MERCANTILE BANK CORP
Form 10-Q
August 07, 2015
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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____ .

Commission File No. 000-26719

MERCANTILE BANK CORPORATION

(Exact name of registrant as specified in its charter)

Michigan	38-3360865
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

310 Leonard Street, NW, Grand Rapids, MI 49504

(Address of principal executive offices) (Zip Code)

(616) 406-3000

(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 ___

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes _X_ No ___

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

Large accelerated filer ___ Accelerated filer _X_
Non-accelerated filer ___ Smaller reporting company ___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ___ No _X_

At August 7, 2015, there were 16,459,841 shares of common stock outstanding.

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MERCANTILE BANK CORPORATION

PART I --- FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$44,811,000	$43,754,000
Interest-bearing deposits	83,774,000	117,777,000
Federal funds sold	9,846,000	11,207,000
Total cash and cash equivalents	138,431,000	172,738,000
Securities available for sale	373,446,000	432,912,000
Federal Home Loan Bank stock	7,567,000	13,699,000
Loans	2,171,832,000	2,089,277,000
Allowance for loan losses	(16,561,000)	(20,041,000)
Loans, net	2,155,271,000	2,069,236,000
Premises and equipment, net	47,902,000	48,812,000
Bank owned life insurance	58,409,000	57,861,000
Goodwill	49,473,000	49,473,000
Core deposit intangible	14,061,000	15,624,000
Other assets	31,384,000	33,024,000
Total assets	$2,875,944,000	$2,893,379,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$612,222,000	$558,738,000
Interest-bearing	1,666,572,000	1,718,177,000
Total deposits	2,278,794,000	2,276,915,000
Securities sold under agreements to repurchase	152,081,000	167,569,000
Federal Home Loan Bank advances	48,000,000	54,022,000
Subordinated debentures	54,813,000	54,472,000

Accrued interest and other liabilities	13,285,000	12,263,000
Total liabilities	2,546,973,000	2,565,241,000
Shareholders' equity		
Preferred stock, no par value; 1,000,000 shares authorized; none issued	0	0
Common stock, no par value; 40,000,000 shares authorized; 16,571,474 shares outstanding at June 30, 2015 and 16,976,839 shares outstanding at December 31, 2014	310,136,000	317,904,000
Retained earnings	18,766,000	10,218,000
Accumulated other comprehensive income	69,000	16,000
Total shareholders’ equity	328,971,000	328,138,000
Total liabilities and shareholders’ equity	$2,875,944,000	$2,893,379,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Interest income				
Loans, including fees	$25,587,000	$16,657,000	$50,898,000	$28,756,000
Securities, taxable	1,489,000	1,393,000	3,174,000	2,627,000
Securities, tax-exempt	523,000	374,000	1,060,000	557,000
Other interest-earning assets	64,000	58,000	120,000	130,000
Total interest income	27,663,000	18,482,000	55,252,000	32,070,000
Interest expense				
Deposits	1,775,000	2,272,000	3,675,000	4,307,000
Short-term borrowings	39,000	27,000	76,000	49,000
Federal Home Loan Bank advances	151,000	156,000	303,000	306,000
Other borrowings	657,000	474,000	1,308,000	791,000
Total interest expense	2,622,000	2,929,000	5,362,000	5,453,000
Net interest income	25,041,000	15,553,000	49,890,000	26,617,000
Provision for loan losses	(600,000)	(700,000)	(1,000,000)	(2,600,000)
Net interest income after provision for loan losses	25,641,000	16,253,000	50,890,000	29,217,000
Noninterest income				
Services charges on accounts	812,000	522,000	1,582,000	887,000
Credit and debit card income	1,079,000	593,000	2,291,000	894,000
Mortgage banking activities	999,000	349,000	1,687,000	412,000
Earnings on bank owned life insurance	262,000	282,000	548,000	581,000
Other income	869,000	542,000	1,607,000	1,020,000
Total noninterest income	4,021,000	2,288,000	7,715,000	3,794,000
Noninterest expense				
Salaries and benefits	11,074,000	7,037,000	21,158,000	12,267,000
Occupancy	1,479,000	914,000	3,052,000	1,626,000

Furniture and equipment	596,000	368,000	1,220,000	615,000
Data processing costs	1,872,000	1,440,000	3,642,000	2,376,000
FDIC insurance costs	483,000	224,000	960,000	401,000
Merger-related costs	0	3,453,000	0	3,830,000
Other expense	4,846,000	2,630,000	9,559,000	4,158,000
Total noninterest expenses	20,350,000	16,066,000	39,591,000	25,273,000
Income before federal income tax expense	9,312,000	2,475,000	19,014,000	7,738,000
Federal income tax expense	2,754,000	966,000	5,810,000	2,649,000
Net income	$6,558,000	$1,509,000	$13,204,000	$5,089,000
Basic earnings per share	$0.39	$0.13	$0.78	$0.50
Diluted earnings per share	$0.39	$0.13	$0.78	$0.50
Cash dividends per share	$0.14	$2.12	$0.28	$2.24
Average basic shares outstanding	$16,767,393	$11,406,908	$16,852,002	$10,080,242
Average diluted shares outstanding	$16,803,846	$11,435,867	$16,887,702	$10,094,725

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Net income	$6,558,000	$1,509,000	$13,204,000	$5,089,000
Other comprehensive income (loss):				
Unrealized holding gains (losses) on securities available for sale	(2,722,000)	1,537,000	165,000	4,148,000
Fair value of interest rate swap	71,000	(140,000)	(126,000)	(126,000)
	(2,651,000)	1,397,000	39,000	4,022,000
Tax effect of unrealized holding gains (losses) on securities available for sale	981,000	(568,000)	(30,000)	(1,481,000)
Tax effect of fair value of interest rate swap	(25,000)	49,000	44,000	45,000
	956,000	(519,000)	14,000	(1,436,000)
Other comprehensive income (loss), net of tax	(1,695,000)	878,000	53,000	2,586,000
Comprehensive income	$4,863,000	$2,387,000	$13,257,000	$7,675,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF

CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2015	$ 0	$ 317,904	$ 10,218	$ 16	$ 328,138
Employee stock purchase plan (1,110 shares)		23			23
Dividend reinvestment plan (13,788 shares)		283			283
Stock option exercises (26,375 shares)		275			275
Stock grants to directors for retainer fees (20,094 shares)		402			402
Stock-based compensation expense		359			359
Share repurchase program (463,060 shares)		(9,110)			(9,110)
Cash dividends ($0.28 per common share)			(4,656)		(4,656)
Net income for the six months ended June 30, 2015			13,204		13,204
Change in net unrealized holding gain on securities available for sale, net of tax effect				135	135
Change in fair value of interest rate swap, net of tax effect				(82)	(82)
Balances, June 30, 2015	$ 0	$ 310,136	$ 18,766	$ 69	$ 328,971

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF

CHANGES IN SHAREHOLDERS' EQUITY (Continued)

(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2014	$ 0	$ 162,999	$ (4,101)	$ (5,573)	$ 153,325
Stock option exercises (5,920 shares)		75			75
Stock grants to directors for retainer fees (7,375 shares)		155			155
Stock-based compensation expense		351			351
Cash dividends ($2.24 per common share)		(20,102)	(315)		(20,417)
Common stock issued in connection with Firstbank merger (8,087,272 shares)		173,310			173,310
Stock options issued to replace existing Firstbank options at merger date		1,664			1,664
Net income for the six months ended June 30, 2014			5,089		5,089
Change in net unrealized holding gain on securities available for sale, net of tax effect				2,667	2,667
Change in fair value of interest rate swap, net of tax effect				(81)	(81)
Balances, June 30, 2014	$ 0	$ 318,452	$ 673	$ (2,987)	$ 316,138

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Cash flows from operating activities		
Net income	$13,204,000	$5,089,000
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	5,588,000	1,967,000
Accretion of acquired loans	(2,910,000)	(512,000)
Provision for loan losses	(1,000,000)	(2,600,000)
Stock-based compensation expense	359,000	351,000
Stock grants to directors for retainer fee	402,000	155,000
Proceeds from sales of mortgage loans held for sale	57,735,000	16,958,000
Origination of mortgage loans held for sale	(56,853,000)	(16,525,000)
Net gain from sales of mortgage loans held for sale	(1,706,000)	(383,000)
Net gain from sales and valuation write-down of foreclosed assets	(71,000)	(605,000)
Net gain from sales of fixed assets	(10,000)	0
Net gain from sales of available for sale securities	(5,000)	0
Earnings on bank owned life insurance	(548,000)	(581,000)
Net change in:		
Accrued interest receivable	212,000	312,000
Other assets	(188,000)	(1,678,000)
Accrued interest and other liabilities	896,000	6,884,000
Net cash from operating activities	15,105,000	8,832,000
Cash flows from investing activities		
Cash received in merger	0	91,806,000
Loan originations and payments, net	(82,399,000)	(75,655,000)
Purchases of securities available for sale	(4,868,000)	(11,679,000)
Proceeds from maturities, calls and repayments of securities available for sale	62,135,000	22,800,000
Proceeds from sales of securities available for sale	665,000	0
Proceeds from sales of foreclosed assets	1,131,000	1,940,000
Proceeds from FHLB stock redemption	6,132,000	0
Purchases of premises and equipment	(589,000)	(874,000)
Net cash from (for) investing activities	(17,793,000)	28,338,000
Cash flows from financing activities		
Net decrease in time deposits	(84,451,000)	(15,516,000)

Net increase (decrease) in all other deposits	87,505,000	(29,743,000)
Net increase (decrease) in securities sold under agreements to repurchase	(15,488,000)	319,000
Maturities of Federal Home Loan Bank advances	(6,000,000)	0
Proceeds from stock option exercises	275,000	75,000
Employee stock purchase plan	23,000	0
Dividend reinvestment plan	283,000	0
Repurchase of common stock shares	(9,110,000)	0
Payment of cash dividends to common shareholders	(4,656,000)	(20,417,000)
Net cash for financing activities	(31,619,000)	(65,282,000)
Net change in cash and cash equivalents	(34,307,000)	(28,112,000)
Cash and cash equivalents at beginning of period	172,738,000	146,965,000
Cash and cash equivalents at end of period	$138,431,000	$118,853,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Unaudited)

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Supplemental disclosures of cash flows information		
Cash paid during the period for:		
Interest	$5,564,000	$5,336,000
Federal income tax	5,700,000	1,400,000
Noncash financing and investing activities:		
Transfers from loans to foreclosed assets	1,098,000	175,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The unaudited financial statements for the six months ended June 30, 2015 include the consolidated results of operations of Mercantile Bank Corporation and its consolidated subsidiaries. These subsidiaries include Mercantile Bank of Michigan ("our bank") and our bank's two subsidiaries, Mercantile Bank Real Estate Co., LLC ("our real estate company") and Mercantile Insurance Center, Inc. ("our insurance center"). These consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and Item 303(b) of Regulation S-K and do not include all disclosures required by accounting principles generally accepted in the United States of America for a complete presentation of our financial condition and results of operations. In the opinion of management, the information reflects all adjustments (consisting only of normal recurring adjustments) which are necessary in order to make the financial statements not misleading and for a fair presentation of the results of operations for such periods. The results for the period ended June 30, 2015 should not be considered as indicative of results for a full year. For further information, refer to the consolidated financial statements and footnotes included in our annual report on Form 10-K for the year ended December 31, 2014.

We have five separate business trusts that were formed to issue trust preferred securities. Subordinated debentures were issued to the trusts in return for the proceeds raised from the issuance of the trust preferred securities. The trusts are not consolidated, but instead we report the subordinated debentures issued to the trusts as a liability.

Earnings Per Share: Basic earnings per share is based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under our stock-based compensation plans and are determined using the treasury stock method. Our unvested restricted shares, which contain non-forfeitable rights to dividends whether paid or accrued (i.e., participating securities), are included in the number of shares outstanding for both basic and diluted earnings per share calculations. In the event of a net loss, our unvested restricted shares are excluded from the calculation of both basic and diluted earnings per share.

Approximately 100,000 unvested restricted shares were included in determining both basic and diluted earnings per share for the three and six months ended June 30, 2015. In addition, stock options for approximately 108,000 shares of common stock were included in determining diluted earnings per share for the three and six months ended June 30,

2015. Stock options for approximately 91,000 shares of common stock were antidilutive and not included in determining diluted earnings per share for the three and six months ended June 30, 2015.

Stock options for approximately 159,000 shares of common stock were included in determining diluted earnings per share for the three and six months ended June 30, 2014. Stock options for approximately 177,000 shares of common stock were antidilutive and not included in determining diluted earnings per share for the three and six months ended June 30, 2014.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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1. **SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Securities: Debt securities classified as held to maturity are carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold prior to maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Federal Home Loan Bank stock is carried at cost.

Interest income includes amortization of purchase premiums and accretion of discounts. Premiums and discounts on securities are amortized or accreted on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of debt securities below their amortized cost that are other than temporary ("OTTI") are reflected in earnings or other comprehensive income, as appropriate. For those debt securities whose fair value is less than their amortized cost, we consider our intent to sell the security, whether it is more likely than not that we will be required to sell the security before recovery and whether we expect to recover the entire amortized cost of the security based on our assessment of the issuer's financial condition. In analyzing an issuer's financial condition, we consider whether the securities are issued by the federal government or its agencies, and whether downgrades by bond rating agencies have occurred. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement, and 2) OTTI related to other factors, such as liquidity conditions in the market or changes in market interest rates, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost.

Loans: Loans that we have the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on commercial loans and mortgage loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and credit card loans are typically charged off no later than when they are 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. As of June 30, 2015 and December 31, 2014, we determined that the fair value of our mortgage loans held for sale approximated the recorded cost of $2.4 million and $1.6 million, respectively. Loans held for sale are reported as part of our total loans on the balance sheet.

Mortgage loans held for sale are generally sold with servicing rights retained. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold, which is reduced by the cost allocated to the servicing right. We generally lock in the sale price to the purchaser of the loan at the same time we make a rate commitment to the borrower. These mortgage banking activities are not designated as hedges and are carried at fair value. The net gain or loss on mortgage banking derivatives is included in the gain on sale of loans. Mortgage loans serviced for others totaled approximately $594 million as of June 30, 2015.

Mortgage Banking Activities: Mortgage loan servicing rights are recognized as assets based on the allocated value of retained servicing rights on mortgage loans sold. Mortgage loan servicing rights are carried at the lower of amortized cost or fair value and are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights using groupings of the underlying mortgage loans as to interest rates. Any impairment of a grouping is reported as a valuation allowance.

Servicing fee income is recorded for fees earned for serving mortgage loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. Amortization of mortgage loan servicing rights is netted against mortgage loan servicing income and recorded in mortgage banking activities in the income statement.

Troubled Debt Restructurings: A loan is accounted for as a troubled debt restructuring if we, for economic or legal reasons, grant a concession to a borrower considered to be experiencing financial difficulties that we would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, or a modification of terms such as a reduction of the stated interest rate or balance of the loan, a reduction of accrued interest, an extension of the maturity date or renewal of the loan at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings can be in either accrual or nonaccrual status. Nonaccrual troubled debt restructurings are included in nonperforming loans. Accruing troubled debt restructurings are generally excluded from nonperforming loans as it is considered probable that all contractual principal and interest due under the restructured terms will be collected.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

In accordance with current accounting guidance, loans modified as troubled debt restructurings are, by definition, considered to be impaired loans. Impairment for these loans is measured on a loan-by-loan basis similar to other impaired loans as described above under “Allowance for Loan Losses.” Certain loans modified as troubled debt restructurings may have been previously measured for impairment under a general allowance methodology (i.e., pooling), thus at the time the loan is modified as a troubled debt restructuring the allowance will be impacted by the difference between the results of these two measurement methodologies. Loans modified as troubled debt restructurings that subsequently default are factored into the determination of the allowance in the same manner as other defaulted loans.

Allowance for Loan Losses: The allowance for loan losses (“allowance”) is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when we believe the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. We estimate the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in our judgment, should be charged-off.

A loan is considered to be impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. We determine the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of delay, the reasons for delay, the borrower’s prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price or the fair value of collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

(Continued)

MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivatives: Derivative financial instruments are recognized as assets or liabilities at fair value. The accounting for changes in the fair value of derivatives depends on the use of the derivatives and whether the derivatives qualify for hedge accounting. Used as part of our asset and liability management to help manage interest rate risk, our derivatives have generally consisted of interest rate swap agreements that qualified for hedge accounting. In February 2012, we entered into an interest rate swap agreement that qualifies for hedge accounting. The current outstanding interest rate swap is discussed in more detail in Note 10. We do not use derivatives for trading purposes.

Changes in the fair value of derivatives that are designated, for accounting purposes, as a hedge of the variability of cash flows to be received on various loans and are effective are reported in other comprehensive income. They are later reclassified into earnings in the same periods during which the hedged transaction affects earnings and are included in the line item in which the hedged cash flows are recorded. If hedge accounting does not apply, changes in the fair value of derivatives are recognized immediately in current earnings as interest income or expense.

If designated as a hedge, we formally document the relationship between derivatives as hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions. This documentation includes linking cash flow hedges to specific assets and liabilities on the balance sheet. If designated as a hedge, we also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in cash flows of the hedged items. Ineffective hedge gains and losses are recognized immediately in current earnings as noninterest income or expense. We discontinue hedge accounting when we determine the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative is settled or terminates, or treatment of the derivative as a hedge is no longer appropriate or intended.

Goodwill and Core Deposit Intangible: Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified. A more frequent assessment is performed if conditions in the market place or changes in the company's organizational structure occur. We use a discounted income approach and a market valuation model, which compares the inherent value of our company to valuations of recent transactions in the market place to determine if our goodwill has been impaired.

The core deposit intangible that arose from the Firstbank Corporation acquisition was initially measured at fair value and is being amortized into noninterest expense over a ten-year period using the sum-of-the-years-digits methodology.

(Continued)

MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. <u>SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

<u>Adoption of New Accounting Standards:</u> In January of 2014, the FASB issued ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* This ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The ASU also requires additional related interim and annual disclosures. The guidance in this ASU is effective for annual and interim periods beginning after December 15, 2014. The adoption of this ASU did not have a material effect on our financial position or results of operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. This ASU is effective for annual and interim periods beginning after December 15, 2016 with three transition methods available – full retrospective, retrospective and cumulative effect approach. Adoption of this ASU is not expected to have a material effect on our financial position or results of operations.

In June 2014, the FASB issued ASU 2014-11, *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. This ASU requires two accounting changes. First, repurchase-to-maturity transactions will be accounted for as secured borrowing transactions on the balance sheet, rather than sales. Second, for repurchase financing arrangements, the ASU requires separate accounting for a transfer of a financial asset executed contemporaneously with (or in contemplation of) a repurchase agreement with the same counterparty, which also will generally result in secured borrowing accounting for the repurchase agreement. The ASU also introduces new disclosures to increase transparency about the types of collateral pledged for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings. The ASU also requires a transferor to disclose information about transactions accounted for as a sale in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets through an agreement with the transferee. The accounting changes and disclosure for certain transactions accounted for as a sale are effective for the first interim or annual period beginning after December 15, 2014. The disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The required disclosures under the ASU are included in Note 7. Adoption of this ASU did not have a material effect on our financial position or results of operations.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. **SIGNIFICANT ACCOUNTING POLICIES** (Continued)

In August 2014, the FASB issued ASU 2014-14, *Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure*. This ASU requires that certain government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration, be derecognized and that a separate other receivable be recognized upon foreclosure if certain conditions are met. Upon foreclosure on the loans that meet these criteria, a separate receivable should be recorded based on the amount of the loan balance expected to be recovered from the guarantor. The amendments are effective for annual periods, and interim periods within those years, beginning after December 15, 2014. The adoption of this ASU did not have a material effect on our financial position or results of operations.

2. BUSINESS COMBINATION

We completed the merger of Firstbank Corporation ("Firstbank"), a Michigan corporation with approximately $1.5 billion in total assets and 46 branch locations, into Mercantile Bank Corporation as of June 1, 2014 ("Merger Date"). The results of operations due to the Firstbank transaction have been included in Mercantile's financial results since the Merger Date. All of Firstbank's common stock was converted into the right to receive one share of Mercantile common stock for each share of Firstbank common stock. The conversion of Firstbank's common stock into Mercantile's common stock resulted in Mercantile issuing 8,087,272 shares of its common stock. The merger provided an expanded geographic footprint for the Company and increased the size of the balance sheet.

The Firstbank transaction was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the Merger Date. Preliminary goodwill of $49.5 million was calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created from combining the two banking organizations as well as the economies of scale expected from combining the operations of the two companies. None of the goodwill is deductible for income tax purposes as the merger is accounted for as a tax-free exchange.

The following table provides the unaudited pro forma information for the results of operations for the three and six month periods ended June 30, 2014 as if the acquisition had occurred on January 1, 2014. These adjustments reflect the impact of certain purchase accounting fair value measurements, primarily comprised of Firstbank's loan and deposit portfolios. We expect to achieve further operating cost savings and other business synergies as a result of the merger which are not reflected in the pro forma amounts. These unaudited pro forma results are presented for illustrative purposes only and are not intended to represent or be indicative of the actual results of operations of the combined banking organization that would have been achieved had the merger occurred at the beginning of each period presented, nor are they intended to represent or be indicative of future results of operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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2. BUSINESS COMBINATION (Continued)

	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Net interest income	$24,051,000	$47,934,000
Noninterest expense	19,698,000	39,716,000
Net income	5,708,000	11,965,000
Net income per diluted share	0.34	0.71

In most instances, determining the fair value of the acquired assets and assumed liabilities required us to estimate cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest. The most significant of those determinations relates to the valuation of acquired loans. For such loans, the excess of cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the impact of estimated credit losses and other factors, such as prepayments. In accordance with the applicable accounting guidance for business combinations, there was no carry-over of Firstbank's previously established allowance for loan losses.

The acquired loans were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 ("acquired impaired"), and loans that do not meet this criteria, which are accounted for under ASC 310-20 ("acquired non-impaired"). In addition, the loans are further categorized into different loan pools based primarily on the type and purpose of the loan.

We also assumed obligations under junior subordinated debentures with an aggregate balance of $36.1 million and an aggregate fair value of $21.1 million as of the Merger Date, payable to four unconsolidated trusts (Firstbank Capital Trust I, Firstbank Capital Trust II, Firstbank Capital Trust III, and Firstbank Capital Trust IV) that have issued trust preferred securities. The junior subordinated debentures are the sole assets of each trust. Interest rates on all trust preferred securities issued by the trusts are tied to the 90 Day Libor rate with spreads ranging from 127 basis points to 199 basis points, and reset quarterly. The trust preferred securities have maturity dates ranging from October, 2034 to July, 2037, and are callable by us in whole or in part quarterly. The junior subordinated debentures are unsecured obligations of Mercantile, who has guaranteed that interest payments on the junior subordinated debentures made to the trust will be distributed by the trust to the holders of the trust preferred securities. The trust preferred securities currently fully qualify as Tier 1 Capital, and under current risk-based capital guidelines, will remain fully qualified as Tier 1 Capital until maturity unless called by us at an earlier date.

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MERCANTILE BANK CORPORATION

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(Unaudited)

3. SECURITIES

The amortized cost and fair value of available for sale securities and the related pre-tax gross unrealized gains and losses recognized in accumulated other comprehensive income are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2015				
U.S. Government agency debt obligations	$162,342,000	$1,702,000	$(2,336,000)	$161,708,000
Mortgage-backed securities	79,018,000	1,083,000	(260,000)	79,841,000
Municipal general obligation bonds	119,609,000	824,000	(622,000)	119,811,000
Municipal revenue bonds	10,051,000	102,000	(4,000)	10,149,000
Other investments	1,940,000	0	(3,000)	1,937,000
	$372,960,000	$3,711,000	$(3,225,000)	$373,446,000
December 31, 2014				
U.S. Government agency debt obligations	$194,894,000	$1,612,000	$(3,038,000)	$193,468,000
Mortgage-backed securities	92,656,000	1,123,000	(218,000)	93,561,000
Municipal general obligation bonds	132,347,000	1,042,000	(307,000)	133,082,000
Municipal revenue bonds	10,769,000	117,000	(13,000)	10,873,000
Other investments	1,925,000	3,000	0	1,928,000
	$432,591,000	$3,897,000	$(3,576,000)	$432,912,000

Securities with unrealized losses at June 30, 2015 and December 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized

	Value	Loss	Value	Loss	Value	Loss
June 30, 2015						
U.S. Government agency debt obligations	$2,986,000	$13,000	$74,876,000	$2,323,000	$77,862,000	$2,336,000
Mortgage-backed securities	6,048,000	33,000	19,822,000	227,000	25,870,000	260,000
Municipal general obligation bonds	9,001,000	164,000	65,947,000	458,000	74,948,000	622,000
Municipal revenue bonds	0	0	2,305,000	4,000	2,305,000	4,000
Other investments	1,431,000	3,000	0	0	1,431,000	3,000
	$19,466,000	$213,000	$162,950,000	$3,012,000	$182,416,000	$3,225,000

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. SECURITIES (Continued)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2014						
U.S. Government agency debt obligations	$81,891,000	$202,000	$74,120,000	$2,836,000	$156,011,000	$3,038,000
Mortgage-backed securities	49,940,000	218,000	0	0	49,940,000	218,000
Municipal general obligation bonds	54,104,000	307,000	0	0	54,104,000	307,000
Municipal revenue bonds	4,644,000	13,000	0	0	4,644,000	13,000
Other investments	0	0	0	0	0	0
	$190,579,000	$740,000	$74,120,000	$2,836,000	$264,699,000	$3,576,000

We evaluate securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability we have to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. For those debt securities whose fair value is less than their amortized cost basis, we also consider our intent to sell the security, whether it is more likely than not that we will be required to sell the security before recovery and if we do not expect to recover the entire amortized cost basis of the security. In analyzing an issuer’s financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer’s financial condition.

At June 30, 2015, 316 debt securities and one mutual fund with fair values totaling $182.4 million have unrealized losses aggregating $3.2 million. After we considered whether the securities were issued by the federal government or its agencies and whether downgrades by bond rating agencies had occurred, we determined that unrealized losses were due to changing interest rate environments. As we do not intend to sell our debt securities before recovery of their cost basis and we believe it is more likely than not that we will not be required to sell our debt securities before recovery of the cost basis, no unrealized losses are deemed to be other-than-temporary.

The amortized cost and fair value of debt securities at June 30, 2015, by maturity, are shown in the following table. The contractual maturity is utilized for U.S. Government agency debt obligations and municipal bonds. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately. Weighted average yields are also reflected, with yields for municipal securities shown at their tax equivalent yield.

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(Unaudited)

3. SECURITIES (Continued)

	Weighted Average Yield		Amortized Cost	Fair Value
Due in 2015	0.88	%	$6,702,000	$6,707,000
Due in 2016 through 2020	1.42		135,850,000	135,897,000
Due in 2021 through 2025	3.13		65,615,000	65,485,000
Due in 2026 and beyond	3.55		83,835,000	83,579,000
Mortgage-backed securities	1.68		79,018,000	79,841,000
Other investments	2.52		1,940,000	1,937,000
	2.18	%	$372,960,000	$373,446,000

Securities issued by the State of Michigan and all its political subdivisions had a combined amortized cost of $103.1 million and $113.1 million at June 30, 2015 and December 31, 2014, respectively, with estimated market values of $103.0 million and $113.9 million, respectively. Securities issued by all other states and their political subdivisions had a combined amortized cost of $26.6 million and $30.0 million at June 30, 2015 and December 31, 2014, respectively, with estimated market values of $27.0 million and $30.0 million, respectively. Total securities of any other specific issuer, other than the U.S. Government and its agencies and the State of Michigan and all its political subdivisions, did not exceed 10% of shareholders' equity.

The carrying value of U.S. Government agency debt obligations and mortgage-backed securities that are pledged to secure repurchase agreements was $152.1 million and $167.6 million at June 30, 2015, and December 31, 2014, respectively. Investments in Federal Home Loan Bank stock are restricted and may only be resold or redeemed by the issuer.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans originated for investment are stated at their principal amount outstanding adjusted for partial charge-offs, the allowance, and net deferred loan fees and costs. Interest income on loans is accrued over the term of the loans primarily using the simple interest method based on the principal balance outstanding. Interest is not accrued on loans where collectability is uncertain. Accrued interest is presented separately in the consolidated balance sheet. Loan origination fees and certain direct costs incurred to extend credit are deferred and amortized over the term of the loan or loan commitment period as an adjustment to the related loan yield.

Acquired loans are those purchased in the Firstbank merger (See Note 2 – Business Combination for further information). These loans were recorded at estimated fair value at the Merger Date with no carryover of the related allowance. The acquired loans were segregated between those considered to be performing ("acquired non-impaired loans") and those with evidence of credit deterioration ("acquired impaired loans"). Acquired loans are considered impaired if there is evidence of credit deterioration and if it is probable, at acquisition, all contractually required payments will not be collected. Acquired loans restructured after acquisition are not considered or reported as troubled debt restructurings if the loans evidenced credit deterioration as of the Merger Date and are accounted for in pools.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The fair value estimates for acquired loans are based on expected prepayments and the amount and timing of discounted expected principal, interest and other cash flows. Credit discounts representing the principal losses expected over the life of the loan are also a component of the initial fair value. In determining the Merger Date fair value of acquired impaired loans, and in subsequent accounting, we have generally aggregated acquired commercial and consumer loans into pools of loans with common risk characteristics.

The difference between the fair value of an acquired non-impaired loan and contractual amounts due at the Merger Date is accreted into income over the estimated life of the loan. Contractually required payments represent the total undiscounted amount of all uncollected principal and interest payments. Acquired non-impaired loans are placed on nonaccrual status and reported as nonperforming or past due using the same criteria applied to the originated loan portfolio.

The excess of an acquired impaired loan's undiscounted contractually required payments over the amount of its undiscounted cash flows expected to be collected is referred to as the non-accretable difference. The non-accretable difference, which is neither accreted into income nor recorded on the consolidated balance sheet, reflects estimated future credit losses and uncollectible contractual interest expected to be incurred over the life of the acquired impaired loan. The excess cash flows expected to be collected over the carrying amount of the acquired loan is referred to as the accretable yield. This amount is accreted into interest income over the remaining life of the acquired loans or pools using the level yield method. The accretable yield is affected by changes in interest rate indices for variable rate loans, changes in prepayment speed assumptions and changes in expected principal and interest payments over the estimated lives of the acquired impaired loans.

We evaluate quarterly the remaining contractual required payments receivable and estimate cash flows expected to be collected over the lives of the impaired loans. Contractually required payments receivable may increase or decrease for a variety of reasons, for example, when the contractual terms of the loan agreement are modified, when interest rates on variable rate loans change, or when principal and/or interest payments are received. Cash flows expected to be collected on acquired impaired loans are estimated by incorporating several key assumptions similar to the initial estimate of fair value. These key assumptions include probability of default, loss given default, and the amount of actual prepayments after the Merger Date. Prepayments affect the estimated lives of loans and could change the amount of interest income, and possibly principal, expected to be collected. In re-forecasting future estimated cash flows, credit loss expectations are adjusted as necessary. The adjustments are based, in part, on actual loss severities recognized for each loan type, as well as changes in the probability of default. For periods in which estimated cash flows are not re-forecasted, the prior reporting period's estimated cash flows are adjusted to reflect the actual cash received and credit events that transpired during the current reporting period.

Increases in expected cash flows of acquired impaired loans subsequent to the Merger Date are recognized prospectively through adjustments of the yield on the loans or pools over their remaining lives, while decreases in expected cash flows are recognized as impairment through a provision for loan losses and an increase in the allowance.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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4. **LOANS AND ALLOWANCE FOR LOAN LOSSES** (Continued)

Our total loans at June 30, 2015 were $2.17 billion compared to $2.09 billion at December 31, 2014, an increase of $82.6 million, or 4.0%. The components of our loan portfolio disaggregated by class of loan within the loan portfolio segments at June 30, 2015 and December 31, 2014, and the percentage change in loans from the end of 2014 to the end of the second quarter of 2015, are as follows:

	June 30, 2015 Balance	%	December 31, 2014 Balance	%	Percent Increase (Decrease)
Originated loans					
Commercial:					
Commercial and industrial	$487,440,000	34.1 %	$384,570,000	30.8 %	26.7 %
Vacant land, land development, and residential construction	28,853,000	2.0	29,826,000	2.4	(3.3)
Real estate – owner occupied	297,694,000	20.8	291,758,000	23.4	2.0
Real estate – non-owner occupied	469,433,000	32.9	410,977,000	33.0	14.2
Real estate – multi-family and residential rental	38,968,000	2.7	36,058,000	2.9	8.1
Total commercial	1,322,388,000	92.5	1,153,189,000	92.5	14.7
Retail:					
Home equity and other	60,417,000	4.2	50,059,000	4.0	20.7
1-4 family mortgages	46,818,000	3.3	42,868,000	3.5	9.2
Total retail	107,235,000	7.5	92,927,000	7.5	15.4
Total originated loans	$1,429,623,000	100.0%	$1,246,116,000	100.0%	14.7 %

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MERCANTILE BANK CORPORATION

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(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	June 30, 2015 Balance	%	December 31, 2014 Balance	%	Percent Increase (Decrease)
Acquired loans					
Commercial:					
Commercial and industrial	$134,633,000	18.1 %	$166,037,000	19.7	(18.9%)
Vacant land, land development, and residential construction	18,769,000	2.5	22,148,000	2.6	(15.3)
Real estate – owner occupied	124,660,000	16.8	138,630,000	16.4	(10.1)
Real estate – non-owner occupied	134,291,000	18.1	148,597,000	17.6	(9.6)
Real estate – multi-family and residential rental	85,690,000	11.6	86,702,000	10.3	(1.2)
Total commercial	498,043,000	67.1	562,114,000	66.6	(11.4)
Retail:					
Home equity and other	89,077,000	12.0	109,219,000	13.0	(18.4)
1-4 family mortgages	155,089,000	20.9	171,828,000	20.4	(9.7)
Total retail	244,166,000	32.9	281,047,000	33.4	(13.1)
Total acquired loans	$742,209,000	100.0%	$843,161,000	100.0%	(12.0%)

	June 30, 2015 Balance	%	December 31, 2014 Balance	%	Percent Increase (Decreas
Total loans					
Commercial:					
Commercial and industrial	$622,073,000	28.7 %	$550,607,000	26.4 %	13.0%
Vacant land, land development, and residential construction	47,622,000	2.2	51,974,000	2.5	(8.4)
Real estate – owner occupied	422,354,000	19.4	430,388,000	20.5	(1.9)
Real estate – non-owner occupied	603,724,000	27.8	559,574,000	26.8	7.9
Real estate – multi-family and residential rental	124,658,000	5.7	122,760,000	5.9	1.5
Total commercial	1,820,431,000	83.8	1,715,303,000	82.1	6.1

Retail:					
Home equity and other	149,494,000	6.9	159,278,000	7.6	(6.1)
1-4 family mortgages	201,907,000	9.3	214,696,000	10.3	(6.0)
Total retail	351,401,000	16.2	373,974,000	17.9	(6.0)
Total loans	$2,171,832,000	100.0 %	$2,089,277,000	100.0 %	4.0 %

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The total outstanding balance and carrying value of acquired impaired loans was $29.4 million and $15.9 million, respectively, as of June 30, 2015. Changes in the accretable yield for acquired impaired loans for the three and six months ended June 30, 2015 were as follows:

Balance at March 31, 2015	$5,241,000
Additions	0
Accretion income	(681,000)
Net reclassification from nonaccretable to accretable	708,000
Reductions (1)	(153,000)
Ending balance	$5,115,000
Balance at December 31, 2014	$4,998,000
Additions	0
Accretion income	(1,327,000)
Net reclassification from nonaccretable to accretable	1,649,000
Reductions (1)	(205,000)
Ending balance	$5,115,000

(1) Reductions primarily reflect the result of exit events, including loan payoffs and charge-offs.

Nonperforming originated loans as of June 30, 2015 and December 31, 2014 were as follows:

	June 30,	December 31,

	2015	2014
Loans past due 90 days or more still accruing interest	$0	$0
Nonaccrual loans	2,893,000	26,048,000
Total nonperforming originated loans	$2,893,000	$26,048,000

Nonperforming acquired loans as of June 30, 2015 and December 31, 2014 were as follows:

	June 30, 2015	December 31, 2014
Loans past due 90 days or more still accruing interest	$0	$26,000
Nonaccrual loans	5,210,000	3,358,000
Total nonperforming acquired loans	$5,210,000	$3,384,000

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The recorded principal balance of nonperforming loans was as follows:

	June 30, 2015	December 31, 2014
Commercial:		
Commercial and industrial	$278,000	$6,478,000
Vacant land, land development, and residential construction	183,000	209,000
Real estate – owner occupied	2,558,000	18,062,000
Real estate – non-owner occupied	246,000	378,000
Real estate – multi-family and residential rental	2,580,000	106,000
Total commercial	5,845,000	25,233,000
Retail:		
Home equity and other	749,000	800,000
1-4 family mortgages	1,509,000	3,399,000
Total retail	2,258,000	4,199,000
Total nonperforming loans	$8,103,000	$29,432,000

Acquired impaired loans are not reported as nonperforming loans based on acquired impaired loan accounting. Acquired non-impaired loans are placed on nonaccrual status and reported as nonperforming or past due using the same criteria applied to the originated loan portfolio.

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

An age analysis of past due loans is as follows as of June 30, 2015:

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Originated loans							
Commercial:							
Commercial and industrial	$0	$0	$0	$0	$487,440,000	$487,440,000	$ 0
Vacant land, land development, and residential construction	0	0	0	0	28,853,000	28,853,000	0
Real estate – owner occupied	0	1,182,000	20,000	1,202,000	296,492,000	297,694,000	0
Real estate – non-owner occupied	0	0	0	0	469,433,000	469,433,000	0
Real estate – multi-family and residential rental	0	0	0	0	38,968,000	38,968,000	0
Total commercial	0	1,182,000	20,000	1,202,000	1,321,186,000	1,322,388,000	0
Retail:							
Home equity and other	64,000	0	0	64,000	60,353,000	60,417,000	0
1-4 family mortgages	0	73,000	312,000	385,000	46,433,000	46,818,000	0
Total retail	64,000	73,000	312,000	449,000	106,786,000	107,235,000	0
Total past due loans	$64,000	$1,255,000	$332,000	$1,651,000	$1,427,972,000	$1,429,623,000	$ 0

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(Unaudited)

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)