INDEPENDENT BANK CORP
Form 10-Q
August 03, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
Commission File Number: 1-9047

Independent Bank Corp.
(Exact name of registrant as specified in its charter)

Massachusetts	04-2870273
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Office Address: 2036 Washington Street, Hanover Massachusetts 02339
Mailing Address: 288 Union Street, Rockland, Massachusetts 02370
(Address of principal executive offices, including zip code)
(781) 878-6100
(Registrant's telephone number, including area code)

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

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

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

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

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

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

As of August 1, 2017, there were 27,437,090 shares of the issuer’s common stock outstanding, par value $0.01 per share.

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

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

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Customer repurchase agreements	159,371	176,913
Junior subordinated debentures (less unamortized debt issuance costs of $128 and $136)	73,069	73,107
Subordinated debentures (less unamortized debt issuance costs of $341 and $365)	34,659	34,635
Total borrowings	320,378	335,474
Other liabilities	86,951	96,958
Total liabilities	7,102,709	6,844,685
Commitments and contingencies	—	—
Stockholders' equity		
Preferred stock, $.01 par value, authorized: 1,000,000 shares, outstanding: none	—	—
Common stock, $.01 par value, authorized: 75,000,000 shares, issued and outstanding: 27,431,171 shares at June 30, 2017 and 27,005,813 shares at December 31, 2016 (includes 185,006 and 212,698 shares of unvested participating restricted stock awards, respectively)	272	268
Value of shares held in rabbi trust at cost: 162,559 shares at June 30, 2017 and 170,036 shares at December 31, 2016	(4,414)	(4,277)
Deferred compensation and other retirement benefit obligations	4,414	4,277
Additional paid in capital	476,684	451,664
Retained earnings	437,587	414,095
Accumulated other comprehensive income (loss), net of tax	41	(1,337)
Total stockholders’ equity	914,584	864,690
Total liabilities and stockholders' equity	$8,017,293	$7,709,375

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

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

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

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

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

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

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

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

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

	Common Stock Outstanding	Common Stock	Value of Shares Held in Rabbi Trust at Cost	Deferred Compensation and Other Retirement Benefit Obligations	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 31, 2016	27,005,813	$ 268	$ (4,277)	$ 4,277	$451,664	$414,095	$ (1,337)	$864,690
Cumulative effect accounting adjustment (1)	—	—	—	—	542	(365)	—	177
Net income	—	—	—	—	—	41,288	—	41,288
Other comprehensive income	—	—	—	—	—	—	1,378	1,378
Common dividend declared ($0.64 per share)	—	—	—	—	—	(17,431)	—	(17,431)
Common stock issued for acquisition	369,286	4	—	—	23,464	—	—	23,468
Proceeds from exercise of stock options, net of cash paid	11,174	—	—	—	8	—	—	8
Stock based compensation	—	—	—	—	1,560	—	—	1,560
Restricted stock awards issued, net of awards surrendered	32,524	—	—	—	(1,361)	—	—	(1,361)
Shares issued under direct stock purchase plan	12,374	—	—	—	807	—	—	807
Deferred compensation and other retirement benefit obligations	—	—	(137)	137	—	—	—	—
Balance June 30, 2017	27,431,171	$ 272	$ (4,414)	$ 4,414	$476,684	$437,587	$ 41	$914,584
Balance December 31, 2015	26,236,352	$ 260	$ (3,958)	$ 3,958	$405,486	$368,169	$ (2,452)	$771,463
Net income	—	—	—	—	—	38,985	—	38,985
Other comprehensive income	—	—	—	—	—	—	6,035	6,035
Common dividend declared ($0.58 per share)	—	—	—	—	—	(15,256)	—	(15,256)
Proceeds from exercise of stock options, net of cash paid	6,652	—	—	—	144	—	—	144
Tax benefit related to equity award activity	—	—	—	—	327	—	—	327

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

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

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

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

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

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

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

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CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Independent Bank Corp. (the “Company”) is a state chartered, federally registered bank holding company, incorporated in 1985. The Company is the sole stockholder of Rockland Trust Company (“Rockland Trust” or the “Bank”), a Massachusetts trust company chartered in 1907.

All material intercompany balances and transactions have been eliminated in consolidation. Certain previously reported amounts have been reclassified to conform to the current year’s presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, primarily consisting of normal recurring adjustments, have been included. Results for the quarter ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or any other interim period.

For further information, refer to the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission.

NOTE 2 - RECENT ACCOUNTING STANDARDS UPDATES

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718 "Compensation - Stock Compensation" Update No. 2016-09. Update No. 2016-09 was issued in March 2016 and affects all entities that issue share-based awards to their employees. This update was issued as part of the FASB’s simplification initiative. The areas for simplification in this update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company adopted this standard effective January 1, 2017. Upon adoption, the Company elected to no longer estimate forfeitures on stock compensation and instead recognize forfeitures when they occur. The election required a cumulative effect adjustment to retained earnings which did not materially impact the Company's consolidated financial position. Additionally, the disclosure requirements of this standard will be applied on a prospective basis.

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

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

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FASB ASC Topic 715 "Compensation - Retirement Benefits" Update No. 2017-07. Update No. 2017-07 was issued in March 2017 to improve the presentation of net periodic pension cost and net periodic postretirement benefit costs. This update requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable. The amendments in this update are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted as of the beginning of an annual period for which the financial statements (interim or annual) have not been issued or made available for issuance. That is, early adoption should be within the first interim period if an employer issues interim financial statements. Disclosures of the nature of and reason for the change in accounting principle are required in the first interim and annual periods of adoption. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Subtopic 610-20 "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets" Update No. 2017-05. Update No. 2017-05 was issued in February 2017 to clarify that a financial asset is within the scope of Subtopic 610-20 if it meets the definition of an in substance nonfinancial asset. The amendments define the term in substance nonfinancial asset, in part, as a financial asset promised to a counterparty in a contract if substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets. The amendments in this update also clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets. For purposes of that evaluation, the amendments require an entity to evaluate the underlying assets in consolidated subsidiaries to determine whether those assets are within the scope of Subtopic 610-20. The amendments are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The guidance may be applied earlier but only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods in that reporting period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 350 "Intangibles - Goodwill and Other " Update No. 2017-04. Update No. 2017-04 was issued in January 2017 to simplify the subsequent measurement of goodwill, by eliminating Step 2 for the goodwill impairment test. The amendments in this update modify the concept of impairment from the condition that exists when the carrying amount of a reporting unit exceeds its fair value. An entity is no longer required to determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit has been acquired in a business combination. An entity should apply the amendments in this update on a prospective basis. An entity is required to disclose the nature of and reason for the change in accounting principle upon transition. That disclosure should be provided in the first annual period and in the interim period within the first annual period when the entity initially adopts the amendments in this update. A public business entity that is a U.S. Securities and Exchange Commission (SEC)filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2014-09. Update No. 2014-09 was issued in May 2014 to address the previous revenue recognition requirements in GAAP that differ from those in International Financial Reporting Standards (IFRS). Accordingly, the FASB and the International Accounting

Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. The largely converged revenue recognition standards will supersede virtually all revenue recognition guidance in GAAP and IFRS. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Since the issuance of Update 2014-09, the FASB has finalized various amendments to the standard as summarized below:

FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-20
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-12
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-10
FASB ASC Topic 606 "Revenue from Contracts with Customers" Update No. 2016-08.

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

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

Through Updates 2016-12, 2016-10 and 2016-08, the FASB amended its new revenue guidance on licenses of intellectual property, identification of performance obligations, collectability, noncash consideration and the presentation of sales and other similar taxes. The FASB also clarified the definition of a completed contract at transition and added a practical expedient to ease transition for contracts that were modified prior to adoption. The FASB also amended the new revenue recognition guidance on determining whether an entity is a principal or an agent in an arrangement which affects whether revenue should be reported gross or net.
Following the issuance of Update 2015-14, Update 2014-09, as amended, is effective for the Company for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. A full or modified retrospective transition method is required. The Company's revenue is comprised of net interest income on financial assets and liabilities, and noninterest income. Interest income, mortgage banking income, gain on sale of equity securities, increase in cash surrender value of life insurance policies and loan level derivative income are accounted for under other U.S. GAAP standards, and are therefore anticipated to be out of scope of the ASC 606 revenue standard. Deposit account fees, interchange and ATM fees, investment management and certain categories of other noninterest income are anticipated to be within the scope of the ASC 606 revenue standard. As such, the Company is currently reviewing contracts related to these revenue streams and at this point does not anticipate any material changes to revenue recognition upon adoption, however, the Company’s review is still ongoing. The Company plans to adopt the revenue recognition standard as of January 1, 2018 and anticipates using the modified retrospective transition method upon adoption.

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NOTE 3 - ACQUISITIONS

Island Bancorp, Inc.

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

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

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

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

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

Cash and Cash Equivalents

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

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Loans

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

Premises and Equipment

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

Core Deposit Intangible

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

Deposits

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

Borrowings

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

Selected Pro Forma Results

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

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

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

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NOTE 4 - SECURITIES
Trading Securities

The Company had trading securities of $1.3 million and $804,000 as of June 30, 2017 and December 31, 2016, respectively. These securities are held in a rabbi trust and will be used for future payments associated with the Company's non-qualified
401(k) Restoration Plan and Non-Qualified Deferred Compensation Plan.
Available for Sale and Held to Maturity Securities
The following table presents a summary of the amortized cost, gross unrealized gains and losses and fair value of securities available for sale and securities held to maturity for the periods indicated:

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

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on the sale.

The actual maturities of certain securities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. A schedule of the contractual maturities of securities available for sale and securities held to maturity as of June 30, 2017 is presented below:

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

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

The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law, was $515.0 million and $482.1 million at June 30, 2017 and December 31, 2016, respectively.

At June 30, 2017 and December 31, 2016, the Company had no investments in obligations of individual states, counties, or municipalities which exceeded 10% of stockholders' equity.

Other-Than-Temporary Impairment ("OTTI")

The Company continually reviews investment securities for the existence of OTTI, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, the credit worthiness of the obligor of the security, volatility of earnings, current analysts' evaluations, the Company's intent to sell the security, whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment.

The following tables show the gross unrealized losses and fair value of the Company's investments in an unrealized loss position, which the Company has not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	June 30, 2017						
		Less than 12 months		12 months or longer		Total	
	# of holdings	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)						
Agency mortgage-backed securities	36	$111,741	$ (589)	$325	$ (2)	$112,066	$ (591)
Agency collateralized mortgage obligations	25	163,824	(2,228)	44,015	(1,681)	207,839	(3,909)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,593	(609)	1,593	(609)
Small business administration pooled securities	6	72,140	(422)	—	—	72,140	(422)
Equity securities	21	1,703	(37)	5,953	(387)	7,656	(424)
Total temporarily impaired securities	89	$349,408	$ (3,276)	$51,886	$ (2,679)	$401,294	$ (5,955)

	December 31, 2016						
		Less than 12 months		12 months or longer		Total	
	# of holdings	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)						
Agency mortgage-backed securities	57	$137,949	$ (1,594)	$—	$ —	$137,949	$ (1,594)
Agency collateralized mortgage obligations	32	243,051	(3,140)	47,403	(1,989)	290,454	(5,129)
Single issuer trust preferred securities issued by banks and insurers	1	—	—	1,036	(3)	1,036	(3)
Pooled trust preferred securities issued by banks and insurers	1	—	—	1,583	(616)	1,583	(616)
Small business administration pooled securities	5	59,846	(699)	—	—	59,846	(699)
Equity securities	25	3,625	(77)	6,334	(476)	9,959	(553)
Total temporarily impaired securities	121	$444,471	$ (5,510)	$56,356	$ (3,084)	$500,827	$ (8,594)

The Company does not intend to sell these investments and has determined based upon available evidence that it is more likely than not that the Company will not be required to sell the security before the recovery of its amortized cost basis. As a result, the Company does not consider these investments to be OTTI. The Company made this determination by reviewing various

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qualitative and quantitative factors regarding each investment category, such as current market conditions, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, and current analysts' evaluations.

As a result of the Company's review of these qualitative and quantitative factors, the causes of the impairments listed in the table above by category are as follows at June 30, 2017:

- Agency Mortgage-Backed Securities, Agency Collateralized Mortgage Obligations and Small Business Administration Pooled Securities: These portfolios have contractual terms that generally do not permit the issuer to settle the securities at a price less than the current par value of the investment. The decline in market value of these securities is attributable to changes in interest rates and not credit quality. Additionally, these securities are either implicitly or explicitly guaranteed by the U.S. Government or one of its agencies.
- Pooled Trust Preferred Securities: This portfolio consists of one below investment grade security which is performing. The unrealized loss on this security is attributable to the illiquid nature of the trust preferred market in the current economic and regulatory environment. Management evaluates collateral credit and instrument structure, including current and expected deferral and default rates and timing. In addition, discount rates are determined by evaluating comparable spreads observed currently in the market for similar instruments.
- Equity Securities: This portfolio consists of mutual funds and other equity investments. During some periods, the mutual funds in the Company's investment portfolio may have unrealized losses resulting from market fluctuations, as well as the risk premium associated with that particular asset class. For example, emerging market equities tend to trade at a higher risk premium than U.S. government bonds and thus, will fluctuate to a greater degree on both the upside and the downside. In the context of a well-diversified portfolio, however, the correlation amongst the various asset classes represented by the funds serves to minimize downside risk. The Company evaluates each mutual fund in the portfolio regularly and measures performance on both an absolute and relative basis. A reasonable recovery period for positions with an unrealized loss is based on management's assessment of general economic data, trends within a particular asset class, valuations, earnings forecasts and bond durations. The Company has the ability and intent to hold these equity securities until a recovery of fair value.

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

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NOTE 5 - LOANS, ALLOWANCE FOR LOAN LOSSES, AND CREDIT QUALITY

The following tables bifurcate the amount of loans and the allowance allocated to each loan category based on the type of impairment analysis as of the periods indicated:

	June 30, 2017 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Financing receivables ending balance:								
Collectively evaluated for impairment	$874,664	$3,055,924	$340,757	$130,804	$728,109	$1,037,064	$10,124	$6,177,446
Individually evaluated for impairment	$36,272	$17,065	$—	$859	$13,879	$6,190	$345	$74,610
Purchased credit impaired loans	$—	$10,031	$—	$—	$7,404	$205	$—	$17,640
Total loans by group	$910,936	$3,083,020	$340,757	$131,663	$749,392	$1,043,459	$10,469	$6,269,696(1)

	December 31, 2016 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Financing receivables ending balance:								
Collectively evaluated for impairment	$862,875	$2,983,642	$320,391	$121,855	$622,392	$982,095	$10,666	$5,903,916
Individually evaluated for impairment	$39,178	$16,813	$—	$871	$14,175	$5,863	$397	$77,297
Purchased credit impaired loans	$—	$10,343	$—	$—	$7,859	$189	$1	$18,392
Total loans by group	$902,053	$3,010,798	$320,391	$122,726	$644,426	$988,147	$11,064	$5,999,605(1)

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

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

	Three Months Ended June 30, 2017 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$16,518	$ 30,743	$ 5,023	$1,533	$ 2,716	$ 5,345	$ 440	$62,318
Charge-offs	(3,591)	—	—	(24)	(116)	(122)	(345)	(4,198)
Recoveries	13	26	—	13	2	26	229	309
Provision (benefit)	604	178	(209)	91	91	104	191	1,050
Ending balance	$13,544	$ 30,947	$ 4,814	$1,613	$ 2,693	$ 5,353	$ 515	$59,479

	Three Months Ended June 30, 2016 (Dollars in thousands)							
	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$13,485	$ 28,595	$ 5,100	$1,341	$ 2,567	$ 4,915	$ 429	$56,432
Charge-offs	(2)	(25)	—	(30)	(8)	(190)	(322)	(577)
Recoveries	649	223	—	73	51	26	250	1,272
Provision (benefit)	(105)	218	116	57	(32)	235	111	600
Ending balance	$14,027	$ 29,011	$ 5,216	$1,441	$ 2,578	$ 4,986	$ 468	$57,727

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Six Months Ended June 30, 2017
(Dollars in thousands)

	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$ 16,921	$ 30,369	$ 4,522	$ 1,502	$ 2,621	$ 5,238	$ 393	$ 61,566
Charge-offs	(3,591)	—	—	(94)	(139)	(136)	(746)	(4,706)
Recoveries	200	57	—	79	14	102	517	969
Provision	14	521	292	126	197	149	351	1,650
Ending balance	$ 13,544	$ 30,947	$ 4,814	$ 1,613	$ 2,693	$ 5,353	$ 515	$ 59,479
Ending balance: individually evaluated for impairment	$ 70	$ 166	$ —	$ 1	$ 1,036	$ 243	$ 20	$ 1,536
Ending balance: collectively evaluated for impairment	$ 13,474	$ 30,781	$ 4,814	$ 1,612	$ 1,657	$ 5,110	$ 495	$ 57,943

Six Months Ended June 30, 2016
(Dollars in thousands)

	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Residential Real Estate	Home Equity	Other Consumer	Total
Allowance for loan losses								
Beginning balance	$ 13,802	$ 27,327	$ 5,366	$ 1,264	$ 2,590	$ 4,889	$ 587	$ 55,825
Charge-offs	(4)	(25)	—	(93)	(27)	(337)	(628)	(1,114)
Recoveries	787	412	—	94	51	53	494	1,891
Provision (benefit)	(558)	1,297	(150)	176	(36)	381	15	1,125
Ending balance	$ 14,027	$ 29,011	$ 5,216	$ 1,441	$ 2,578	$ 4,986	$ 468	$ 57,727
Ending balance: individually evaluated for impairment	$ 255	$ 791	$ —	$ 3	$ 1,188	$ 228	$ 27	$ 2,492
Ending balance: collectively evaluated for impairment	$ 13,772	$ 28,220	$ 5,216	$ 1,438	$ 1,390	$ 4,758	$ 441	$ 55,235

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

Commercial Portfolio

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

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

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

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

Consumer Portfolio

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

Credit Quality

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

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

- 1- 6 Rating — Pass: Risk-rating grades "1" through "6" comprise those loans ranging from 'Substantially Risk Free' which indicates borrowers are of unquestioned credit standing and the pinnacle of credit quality, well established companies with a very strong financial condition, and loans fully secured by cash collateral, through 'Acceptable Risk', which indicates borrowers may exhibit declining earnings, strained cash flow, increasing or above average leverage and/or weakening market fundamentals that indicate below average asset quality, margins and market share. Collateral coverage is protective.
- 7 Rating — Potential Weakness: Borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Company's asset and position. While potentially weak, currently these borrowers are marginally acceptable; no loss of principal or interest is envisioned.
-

8 Rating — Definite Weakness Loss Unlikely: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. Loan may be inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. However, there is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Collateral coverage may be inadequate to cover the principal obligation.

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

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

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

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

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

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

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

		December 31, 2016				
Category	Risk Rating	Commercial and Industrial	Commercial Real Estate	Commercial Construction	Small Business	Total
		(Dollars in thousands)				
Pass	1 - 6	$783,825	$2,876,570	$ 317,099	$ 120,304	$4,097,798
Potential weakness	7	46,176	84,641	1,363	1,859	134,039
Definite weakness-loss unlikely	8	71,991	47,164	1,929	556	121,640