INDEPENDENT BANK CORP /MI/
Form 10-Q
May 11, 2010

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED March 31, 2010
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 þ 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 o 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 (Do not check if a smaller reporting company)	Smaller reporting company þ

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

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	24,032,177
Class	Outstanding at May 7, 2010

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

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Part I
Item 1.

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Financial Condition

	March 31, 2010	December 31, 2009
	(unaudited)	
	(in thousands)	
Assets		
Cash and due from banks	$ 46,939	$ 65,214
Interest bearing deposits	323,495	223,522
Cash and Cash Equivalents	370,434	288,736
Trading securities	49	54
Securities available for sale	149,858	164,151
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	27,854	27,854
Loans held for sale, carried at fair value	30,531	34,234
Loans		
Commercial	799,673	840,367
Mortgage	728,705	749,298
Installment	286,501	303,366
Finance receivables	340,719	406,341
Total Loans	2,155,598	2,299,372
Allowance for loan losses	(76,132)	(81,717)
Net Loans	2,079,466	2,217,655
Other real estate and repossessed assets	40,284	31,534
Property and equipment, net	71,910	72,616
Bank owned life insurance	46,982	46,514
Other intangibles	9,938	10,260
Capitalized mortgage loan servicing rights	15,435	15,273
Prepaid FDIC deposit insurance assessment	20,352	22,047
Accrued income and other assets	37,677	34,436
Total Assets	$ 2,900,770	$ 2,965,364
Liabilities and Shareholders Equity		
Deposits		
Non-interest bearing	$ 331,217	$ 334,608
Savings and NOW	1,092,273	1,059,840
Retail time	551,000	542,170
Brokered time	523,052	629,150
Total Deposits	2,497,542	2,565,768
Other borrowings	157,524	131,182
Subordinated debentures	92,888	92,888
Financed premiums payable	14,387	21,309

Accrued expenses and other liabilities	41,218	44,356
Total Liabilities	2,803,559	2,855,503
Shareholders Equity		
Preferred stock, Series A, no par value, $1,000 liquidation preference per share 200,000 shares authorized; 72,000 shares issued and outstanding at March 31, 2010 and December 31, 2009	69,334	69,157
Common stock, $1.00 par value authorized: 500,000,000 shares at March 31, 2010 and 60,000,000 shares at December 31, 2009; issued and outstanding: 24,032,177 shares at March 31, 2010 and 24,028,505 shares at December 31, 2009	23,884	23,863
Capital surplus	201,754	201,618
Accumulated deficit	(184,012)	(169,098)
Accumulated other comprehensive loss	(13,749)	(15,679)
Total Shareholders Equity	97,211	109,861
Total Liabilities and Shareholders Equity	$ 2,900,770	$ 2,965,364

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 March 31, 2010	2009
	(unaudited) (in thousands, except per share data)	
Interest Income		
Interest and fees on loans	$ 39,027	$ 44,401
Interest on securities		
Taxable	1,160	1,733
Tax-exempt	685	1,107
Other investments	372	324
Total Interest Income	41,244	47,565
Interest Expense		
Deposits	8,219	8,548
Other borrowings	2,994	4,670
Total Interest Expense	11,213	13,218
Net Interest Income	30,031	34,347
Provision for loan losses	17,070	30,038
Net Interest Income After Provision for Loan Losses	12,961	4,309
Non-interest Income		
Service charges on deposit accounts	5,275	5,507
Net gains (losses) on assets		
Mortgage loans	1,843	3,281
Securities	265	(564)
Other than temporary loss on securities available for sale		
Total impairment loss	(118)	(17)
Loss recognized in other comprehensive loss		
Net impairment loss recognized in earnings	(118)	(17)
VISA check card interchange income	1,572	1,415
Mortgage loan servicing	432	(842)
Title insurance fees	494	609
Other income	2,254	2,189
Total Non-interest Income	12,017	11,578
Non-interest Expense		
Compensation and employee benefits	13,213	12,577

Loan and collection	4,786	4,038
Vehicle service contract counterparty contingencies	3,418	800
Occupancy, net	2,909	3,048
Data processing	2,105	2,096
Loss on other real estate and repossessed assets	2,029	1,261
FDIC deposit insurance	1,802	1,186
Furniture, fixtures and equipment	1,719	1,849
Credit card and bank service fees	1,675	1,464
Advertising	779	1,442
Other expenses	4,644	4,430
Total Non-interest Expense	39,079	34,191
Loss Before Income Tax	(14,101)	(18,304)
Income tax expense (benefit)	(264)	293
Net Loss	$ (13,837)	$ (18,597)
Preferred dividends and discount accretion	1,077	1,075
Net Loss Applicable to Common Stock	$ (14,914)	$ (19,672)
Comprehensive Loss	$ (11,907)	$ (17,664)
Net Loss Per Common Share		
Basic	$ (.62)	$ (.84)
Diluted	(.62)	(.84)
Dividends Per Common Share		
Declared	$ .00	$ .01
Paid	.00	.01

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

	Three months ended March 31,	
	2010	2009
	(unaudited) (in thousands)	
Net Loss	$ (13,837)	$ (18,597)
Adjustments to Reconcile Net Loss to Net Cash from (used in) Operating Activities		
Proceeds from sales of loans held for sale	91,496	145,692
Disbursements for loans held for sale	(85,950)	(148,900)
Provision for loan losses	17,070	30,038
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	(9,321)	(8,809)
Net gains on sales of mortgage loans	(1,843)	(3,281)
Net (gains) losses on securities	(265)	564
Securities impairment recognized in earnings	118	17
Net loss on other real estate and repossessed assets	2,029	1,261
Deferred loan fees	329	(9)
Share based compensation	157	170
(Increase) decrease in accrued income and other assets	(3,059)	5,386
Increase (decrease) in accrued expenses and other liabilities	(3,916)	5,334
	6,845	27,463
Net Cash from (used in) Operating Activities	(6,992)	8,866
Cash Flow from (used in) Investing Activities		
Proceeds from the sale of securities available for sale	25,415	6,434
Proceeds from the maturity of securities available for sale	890	1,293
Principal payments received on securities available for sale	6,006	6,610
Purchases of securities available for sale	(15,188)	(11,386)
Portfolio loans originated, net of principal payments	117,797	(14,537)
Proceeds from the sale of other real estate	4,008	1,624
Capital expenditures	(1,432)	(2,988)
Net Cash from (used in) Investing Activities	137,496	(12,950)
Cash Flow from (used in) Financing Activities		
Net increase (decrease) in total deposits	(68,226)	94,549
Net decrease in other borrowings and federal funds purchased	(1,648)	(60,839)
Proceeds from Federal Home Loan Bank advances	28,000	176,524
Payments of Federal Home Loan Bank advances	(10)	(214,033)
Net increase (decrease) in financed premiums payable	(6,922)	13,423
Dividends paid		(861)
Net Cash from (used in) Financing Activities	(48,806)	8,763

Net Increase in Cash and Cash Equivalents	81,698	4,679
Cash and Cash Equivalents at Beginning of Period	288,736	57,705
Cash and Cash Equivalents at End of Period	$ 370,434	$ 62,384
Cash paid during the period for		
Interest	$ 9,892	$ 14,169
Income taxes	62	59
Transfer of loans to other real estate	14,787	9,009

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Shareholders Equity

	Three months ended March 31, 2010	2009
	(unaudited) (in thousands)	
Balance at beginning of period	$ 109,861	$ 194,877
Net loss	(13,837)	(18,597)
Preferred dividends	(900)	(900)
Cash dividends declared		(240)
Issuance of common stock		1,193
Share based compensation	157	170
Net change in accumulated other comprehensive income, net of related tax effect	1,930	933
Balance at end of period	$ 97,211	$ 177,436

See notes to interim condensed consolidated financial statements (unaudited)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. 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 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, 2009 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 March 31, 2010 and December 31, 2009, and the results of operations for the three-month periods ended March 31, 2010 and 2009. The results of operations for the three-month period ended March 31, 2010, 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 payment plan counterparty contingencies, the valuation of derivative financial instruments, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2009 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. In June 2009, the FASB issued FASB ASC Topic 860 Transfers and Servicing (formerly SFAS No. 166 Accounting for Transfers of Financial Assets an Amendment of FASB Statement No. 140). This standard removes the concept of a qualifying special-purpose entity and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset. The adoption of this standard on January 1, 2010 did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued FASB ASC Topic 810-10, Consolidation (formerly SFAS No. 167 Amendments to FASB Interpretation No. 46(R)). The standard amends tests for variable interest entities to determine whether a variable interest entity must be consolidated. This standard requires an entity to perform an analysis to determine whether an entity s variable interest or interests give it a controlling financial interest in a variable interest entity. This standard requires ongoing reassessments of whether an entity is the primary beneficiary of a variable interest entity and enhanced disclosures that provide more transparent information about an entity s involvement with a variable interest entity. The adoption of this standard on January 1, 2010 did not have a material impact on our consolidated financial statements.

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

3. Securities available for sale consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
March 31, 2010				
U.S. agency residential mortgage-backed	$ 57,992	$ 1,381	$ 55	$ 59,318
Private label residential mortgage-backed	21,879	5	5,931	15,953
Other asset-backed	5,411	29	8	5,432
Obligations of states and political subdivisions	59,321	1,255	269	60,307
Trust preferred	9,463	183	798	8,848
Total	$ 154,066	$ 2,853	$ 7,061	$ 149,858
December 31, 2009				
U.S. agency residential mortgage-backed	$ 46,108	$ 1,500	$ 86	$ 47,522
Private label residential mortgage-backed	38,531	97	7,653	30,975
Other asset-backed	5,699		194	5,505
Obligations of states and political subdivisions	66,439	1,096	403	67,132
Trust preferred	14,272	456	1,711	13,017
Total	$ 171,049	$ 3,149	$ 10,047	$ 164,151

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)					
March 31, 2010						
U.S. agency residential mortgage-backed	$ 5,816	$ 55			$ 5,816	$ 55
Private label residential mortgage-backed	295	1	$ 14,386	$ 5,930	14,681	5,931
Other asset backed			2,477	8	2,477	8
Obligations of states and political subdivisions	1,401	49	4,262	220	5,663	269
Trust preferred			3,884	798	3,884	798
Total	$ 7,512	$ 105	$ 25,009	$ 6,956	$ 32,521	$ 7,061

December 31, 2009

U.S. agency residential mortgage-backed	$ 7,310	$ 86			$ 7,310	$ 86
Private label residential mortgage-backed	4,343	112	$ 18,126	$ 7,541	22,469	7,653
Other asset backed	783	3	4,722	191	5,505	194
Obligations of states and subdivisions	4,236	124	3,960	279	8,196	403
Trust preferred			7,715	1,711	7,715	1,711
Total	$ 16,672	$ 325	$ 34,523	$ 9,722	$ 51,195	$ 10,047

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

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 residential mortgage-backed securities at March 31, 2010 we had 3 securities whose fair market value is less than amortized cost. The unrealized losses are largely attributed to rising interest rates. 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 and other asset-backed securities at March 31, 2010 we had 14 securities whose fair value is less than amortized cost. Eleven of the issues are rated by a major rating agency as investment grade while three are below investment grade. During 2009 pricing conditions in the private label residential mortgage and other asset-backed security markets were characterized by sporadic secondary market flow, significant implied liquidity risk premiums, a wide bid / ask spread and an absence of new issuances of similar securities. In the first quarter of 2010, while this market is still closed to new issuance, secondary market trading activity increased and appeared to be more orderly than compared to 2009. In addition, many bonds are trading at levels near their economic value with fewer distressed valuations relative to 2009. Prices for many securities have been rising, due in part to negative new supply. This improvement in trading activity is supported by sales of 11 securities with an amortized cost of $14.2 million at a $0.2 million gain during the first quarter of 2010.

The unrealized losses, while showing improvement in the aggregate in the first quarter of 2010, are largely attributable to credit spread widening on these securities. The underlying loans within these securities include Jumbo (46%), Alt A (29%) and manufactured housing (25%).

	March 31, 2010		December 31, 2009	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Private label residential mortgage-backed				
Jumbo	$9,732	$(3,571)	$21,718	$(5,749)
Alt-A	6,221	(2,355)	9,257	(1,807)
Other asset-backed Manufactured housing	5,432	21	5,505	(194)
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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

All of the private label residential mortgage-backed transactions have geographic concentrations in California, ranging from 29% to 59% of the collateral pool. Typical exposure levels to California (median exposure is 39%) are consistent with overall market collateral characteristics. Five transactions have modest exposure to Florida, ranging from 5% to 11%, and one transaction has modest exposure to Arizona (5%). The underlying collateral pools do not have meaningful exposure to Nevada, 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, eight transactions have concentrations in interest only loans ranging from 31% to 94%. The structure of the residential mortgage and other asset-backed securities portfolio provides protection to credit losses. The portfolio primarily consists of senior securities as demonstrated by the following: super senior (7%), senior (66%), senior support (15%) and mezzanine (12%). The mezzanine classes are from seasoned transactions (68 to 96 months) with significant levels of subordination (8% to 24%). Except for the additional discussion below relating to other than temporary impairment, each private label residential mortgage and other asset-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 principal and interest payments. Most of these transactions are passthrough structures, receiving pro rata principal and interest payments from a dedicated collateral pool. The nonreceipt of interest cash flows is not expected and thus not presently considered in our discounted cash flow methodology discussed below.

In addition to the review discussed above, certain securities, including the three securities with a rating below investment grade, were reviewed for OTTI utilizing a cash flow projection. The scope of review included securities that account for 91% of the $5.9 million in gross unrealized losses. The cash flow analysis forecasted cash flow from the underlying loans in each transaction and then applied these cash flows to the bonds in the securitization. The cash flows from the underlying loans considered contractual payment terms (scheduled amortization), prepayments, defaults and severity of loss given default. The analysis used dynamic assumptions for prepayments, defaults and severity. Near term prepayment assumptions were based on recently observed prepayment rates. In many cases, recently observed prepayment rates are depressed due to a sharp decline in new jumbo loan issuance. This loan market is heavily dependent upon securitization for funding, and new securitization transactions have been minimal. Some transactions have experienced a decline in prepayment activity due to the lack of refinancing opportunities for nonconforming mortgages. In these cases, our projections anticipate that prepayment rates gradually revert to historical levels. For seasoned ARM transactions, normalized prepayment rates are estimated at 15% to 25% CPR. For fixed rate collateral (one transaction), the prepayment speed is projected to increase modestly given the spread differential between the collateral and the current market rate for conforming mortgages.

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

Near term default assumptions were based on recent default observations as well as the volume of existing real-estate owned, pending foreclosures and severe delinquencies. Default levels generally are projected to remain elevated for a period of time sufficient to address the level of distressed loans in the transaction. Our projections expect defaults to then decline as the housing market and the economy stabilize, generally after 2 to 3 years. Current severity assumptions are based on recent observations. Loss severity is expected to decline gradually as the housing market and the economy stabilize, generally after 2 to 3 years. Except for one below investment grade security discussed in further detail below, our cash flow analysis forecasts complete recovery of our cost basis for each reviewed security.

At March 31, 2010 one below investment grade private label residential mortgage-backed security with a fair value of $6.1 million and an unrealized loss of $1.4 million (amortized cost of $7.5 million) had unrealized losses that were considered other than temporary. The underlying loans in this transaction are 30 year fixed rate jumbos with an average origination date FICO of 748 and an average origination date loan-to-value ratio of 73%. The loans backing this transaction were originated in 2007 and 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 an OTTI of $1.4 million at March 31, 2010, $0.116 million of this amount was attributed to credit and was recognized in our consolidated statements of operations ($0.051 million during the three months ending March 31, 2010 and $0.065 million during the three months ending December 31, 2009) while the balance was attributed to other factors and 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 March 31, 2010 we had 22 municipal securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to a widening of market spreads and continued illiquidity for certain issues. The majority of the securities are not rated by a major rating agency. Approximately 76% of the non rated securities originally had a AAA credit rating by virtue of bond insurance. However, the insurance provider no longer has an investment grade rating. The remaining non rated issues are small local issues that did not receive a credit rating due to the size of the transaction. 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 March 31, 2010 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 two 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. During the first quarter of 2010, although still showing signs of weakness, pricing for non-rated issues improved due to Libor spread tightening. One of the four securities is rated by a major rating agency as investment grade, while one is split rated (this security is rated as investment grade by one major rating agency and below investment grade by another) and the other two are

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

non-rated. The two non-rated issues are relatively small banks and neither of these issues were ever rated. The issuers on these trust preferred securities, which had a combined book value of $2.8 million and a combined fair value of $2.5 million as of March 31, 2010, continue to make interest payments and have satisfactory credit metrics.

Our OTTI analysis for trust preferred securities is based on a security level financial analysis of the issuer. This review considers: external credit ratings, maturity date of the instrument, the scope of the bank s operations, relevant financial metrics and recent issuer specific news. The analysis of relevant financial metrics includes: capital adequacy, asset quality, earnings and liquidity. We use the same OTTI review methodology for both rated and non-rated issues.

During the first quarter of 2010 we recorded OTTI on an unrated trust preferred security of $0.067 million (we had recorded OTTI on this security of $0.183 million in prior periods). Specifically, this issuer has deferred interest payments on all of its trust preferred securities and is operating under a written agreement with the regulatory agencies that specifically prohibits dividend payments. The issuer is a relatively small bank with operations centered in southeast Michigan. The issuer reported losses in 2008 and 2009 and now is insolvent. Additionally, the issuer has a high volume of nonperforming assets. This investment s amortized cost has been written down to zero, compared to a par value of $0.25 million.

The following table breaks out our trust preferred securities in further detail as of March 31, 2010 and December 31, 2009:

	March 31, 2010		December 31, 2009	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(In thousands)			
Trust preferred securities				
Rated issues no OTTI	$6,392	$(267)	$11,188	$ (212)
Unrated issues no OTTI	2,456	(348)	1,761	(1,044)
Unrated issues with OTTI	0	0	68	1

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.

The amortized cost and fair value of securities available for sale at March 31, 2010, 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.

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

	Amortized Cost	Fair Value
	(In thousands)	
Maturing within one year	$ 2,559	$ 2,582
Maturing after one year but within five years	11,728	12,076
Maturing after five years but within ten years	24,857	25,225
Maturing after ten years	29,640	29,272
	68,784	69,155
U.S. agency residential mortgage-backed	57,992	59,318
Private label residential mortgage-backed	21,879	15,953
Other asset-backed	5,411	5,432
Total	$ 154,066	$ 149,858

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 three month periods ending March 31, follows:

	Proceeds	Realized Gains	Losses(1)
		(In thousands)	
2010	$25,415	$304	$34
2009	6,434	225	6

(1) Losses in 2010 and 2009 exclude $0.118 million and $0.017 million of other than temporary impairment, respectively.

During 2010 and 2009 our trading securities consisted of various preferred stocks. During the first three months of 2010 and 2009 we recognized losses on trading securities of $0.005 million and $0.783 million, respectively, that are included in net gains (losses) on assets in the consolidated statements of operations. Both of these amounts relate to losses recognized on trading securities still held at each respective period end.

4. Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors. Loans on non-accrual status and past due more than 90 days (Non-performing Loans) amounted to $98.3 million at March 31, 2010, and $109.9 million at December 31, 2009.

Impaired loans are as follows:

	March 31, 2010	December 31, 2009
	(in thousands)	
Impaired loans with no allocated allowance		
TDR	$ 8,846	$ 9,059
Non - TDR	5,364	2,995
Impaired loans with an allocated allowance		

TDR - allowance based on collateral	29,267	3,552
TDR - allowance based on present value cash flow	82,298	74,287
Non - TDR - allowance based on collateral	43,105	68,032
Total impaired loans	$ 168,880	$ 157,925
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	$ 7,850	$ 761
TDR - allowance based on present value cash flow	9,996	7,828
Non - TDR - allowance based on collateral	12,578	21,004
Total amount of allowance for losses allocated	$ 30,424	$ 29,593

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Our average investment in impaired loans was approximately $163.4 million and $90.3 million for the three-month periods ended March 31, 2010 and 2009, 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 first three months of 2010 and 2009 was approximately $1.3 million and $0.2 million, respectively, the majority of which was received in cash.

The increase in impaired loans relative to the decrease in Non-performing Loans during the first quarter of 2010 reflects a $23.5 million increase from December 31, 2009 in troubled debt restructured (TDR) loans that remain performing at March 31, 2010. The increase in TDR loans is primarily attributed to the restructuring of repayment terms of residential mortgage and commercial loans. TDR loans not already included in Non-performing Loans totaled $95.5 million and $72.0 million at March 31, 2010 and December 31, 2009, respectively.

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

	Three months ended March 31,			
	2010		2009	
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(dollars in thousands)			
Balance at beginning of period	$ 81,717	$ 1,858	$ 57,900	$ 2,144
Additions (deduction)				
Provision charged to operating expense	17,014	56	30,124	(86)
Recoveries credited to allowance	991		607	
Loans charged against the allowance	(23,590)		(30,326)	
Balance at end of period	$ 76,132	$ 1,914	$ 58,305	$ 2,058
Net loans charged against the allowance to average Portfolio Loans (annualized)	4.10%		4.91%	

5. Comprehensive loss for the three-month periods ended March 31 follows:

	Three months ended March 31,	
	2010	2009
	(in thousands)	
Net loss	$ (13,837)	$ (18,597)
Net change in unrealized loss on securities available for sale, net of related tax effect	82	833
Change in unrealized losses on securities available for sale for which a portion of other than temporary impairment has been recognized in earnings	1,667	
Net change in unrealized loss on derivative instruments, net of related tax effect	106	100
Reclassification adjustment for accretion on settled derivative instruments	75	
Comprehensive loss	$ (11,907)	$ (17,664)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The net change in unrealized loss on securities available for sale reflects net gains reclassified into earnings as follows:

	Three months ended March 31,	
	2010	2009
	(in thousands)	
Net gain reclassified into earnings	$152	$202
Federal income tax expense as a result of the reclassification of these amounts from comprehensive income		

6. Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank (IB) and Mepco Finance Corporation (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 Prime beginning on January 1, 2010 and priced principally based on Brokered CD rates prior to that time. 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.

A summary of selected financial information for our reportable segments as of or for the three-month periods ended March 31, follows:

	IB	Mepco[1]	Other[2]	Elimination [3]	Total
			(in thousands)		
2010					
Total assets	$2,533,434	$365,248	$200,554	$(198,466)	$2,900,770
Interest income	29,661	11,583			41,244
Net interest income	22,889	8,977	(1,835)		30,031
Provision for loan losses	17,173	(103)			17,070
Income (loss) before income tax	(12,721)	1,084	(2,440)	(24)	(14,101)
Net income (loss)	(12,042)	669	(2,440)	(24)	(13,837)
2009					
Total assets	$2,572,665	$380,492	$273,369	$(273,545)	$2,952,981
Interest income	36,282	11,283			47,565
Net interest income	25,628	10,428	(1,709)		34,347
Provision for loan losses	29,876	162			30,038
Income (loss) before income tax	(23,363)	7,096	(2,013)	(24)	(18,304)
Net income (loss)	(21,145)	4,585	(2,013)	(24)	(18,597)

[1] Total assets include gross

finance receivables of $0.8 million and $12.0 million at March 31, 2010 and 2009, respectively from customers domiciled in Canada. The amount at March 31, 2010 represents less than 1% of total finance receivables outstanding and we anticipate this balance to decline in future periods.

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

(3) 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) (unaudited)

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

A reconciliation of basic and diluted earnings per share for the three-month periods ended March 31 follows:

	Three months ended March 31, 2010	Three months ended March 31, 2009
	(in thousands, except per share amounts)	
Net loss applicable to common stock	$ (14,914)	$ (19,672)
Shares outstanding	24,032	23,366
Effect of stock options		
Stock units for deferred compensation plan for non-employee directors	72	66
Shares outstanding for calculation of diluted earnings per share	24,104	23,432
Net loss per common share		
Basic	$ (.62)	$ (.84)
Diluted[1]	(.62)	(.84)

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

Weighted average stock options outstanding that were anti-dilutive totaled 1.1 million and 1.5 million for the three-months ended March 31, 2010 and 2009, respectively.

8. We are required to record derivatives on the balance sheet as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the

derivatives qualify for hedge accounting.

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

	March 31, 2010		
	Notional Amount	Average Maturity (years)	Fair Value
	(dollars in thousands)		
Cash Flow Hedges			
Pay fixed interest-rate swap agreements	$ 70,000	1.6	$ (2,211)
Interest-rate cap agreements	35,000	0.3	(7)
	$ 105,000	1.2	$ (2,218)
No hedge designation			
Pay fixed interest-rate swap agreements	$ 45,000	1.5	$ (1,919)
Interest-rate cap agreements	50,000	0.5	
Rate-lock mortgage loan commitments	25,284	0.1	512
Mandatory commitments to sell mortgage loans	54,992	0.1	108
Total	$ 175,276	0.6	$ (1,299)

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

We use variable-rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our balance sheet, which exposes us to variability in interest rates. To meet our objectives, we may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates (Cash Flow Hedges). Cash Flow Hedges currently include certain pay-fixed interest-rate swaps and interest-rate cap agreements.

Through certain special purposes entities we issue trust preferred securities as part of our capital management strategy. Certain of these trust preferred securities are variable rate which exposes us to variability in cash flows . To mitigate our exposure to fluctuations in cash flows resulting from changes in interest rates, on approximately $20.0 million of variable rate trust preferred securities, we entered into a pay-fixed interest-rate swap agreement in September, 2007. During the fourth quarter of 2009 we elected to defer payment of interest on this variable rate trust preferred security. As a result, this pay-fixed interest rate swap was transferred to a no hedge designation and the $1.6 million unrealized loss which was included as a component of accumulated other comprehensive loss at the time of the transfer will be reclassified into earnings over the remaining life of this pay-fixed swap. Subsequent changes in the fair value of this pay-fixed swap are recorded in earnings.

Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates. Under interest-rate cap agreements, we will receive cash if interest rates rise above a predetermined level. As a result, we effectively have variable-rate debt with an established maximum rate. We pay an upfront premium on interest rate caps which is recognized in earnings in the same period in which the hedged item affects earnings. Unrecognized premiums from interest rate caps aggregated to $0.1 million at both March 31, 2010 and December 31, 2009, respectively.

We record the fair value of Cash Flow Hedges in accrued income and other assets and accrued expenses and other liabilities. On an ongoing basis, we adjust our balance sheet to reflect the then current fair value of Cash Flow Hedges. The related gains or losses are reported in other comprehensive income 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 $2.2 million, of unrealized losses on Cash Flow Hedges at March 31, 2010 will be reclassified to earnings over the next twelve months. To the extent that the Cash Flow Hedges are not effective, the ineffective portion of the Cash Flow Hedges are immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at March 31, 2010 is 4.8 years.

Certain financial derivative instruments are not designated as hedges. The fair value of these derivative financial instruments have been recorded on our balance sheet and are adjusted on an ongoing basis to reflect their then current fair value. The changes in the fair value of derivative financial instruments not designated as hedges, are recognized currently in earnings.

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

The following table illustrates 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			
	March 31, 2010		December 31, 2009		March 31, 2010		December 31, 2009	
	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	$ 2,211	Other liabilities	$ 2,328
Interest-rate cap agreements					Other liabilities	7	Other liabilities	1
Total						2,218		2,329
Derivatives not designated as hedging intruments								
Pay-fixed interest rate swap agreements					Other liabilities	1,919	Other liabilities	1,930
Interest-rate cap agreements								
Rate-lock mortgage loan commitments	Other assets	$ 512	Other assets	$ 217				
Mandatory commitments to sell mortgage loans	Other assets	108	Other assets	715				
Total		620		932		1,919		1,930
Total derivatives		$ 620		$ 932		$ 4,137		$ 4,259

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The effect of derivative financial instruments on the Condensed Consolidated Statements of Operations follows:

	Three Month Periods Ended March 31,							
	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income(1)	
	2010	2009		2010	2009		2010	2009
				(in thousands)				
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ 931	$ 429	Interest expense	$ (699)	$ (493)			
Interest-rate cap agreements	92	330	Interest expense	(46)	(166)	Interest expense	$ (6)	$ (16)
Total	$ 1,023	$ 759		$ (745)	$ (659)		$ (6)	$ (16)
No hedge designation								
Pay-fixed interest rate swap agreements						Interest expense	$ 11	$ (99)
Interest-rate cap agreements						Interest expense		(90)
Rate-lock mortgage loan commitments						Mortgage loan gains	295	653
Mandatory commitments to sell mortgage loans						Mortgage loan gains	(607)	46
Total							$ (301)	$ 510

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

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9. Intangible assets, net of amortization, were comprised of the following at March 31, 2010 and December 31, 2009:

		March 31, 2010		December 31, 2009	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
		(in thousands)			
Amortized intangible assets	Core deposit	$ 31,326	$ 21,388	$ 31,326	$ 21,066

Amortization of intangibles has been estimated through 2015 and thereafter in the following table, and does not take into consideration any potential future acquisitions or branch purchases.

	(in thousands)
Nine months ended December 31, 2010	$ 958
Year ending December 31:	
2011	1,371
2012	1,088
2013	1,078
2014	801
2015 and thereafter	4,642
Total	$ 9,938

10. We maintain performance-based compensation plans that include a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. This plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.9 million shares of common stock as of March 31, 2010. Share based compensation awards are measured at fair value at the date of grant and are expensed over the requisite service period. Common shares issued upon exercise of stock options come from currently authorized but unissued shares.

During the first quarter of 2010 we completed a stock option exchange program under which eligible employees were able to exchange certain stock options for a lesser amount of new stock options. Pursuant to this stock option exchange program, 0.5 million stock options were exchanged for 0.1 million new stock options. The new stock options granted have an exercise price equal to the market value on the date of grant, generally vest over a one year period and have the same expiration dates as the options exchanged which ranged from 1.2 years to 7.2 years. The new options had a value substantially equal to the value of the options exchanged.

We also granted, pursuant to our performance-based compensation plans, 0.3 million stock options to our officers on January 30, 2009. The stock options have an exercise price equal to the market value on the date of grant, vest ratably over a three year period and expire 10 years from date of grant. We use the Black Scholes option pricing model to measure compensation cost for stock options. We also estimate expected forfeitures over the vesting period.

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Total compensation cost recognized during the first three months of 2010 and 2009 for stock option and restricted stock grants was $0.2 million in each period, respectively. The corresponding tax benefit relating to this expense was zero for the first three months of 2010 and 2009, respectively.

At March 31, 2010, the total expected compensation cost related to non-vested stock option and restricted stock awards not yet recognized was $1.5 million. The weighted-average period over which this amount will be recognized is 2.5 years.

A summary of outstanding stock option grants and transactions follows:

	Three-months ended March 31, 2010			
	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregated Intrinsic Value (in thousands)
Outstanding at January 1, 2010	1,098,550	$ 13.19		
Granted	99,855	0.74		
Exercised				
Exchanged	(547,138)	20.86		
Expired	(17,806)	7.50		
Outstanding at March 31, 2010	633,461	$ 4.76	5.34	$ 0
Vested and expected to vest at March 31, 2010	624,754	$ 4.81	5.31	$ 0
Exercisable at March 31, 2010	333,625	$ 7.87	3.46	$ 0

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

	2010	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2010	262,381	$ 9.27
Granted		
Vested		
Forfeited		
Outstanding at March 31, 2010	262,381	$ 9.27

A summary of the weighted-average assumptions used in the Black-Scholes option pricing model for grants of stock options during 2010 follows:

Expected dividend yield	0.33%
Risk-free interest rate	2.10
Expected life (in years)	4.60
Expected volatility	91.77%
Per share weighted-average fair value	$ 0.50

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The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life was obtained using the weighted average original contractual term of the stock option. This method was used as relevant historical data of actual exercise activity was not available. The expected volatility was based on historical volatility of our common stock.

There were no stock option exercises during the three month periods ending March 31, 2010 and 2009, respectively.

11. At both March 31, 2010 and December 31, 2009 we had approximately $2.0 million of gross unrecognized tax benefits. If recognized, the entire amount of unrecognized tax benefits, net of $0.5 million federal tax on state benefits, would affect our effective tax rate. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2010.

As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance against the majority of our net deferred tax assets. Accordingly, we are not able to recognize much income tax benefit related to the loss before income tax. The income tax expense (benefit) was $(0.26) million and $0.29 million for the three month periods ending March 31, 2010 and 2009, respectively. The benefit recognized during the three-month period in 2010 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 calculation for income tax expense (benefit) does not consider the tax effects of changes in other comprehensive income or loss, which is a component of shareholders equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a pre-tax loss from continuing operations. In such case, pre-tax income from other categories (such as changes in OCI) is included in the calculation of the tax expense (benefit) for the current year. For the three month period in 2010, this resulted in an income tax benefit of $0.24 million.

12. 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 that impose the following restrictions:

- We will not pay dividends on our outstanding common stock or the outstanding preferred stock held by the U.S. Department of Treasury (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 Bank (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.

In December 2009, the Board of Directors of Independent Bank, our subsidiary bank, adopted resolutions 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 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 troubled debt restructurings;
- 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;

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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 in response to the FRB s most recent examination report of Independent Bank, which was completed in October 2009. Based on those discussions, we acted proactively to adopt the resolutions described above to address those areas of the Bank s condition and operations that were highlighted in the examination report and that we believe most require our focus at this time. It is very possible that if we had not adopted these resolutions, the FRB and the OFIR may have imposed similar requirements on us through a memorandum of understanding or similar undertaking. We are not currently subject to any such regulatory agreement or enforcement action. However, we believe that if we are unable to substantially comply with the resolutions set forth above and if our financial condition and performance do not otherwise materially improve, we may face additional regulatory scrutiny and restrictions in the form of a memorandum of understanding or similar undertaking imposed by the regulators.

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 March 31, 2010 and December 31, 2009 categorized our bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent FDIC categorization.

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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)			
March 31, 2010						
Total capital to risk-weighted assets						
Consolidated	$216,385	10.49%	$165,014	8.00%	NA	NA
Independent Bank	214,551	10.41	164,844	8.00	$206,054	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	$136,875	6.64%	$ 82,507	4.00%	NA	NA
Independent Bank	188,149	9.13	82,422	4.00	$123,633	6.00%
Tier 1 capital to average assets						
Consolidated	$136,875	4.67%	$117,114	4.00%	NA	NA
Independent Bank	188,149	6.43	117,034	4.00	$146,292	5.00%
December 31, 2009						
Total capital to risk-weighted assets						
Consolidated	$233,166	10.58%	$176,333	8.00%	NA	NA
Independent Bank	228,128	10.36	176,173	8.00	$220,216	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	$156,702	7.11%	$ 88,166	4.00%	NA	NA
Independent Bank	199,909	9.08	88,086	4.00	$132,130	6.00%
Tier 1 capital to average assets						
Consolidated	$156,702	5.27%	$119,045	4.00%	NA	NA
Independent Bank	199,909	6.72	118,909	4.00	$148,636	5.00%

NA Not applicable

The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	March 31, 2010	December 31, 2009	March 31, 2010	December 31, 2009

	(in thousands)		(in thousands)	
Total shareholders equity	$ 97,211	$ 109,861	$ 186,857	$ 196,416
Add (deduct)				
Qualifying trust preferred securities	37,019	41,880		
Accumulated other comprehensive loss	13,749	15,679	12,394	14,208
Intangible assets	(9,938)	(10,260)	(9,936)	(10,257)
Disallowed capitalized mortgage loan servicing rights	(544)	(559)	(544)	(559)
Disallowed deferred tax assets	(720)		(720)	
Other	98	101	98	101
Tier 1 capital	136,875	156,702	188,149	199,909
Qualifying trust preferred securities	53,081	48,220		
Allowance for loan losses and allowance for unfunded commitments limited to 1.25% of total risk-weighted assets	26,429	28,244	26,402	28,219
Total risk-based capital	$ 216,385	$ 233,166	$ 214,551	$ 228,128

In January 2010, we adopted a Capital Restoration Plan (the Capital Plan), as required by the Board resolutions adopted in December 2009, and described above, and submitted such Capital Plan to the FRB and the OFIR.

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 of March 31, 2010, our Bank continued to meet the requirements to be considered well-capitalized under federal regulatory standards. However, 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 elevated level of non-performing assets and given certain other risks and uncertainties we face.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Set forth below are the actual capital ratios of our subsidiary bank as of March 31, 2010, 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 at 3/31/10	Minimum Ratios Established by our Board	Ratios Required to be Well-Capitalized
Total capital to risk weighted assets	10.41%	11.0%	10.0%
Tier 1 capital to average assets	6.43	8.0	5.0

The Capital Plan (as modified in March 2010) sets forth an objective of achieving these minimum capital ratios as soon as practicable, but no later than June 30, 2010, and maintaining such capital ratios though at least the end of 2012.

The Capital Plan includes projections prepared by us that reflect forecasted financial data through 2012. Those projections anticipate a need for a minimum of $60 million of additional capital in order for us to achieve and maintain the minimum ratios established by our Board. The projections take into account the various risks and uncertainties we face. However, because the projections are based on assumptions regarding such risks and uncertainties, which assumptions may not prove to be true, the Capital Plan contains a target of $100 million to $125 million of additional capital to be raised by us. The Capital Plan sets forth certain initiatives to be pursued in order to raise additional capital and meet the objectives of the Capital Plan.

13. 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. At March 31, 2010, Level 1 securities included certain preferred stocks included in our trading portfolio for which there are quoted prices in active markets. A trust preferred security included in our available for sale portfolio and classified as Level 1 at December 31, 2009 was sold during the first quarter of 2010. 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, other asset-backed securities, municipal securities and trust preferred securities. Level 3 securities at December 31, 2009 consisted of certain private label residential mortgage-backed and other asset-backed securities whose fair values were estimated using an internal discounted cash flow analysis. At December 31, 2009, the underlying loans within these securities included Jumbo (60%), Alt A (25%) and manufactured housing (15%). Except for the discount rate, the inputs used in this analysis could generally be verified and did not involve judgment by management. The discount rate used (an unobservable input) was established using a multifactored matrix whose base rate was the yield on agency mortgage-backed securities. The analysis added a spread to this base rate based on several credit related factors, including vintage, product, payment priority, credit rating and non performing asset coverage ratio. The add-on for vintage ranged from zero for transactions backed by loans originated before 2003 to 0.525% for the 2007 vintage. Product adjustments to the discount rate were: 0.05% to 0.20% for jumbo, 0.35% to 2.575% for Alt-A, and 3.00% for manufactured housing. Adjustments for payment priority were -0.25% for super seniors, zero for seniors, 1.00% for senior supports and 3.00% for mezzanine securities. The add-on for credit rating ranged from zero for AAA securities to 5.00% for ratings below investment grade. The discount rate for subordination coverage of nonperforming loans ranged from zero for structures with a coverage ratio of more than 10 times to 10.00% if the coverage ratio declined to less than 0.5 times. The discount rate calculation had a minimum add on rate of 0.25%. These discount rate adjustments were reviewed for reasonableness and considered trends in mortgage market credit metrics by product and vintage. The discount rates calculated in this manner were intended to differentiate investments by risk characteristics. Using this approach, discount rates ranged from 4.11% to 16.64%, with a weighted average rate of 8.91% and a median rate of 7.99%. The assumptions used reflected what we believed market participants would use in pricing these assets. See discussion below regarding transfer of these securities from Level 3 to Level 2 pricing.

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Capitalized mortgage loan servicing rights: The fair value of capitalized mortgage loan servicing rights is based on a valuation model 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. The valuation model inputs and results can be compared to widely available published industry data for reasonableness and, therefore, are recorded as nonrecurring Level 2.

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). During the fourth quarter of 2009, we transferred a $2.2 million commercial real-estate loan from the commercial loan portfolio to held for sale. The fair value of this loan was based on a bid from a buyer and, therefore, is classified as a recurring Level 1 at December 31, 2009. This loan was sold for the recorded amount in January, 2010.

Derivatives: The fair value of derivatives, 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).

Impaired loans with specific loss allocations: 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 March 31, 2010, 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.

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 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 (nonrecurring Level 3).

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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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)		
March 31, 2010:				
Measured at Fair Value on a Recurring basis:				
Assets				
Trading securities	$ 49	$ 49		
Securities available for sale				
U.S. agency residential mortgage-backed	59,318		$59,318	
Private label residential mortgage-backed	15,953		15,953	
Other asset-backed	5,432		5,432	
Obligations of states and political subdivisions	60,307		60,307	
Trust preferred	8,848		8,848	
Loans held for sale	30,531		30,531	
Derivatives (1)	620		620	
Liabilities				
Derivatives (2)	4,137		4,137	
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	9,142		9,142	
Impaired loans	51,943			$51,943
Other real estate	39,606			39,606
December 31, 2009:				
Measured at Fair Value on a Recurring basis:				
Assets				
Trading securities	$ 54	$ 54		
Securities available for sale				
U.S. agency residential mortgage-backed	47,522		$47,522	
Private label residential mortgage-backed	30,975			$30,975
Other asset-backed	5,505			5,505
Obligations of states and political subdivisions	67,132		67,132	
Trust preferred	13,017	612	12,405	
Loans held for sale	34,234	2,200	32,034	
Derivatives (1)	932		932	
Liabilities				
Derivatives (2)	4,259		4,259	
Measured at Fair Value on a Non-recurring basis:				

Assets				
Capitalized mortgage loan servicing rights (3)	9,599		9,599	
Impaired loans	49,819			49,819
Other real estate	30,821			30,821

(1) Included in accrued income and other assets

(2) Included in accrued expenses and other liabilities

(3) Only includes servicing rights that are carried at fair value due to recognition of a valuation allowance.

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Changes in fair values for financial assets which we have elected the fair value option for the periods presented were as follows:

	Changes in Fair Values for the Three-Month Periods Ended March 31 for items Measured at Fair Value Pursuant to Election of the Fair Value Option					
	2010			2009		
	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period Earnings	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period Earnings
	Securities	Loans		Securities	Loans	