	Resort Lending	Home Equity 1st Lien	Home Equity 2nd Lien	Total
			(In thousands)		
June 30, 2012					
800 and above	$24,454	$16,742	$2,800	$5,408	$49,404
750-799	59,134	71,244	5,707	14,147	150,232
700-749	52,303	49,423	3,577	10,143	115,446
650-699	51,716	20,267	2,387	6,861	81,231
600-649	38,761	10,220	2,363	4,834	56,178
550-599	27,954	9,041	1,550	3,270	41,815
500-549	26,443	3,024	1,459	2,579	33,505
Under 500	10,678	557	508	740	12,483
Unknown	8,689	578	71	136	9,474
Total	$300,132	$181,096	$20,422	$48,118	$549,768
Accrued interest included in total	$1,368	$832	$105	$253	$2,558
December 31, 2011					
800 and above	$26,509	$17,345	$4,062	$6,317	$54,233
750-799	63,746	76,381	8,058	16,892	165,077
700-749	55,047	53,210	4,280	12,131	124,668
650-699	54,579	21,579	2,854	7,909	86,921
600-649	40,977	12,750	2,485	5,066	61,278
550-599	29,732	10,698	1,547	3,466	45,443
500-549	28,573	3,716	1,615	2,758	36,662
Under 500	12,434	565	539	886	14,424
Unknown	4,082	579	80	174	4,915
Total	$315,679	$196,823	$25,520	$55,599	$593,621
Accrued interest included in total	$1,404	$928	$123	$290	$2,745

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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	Home Equity 1st Lien	Home Equity 2nd Lien	Installment(1) Loans not Secured by Real Estate	Other	Total
			(In thousands)		
June 30, 2012					
800 and above	$4,188	$3,811	$17,761	$53	$25,813
750-799	8,736	12,808	43,719	512	65,775
700-749	5,342	8,690	23,724	746	38,502
650-699	5,413	6,869	13,903	589	26,774
600-649	4,673	4,877	6,681	394	16,625
550-599	3,121	2,984	3,859	225	10,189
500-549	2,634	2,791	2,444	155	8,024
Under 500	975	687	1,001	39	2,702
Unknown	62	27	5,414	59	5,562
Total	$35,144	$43,544	$118,506	$2,772	$199,966
Accrued interest included in total	$142	$168	$444	$22	$776
December 31, 2011					
800 and above	$5,466	$5,047	$18,245	$70	$28,828
750-799	11,651	16,475	41,501	572	70,199
700-749	6,899	10,693	23,174	883	41,649
650-699	7,144	8,407	15,646	673	31,870
600-649	4,943	5,412	7,599	434	18,388
550-599	3,435	3,221	4,573	270	11,499
500-549	3,021	3,145	3,011	183	9,360
Under 500	1,160	854	1,391	50	3,455
Unknown	83	34	5,037	59	5,213
Total	$43,802	$53,288	$120,177	$3,194	$220,461
Accrued interest included in total	$176	$208	$489	$29	$902

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

Mepco Finance Corporation ("Mepco") is a wholly-owned subsidiary of our Bank that operates a vehicle service contract payment plan business throughout the United States. See note #14 for more information about Mepco's business. As of June 30, 2012, approximately 91.8% of Mepco's outstanding payment plan receivables relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the full refund owing upon cancellation of the related service contract (including with respect to both the portion funded to the service contract seller and the portion funded to the administrator). These receivables are shown as "Full Refund" in the table below. Another approximately 7.7% of Mepco's outstanding payment plan receivables as of June 30, 2012, relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the refund owing upon cancellation only with respect to the unearned portion previously funded by Mepco to the administrator (but not to the service contract seller). These receivables are shown as "Partial Refund" in the table below. The balance of Mepco's outstanding payment plan receivables relate to programs in which there is no insurer or risk retention group that has any contractual liability to Mepco for any portion of the refund amount. These receivables are shown as "Other" in the table below. For each class of our payment plan receivables we monitor credit ratings of the counterparties as we evaluate the credit quality of this portfolio.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The following table summarizes credit ratings of insurer or risk retention group counterparties by class of payment plan receivable:

	Payment Plan Receivables			
	Full Refund	Partial Refund	Other	Total
	(In thousands)			
June 30, 2012				
AM Best rating				
A +	$ -	$ -	$ 201	$ 201
A	30,724	5,603	-	36,327
A -	20,094	2,056	-	22,150
B +	421	-	-	421
B	-	-	-	-
Not rated	39,608	-	239	39,847
Total	$ 90,847	$ 7,659	$ 440	$ 98,946
December 31, 2011				
AM Best rating				
A +	$ -	$ 118	$ 7	$ 125
A	32,461	165	269	32,895
A -	27,056	10,639	-	37,695
B +	1,390	-	-	1,390
B	-	-	-	-
Not rated	42,762	-	151	42,913
Total	$ 103,669	$ 10,922	$ 427	$ 115,018

Although Mepco has contractual recourse against various counterparties for refunds owing upon cancellation of vehicle service contracts, please see note #14 below regarding certain risks and difficulties associated with collecting these refunds.

5. Segments

Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank (“IB” or “Bank”) and Mepco. These business segments are also differentiated based on the products and services provided. We evaluate performance based principally on net income (loss) of the respective reportable segments.

In the normal course of business, our IB segment provides funding to our Mepco segment through an intercompany line of credit priced at the prime rate of interest as published in the Wall Street Journal. Our IB segment also provides certain administrative services to our Mepco segment which reimburses at an agreed upon rate. These intercompany transactions are eliminated upon consolidation. The only other material intersegment balances and transactions are investments in subsidiaries at the parent entities and cash balances on deposit at our IB segment.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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)	Elimination(2)	Total
2012			(In thousands)		
Total assets	$ 2,246,538	$ 154,248	$ 169,019	$ (166,340)	$ 2,403,465
Interest income	21,550	3,705	-	-	25,255
Net interest income	19,766	2,799	(735)	-	21,830
Provision for loan losses	1,063	(7)	-	-	1,056
Income (loss) before income tax	4,944	337	(925)	(23)	4,333
Net income (loss)	5,059	222	(925)	(23)	4,333
2011					
Total assets	$ 2,094,597	$ 223,799	$ 171,396	$ (172,184)	$ 2,317,608
Interest income	23,733	5,394	-	-	29,127
Net interest income	20,073	3,987	(676)	-	23,384
Provision for loan losses	4,122	34	-	-	4,156
Income (loss) before income tax	367	(322)	(243)	(23)	(221)
Net income (loss)	510	(207)	(243)	(23)	37

(1)Includes amounts relating to our parent company and certain insignificant operations.
(2)Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

As of or for the six months ended June 30,

	IB	Mepco	Other(1)	Elimination(2)	Total
2012			(In thousands)		
Total assets	$ 2,246,538	$ 154,248	$ 169,019	$ (166,340)	$ 2,403,465
Interest income	43,395	7,556	-	-	50,951
Net interest income	39,705	5,681	(1,456)	-	43,930
Provision for loan losses	6,166	21	-	-	6,187
Income (loss) before income tax	7,957	1,893	(1,966)	(47)	7,837
Net income (loss)	8,601	1,249	(1,966)	(47)	7,837
2011					
Total assets	$ 2,094,597	$ 223,799	$ 171,396	$ (172,184)	$ 2,317,608
Interest income	48,313	11,532	-	-	59,845
Net interest income	40,604	8,574	(1,344)	-	47,834

Provision for loan losses	14,821	37	-	-	14,858
Income (loss) before income tax	(5,869)	(912)	(802)	(47)	(7,630)
Net income (loss)	(5,933)	(582)	(802)	(47)	(7,364)

(1)Includes amounts relating to our parent company and certain insignificant operations.
(2)Includes parent company’s investment in subsidiaries and cash balances maintained at subsidiary.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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6. Earnings Per Common Share

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(in thousands, except per share amounts)			
Net income (loss) applicable to common stock	$3,241	$ (1,014)	$ 5,689	$ (9,423)
Convertible preferred stock dividends	1,092	-	2,148	-
Net income (loss) applicable to common stock for calculation of diluted earnings per share(1) (2)	$4,333	$ (1,014)	$ 7,837	$ (9,423)
Weighted average shares outstanding	8,607	8,287	8,570	8,111
Effect of convertible preferred stock	31,987	41,207	31,987	41,207
Restricted stock units	140	139	140	104
Stock units for deferred compensation plan for non-employee directors	58	7	41	7
Effect of stock options	7	-	-	-
Weighted average shares outstanding for calculation of diluted income (loss) per share(1)	40,799	49,640	40,738	49,429
Net income (loss) per common share				
Basic	$.38	$ (.12)	$ .66	$ (1.16)
Diluted(2)	.11	(.12)	.19	(1.16)

(1) For any period in which a loss is recorded, dividends on convertible preferred stock are not added back in the diluted per share calculation. For any period in which a loss is recorded, the assumed conversion of convertible preferred stock, assumed exercise of common stock warrants, assumed exercise of stock options, restricted stock units and stock units for a 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.
(2) Basic income (loss) per 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 loss per share because they were anti-dilutive totaled 0.04 million and 0.05 million for the three-month periods ended June 30, 2012 and 2011, respectively and totaled 0.2 million and 0.05 million for the six-month periods ended June 30, 2012 and 2011, respectively. The warrant to purchase 346,154 shares of our common stock (see note #15) was not considered in computing the diluted loss per share in all periods in 2012 and 2011 as it was anti-dilutive.

7. Derivative Financial Instruments

We are required to record derivatives on our Condensed 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.

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

	June 30, 2012		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
Cash Flow Hedges - Pay fixed interest-rate swap agreements	$10,000	2.5	$(872)
No hedge designation			
Mandatory commitments to sell mortgage loans	$63,013	0.1	$1,983
Rate-lock mortgage loan commitments	103,722	0.1	(696)
Amended Warrant	2,504	6.4	(353)
Total	$169,239	0.2	$934

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. Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates.

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 Condensed Consolidated Statements of Financial Condition to reflect the then current fair value of Cash Flow Hedges. The related gains or losses are reported in other comprehensive income or loss 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 obligations) affect earnings. It is anticipated that approximately $0.3 million, of unrealized losses on Cash Flow Hedges at June 30, 2012 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 is immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at June 30, 2012 is 2.5 years.

Certain financial derivative instruments have not been designated as hedges. The fair value of these derivative financial instruments has been recorded on our Condensed Consolidated Statements of Financial Condition and are 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.

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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. We obtain market prices on Mandatory Commitments and Rate Lock Commitments. Net gains on mortgage loans, as well as net income (loss) may be more volatile as a result of these derivative instruments, which are not designated as hedges.

During 2010, we entered into an amended and restated warrant with the U.S. Department of the Treasury ("UST") that would allow them to purchase our common stock at a fixed price (see note #15). Because of certain anti-dilution features included in the Amended Warrant (as defined in note #15), it is not considered to be indexed to our common stock and is therefore accounted for as a derivative instrument and recorded as a liability. Any change in value of the Amended Warrant is recorded in other income in our Condensed Consolidated Statements of Operations.

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

	Asset Derivatives				Liability Derivatives			
	June 30, 2012		December 31, 2011		June 30, 2012		December 31, 2011	
	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 liabilities	$ 872	Other liabilities	$ 1,103
Total						872		1,103
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	$ 1,983	Other assets	$ 857				
Mandatory commitments to sell mortgage	Other assets	-		-		696	Other liabilities	606

loans

Amended Warrant	-	-	Other liabilities	353	Other liabilities	174
Total	1,983	857		1,049		780
Total derivatives	$ 1,983	$ 857		$ 1,921		$ 1,883

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

	Three Month Periods Ended June 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income	
	2012	2011		2012	2011		2012	2011
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ (24)	$ (270)	Interest expense	$ (266)	$ (341)		$ -	$ (3)
Interest-rate cap agreements	-	30	Interest expense	-	(7)		-	-
Total	$ (24)	$ (240)		$ (266)	$ (348)		$ -	$ (3)
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$ 283	$ 68
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(704)	196
Amended warrant						(Increase)decrease in fair value of U.S. Treasury warrant	(25)	642
Total							$ (446)	$ 906

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

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	Six Month Periods Ended June 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income	
	2012	2011		2012	2011		2012	2011
				(In thousands)				
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ (75)	$ (293)	Interest expense	$ (596)	$ (757)		$ -	$ (3)
Interest-rate cap agreements	-	30	Interest expense	-	(15)		-	-
Total	$ (75)	$ (263)		$ (596)	$ (772)		$ -	$ (3)
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$ 1,126	$ 99
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(90)	(1,296)
Amended warrant						(Increase) decrease in fair value of U.S. Treasury warrant	(179)	996
Total							$ 857	$ (201)

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

8. Intangible Assets

Other intangible assets, net of amortization, were comprised of the following at June 30, 2012 and December 31, 2011:

	June 30, 2012		December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized other intangible assets - core deposits	$31,326	$ 24,261	$ 31,326	$ 23,717

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Amortization of other intangibles has been estimated through 2017 and thereafter in the following table.

	(In thousands)
Six months ended December 31, 2012	$ 544
Year ending December 31:	
2013	1,078
2014	801
2015	613
2016	613
2017 and thereafter	3,416
Total	$ 7,065

9. Share Based Compensation

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 0.5 million shares of common stock as of June 30, 2012. The non-employee director stock purchase plan permits the grant of additional share based payments for up to 0.4 million shares of common stock as of June 30, 2012. 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 the first quarter of 2012 our president’s annual salary was increased by $0.03 million, effective January 1, 2012. One half of this increase is currently being paid in the form of common stock (also referred to as “salary stock”). During the first quarter of 2011, pursuant to a management transition plan, our chief executive officer’s annual salary was increased by $0.2 million effective January 1, 2011. This increase is currently being paid entirely in the form of salary stock. These shares are issued each pay period and vest immediately.

During the first quarter of 2011, we issued 0.14 million restricted stock units to five of our executive officers. These restricted stock units do not vest for a minimum of two years and until we repay in full our obligations related to the Troubled Asset Relief Program (“TARP”).

Beginning in the second quarter of 2011 our directors elected to receive their quarterly cash retainer fees in the form of common stock currently (or on a deferred basis pursuant to a deferred compensation and stock purchase plan). Shares equal in value to each director’s quarterly cash retainer are issued each quarter and vest immediately. We have issued 0.13 million shares and 0.03 million shares to directors during the first six months of 2012 and 2011, respectively and expensed their value during those same periods.

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Total compensation expense recognized for stock option grants, restricted stock grants, restricted stock unit grants and salary stock was $0.2 million and $0.1 million during the three and six month periods ended June 30, 2012, and was $0.2 million and $0.4 million during the same periods in 2011. The corresponding tax benefit relating to this expense was zero for the three and six month periods ended June 30, 2012 and 2011, respectively. Total expense recognized for non-employee director share based payments was $0.1 million in both three month periods ended June 30, 2012 and 2011 and $0.2 million and $0.1 million in the six month periods ended June 30, 2012 and 2011, respectively.

At June 30, 2012, the total expected compensation cost related to non-vested stock options, restricted stock and restricted stock unit awards not yet recognized was $0.7 million. The weighted-average period over which this amount will be recognized is 2.6 years.

A summary of outstanding stock option grants and transactions follows:

	Six-months ended June 30, 2012			
	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregated Intrinsic Value (in thousands)
Outstanding at January 1, 2012	180,862	$ 7.98		
Granted	-	-		
Exercised	-	-		
Exchanged	-	-		
Forfeited	(11,200)	1.92		
Expired	(5,495)	90.66		
Outstanding at June 30, 2012	164,167	$ 5.62	8.26	$ 70
Vested and expected to vest at June 30, 2012	154,970	$ 5.84	8.22	$ 65
Exercisable at June 30, 2012	79,282	$ 9.59	7.47	$ 23

A summary of non-vested restricted stock and stock units and transactions follows:

	2012	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2012	165,045	$ 17.90
Granted	-	-
Vested	(4,496)	166.90
Forfeited	(522)	93.14
Outstanding at June 30, 2012	160,027	$ 13.47

There were no stock option exercises during the six month periods ending June 30, 2012 and 2011, respectively.

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10. Income Tax

At both June 30, 2012 and December 31, 2011, we had approximately $2.1 million of gross unrecognized tax benefits. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2012.

As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance of $72.1 million and $75.2 million as of June 30, 2012 and December 31, 2011, respectively against all of our net deferred tax assets. Accordingly, we are not recognizing much income tax expense (benefit) related to any income or loss before income tax. The income tax expense (benefit) was zero for the three and six month periods ending June 30, 2012. Income tax (benefit) was $(0.26) million and $(0.27) million for the three and six month periods ending June 30, 2011, respectively. The benefit recognized during these periods was primarily the result of current period adjustments to other comprehensive income ("OCI"), net of state income tax expense and adjustments to the deferred tax asset valuation allowance.

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 other comprehensive income (loss). 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. For the three and six month periods ending June 30, 2011 this resulted in an income tax (benefit) of $(0.26) million in both periods.

11. 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's net profits, combined with the retained net profits of the preceding two years. It is not our intent to have dividends paid in amounts which would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

In December 2009, the Board of Directors of Independent Bank Corporation adopted resolutions (as subsequently amended) that impose the following restrictions:

We will not pay dividends on our outstanding common stock or the outstanding preferred stock held by the UST and we will not pay distributions on our outstanding trust preferred securities without, in each case, the prior written approval of the Federal Reserve Board ("FRB") and the Michigan Office of Financial and Insurance Regulation ("OFIR");

We will not incur or guarantee any additional indebtedness without the prior approval of the FRB;

We will not repurchase or redeem any of our common stock without the prior approval of the FRB; and

We will not rescind or materially modify any of these limitations without notice to the FRB and the OFIR.

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In December 2009, the Board of Directors of Independent Bank adopted resolutions (as subsequently amended) designed to enhance certain aspects of the Bank's performance and, most importantly, to improve the Bank's capital position. These resolutions require the following:

- The adoption by the Bank of a capital restoration plan designed to help the Bank achieve the minimum capital ratios established by the Bank's Board of Directors as described below;
- The enhancement of the Bank's documentation of the rationale for discounts applied to collateral valuations on impaired loans and improved support for the identification, tracking, and reporting of loans classified as TDR's;
- The adoption of certain changes and enhancements to our liquidity monitoring and contingency planning and our interest rate risk management practices;
- Additional reporting to the Bank's Board of Directors regarding initiatives and plans pursued by management to improve the Bank's risk management practices;
- Prior approval of the FRB and the OFIR for any dividends or distributions to be paid by the Bank to Independent Bank Corporation; and
- Notice to the FRB and the OFIR of any rescission of or material modification to any of these resolutions.

The substance of all of the resolutions described above was developed in conjunction with discussions held with the FRB and the OFIR. Based on those discussions, we acted proactively to adopt the resolutions described above to address those areas of the Bank's financial condition and operations that we believe most require our focus at this time.

On October 25, 2011, the respective Boards of Directors of the Company and the Bank entered into a Memorandum of Understanding ("MOU") with the FRB and OFIR. The MOU largely duplicates certain of the provisions in the Board resolutions described above, but also has the following specific requirements:

- Submission of a joint revised capital plan (the "Capital Plan") by November 30, 2011 to maintain sufficient capital at the Company on a consolidated basis and at the Bank on a stand-alone basis;
- Submission of quarterly progress reports regarding disposition plans for any assets in excess of $1.0 million that are in ORE, are 90 days or more past due, are on our "watch list", or were adversely classified in our most recent examination;
- Enhanced reporting and monitoring at Mepco regarding risk management and the internal classification of assets; and
- Enhanced interest rate risk modeling practices.

We submitted our Capital Plan on a timely basis and believe that we are generally in compliance with the provisions of the MOU, however, we must still execute on certain strategies outlined in our Capital Plan.

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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 and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. 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 June 30, 2012 and December 31, 2011 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.

Our actual capital amounts and ratios follow:

	Actual			Minimum for Adequately Capitalized Institutions			Minimum for Well-Capitalized Institutions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
				(Dollars in thousands)					
June 30, 2012									
Total capital to risk-weighted assets									
Consolidated	$183,061	12.29	%	$119,150	8.00	%	NA	NA	
Independent Bank	185,594	12.48		118,933	8.00		$148,667	10.00	%
Tier 1 capital to risk-weighted assets									
Consolidated	$156,419	10.50	%	$59,575	4.00	%	NA	NA	
Independent Bank	166,591	11.21		59,467	4.00		$89,200	6.00	%
Tier 1 capital to average assets									
Consolidated	$156,419	6.55	%	$95,522	4.00	%	NA	NA	
Independent Bank	166,591	6.98		95,416	4.00		$119,270	5.00	%
December 31, 2011									
Total capital to risk-weighted assets									
Consolidated	$174,547	11.31	%	$123,470	8.00	%	NA	NA	
Independent Bank	175,868	11.41		123,254	8.00		$154,068	10.00	%
Tier 1 capital to risk-weighted assets									
Consolidated	$144,265	9.35	%	$61,735	4.00	%	NA	NA	
Independent Bank	156,104	10.13		61,627	4.00		$92,441	6.00	%
Tier 1 capital to average assets									
Consolidated	$144,265	6.25	%	$92,338	4.00	%	NA	NA	

Independent Bank	156,104	6.77	92,268	4.00	$115,335	5.00	%

NA - Not applicable

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The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	June 30, 2012	December 31, 2011	June 30, 2012	December 31, 2011
	(In thousands)			
Total shareholders' equity	$ 113,172	$ 102,627	$ 164,453	$ 152,987
Add (deduct)				
Qualifying trust preferred securities	41,062	38,183	-	-
Accumulated other comprehensive loss	10,014	11,921	9,967	11,583
Intangible assets	(7,065)	(7,609)	(7,065)	(7,609)
Disallowed capitalized mortgage loan servicing rights	(764)	(857)	(764)	(857)
Tier 1 capital	156,419	144,265	166,591	156,104
Qualifying trust preferred securities	7,606	10,485	-	-
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	19,036	19,797	19,003	19,764
Total risk-based capital	$ 183,061	$ 174,547	$ 185,594	$ 175,868

In November, 2011, our Board adopted the Capital Plan and submitted such Capital Plan to the FRB and the OFIR. The Capital Plan was updated in February, 2012. The FRB and OFIR have accepted such Capital Plan, assuming the execution of certain strategies and the attainment of the required Tier 1 Capital to Average Total Assets Ratio of 8%.

The primary objective of our Capital Plan is to achieve and thereafter maintain the minimum capital ratios required by the Board resolutions adopted in December 2009 (as subsequently amended). The minimum capital ratios established by our Board are higher than the ratios required in order to be considered "well-capitalized" under federal standards. The Board imposed these higher ratios in order to ensure that we have sufficient capital to withstand potential continuing losses based on our prevailing elevated level of non-performing assets and given certain other risks and uncertainties we face. As of June 30, 2012, our Bank continued to meet the requirements to be considered "well-capitalized" under federal regulatory standards and met one of the minimum capital ratio goals established by our Board.

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Set forth below are the actual capital ratios of our Bank as of June 30, 2012, the minimum capital ratios imposed by the Board resolutions, and the minimum ratios necessary to be considered "well-capitalized" under federal regulatory standards:

	Independent Bank Actual as of June 30, 2012	Minimum Ratios Established by our Board	Minimum Ratio Required to be Well-Capitalized
Total Capital to Risk-Weighted Assets	12.48 %	11.00 %	10.00 %
Tier 1 Capital to Average Total Assets	6.98	8.00	5.00

If we are unable to achieve both minimum capital ratios set forth in our Capital Plan it may adversely affect our business and financial condition. An inability to improve our capital position could make it difficult for us to withstand continued losses. In addition, we believe that if our financial condition and performance fail to improve, we may not be able to remain well-capitalized under federal regulatory standards. In that case, our primary bank regulators may impose additional regulatory restrictions and requirements on us. If we fail to remain well-capitalized under federal regulatory standards, we will be prohibited from accepting or renewing brokered certificates of deposit without the prior consent of the FDIC, which would likely have an adverse impact on our business and financial condition. If our regulators take more formal enforcement action against us, it would likely increase our expenses and could limit our business operations. There could be other expenses associated with a continued deterioration of our capital, such as increased deposit insurance premiums payable to the FDIC. At the present time, based on our current forecasts and expectations, we believe that our Bank can remain above "well-capitalized" for regulatory purposes for the foreseeable future, even without additional capital, due to our projected further decline in total assets (principally loans), our improved performance in 2012 and the impact of a pending branch sale (see note #16).

12. 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.

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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 (trading or available for sale) are classified as Level 1 of the valuation hierarchy. Level 1 securities include certain preferred stocks included in our trading portfolio for which there are quoted prices in active markets. 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 include agency and private label residential mortgage-backed securities, municipal securities and trust preferred securities.

Loans held for sale: The fair value of mortgage loans held for sale is based on mortgage backed security pricing for comparable assets (recurring Level 2). The fair value of loans held for sale relating to branch sale is based on a discount provided for in the branch sale agreement (non-recurring Level 2).

Impaired loans with specific loss allocations based on collateral value: From time to time, certain loans are considered impaired and an allowance for loan losses 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 June 30, 2012 and December 31, 2011, 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 or when an appraised value is not available 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.

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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 other expense in the Condensed 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 owned 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 (for commercial properties over $0.25 million) or a member of our special assets group (for commercial properties under $0.25 million and retail 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. On an annual basis, we compare the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment, if any, should be made to the appraisal value to arrive at fair value. For commercial properties we typically do not discount an appraisal while for retail properties we generally discount the value by 5%. In addition, we will adjust the appraised values for expected liquidation costs including sales commissions and transfer taxes.

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. Since the secondary servicing market has not been active since the later part of 2009, 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 nonrecurring Level 3. At June 30, 2012 these assumptions included a weighted average ("WA") discount rate of 10.5%, WA cost to service of $79, WA ancillary income of $44 and WA float rate of 0.96%. Management evaluates the third party valuation for reasonableness each quarter as part of our financial reporting control processes.

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

Derivatives: The fair value of interest rate swap agreements, in general, is determined using a discounted cash flow model whose significant fair value inputs can generally be verified and do not typically involve judgment by management (recurring Level 2). The fair value of the Amended Warrant at June 30, 2012 was estimated based on an internal update of an independent third party analysis that was performed at March 31, 2012 (the December 31, 2011 fair value was also based on an independent valuation performed at that date). Nearly all key variables remained consistent between March 31, 2012 (the last date a third party valuation was performed) and June 30, 2012. The internal update primarily focused on the change in our stock price during the second quarter of 2012, which was not significant. The third party valuation uses a simulation analysis which considers potential outcomes for a large number of independent scenarios regarding the future prices of our common stock. The simulation analysis relies on a binomial lattice model, a standard technique usually applied to the valuation of stock options. The binomial lattice maps out possible price paths of our common stock, the underlying asset of the Amended Warrant. The simulation is based on a 500-step lattice covering the term of the Amended Warrant. The binomial lattice requires specification of 14 variables, of which several are unobservable in the market including probability of a non-permitted capital raise (1.0% at June 30, 2012 and December 31, 2011), expected discount to stock price in an equity raise (10%), dollar amount of expected capital raise ($100 million) and expected time of equity raise (April, 2013 at June 30, 2012 and December 31, 2011). As a result of these unobservable inputs, the resulting fair value of the Amended Warrant is classified as Level 3 pricing. Changes in these variables would have an impact on the fair value of the Amended Warrant. If the probability of a non-permitted capital raise increased to 2.5%, 5.0% or 10.0%, the value of the Amended Warrant is estimated to increase to $0.40 million, $0.45 million and $0.58 million, respectively.

Fixed assets held for sale relating to branch sale: The fair value of fixed assets held for sale was determined based upon a value agreed upon in the branch sale agreement (non-recurring Level 2).

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

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 Using		
	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)			
June 30, 2012:				
Measured at Fair Value on a Recurring Basis:				
Assets				
Trading securities	$86	$86	$-	$-
Securities available for sale				
U.S. agency	38,143	-	38,143	-
U.S. agency residential mortgage-backed	157,164	-	157,164	-
Private label residential mortgage-backed	7,679	-	7,679	-
Obligations of states and political subdivisions	40,964	-	40,964	-
Trust preferred	3,097	-	3,097	-
Loans held for sale	43,386	-	43,386	-
Derivatives (1)	1,983	-	1,983	-
Liabilities				
Derivatives (2)	1,921	-	1,568	353
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	9,354	-	-	9,354
Impaired loans (4)				
Commercial				
Income producing - real estate	5,867	-	-	5,867
Land, land development & construction-real estate	3,062	-	-	3,062
Commercial and industrial	7,779	-	-	7,779
Mortgage				
1-4 Family	2,256	-	-	2,256
Resort Lending	306	-	-	306
Other real estate (5)				
Commercial				
Income producing - real estate	860			