

Edgar Filing: First Internet Bancorp - Form 10-Q

First Internet Bancorp
Form 10-Q
August 03, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period ended June 30, 2017

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _____ to _____.

Commission File Number 001-35750

First Internet Bancorp

(Exact Name of Registrant as Specified in Its Charter)

Indiana	20-3489991
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

11201 USA Parkway	46037
Fishers, IN	
(Address of Principal Executive Offices)	(Zip Code)
(317) 532-7900	
(Registrant's Telephone Number, Including Area Code)	

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

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 ☒ 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 such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer ☐	Accelerated Filer ☒
Non-accelerated Filer ☐ (Do not check if a smaller reporting company)	Smaller Reporting Company ☐
Emerging growth company ☐	

Edgar Filing: First Internet Bancorp - Form 10-Q

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 Act. "

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

As of July 28, 2017, the registrant had 6,513,577 shares of common stock issued and outstanding.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the federal securities laws. These statements are not historical facts, but rather statements based on the current expectations of First Internet Bancorp and its consolidated subsidiaries (“we,” “our,” “us” or the “Company”) regarding its business strategies, intended results and future performance. Forward-looking statements are generally preceded by terms such as “expects,” “believes,” “anticipates,” “intends,” “plan,” and similar expressions. Such statements are subject to certain risks and uncertainties including: general economic conditions, whether national or regional, and conditions in the lending markets in which we participate that may have an adverse effect on the demand for our loans and other products; our credit quality and related levels of nonperforming assets and loan losses, and the value and salability of the real estate that we own or that is the collateral for our loans; failures of or interruptions in the communication and information systems on which we rely to conduct our business that could reduce our revenues, increase our costs or lead to disruptions in our business; our plans to grow our commercial real estate and commercial and industrial loan portfolios which may carry greater risks of non-payment or other unfavorable consequences; our dependence on capital distributions from First Internet Bank of Indiana (the “Bank”); results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for loan losses or to write-down assets; changing bank regulatory conditions, policies or programs, whether arising as new legislation or regulatory initiatives, that could lead to restrictions on activities of banks generally, or the Bank in particular; more restrictive regulatory capital requirements; increased costs, including deposit insurance premiums; regulation or prohibition of certain income producing activities or changes in the secondary market for loans and other products; changes in market rates and prices that may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet; our liquidity requirements being adversely affected by changes in our assets and liabilities; the effect of legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry; competitive factors among financial services organizations, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals; the growth and profitability of noninterest or fee income being less than expected; the loss of any key members of senior management; the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board (the “FASB”), the Securities and Exchange Commission (the “SEC”), the Public Company Accounting Oversight Board (the “PCAOB”) and other regulatory agencies; and the effect of fiscal and governmental policies of the United States federal government. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading “Risk Factors” and in other reports filed with the SEC. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors listed above could affect our financial performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

Except as required by law, we do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

PART I

ITEM 1. FINANCIAL STATEMENTS

First Internet Bancorp

Condensed Consolidated Balance Sheets

(Amounts in thousands except share data)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Cash and due from banks	\$5,425	\$ 2,282
Interest-bearing deposits	60,818	37,170
Total cash and cash equivalents	66,243	39,452
Interest-bearing time deposits	—	250
Securities available-for-sale, at fair value (amortized cost of \$499,089 and \$471,070 in 2017 and 2016, respectively)	489,775	456,700
Securities held-to-maturity, at amortized cost (fair value of \$19,004 and \$16,197 in 2017 and 2016, respectively)	19,215	16,671
Loans held-for-sale (includes \$16,996 and \$27,101 at fair value in 2017 and 2016, respectively)	27,335	27,101
Loans	1,698,421	1,250,789
Allowance for loan losses	(13,194)	(10,981)
Net loans	1,685,227	1,239,808
Accrued interest receivable	8,479	6,708
Federal Home Loan Bank of Indianapolis stock	19,575	8,910
Cash surrender value of bank-owned life insurance	34,602	24,195
Premises and equipment, net	9,667	10,044
Goodwill	4,687	4,687
Other real estate owned	4,488	4,533
Accrued income and other assets	11,978	15,276
Total assets	\$2,381,271	\$ 1,854,335
Liabilities and Shareholders' Equity		
Liabilities		
Noninterest-bearing deposits	\$36,636	\$ 31,166
Interest-bearing deposits	1,695,476	1,431,701
Total deposits	1,732,112	1,462,867
Advances from Federal Home Loan Bank	435,183	189,981
Subordinated debt, net of unamortized discounts and debt issuance costs of \$1,348 and \$1,422 in 2017 and 2016, respectively	36,652	36,578
Accrued interest payable	210	112
Accrued expenses and other liabilities	13,284	10,855
Total liabilities	2,217,441	1,700,393
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none	—	—
Voting common stock, no par value; 45,000,000 shares authorized; 6,513,577 and 6,478,050 shares issued and outstanding in 2017 and 2016, respectively	119,883	119,506
	—	—

Edgar Filing: First Internet Bancorp - Form 10-Q

Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding
- none

Retained earnings	49,738	43,704
Accumulated other comprehensive loss	(5,791)	(9,268)
Total shareholders' equity	163,830	153,942
Total liabilities and shareholders' equity	\$2,381,271	\$ 1,854,335

See Notes to Condensed Consolidated Financial Statements

Edgar Filing: First Internet Bancorp - Form 10-Q

First Internet Bancorp

Condensed Consolidated Statements of Income – Unaudited

(Amounts in thousands except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest Income				
Loans	\$16,416	\$11,661	\$30,572	\$22,850
Securities – taxable	2,566	1,747	4,933	2,916
Securities – non-taxable	696	368	1,393	533
Other earning assets	297	195	467	365
Total interest income	19,975	13,971	37,365	26,664
Interest Expense				
Deposits	5,324	3,930	10,023	6,818
Other borrowed funds	1,677	735	2,911	1,399
Total interest expense	7,001	4,665	12,934	8,217
Net Interest Income	12,974	9,306	24,431	18,447
Provision for Loan Losses	1,322	924	2,357	1,870
Net Interest Income After Provision for Loan Losses	11,652	8,382	22,074	16,577
Noninterest Income				
Service charges and fees	220	215	431	415
Mortgage banking activities	2,155	3,295	3,771	5,549
Gain on sale of securities	—	177	—	177
Other	361	61	665	147
Total noninterest income	2,736	3,748	4,867	6,288
Noninterest Expense				
Salaries and employee benefits	5,193	4,329	10,266	8,227
Marketing, advertising and promotion	544	434	1,062	898
Consulting and professional services	764	895	1,577	1,533
Data processing	245	275	482	549
Loan expenses	248	200	462	384
Premises and equipment	1,025	963	1,978	1,761
Deposit insurance premium	300	215	615	395
Other	604	564	1,179	1,133
Total noninterest expense	8,923	7,875	17,621	14,880
Income Before Income Taxes	5,465	4,255	9,320	7,985
Income Tax Provision	1,464	1,421	2,487	2,719
Net Income	\$4,001	\$2,834	\$6,833	\$5,266
Income Per Share of Common Stock				
Basic	\$0.61	\$0.57	\$1.04	\$1.11
Diluted	\$0.61	\$0.57	\$1.04	\$1.10
Weighted-Average Number of Common Shares Outstanding				
Basic	6,583,515	4,972,759	6,565,760	4,757,243
Diluted	6,597,994	4,992,025	6,599,684	4,782,700
Dividends Declared Per Share	\$0.06	\$0.06	\$0.12	\$0.12

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Comprehensive Income – Unaudited
(Amounts in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$4,001	\$2,834	\$6,833	\$5,266
Other comprehensive income				
Net unrealized holding gains on securities available-for-sale recorded within other comprehensive income before income tax	3,991	3,917	5,056	5,791
Reclassification adjustment for gains realized	—	(177)	—	(177)
Other comprehensive income before income tax	3,991	3,740	5,056	5,614
Income tax provision	1,507	1,331	1,579	1,998
Other comprehensive income	2,484	2,409	3,477	3,616
Comprehensive income	\$6,485	\$5,243	\$10,310	\$8,882

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp

Condensed Consolidated Statement of Shareholders' Equity - Unaudited

Six Months Ended June 30, 2017

(Amounts in thousands except per share data)

	Voting and Nonvoting Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, January 1, 2017	\$ 119,506	\$ 43,704	\$ (9,268)	\$ 153,942
Net income	—	6,833	—	6,833
Other comprehensive income	—	—	3,477	3,477
Dividends declared (\$0.12 per share)	—	(799)	—	(799)
Recognition of the fair value of share-based compensation	532	—	—	532
Deferred stock rights and restricted stock units issued in lieu of cash dividends payable on outstanding deferred stock rights and restricted stock units	18	—	—	18
Common stock redeemed for the net settlement of share-based awards	(173)	—	—	(173)
Balance, June 30, 2017	\$ 119,883	\$ 49,738	\$ (5,791)	\$ 163,830

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Cash Flows – Unaudited
(Amounts in thousands)

	Six Months Ended June 30,	
	2017	2016
Operating Activities		
Net income	\$6,833	\$5,266
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,468	1,468
Increase in cash surrender value of bank-owned life insurance	(407)	(205)
Provision for loan losses	2,357	1,870
Share-based compensation expense	532	358
Gain from sale of available-for-sale securities	—	(177)
Loans originated for sale	(195,126)	(259,095)
Proceeds from sale of loans	198,840	256,592
Gain on loans sold	(3,423)	(4,496)
Increase in fair value of loans held-for-sale	(525)	(986)
Loss (gain) on derivatives	177	(67)
Net change in accrued income and other assets	(214)	(3,942)
Net change in accrued expenses and other liabilities	887	1,485
Net cash provided by (used in) operating activities	12,399	(1,929)
Investing Activities		
Net loan activity, excluding purchases	(425,497)	(136,643)
Proceeds from sale of other real estate owned	30	—
Net change in interest-bearing time deposits	250	750
Maturities and calls of securities available-for-sale	36,658	16,303
Proceeds from sale of securities available-for-sale	—	49,430
Purchase of securities available-for-sale	(64,677)	(272,129)
Purchase of securities held-to-maturity	(2,550)	—
Purchase of Federal Home Loan Bank of Indianapolis stock	(10,665)	—
Purchase of bank-owned life insurance	(10,000)	—
Purchase of premises and equipment	(369)	(1,653)
Loans purchased	(22,279)	(21,325)
Net cash used in investing activities	(499,099)	(365,267)
Financing Activities		
Net increase in deposits	269,245	432,879
Cash dividends paid	(776)	(538)
Proceeds from advances from Federal Home Loan Bank	387,000	40,000
Repayment of advances from Federal Home Loan Bank	(141,805)	(83,000)
Net proceeds from common stock issuance	—	22,754
Other, net	(173)	(43)
Net cash provided by financing activities	513,491	412,052
Net Increase in Cash and Cash Equivalents	26,791	44,856
Cash and Cash Equivalents, Beginning of Period	39,452	25,152
Cash and Cash Equivalents, End of Period	\$66,243	\$70,008
Supplemental Disclosures		
Cash paid during the period for interest	\$12,836	\$8,196
Cash paid during the period for taxes	81	2,911

Edgar Filing: First Internet Bancorp - Form 10-Q

Cash dividends declared, paid in subsequent period	391	331
Securities purchased during the period, settled in subsequent period	1,635	8,705

See Notes to Condensed Consolidated Financial Statements

5

First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited

(Table amounts in thousands except share and per share data)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with GAAP. In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results expected for the year ending December 31, 2017 or any other period. The June 30, 2017 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2016.

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates, judgments, or assumptions that could have a material effect on the carrying value of certain assets and liabilities. These estimates, judgments, and assumptions affect the amounts reported in the condensed consolidated financial statements and the disclosures provided. The determination of the allowance for loan losses, valuations and impairments of investment securities, and the accounting for income tax expense are highly dependent upon management’s estimates, judgments, and assumptions where changes in any of these could have a significant impact on the financial statements.

The condensed consolidated financial statements include the accounts of First Internet Bancorp (the “Company”), its wholly-owned subsidiary, First Internet Bank of Indiana (the “Bank”), and the Bank’s two wholly-owned subsidiaries, First Internet Public Finance Corp. and JKH Realty Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations, and cash flows of the Company.

Certain reclassifications have been made to the 2016 financial statements to conform to the presentation of the 2017 financial statements. These reclassifications had no effect on net income.

Note 2: Earnings Per Share

Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the period.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three and six months ended June 30, 2017 and 2016.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Basic earnings per share				
Net income	\$4,001	\$ 2,834	\$6,833	\$ 5,266
Weighted-average common shares	6,583,515	6,972,759	6,565,760	6,757,243
Basic earnings per common share	\$0.61	\$ 0.57	\$1.04	\$ 1.11
Diluted earnings per share				
Net income	\$4,001	\$ 2,834	\$6,833	\$ 5,266
Weighted-average common shares	6,583,515	6,972,759	6,565,760	6,757,243
Dilutive effect of warrants	6,539	9,743	12,208	10,518
Dilutive effect of equity compensation	7,937	9,523	21,713	14,939
Weighted-average common and incremental shares	6,597,991	6,992,025	6,599,681	6,782,700
Diluted earnings per common share	\$0.61	\$ 0.57	\$1.04	\$ 1.10
Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period	—	—	—	—

Note 3: Securities

The following tables summarize securities available-for-sale and securities held-to-maturity as of June 30, 2017 and December 31, 2016.

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Unrealized Losses	Fair Value
Securities available-for-sale				
U.S. Government-sponsored agencies	\$129,926	\$364	\$(608)	\$129,682
Municipal securities	97,508	276	(2,713)	95,071
Mortgage-backed securities	231,591	54	(5,531)	226,114
Asset-backed securities	9,946	54	—	10,000
Corporate securities	27,118	14	(1,172)	25,960
Other securities	3,000	—	(52)	2,948
Total available-for-sale	\$499,089	\$762	\$(10,076)	\$489,775

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Unrealized Losses	Fair Value
Securities held-to-maturity				
Municipal securities	\$10,168	\$25	\$(346)	\$9,847
Corporate securities	9,047	126	(16)	9,157
Total held-to-maturity	\$19,215	\$151	\$(362)	\$19,004

	December 31, 2016			
	Amortized	Gross	Unrealized	Fair
	Cost	Gains	Losses	Value
Securities available-for-sale				
U.S. Government-sponsored agencies	\$92,599	\$167	\$(870)	) \$91,896
Municipal securities	97,647	85	(5,846)	) 91,886
Mortgage-backed securities	238,354	—	(6,713)	) 231,641
Asset-backed securities	19,470	65	(1)	) 19,534
Corporate securities	20,000	—	(1,189)	) 18,811
Other securities	3,000	—	(68)	) 2,932
Total available-for-sale	\$471,070	\$317	\$(14,687)	) \$456,700

	December 31, 2016			
	Amortized	Gross	Unrealized	Fair
	Cost	Gain	Losses	Value
Securities held-to-maturity				
Municipal securities	\$10,171	\$—	\$(498)	) \$9,673
Corporate securities	6,500	24	—	) 6,524
Total held-to-maturity	\$16,671	\$24	\$(498)	) \$16,197

The carrying value of securities at June 30, 2017 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized	Fair
	Cost	Value
One to five years	\$1,344	\$1,316
Five to ten years	45,868	45,194
After ten years	207,340	204,203
	254,552	250,713
Mortgage-backed securities	231,591	226,114
Asset-backed securities	9,946	10,000
Other securities	3,000	2,948
Total	\$499,089	\$489,775
	Held-to-Maturity	
	Amortized	Fair
	Cost	Value
Five to ten years	\$12,446	\$12,431
After ten years	6,769	6,573
Total	\$19,215	\$19,004

There were no sales of available-for-sale securities that resulted in gross gains or gross losses during the three and six months ended June 30, 2017. Gross gains of \$0.2 million and gross losses of \$0.0 million resulted from sales of available-for-sale securities during the three and six months ended June 30, 2016.

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. The total fair value of these investments at June 30, 2017 and December 31, 2016 was

Edgar Filing: First Internet Bancorp - Form 10-Q

\$386.4 million and \$422.9 million, which was approximately 76% and 89%, respectively, of the Company's available-for-sale and held-to-maturity securities portfolios. These declines resulted primarily from fluctuations in market interest rates after purchase. Management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced with the resulting loss recognized in net income in the period the other-than-temporary impairment (“OTTI”) is identified.

U. S. Government-Sponsored Agencies, Municipal Securities and Corporate Securities

The unrealized losses on the Company’s investments in securities issued by U.S. Government-sponsored agencies, municipal organizations and corporate entities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2017.

Mortgage-Backed Securities

The unrealized losses on the Company’s investments in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost bases over the term of the securities. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2017.

Other Securities

The unrealized losses on the Company’s investments in other securities were caused by the investment in the Community Reinvestment Act Qualified Fund. Because the Company does not intend to sell the investment and it is not likely that the Company will be required to sell the investment before recovery of its amortized cost basis, the Company does not consider this investment to be other-than-temporarily impaired at June 30, 2017.

The following tables show the available-for-sale and held-to-maturity securities portfolios’ gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2017 and December 31, 2016.

June 30, 2017						
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available-for-sale						
U.S. Government-sponsored agencies	\$54,696	\$ (497)	\$8,652	\$ (111)	\$63,348	\$ (608)
Municipal securities	70,509	(2,573)	2,109	(140)	72,618	(2,713)
Mortgage-backed securities	191,761	(4,734)	22,075	(797)	213,836	(5,531)
Corporate securities	3,948	(65)	18,893	(1,107)	22,841	(1,172)
Other securities	2,948	(52)	—	—	2,948	(52)
Total	\$323,862	\$ (7,921)	\$51,729	\$ (2,155)	\$375,591	\$ (10,076)

June 30, 2017					
	Less Than 12 Months		12 Months or Longer		Total
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Securities held-to-maturity					

Edgar Filing: First Internet Bancorp - Form 10-Q

Municipal securities	\$8,269	\$ (346)	\$ —\$	—\$8,269	\$ (346)
Corporate securities	2,531	(16)	— —	2,531	(16)
Total	\$10,800	\$ (362)	\$ —\$	—\$10,800	\$ (362)

	December 31, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available-for-sale						
U.S. Government-sponsored agencies	\$68,625	\$(840)	\$260	\$(30)	\$68,885	\$(870)
Municipal securities	86,424	(5,846)	—	—	86,424	(5,846)
Mortgage-backed securities	231,641	(6,713)	—	—	231,641	(6,713)
Asset-backed securities	—	—	4,520	(1)	4,520	(1)
Corporate securities	—	—	18,811	(1,189)	18,811	(1,189)
Other securities	2,932	(68)	—	—	2,932	(68)
Total	\$389,622	\$(13,467)	\$23,591	\$(1,220)	\$413,213	\$(14,687)

	December 31, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities held-to-maturity						
Municipal securities	\$9,673	\$(498)	\$—	—	\$9,673	\$(498)
Total	\$9,673	\$(498)	\$—	—	\$9,673	\$(498)

There were no amounts reclassified from accumulated other comprehensive loss during the three and six months ended June 30, 2017. Amounts reclassified from accumulated other comprehensive loss and the affected line items in the consolidated statements of income during the three and six months ended June 30, 2016 were as follows:

Details About Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss for the		Affected Line Item in the Statements of Income
	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016	
Realized gains and losses on securities available-for-sale			
Gain realized in earnings	\$ 177	\$ 177	Gain on sale of securities
Total reclassified amount before tax	177	177	Income Before Income Taxes
Tax expense	60	60	Income Tax Provision
Total reclassifications out of accumulated other comprehensive loss	\$ 117	\$ 117	Net Income

Note 4: Loans

Loans that management intends to hold until maturity are reported at their outstanding principal balance adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans.

For loans recorded at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

Categories of loans include:

	June 30, 2017	December 31, 2016
Commercial loans		
Commercial and industrial	\$ 110,379	\$ 102,437
Owner-occupied commercial real estate	66,952	57,668
Investor commercial real estate	10,062	13,181
Construction	45,931	53,291
Single tenant lease financing	747,790	606,568
Public finance	179,873	—
Total commercial loans	1,160,987	833,145
Consumer loans		
Residential mortgage	292,997	205,554
Home equity	33,312	35,036
Other consumer	208,602	173,449
Total consumer loans	534,911	414,039
Total commercial and consumer loans	1,695,898	1,247,184
Deferred loan origination costs and premiums and discounts on purchased loans	2,523	3,605
Total loans	1,698,421	1,250,789
Allowance for loan losses	(13,194)	(10,981)
Net loans	\$ 1,685,227	\$ 1,239,808

The risk characteristics of each loan portfolio segment are as follows:

Commercial and Industrial: Commercial and industrial loans' sources of repayment are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Loans are made for working capital, equipment purchases, or other purposes. Most commercial and industrial loans are secured by the assets being financed and may incorporate a personal guarantee.

Owner-Occupied Commercial Real Estate: The primary source of repayment is the cash flow from the ongoing operations and activities conducted by the borrower, or an affiliate of the borrower, who owns the property. This portfolio segment is generally concentrated in the Central Indiana and greater Phoenix, Arizona markets and its loans are often secured by manufacturing and service facilities, as well as office buildings.

Investor Commercial Real Estate: These loans are underwritten primarily based on the cash flow expected to be generated from the property and are secondarily supported by the value of the real estate. These loans typically incorporate a personal guarantee. This portfolio segment generally involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the

business conducted on the property securing the loan. Investor commercial real estate loans may be more adversely affected by conditions in the real estate markets, changing industry dynamics, or the overall health of the general economy. The properties securing the Company's investor commercial real estate portfolio tend to be diverse in terms of property type and are typically located in the state of Indiana and markets adjacent to Indiana. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value, guarantor strength, and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas unless other underwriting factors are present to mitigate these additional risks.

Construction: Construction loans are secured by real estate and improvements and are made to assist in the construction of new structures, which may include commercial (retail, industrial, office, multi-family) properties or single family residential properties offered for sale by the builder. These loans generally finance a variety of project costs, including land, site preparation, construction, closing and soft costs and interim financing needs. The cash flows of builders, while initially predictable, may fluctuate with market conditions, and the value of the collateral securing these loans may be subject to fluctuations based on general economic changes.

Single Tenant Lease Financing: These loans are made to property owners of real estate subject to long term lease arrangements with single tenant operators. The real estate is typically operated by regionally, nationally or globally branded businesses. The loans are underwritten based on the financial strength of the borrower, characteristics of the real estate, cash flows generated from the lease arrangements and the financial strength of the tenant. Similar to the other loan portfolio segments, management monitors and evaluates these loans based on borrower and tenant financial performance, collateral value, industry trends and other risk grade criteria.

Public Finance: These loans are made to governmental and not-for-profit entities to provide both tax-exempt and taxable loans for a variety of purposes including: short term cash-flow needs; debt refinancing; economic development; quality of life projects; infrastructure improvements; and equipment financing. The primary sources of repayment for public finance loans include pledged revenue sources including but not limited to: general obligations; property taxes; income taxes; tax increment revenue; utility revenue; gaming revenues; sales tax; and pledged general revenue. Certain loans may also include an additional collateral pledge of mortgaged property or a security interest in financed equipment.

Residential Mortgage: With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company typically establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the financial circumstances of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.

Home Equity: Home equity loans and lines of credit are typically secured by a subordinate interest in 1-4 family residences. The properties securing the Company's home equity portfolio segment are generally geographically diverse as the Company offers these products on a nationwide basis. Repayment of home equity loans and lines of credit may be impacted by changes in property values on residential properties and unemployment levels, among other economic conditions and financial circumstances in the market.

Other Consumer: These loans primarily consist of consumer loans and credit cards. Consumer loans may be secured by consumer assets such as horse trailers or recreational vehicles. Some consumer loans are unsecured, such as small installment loans, home improvement loans and certain lines of credit. Repayment of consumer loans is primarily dependent upon the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.

Allowance for Loan Losses Methodology

Company policy is designed to maintain an adequate allowance for loan losses (“ALLL”). The portfolio is segmented by loan type, and the required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on average historical losses, adjusted for current economic factors and portfolio trends. Management believes the historical loss experience methodology is appropriate in the current economic environment as it captures loss rates that are comparable to the current period being analyzed. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. The Company evaluates the impact of internal changes such as management and staff experience levels or modification to loan underwriting processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, or classified loans as well as any changes in the value of underlying collateral. Finally, the Company considers the effect of other external factors such as national, regional, and local economic and business conditions, as well as competitive, legal, and regulatory requirements. Loans that are considered to be impaired are evaluated to determine the need for a specific allowance by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less costs to sell; or the loan’s observable market price. All troubled debt restructurings (“TDR”) are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting. Accounting Standards Codification (“ASC”) Topic 310, Receivables, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans’ effective interest rates or the fair value of the underlying collateral less costs to sell and allows existing methods for recognizing interest income.

Provision for Loan Losses

A provision for estimated losses on loans is charged to income based upon management’s evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full repayment may not be reasonably assured, considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, loan loss experience, and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management attempts to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

Policy for Charging Off Loans

The Company’s policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectible within the parameters of policy. A secured loan is generally charged down to the estimated fair value of the collateral, less costs to sell, no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest. A home improvement loan generally is charged off no later than when it is 90 days past due as to principal or interest. The following tables present changes in the balance of the ALLL during the three and six months ended June 30, 2017 and 2016.

	Three Months Ended June 30, 2017			
	Balance, Beginning of Period	Provision (Credit) Charged to Expense	Losses Charged Off	Recoveries End of Period
Allowance for loan losses:				
Commercial and industrial	\$1,323	\$ 205	\$ —	\$ 25
				\$1,553

Edgar Filing: First Internet Bancorp - Form 10-Q

Owner-occupied commercial real estate	635	81	—	—	716	
Investor commercial real estate	101	8	—	—	109	
Construction	462	(67	)	—	395	
Single tenant lease financing	6,853	550	—	—	7,403	
Public finance	142	220	—	—	362	
Residential mortgage	904	85	—	2	991	
Home equity	101	(38	)	—	17	80
Other consumer	1,373	278	(170	)	104	1,585
Total	\$11,894	\$1,322	\$ (170	)	\$ 148	\$13,194

Six Months Ended June 30, 2017					
Allowance for loan losses:	Balance, Beginning of Period	Provision (Credit) Charged to Expense	Losses Charged Off	Recoveries	Balance, End of Period
Commercial and industrial	\$1,352	\$ 132	\$ —	\$ 69	\$1,553
Owner-occupied commercial real estate	582	134	—	—	716
Investor commercial real estate	168	(59)	—	—	109
Construction	544	(149)	—	—	395
Single tenant lease financing	6,248	1,155	—	—	7,403
Public finance	—	362	—	—	362
Residential mortgage	754	235	—	2	991
Home equity	102	(42)	—	20	80
Other consumer	1,231	589	(393)	158	1,585
Total	\$10,981	\$ 2,357	\$ (393)	\$ 249	\$13,194

Three Months Ended June 30, 2016					
Allowance for loan losses:	Balance, Beginning of Period	Provision (Credit) Charged to Expense	Losses Charged Off	Recoveries	Balance, End of Period
Commercial and industrial	\$1,383	\$ 451	\$ —	\$ —	\$1,834
Owner-occupied commercial real estate	475	(14)	—	—	461
Investor commercial real estate	197	(26)	—	—	171
Construction	563	(8)	—	—	555
Single tenant lease financing	4,678	381	—	—	5,059
Residential mortgage	871	42	(134)	2	781
Home equity	120	30	(33)	4	121
Other consumer	933	68	(65)	98	1,034
Total	\$9,220	\$ 924	\$ (232)	\$ 104	\$10,016

Six Months Ended June 30, 2016					
Allowance for loan losses:	Balance, Beginning of Period	Provision (Credit) Charged to Expense	Losses Charged Off	Recoveries	Balance, End of Period
Commercial and industrial	\$1,367	\$ 467	\$ —	\$ —	\$1,834
Owner-occupied commercial real estate	476	(15)	—	—	461
Investor commercial real estate	212	(41)	—	—	171
Construction	500	55	—	—	555
Single tenant lease financing	3,931	1,128	—	—	5,059
Residential mortgage	896	(8)	(134)	27	781
Home equity	125	23	(33)	6	121
Other consumer	844	261	(214)	143	1,034
Total	\$8,351	\$ 1,870	\$ (381)	\$ 176	\$10,016

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2017, and December 31, 2016.

	Loans			Allowance for Loan Losses		
	Ending Balance:	Ending Balance:	Ending Balance:	Ending Balance:	Ending Balance:	Ending Balance:
June 30, 2017	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Ending Balance	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Ending Balance
Commercial and industrial	\$108,530	\$ 1,849	\$110,379	\$1,508	\$ 45	\$1,553
Owner-occupied commercial real estate	66,952	—	66,952	716	—	716
Investor commercial real estate	10,062	—	10,062	109	—	109
Construction	45,931	—	45,931	395	—	395
Single tenant lease financing	747,790	—	747,790	7,403	—	7,403
Public finance	179,873	—	179,873	362	—	362
Residential mortgage	291,363	1,634	292,997	991	—	991
Home equity	33,312	—	33,312	80	—	80
Other consumer	208,510	92	208,602	1,585	—	1,585
Total	\$1,692,323	\$ 3,575	\$1,695,898	\$13,149	\$ 45	\$13,194
December 31, 2016	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Ending Balance	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Ending Balance
Commercial and industrial	\$102,437	\$ —	\$102,437	\$1,352	\$ —	\$1,352
Owner-occupied commercial real estate	57,668	—	57,668	582	—	582
Investor commercial real estate	13,181	—	13,181	168	—	168
Construction	53,291	—	53,291	544	—	544
Single tenant lease financing	606,568	—	606,568	6,248	—	6,248
Residential mortgage	203,842	1,712	205,554	754	—	754
Home equity	35,036	—	35,036	102	—	102
Other consumer	173,321	128	173,449	1,231	—	1,231
Total	\$1,245,344	\$ 1,840	\$1,247,184	\$10,981	\$ —	\$10,981

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. A description of the general characteristics of the risk grades is as follows:

•“Pass” - Higher quality loans that do not fit any of the other categories described below.

•“Special Mention” - Loans that possess some credit deficiency or potential weakness, which deserves close attention.

•“Substandard” - Loans that possess a defined weakness or weaknesses that jeopardize the liquidation of the debt. Loans characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

•Loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any.

•

“Doubtful” - Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event that lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.

“Loss” - Loans that are considered uncollectible and of such little value that continuing to carry them as assets is not warranted.

Nonaccrual Loans

Any loan which becomes 90 days delinquent or for which the full collection of principal and interest may be in doubt will be considered for nonaccrual status. At the time a loan is placed on nonaccrual status, all accrued but unpaid interest will be reversed from interest income. Placing the loan on nonaccrual status does not relieve the borrower of the obligation to repay interest. A loan placed on nonaccrual status may be restored to accrual status when all delinquent principal and interest has been brought current, and the Company expects full payment of the remaining contractual principal and interest.

The following tables present the credit risk profile of the Company’s commercial and consumer loan portfolios based on rating category and payment activity as of June 30, 2017 and December 31, 2016.

	June 30, 2017			
	Pass	Special Mention	Substandard	Total
Commercial and industrial	\$98,311	\$ 10,200	\$ 1,868	\$ 110,379
Owner-occupied commercial real estate	62,517	4,426	9	66,952
Investor commercial real estate	10,062	—	—	10,062
Construction	45,931	—	—	45,931
Single tenant lease financing	741,835	5,955	—	747,790
Public finance	179,873	—	—	179,873
Total commercial loans	\$1,138,529	\$ 20,581	\$ 1,877	\$ 1,160,987

	June 30, 2017		
	Performing	Nonaccrual	Total
Residential mortgage	\$291,788	\$ 1,209	\$292,997
Home equity	33,312	—	33,312
Other consumer	208,573	29	208,602
Total consumer loans	\$533,673	\$ 1,238	\$534,911

	December 31, 2016			
	Pass	Special Mention	Substandard	Total
Commercial and industrial	\$99,200	\$ 2,746	\$ 491	\$102,437
Owner-occupied commercial real estate	57,657	—	11	57,668
Investor commercial real estate	13,181	—	—	13,181
Construction	53,291	—	—	53,291
Single tenant lease financing	605,190	1,378	—	606,568
Total commercial loans	\$828,519	\$ 4,124	\$ 502	\$833,145

	December 31, 2016		
	Performing	Nonaccrual	Total
Residential mortgage	\$204,530	\$ 1,024	\$205,554
Home equity	35,036	—	35,036
Other consumer	173,390	59	173,449
Total consumer loans	\$412,956	\$ 1,083	\$414,039

Edgar Filing: First Internet Bancorp - Form 10-Q

The following tables present the Company's loan portfolio delinquency analysis as of June 30, 2017 and December 31, 2016.

	June 30, 2017					Total Commercial and Consumer Loans	Non- accrual Loans	Total Loans 90 Days or More Past Due and Accruing
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current			
Commercial and industrial	\$228	\$ 13	\$ 88	\$ 329	\$110,050	\$110,379	\$1,850	\$ —
Owner-occupied commercial real estate	—	—	—	—	66,952	66,952	—	—
Investor commercial real estate	—	—	—	—	10,062	10,062	—	—
Construction	—	—	—	—	45,931	45,931	—	—
Single tenant lease financing	—	—	—	—	747,790	747,790	—	—
Public finance	—	—	—	—	179,873	179,873	—	—
Residential mortgage	—	—	1,518	1,518	291,479	292,997	1,209	341
Home equity	—	—	—	—	33,312	33,312	—	—
Other consumer	109	54	9	172	208,430	208,602	29	9
Total	\$337	\$ 67	\$ 1,615	\$ 2,019	\$1,693,879	\$1,695,898	\$3,088	\$ 350
	December 31, 2016					Total Commercial and Consumer Loans	Non- accrual Loans	Total Loans 90 Days or More Past Due and Accruing
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current			
Commercial and industrial	\$27	\$ —	\$ —	\$ 27	\$102,410	\$102,437	\$—	\$ —
Owner-occupied commercial real estate	—	—	—	—	57,668	57,668	—	—
Investor commercial real estate	—	—	—	—	13,181	13,181	—	—
Construction	—	—	—	—	53,291	53,291	—	—
Single tenant lease financing	—	—	—	—	606,568	606,568	—	—
Residential mortgage	—	347	991	1,338	204,216	205,554	1,024	—
Home equity	—	—	—	—	35,036	35,036	—	—
Other consumer	173	91	25	289	173,160	173,449	59	—
Total	\$200	\$ 438	\$ 1,016	\$ 1,654	\$1,245,530	\$1,247,184	\$1,083	\$ —

Impaired Loans

A loan is designated as impaired, in accordance with the impairment accounting guidance, when, based on current information or events, it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Payments with delays generally not exceeding 90 days outstanding are not considered impaired. Certain nonaccrual and substantially all delinquent loans more than 90 days past due may be considered to be impaired. Generally, loans are placed on nonaccrual status at 90 days past due and accrued interest is reversed against earnings, unless the loan is well-secured and in the process of collection. The accrual of interest on impaired and nonaccrual loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due.

Impaired loans include nonperforming loans as well as loans modified in TDRs where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance, or other actions intended to maximize collection.

ASC Topic 310, Receivables, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the underlying collateral, less costs to sell, and allows existing methods for recognizing interest income.

The following table presents the Company's impaired loans as of June 30, 2017 and December 31, 2016.

	June 30, 2017			December 31, 2016		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance						
Commercial and industrial	\$ 1,769	\$ 1,769	\$ —	\$ —	\$ —	\$ —
Residential mortgage	1,634	1,745	—	1,712	1,824	—
Other consumer	92	123	—	128	184	—
Total	3,495	3,637	—	1,840	2,008	—
Loans with a specific valuation allowance						
Commercial and industrial	80	80	45	—	—	—
Total	80	80	45	—	—	—
Total impaired loans	\$ 3,575	\$ 3,717	\$ 45	\$ 1,840	\$ 2,008	\$ —

The table below presents average balances and interest income recognized for impaired loans during the three and six months ended June 30, 2017 and June 30, 2016.

	Three Months Ended June 30, 2017		Six Months Ended		Three Months Ended June 30, 2016		Six Months Ended	
	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income
Loans without a specific valuation allowance								
Commercial and industrial	\$ 1,996	\$ —	\$ 1,265	\$ —	\$ —	\$ —	\$ —	\$ —
Residential mortgage	1,636	—	1,664	—	1,489	1	1,278	4
Other consumer	105	—	123	—	138	2	147	4
Total	3,737	—	3,052	—	1,627	3	1,425	8
Loans with a specific valuation allowance								
Commercial and industrial	61	—	\$ 44	\$ —	\$ 1,179	—	\$ 590	\$ —
Total	61	—	44	—	1,179	—	590	—
Total impaired loans	\$ 3,798	\$ —	\$ 3,096	\$ —	\$ 2,806	\$ 3	\$ 2,015	\$ 8

The Company had no residential mortgage other real estate owned as of June 30, 2017 and had less than \$0.1 million in residential mortgage other real estate owned as of December 31, 2016. There were \$1.0 million of loans at June 30, 2017 and December 31, 2016, in the process of foreclosure.

Troubled Debt Restructurings ("TDRs")

The loan portfolio includes TDRs, which are loans that have been modified to grant economic concessions to borrowers who have experienced financial difficulties. These concessions typically result from loss mitigation efforts and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally not less than six consecutive months.

When loans are modified in a TDR, any possible impairment similar to other impaired loans is evaluated based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or using the current fair value of the collateral, less selling costs for collateral dependent loans. If it is determined that

the value of the modified loan is less than the recorded balance of the loan, impairment is recognized through a specific allowance or charge-off to the allowance. In periods subsequent to modification, all TDRs, including those that have payment defaults, are evaluated for possible impairment, and impairment is recognized through the allowance.

In the course of working with troubled borrowers, the Company may choose to restructure the contractual terms of certain loans in an effort to work out an alternative payment schedule with the borrower in order to optimize the collectability of the loan. Any loan modification is reviewed by the Company to identify whether a TDR has occurred when the Company grants a concession to the borrower that it would not otherwise consider based on economic or legal reasons related to a borrower's financial difficulties. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status or the loan may be restructured to secure additional collateral and/or guarantees to support the debt, or a combination of the two.

There were two commercial and industrial loans classified as new TDRs during the three and six months ended June 30, 2017 with a pre-modification and post-modification outstanding recorded investment of \$1.8 million. The Company did not allocate a specific allowance for those loans as of June 30, 2017, nor has it committed to lend additional amounts. The 2017 modifications consisted of maturity date amendments and certain other term modifications. There were no loans classified as new TDRs during the three and six months ended June 30, 2016.

Note 5: Premises and Equipment

The following table summarizes premises and equipment at June 30, 2017 and December 31, 2016.

	June 30, December 31,	
	2017	2016
Land	\$2,500	\$ 2,500
Building and improvements	5,666	5,441
Furniture and equipment	7,223	7,079
Less: accumulated depreciation	(5,722)	(4,976)
Total	\$9,667	\$ 10,044

Note 6: Goodwill

As of June 30, 2017 and December 31, 2016, the carrying amount of goodwill was \$4.7 million. There have been no changes in the carrying amount of goodwill for the periods ended June 30, 2017 and December 31, 2016. Goodwill is tested for impairment on an annual basis as of August 31, or whenever events or changes in circumstances indicate the carrying amount of goodwill exceeds its implied fair value. No events or changes in circumstances have occurred since the August 31, 2016 annual impairment test that would suggest it was more likely than not goodwill impairment existed.

Note 7: Subordinated Debt

In June 2013, the Company issued a subordinated debenture (the "2021 Debenture") in the principal amount of \$3.0 million. The 2021 Debenture bears a fixed interest rate of 8.00% per year, payable quarterly, and is scheduled to mature on June 28, 2021. The 2021 Debenture may be repaid, without penalty, at any time after June 28, 2016. The 2021 Debenture is intended to qualify as Tier 2 capital under regulatory guidelines.

In connection with the 2021 Debenture, the Company also issued a warrant to purchase up to 48,750 shares of common stock at an initial per share exercise price equal to \$19.33. The warrant became exercisable on June 28, 2014. On May 4, 2017, the Company issued a net amount of 15,915 shares of our common stock pursuant to an exercise by the holder of a warrant to purchase 48,750 shares of our common stock at a price of \$19.33 per share. The holder satisfied the exercise price by instructing the Company to withhold 32,835 of the shares of common stock in accordance with the warrant's cashless exercise feature.

In October 2015, the Company entered into a term loan in the principal amount of \$10.0 million, evidenced by a term note due 2025 (the “2025 Note”). The 2025 Note bears a fixed interest rate of 6.4375% per year, payable quarterly, and is scheduled to mature on October 1, 2025. The 2025 Note is an unsecured subordinated obligation of the Company and may be repaid, without penalty, on any interest payment date on or after October 15, 2020. The 2025 Note is intended to qualify as Tier 2 capital under regulatory guidelines.

In September 2016, the Company issued \$25.0 million aggregate principal amount of 6.0% Fixed-to-Floating Rate Subordinated Notes due 2026 (the “2026 Notes”) in a public offering. The 2026 Notes initially bear a fixed interest rate of 6.00% per year to, but excluding September 30, 2021, and thereafter a floating rate equal to the then-current three-month LIBOR rate plus 485 basis points. All interest on the 2026 Notes is payable quarterly. The 2026 Notes are scheduled to mature on September 30, 2026. The 2026 Notes are unsecured subordinated obligations of the Company and may be repaid, without penalty, on any interest payment date on or after September 30, 2021. The 2026 Notes are intended to qualify as Tier 2 capital under regulatory guidelines.

The following table presents the principal balance and unamortized discount and debt issuance costs for the 2021 Debenture, the 2025 Note and the 2026 Notes as of June 30, 2017 and December 31, 2016.

	June 30, 2017		December 31, 2016	
	Unamortized Discount		Unamortized Discount	
	Principal and Debt Issuance Costs		Principal and Debt Issuance Costs	
2021 Debenture	\$3,000	\$ —	\$3,000	\$ —
2025 Note	10,000	(198)	10,000	(210)
2026 Notes	25,000	(1,150)	25,000	(1,212)
Total	\$38,000	\$ (1,348)	\$38,000	\$ (1,422)

Note 8: Benefit Plans

Employment Agreement

The Company has entered into an employment agreement with its Chief Executive Officer that provides for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreement, these payments could occur in the event of a change in control of the Company, as defined in the agreement, along with other specific conditions.

2013 Equity Incentive Plan

The 2013 Equity Incentive Plan (the “2013 Plan”) authorizes the issuance of 750,000 shares of the Company’s common stock in the form of equity-based awards to employees, directors, and other eligible persons. Under the terms of the 2013 Plan, the pool of shares available for issuance may be used for available types of equity awards under the 2013 Plan, which includes stock options, stock appreciation rights, restricted stock awards, stock unit awards, and other share-based awards. All employees, consultants, and advisors of the Company or any subsidiary, as well as all non-employee directors of the Company, are eligible to receive awards under the 2013 Plan.

The Company recorded \$0.2 million and \$0.5 million of share-based compensation expense for the three and six months ended June 30, 2017, respectively, related to awards made under the 2013 Plan. The Company recorded \$0.2 million and \$0.4 million of share-based compensation expense for the three and six months ended June 30, 2016, respectively, related to awards made under the 2013 Plan.

The following table summarizes the status of the 2013 Plan awards as of June 30, 2017, and activity for the six months ended June 30, 2017.

Restricted Stock Units	Weighted-Average Grant Date Fair Value Per Share	Restricted Stock Awards	Weighted-Average Grant Date Fair Value Per Share	Deferred Stock Units	Weighted-Average Grant Date Fair Value Per Share
------------------------------	--	-------------------------------	--	----------------------------	--

Edgar Filing: First Internet Bancorp - Form 10-Q

Nonvested at December 31, 2016	49,781	\$ 23.07	16,330	\$ 19.06	—	\$	—
Granted	42,542	30.99	5,628	31.00	4	29.03	
Vested	(19,835)	22.43	(15,817)	20.06	(4)	29.03	
Nonvested at June 30, 2017	72,488	\$ 27.89	6,141	\$ 27.44	—	\$	—

At June 30, 2017, the total unrecognized compensation cost related to nonvested awards was \$1.8 million with a weighted-average expense recognition period of 2.2 years.

Directors Deferred Stock Plan

Until January 1, 2014, the Company had a stock compensation plan for members of the Board of Directors (“Directors Deferred Stock Plan”). The Company reserved 180,000 shares of common stock that could have been issued pursuant to the Directors Deferred Stock Plan. The plan provided directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Deferred stock rights were to be settled in common stock following the end of the deferral period payable on the basis of one share of common stock for each deferred stock right.

The following table summarizes the status of deferred stock rights related to the Directors Deferred Stock Plan for the six months ended June 30, 2017.

	Deferred Stock Rights
Outstanding, beginning of period	82,377
Granted	310
Exercised	—
Outstanding, end of period	82,687

All deferred stock rights granted during the 2017 period were additional rights issued in lieu of cash dividends payable on outstanding deferred stock rights.

Note 9: Fair Value of Financial Instruments

ASC Topic 820, Fair Value Measurement, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

Level 2 securities include U.S. Government-sponsored agencies, municipal securities, mortgage and asset-backed securities and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but also on the investment securities' relationship to other benchmark quoted investment securities.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation. The Company did not own any securities classified within Level 3 of the hierarchy as of June 30, 2017 or December 31, 2016.

Loans Held-for-Sale (mandatory pricing agreements)

The fair value of loans held-for-sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

Forward Contracts

The fair values of forward contracts on to-be-announced securities are determined using quoted prices in active markets, or benchmarked thereto (Level 1).

Interest Rate Lock Commitments

The fair values of interest rate lock commitments (“IRLCs”) are determined using the projected sale price of individual loans based on changes in market interest rates, projected pull-through rates (the probability that an IRLC will ultimately result in an originated loan), the reduction in the value of the applicant’s option due to the passage of time, and the remaining origination costs to be incurred based on management’s estimate of market costs (Level 3).

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2017 and December 31, 2016.

June 30, 2017				
Fair Value Measurements Using				
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government-sponsored agencies	\$ 129,682	\$ —	\$ 129,682	\$ —
Municipal securities	95,071	—	95,071	—
Mortgage-backed securities	226,114	—	226,114	—
Asset-backed securities	10,000	—	10,000	—
Corporate securities	25,960	—	25,960	—
Other securities	2,948	2,948	—	—
Total available-for-sale securities	489,775	2,948	486,827	—
Loans held-for-sale (mandatory pricing agreements)	16,996	—	16,996	—
Forward contracts	219	219	—	—
IRLCs	652	—	—	652
December 31, 2016				
Fair Value Measurements Using				
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government-sponsored agencies	\$ 91,896	\$ —	\$ 91,896	\$ —
Municipal securities	91,886	—	91,886	—
Mortgage-backed securities	231,641	—	231,641	—

Edgar Filing: First Internet Bancorp - Form 10-Q

Asset-backed securities	19,534	—	19,534	—
Corporate securities	18,811	—	18,811	—
Other securities	2,932	2,932	—	—
Total available-for-sale securities	456,700	2,932	453,768	—
Loans held-for-sale (mandatory pricing agreements)	27,101	—	27,101	—
Forward contracts	438	438	—	—
IRLCs	610	—	—	610

The following tables reconcile the beginning and ending balances of recurring fair value measurements recognized in the accompanying condensed consolidated balance sheets using significant unobservable (Level 3) inputs for the three and six months ended June 30, 2017 and June 30, 2016.

	Three Months Ended Interest Rate Lock Commitments
Balance, April 1, 2017	\$ 645
Total realized gains	
Included in net income	7
Balance, June 30, 2017	\$ 652
Balance, April 1, 2016	\$ 1,283
Total realized gains	
Included in net income	441
Balance, June 30, 2016	\$ 1,724

	Six Months Ended Interest Rate Lock Commitments
Balance, January 1, 2017	\$ 610
Total realized gains	
Included in net income	42
Included in other comprehensive income (loss)	—
Balance, June 30, 2017	\$ 652
Balance, January 1, 2016	\$ 582
Total realized gains	
Included in net income	1,142
Included in other comprehensive income (loss)	—
Balance, June 30, 2016	\$ 1,724

The following describes valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. The amount of the impairment may be determined based on the fair value of the underlying collateral, less costs to sell, the estimated present value of future cash flows or the loan's observable market price.

If the impaired loan is identified as collateral dependent, the fair value of the underlying collateral, less costs to sell, is used to measure impairment. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. If the impaired loan is not collateral dependent, the Company utilizes a discounted cash flow analysis to measure impairment.

Impaired loans with a specific valuation allowance based on the value of the underlying collateral or a discounted cash flow analysis are classified as Level 3 assets.

There were no impaired loans that were measured at fair value on a nonrecurring basis at June 30, 2017 or December 31, 2016.

Significant Unobservable (Level 3) Inputs

The following tables present quantitative information about significant unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

	Fair Value at June 30, 2017	Valuation Technique	Significant Unobservable Inputs	Range
IRLCs	\$ 652	Discounted cash flow	Loan closing rates	42% - 99%
	Fair Value at December 31, 2016	Valuation Technique	Significant Unobservable Inputs	Range
IRLCs	\$ 610	Discounted cash flow	Loan closing rates	43% - 99%

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying condensed consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Interest-Bearing Time Deposits

The fair value of these financial instruments approximates carrying value.

Securities Held-to-Maturity

Fair values are determined by using models that are based on security-specific details, as well as relevant industry and economic factors. The most significant of these inputs are quoted market prices, and interest rate spreads on relevant benchmark securities.

Loans Held-for-Sale (best efforts pricing agreements)

The fair value of these loans approximates carrying value.

Loans

The fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank of Indianapolis Stock

The fair value approximates carrying value.

Deposits

The fair value of noninterest-bearing and interest-bearing demand deposits, savings and money market accounts approximates carrying value. The fair value of fixed maturity certificates of deposit and brokered deposits are estimated using rates currently offered for deposits of similar remaining maturities.

Advances from Federal Home Loan Bank

The fair value of fixed rate advances is estimated using rates currently available for advances with similar remaining maturities. The carrying value of variable rate advances approximates fair value.

Subordinated Debt

The fair value of the Company's publicly traded subordinated debt is obtained from quoted market prices. The fair value of the Company's remaining subordinated debt is estimated using discounted cash flow analysis, based on current borrowing rates for similar types of debt instruments.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at each of June 30, 2017 and December 31, 2016.

The following tables present the carrying value and estimated fair value of all financial assets and liabilities at June 30, 2017 and December 31, 2016.

	June 30, 2017		Fair Value Measurements Using			
	Carrying Amount	Fair Value	Quoted Prices In Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$66,243	\$ 66,243	\$66,243	\$ —	\$ —	
Securities held-to-maturity	19,215	19,004	—	19,004	—	
Loans held-for-sale (best efforts pricing agreements)	10,339	10,339	—	10,339	—	
Net loans	1,685,227	1,688,719	—	—	1,688,719	
Accrued interest receivable	8,479	8,479	8,479	—	—	
Federal Home Loan Bank of Indianapolis stock	19,575	19,575	—	19,575	—	
Deposits	1,732,112	1,711,020	553,350	—	1,157,670	
Advances from Federal Home Loan Bank	435,183	424,079	—	424,079	—	
Subordinated debt	36,652	39,759	26,270	13,489	—	
Accrued interest payable	210	210	210	—	—	
	December 31, 2016		Fair Value Measurements Using			
	Carrying Amount	Fair Value	Quoted Prices In Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	

Edgar Filing: First Internet Bancorp - Form 10-Q

			Assets (Level 1)			
Cash and cash equivalents	\$39,452	\$ 39,452	\$39,452	\$	—\$	—
Interest-bearing time deposits	250	250	250	—	—	—
Securities held-to-maturity	16,671	16,197	—	16,197	—	—
Net loans	1,239,808	1,233,937	—	—	1,233,937	—
Accrued interest receivable	6,708	6,708	6,708	—	—	—
Federal Home Loan Bank of Indianapolis stock	8,910	8,910	—	8,910	—	—
Deposits	1,462,867	1,441,794	492,435	—	949,359	—
Advances from Federal Home Loan Bank	189,981	186,258	—	186,258	—	—
Subordinated debt	36,578	38,425	24,900	13,525	—	—
Accrued interest payable	112	112	112	—	—	—

Note 10: Mortgage Banking Activities

The Company's residential real estate lending business originates mortgage loans for customers and typically sells a majority of the originated loans into the secondary market. For most of the mortgages it sells in the secondary market, the Company hedges its mortgage banking pipeline by entering into forward contracts for the future delivery of mortgage loans to third party investors and entering into IRLCs with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. To facilitate the hedging of the loans, the Company has elected the fair value option for loans originated and intended for sale in the secondary market under mandatory pricing agreements. Changes in the fair value of loans held-for-sale, IRLCs and forward contracts are recorded in the mortgage banking activities line item within noninterest income. Refer to Note 11 for further information on derivative financial instruments.

During the three months ended June 30, 2017 and 2016, the Company originated mortgage loans held-for-sale of \$109.0 million and \$151.1 million, respectively, and sold \$96.6 million and \$139.6 million of mortgage loans, respectively, into the secondary market. During the six months ended June 30, 2017 and 2016, the Company originated mortgage loans held-for-sale of \$195.1 million and \$259.1 million, respectively, and sold \$198.8 million and \$256.6 million of mortgage loans, respectively, into the secondary market.

The following table presents the components of income from mortgage banking activities for the three and six months ended June 30, 2017 and 2016.

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Gain on loans sold	\$1,586	\$2,896	\$3,423	\$4,496
Gain resulting from the change in fair value of loans held-for-sale	152	632	525	986
Gain (loss) resulting from the change in fair value of derivatives	417	(233)	(177)	67
Net revenue from mortgage banking activities	\$2,155	\$3,295	\$3,771	\$5,549

Fluctuations in interest rates and changes in IRLC and loan volume within the mortgage banking pipeline may cause volatility in the fair value of loans held-for-sale and the fair value of derivatives used to hedge the mortgage banking pipeline.

Note 11: Derivative Financial Instruments

The Company uses derivative financial instruments to help manage exposure to interest rate risk and the effects that changes in interest rates may have on net income and the fair value of assets and liabilities. The Company enters into forward contracts for the future delivery of mortgage loans to third party investors and enters into IRLCs with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. The forward contracts are entered into in order to economically hedge the effect of changes in interest rates resulting from the Company's commitment to fund the loans.

Each of these items are considered derivatives, but are not designated as accounting hedges, and are recorded at fair value with changes in fair value reflected in noninterest income on the condensed consolidated statements of income. The fair value of derivative instruments with a positive fair value are reported in accrued income and other assets in the condensed consolidated balance sheets while derivative instruments with a negative fair value are reported in accrued expenses and other liabilities in the condensed consolidated balance sheets.

The following table presents the notional amount and fair value of IRLCs and forward contracts utilized by the Company at June 30, 2017 and December 31, 2016.

Edgar Filing: First Internet Bancorp - Form 10-Q

	June 30, 2017		December 31, 2016	
	Notional Fair		Notional Fair	
	Amount	Value	Amount	Value
Asset Derivatives				
Derivatives not designated as hedging instruments				
IRLCs	\$43,986	\$ 652	\$36,311	\$ 610
Forward contracts	63,000	219	61,000	438

Fair values of derivative financial instruments were estimated using changes in mortgage interest rates from the date the Company entered into the IRLC and the balance sheet date. The following table summarizes the periodic changes in the fair value of the derivative financial instruments on the condensed consolidated statements of income for the three and six months ended June 30, 2017 and 2016.

	Amount of gain / (loss) recognized in the three months ended June 30, 2017		Amount of gain / (loss) recognized in the six months ended June 30, 2016	
Asset Derivatives				
Derivatives not designated as hedging instruments				
IRLCs	\$ 7	\$ 441	\$42	\$1,142
Forward contracts	410	—	(219)	—
Liability Derivatives				
Derivatives not designated as hedging instruments				
Forward contracts	\$ —	\$ (674)	\$—	\$(1,075)

Note 12: Recent Accounting Pronouncements

Accounting Standards Update (“Update”) 2014-09, Revenue from Contracts with Customers (Topic 606) (May 2014)

The amendments in this Update clarify the principles for recognizing revenue and develop a common revenue standard among industries. 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. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The entity should apply the amendments using one of two retrospective methods described in the amendment. Accounting Standard Update 2015-14, Revenue from Contracts with Customers (Topic 606) delayed the effective date for public entities to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Several subsequent amendments have been issued that provide clarifying guidance and are effective with the adoption of the original Update. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The guidance does not apply to revenues associated with financial instruments, including loans and investment securities. The Company does not expect the guidance to have a material impact on the Company's condensed consolidated financial statements, as the Company's most significant sources of revenue are excluded from the scope of Topic 606.

Accounting Standards Update 2016-02, Leases (Topic 842) (February 2016)

In February 2016, the FASB amended its standards with respect to the accounting for leases. The amended standard serves to replace all current GAAP guidance on this topic and requires that an operating lease be recognized by the lessee on the balance sheet as a “right-of-use” asset along with a corresponding liability representing the rent obligation. Key aspects of current lessor accounting remain unchanged from existing guidance. This standard is expected to result in an increase to assets and liabilities recognized and, therefore, increase risk-weighted assets for regulatory capital

purposes. The amended standard requires the use of the modified retrospective transition approach for existing leases that have not expired before the date of initial application and will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Earlier adoption of the amended standard is permitted. The Company does not expect to early adopt and is currently in the process of fully evaluating the amendments on the condensed consolidated financial statements and will subsequently implement updated processes and accounting policies as deemed necessary. The overall impact of the new standard on the Company's financial condition, results of operations and regulatory capital is not yet determinable.

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (June 2016)

The main objective of this Update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this Update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.

The amendments affect entities holding financial assets that are not accounted for at fair value through net income. The amendments affect loans, debt securities, off-balance-sheet credit exposures, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this Update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. There is diversity in practice in applying the incurred loss methodology, which means that before transition some entities may be more aligned, under current GAAP than others to the new measure of expected credit losses. The following describes the main provisions of this Update.

- **Assets Measured at Amortized Cost:** The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances.

- **Available-for-Sale Debt Securities:** Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. Available-for-sale accounting recognizes that value may be realized either through collection of contractual cash flows or through sale of the security. Therefore, the amendments limit the amount of the allowance for credit losses to the amount by which fair value is below amortized cost because the classification as available-for-sale is premised on an investment strategy that recognizes that the investment could be sold at fair value, if cash collection would result in the realization of an amount less than fair value.

For public business entities that are SEC filers, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The effect of a prospective transition approach is to maintain the same amortized cost basis before and after the effective date of this Update.

The Company does not expect to early adopt and is currently evaluating the impact of the amendments on the Company's consolidated financial statements and cannot determine or reasonably quantify the impact of the adoption of the amendments due to the complexity and extensive changes. The Company intends to develop processes and procedures during the next two years to ensure it is fully compliant with the amendments at adoption date. The Company has formed an implementation committee and has begun evaluating the data needed for implementation as well as considering appropriate methodologies.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this report. This discussion and analysis includes certain forward-looking statements that involve risks, uncertainties, and assumptions. You should review the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2016 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by such forward-looking statements. See also "Cautionary Note Regarding Forward-Looking Statements" at the beginning of this report.

Overview

First Internet Bancorp ("we," "our," "us," or the "Company") is a bank holding company that conducts its business activities through its wholly-owned subsidiary, First Internet Bank of Indiana, an Indiana chartered bank (the "Bank"). The Bank was the first state-chartered, Federal Deposit Insurance Corporation ("FDIC") insured Internet bank and commenced banking operations in 1999. The Company was incorporated under the laws of the State of Indiana on September 15, 2005. On March 21, 2006, we consummated a plan of exchange by which we acquired all of the outstanding shares of the Bank.

We offer a wide range of commercial, small business, consumer and municipal banking products and services. We conduct our consumer and small business deposit operations primarily through online channels on a nationwide basis and have no traditional branch offices. Our residential mortgage products are offered nationwide primarily through an online direct-to-consumer platform and are supplemented with Central Indiana-based mortgage and construction lending. Our consumer lending products are primarily originated on a nationwide basis over the Internet as well as through relationships with dealerships and financing partners.

Our commercial banking products and services are delivered through a relationship banking model and include commercial real estate ("CRE") banking, commercial and industrial ("C&I") banking and public finance. Through our CRE team, we offer single tenant lease financing on a nationwide basis in addition to traditional investor commercial real estate and construction loans primarily within Central Indiana and adjacent markets. To meet the needs of commercial borrowers and depositors located primarily in Central Indiana, Phoenix, Arizona and adjacent markets, our C&I banking team provides credit solutions such as lines of credit, term loans, owner-occupied commercial real estate loans and corporate credit cards as well as treasury management services. Our public finance team, established in early 2017, provides a range of public and municipal lending and leasing products to government entities on a nationwide basis.

Results of Operations

The following table presents a summary of the Company's financial performance for the five most recent quarters and the six months ended June 30, 2017 and 2016.

(dollars in thousands except for per share data)	Three Months Ended					Six Months Ended		
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016	
Income Statement Summary:								
Net interest income	\$12,974	\$11,457	\$ 10,904	\$ 10,338	\$9,306	\$24,431	\$18,447	
Provision for loan losses	1,322	1,035	256	2,204	924	2,357	1,870	
Noninterest income	2,736	2,131	2,891	4,898	3,748	4,867	6,288	
Noninterest expense	8,923	8,698	8,158	8,413	7,875	17,621	14,880	
Income tax provision	1,464	1,023	1,671	1,521	1,421	2,487	2,719	
Net income	\$4,001	\$2,832	\$ 3,710	\$ 3,098	\$2,834	\$6,833	\$5,266	
Per Share Data:								
Earnings per share - basic	\$0.61	\$0.43	\$ 0.65	\$ 0.55	\$0.57	\$1.04	\$1.11	
Earnings per share - diluted	\$0.61	\$0.43	\$ 0.64	\$ 0.55	\$0.57	\$1.04	\$1.10	
Dividends declared per share	\$0.06	\$0.06	\$ 0.06	\$ 0.06	\$0.06	\$0.12	\$0.12	
Book value per common share	\$25.15	\$24.24	\$ 23.76	\$ 24.79	\$24.52	\$25.15	\$24.52	
Tangible book value per common share ¹	\$24.43	\$23.52	\$ 23.04	\$ 23.94	\$23.67	\$24.43	\$23.67	
Common shares outstanding	6,513,577	6,497,662	6,478,050	5,533,050	5,533,050	6,513,577	5,533,050	
Average common shares outstanding:								
Basic	6,583,515	6,547,807	5,722,615	5,597,867	4,972,759	6,565,760	4,757,243	
Diluted	6,597,991	6,602,200	5,761,931	5,622,181	4,992,025	6,599,681	4,782,700	
Performance Ratios:								
Return on average assets	0.73	% 0.60	% 0.81	% 0.71	% 0.71	% 0.67	% 0.72	%
Return on average shareholders' equity	9.95	% 7.42	% 10.85	% 9.08	% 9.67	% 8.72	% 9.45	%
Return on average tangible common equity ¹	10.25	% 7.65	% 11.24	% 9.41	% 10.07	% 8.99	% 9.86	%
Net interest margin	2.43	% 2.50	% 2.42	% 2.42	% 2.39	% 2.46	% 2.57	%
Net interest margin - FTE ^{1,2}	2.53	% 2.57	% 2.48	% 2.47	% 2.43	% 2.55	% 2.60	%
Capital Ratios:								
Total shareholders' equity to assets	6.88	% 7.67	% 8.30	% 7.52	% 7.97	% 6.88	% 7.97	%
Tangible common equity to tangible assets ratio ¹	6.70	% 7.46	% 8.07	% 7.28	% 7.72	% 6.70	% 7.72	%
Tier 1 leverage ratio	7.50	% 8.41	% 8.65	% 7.62	% 8.08	% 7.50	% 8.08	%
Common equity tier 1 capital ratio	9.74	% 10.88	% 11.54	% 10.07	% 10.66	% 9.74	% 10.66	%
Tier 1 capital ratio	9.74	% 10.88	% 11.54	% 10.07	% 10.66	% 9.74	% 10.66	%
Total risk-based capital ratio	12.68	% 14.16	% 15.01	% 13.67	% 12.54	% 12.68	% 12.54	%

¹ This information represents a non-GAAP financial measure. See the "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of these measures to their most directly comparable GAAP measures.

² On a fully-taxable equivalent ("FTE") basis assuming a 35% tax rate. Net interest income is adjusted to reflect income from assets such as municipal loans and securities that are exempt from Federal income taxes. This is to recognize

the income tax savings that facilitates a comparison between taxable and tax-exempt assets. The Company believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully-taxable equivalent basis as these measures provide useful information to make peer comparisons.

During the second quarter 2017, net income was \$4.0 million, or \$0.61 per diluted share, compared to second quarter 2016 net income of \$2.8 million, or \$0.57 per diluted share, representing an increase in net income of \$1.2 million, or 41.2%. During the six months ended June 30, 2017, net income was \$6.8 million, or \$1.04 per diluted share, compared to the six months ended June 30, 2016 net income of \$5.3 million, or \$1.10 per diluted share, resulting in an increase in net income of \$1.6 million, or 29.8%. The comparability of diluted earnings per share between both the second quarter 2017 and the second quarter 2016 as well as the six months ended June 30, 2017 and the six months ended June 30, 2016 is impacted by the effect on average diluted shares outstanding resulting from the Company's issuance of an aggregate of 1,980,766 shares of common stock through equity offerings completed during May and December 2016.

The increase in net income in the second quarter 2017 compared to the second quarter 2016 was primarily due to a \$3.7 million, or 39.4%, increase in net interest income, partially offset by a \$1.0 million, or 13.3%, increase in noninterest expense, a \$1.0 million, or 27.0%, decrease in noninterest income and a \$0.4 million, or 43.1%, increase in provision for loan losses.

The increase in net income in the six months ended June 30, 2017 compared to the six months ended June 30, 2016 was primarily due to a \$6.0 million, or 32.4%, increase in net interest income and a \$0.2 million, or 8.5%, decrease in income tax expense, partially offset by a \$2.7 million, or 18.4%, increase in noninterest expense, a \$1.4 million, or 22.6%, decrease in noninterest income and a \$0.5 million, or 26.0%, increase in provision for loan losses.

During the second quarter 2017, return on average assets ("ROAA") and return on average shareholders' equity ("ROAE") were 0.73% and 9.95%, respectively, compared to 0.71% and 9.67%, respectively, for the second quarter 2016. During the six months ended June 30, 2017, ROAA and ROAE were 0.67% and 8.72%, respectively, compared to 0.72% and 9.45%, respectively, for the six months ended June 30, 2016. The decline in ROAA during the six months ended was a result of the Company's growth in average assets of \$576.3 million, or 39.1%, outpacing the net income growth of 29.8%. The decline in ROAE was a result of the Company's growth in average shareholders' equity of \$45.9 million, or 41.0%, which also outpaced net income growth. The increase in average shareholders' equity was primarily due to the equity offerings completed in May and December 2016, which resulted in net proceeds of \$46.2 million of common equity. While most significant components driving the results of operations were directionally consistent with average asset growth and average shareholders' equity growth, net income growth was impacted by the decrease in noninterest income driven by lower revenue from mortgage banking activities (see Noninterest Income for further discussion of mortgage banking activities).

Edgar Filing: First Internet Bancorp - Form 10-Q

Consolidated Average Balance Sheets and Net Interest Income Analyses

For the periods presented, the following tables provide the average balances of interest-earning assets and interest-bearing liabilities and the related yields and cost of funds. The tables do not reflect any effect of income taxes except for net interest income - FTE as discussed below. Balances are based on the average of daily balances.

Nonaccrual loans are included in average loan balances.

(dollars in thousands) Three Months Ended

	June 30, 2017			March 31, 2017			June 30, 2016		
	Average Balance	Interest /Dividends	Yield /Cost	Average Balance	Interest /Dividends	Yield /Cost	Average Balance	Interest /Dividends	Yield /Cost
Assets									
Interest-earning assets									
Loans, including loans held-for-sale	\$1,570,235	\$ 16,416	4.19 %	\$1,338,694	\$ 14,156	4.29 %	\$1,110,282	\$ 11,661	4.22 %
Securities - taxable	405,380	2,566	2.54 %	381,522	2,367	2.52 %	307,336	1,747	2.29 %
Securities - non-taxable	95,436	696	2.93 %	93,323	697	3.03 %	51,162	368	2.89 %
Other earning assets	67,989	297	1.75 %	45,392	170	1.52 %	97,774	195	0.80 %
Total interest-earning assets	2,139,040	19,975	3.75 %	1,858,931	17,390	3.79 %	1,566,554	13,971	3.59 %
Allowance for loan losses	(12,372)			(11,299)			(9,472)		
Noninterest-earning assets	67,984			58,104			39,422		
Total assets	\$2,194,652			\$1,905,736			\$1,596,504		
Liabilities									
Interest-bearing liabilities									
Interest-bearing demand deposits	\$92,676	\$ 127	0.55 %	\$88,295	\$ 119	0.55 %	\$83,712	\$ 114	0.55 %
Regular savings accounts	34,545	67	0.78 %	28,333	47	0.67 %	28,023	40	0.57 %
Money market accounts	394,735	915	0.93 %	347,696	696	0.81 %	363,767	641	0.71 %
Certificates and brokered deposits	1,071,408	4,215	1.58 %	986,353	3,837	1.58 %	809,450	3,135	1.56 %
Total interest-bearing deposits	1,593,364	5,324	1.34 %	1,450,677	4,699	1.31 %	1,284,952	3,930	1.23 %
Other borrowed funds	398,044	1,677	1.69 %	262,573	1,234	1.91 %	161,127	735	1.83 %
Total interest-bearing liabilities	1,991,408	7,001	1.41 %	1,713,250	5,933	1.40 %	1,446,079	4,665	1.30 %
Noninterest-bearing deposits	32,897			31,463			27,687		
Other noninterest-bearing liabilities	9,119			6,225			4,825		
Total liabilities	2,033,424			1,750,938			1,478,591		

Edgar Filing: First Internet Bancorp - Form 10-Q

Shareholders' equity	161,228	154,798	117,913
Total liabilities and shareholders' equity	\$2,194,652	\$1,905,736	\$1,596,504
Net interest income	\$ 12,974	\$ 11,457	\$ 9,306
Interest rate spread ¹	2.34 %	2.39 %	2.29 %
Net interest margin ²	2.43 %	2.50 %	2.39 %
Net interest margin - FTE ³	2.53 %	2.57 %	2.43 %

¹ Yield on total interest-earning assets minus cost of total interest-bearing liabilities

² Net interest income divided by total average interest-earning assets (annualized)

³ On a FTE basis assuming a 35% tax rate. Net interest income is adjusted to reflect income from assets such as municipal loans and securities that are exempt from Federal income taxes. This is to recognize the income tax savings that facilitates a comparison between taxable and tax-exempt assets. The Company believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully-taxable equivalent basis as these measures provide useful information to make peer comparisons.

Edgar Filing: First Internet Bancorp - Form 10-Q

(dollars in thousands)	Six Months Ended			June 30, 2016		
	Average Balance	Interest /Dividends	Yield /Cost	Average Balance	Interest /Dividends	Yield /Cost
Assets						
Interest-earning assets						
Loans, including loans held-for-sale	\$ 1,455,104	\$ 30,572	4.24 %	\$ 1,065,225	\$ 22,850	4.31 %
Securities - taxable	393,517	4,933	2.53 %	255,116	2,916	2.30 %
Securities - non-taxable	94,385	1,393	2.98 %	36,671	533	2.92 %
Other earning assets	56,753	467	1.66 %	88,033	365	0.83 %
Total interest-earning assets	1,999,759	37,365	3.77 %	1,445,045	26,664	3.71 %
Allowance for loan losses	(11,839)			(9,063)		
Noninterest-earning assets	63,072			38,686		
Total assets	\$ 2,050,992			\$ 1,474,668		
Liabilities						
Interest-bearing liabilities						
Interest-bearing demand deposits	\$ 90,498	\$ 246	0.55 %	\$ 82,525	\$ 225	0.55 %
Regular savings accounts	31,456	114	0.73 %	26,522	76	0.58 %
Money market accounts	371,346	1,611	0.87 %	357,288	1,257	0.71 %
Certificates and brokered deposits	1,029,115	8,052	1.58 %	692,713	5,260	1.53 %
Total interest-bearing deposits	1,522,415	10,023	1.33 %	1,159,048	6,818	1.18 %
Other borrowed funds	330,683	2,911	1.78 %	173,372	1,399	1.62 %
Total interest-bearing liabilities	1,853,098	12,934	1.41 %	1,332,420	8,217	1.24 %
Noninterest-bearing deposits	32,184			25,293		
Other noninterest-bearing liabilities	7,680			4,859		
Total liabilities	1,892,962			1,362,572		
Shareholders' equity	158,030			112,096		
Total liabilities and shareholders' equity	\$ 2,050,992			\$ 1,474,668		
Net interest income		\$ 24,431			\$ 18,447	
Interest rate spread ¹			2.36 %			2.47 %
Net interest margin ²			2.46 %			2.57 %
Net interest margin - FTE ³			2.55 %			2.60 %

¹ Yield on total interest-earning assets minus cost of total interest-bearing liabilities

² Net interest income divided by total average interest-earning assets (annualized)

³ On a FTE basis assuming a 35% tax rate. Net interest income is adjusted to reflect income from assets such as municipal loans and securities that are exempt from Federal income taxes. This is to recognize the income tax savings that facilitates a comparison between taxable and tax-exempt assets. The Company believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully-taxable equivalent basis as these measures provide useful information to make peer comparisons.

Rate/Volume Analysis

The following table illustrates the impact of changes in the volume of interest-earning assets and interest-bearing liabilities and interest rates on net interest income for the periods indicated. The change in interest not due solely to volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each.

(dollars in thousands)	Rate/Volume Analysis of Net Interest Income								
	Three Months Ended June 30, 2017 vs. March 31, 2017 Due to Changes in			Three Months Ended June 30, 2017 vs. June 30, 2016 Due to Changes in			Six Months Ended June 30, 2017 vs. June 30, 2016 Due to Changes in		
	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
Interest income									
Loans, including loans held-for-sale	\$4,351	\$(2,091)	\$2,260	\$5,330	\$(575)	\$4,755	\$8,822	\$(1,100)	\$7,722
Securities – taxable	177	22	199	610	209	819	1,703	314	2,017
Securities – non-taxable	75	(76)	(1)	323	5	328	849	11	860
Other earning assets	97	30	127	(358)	460	102	(357)	459	102
Total	4,700	(2,115)	2,585	5,905	99	6,004	11,017	(316)	10,701
Interest expense									
Interest-bearing deposits	507	118	625	1,016	378	1,394	2,280	925	3,205
Other borrowed funds	1,307	(864)	443	1,325	(383)	942	1,364	148	1,512
Total	1,814	(746)	1,068	2,341	(5)	2,336	3,644	1,073	4,717
Increase (decrease) in net interest income	\$2,886	\$(1,369)	\$1,517	\$3,564	\$104	\$3,668	\$7,373	\$(1,389)	\$5,984

Net interest income for the second quarter 2017 was \$13.0 million, an increase of \$3.7 million, or 39.4%, compared to \$9.3 million for the second quarter 2016. The increase in net interest income was the result of a \$6.0 million, or 43.0%, increase in total interest income to \$20.0 million for the second quarter 2017 from \$14.0 million for the second quarter 2016. The increase in total interest income was partially offset by a \$2.3 million, or 50.1%, increase in total interest expense to \$7.0 million for the second quarter 2017 from \$4.7 million for the second quarter 2016.

The increase in total interest income from the second quarter 2017 compared to the second quarter 2016 was due primarily to an increase in interest earned on loans resulting from an increase of \$460.0 million, or 41.4%, in the average balance of loans, including loans held-for-sale, partially offset by a decline of 3 basis points (“bps”) in the yield on loans, including loans held-for-sale. In addition, the average balance of securities increased \$142.3 million, or 39.7%, and the yield earned on the securities portfolio increased 24 bps for the second quarter 2017 compared to the second quarter 2016.

The increase in total interest expense was driven primarily by an increase of \$308.4 million, or 24.0%, in the average balance of interest-bearing deposits for the second quarter 2017 compared to the second quarter 2016, as well as an 11 bp increase in the cost of funds related to interest-bearing deposits. The increase in the cost of interest-bearing deposits was primarily due to a \$272.3 million, 34.2%, increase in average certificates of deposits balances and a 5 bp increase in the related cost of those deposits. Interest expense related to other borrowed funds also contributed to the increase in total interest expense due to a \$236.9 million, or 147.0%, increase in the average balance of other borrowed funds for the second quarter 2017 compared to the second quarter 2016, partially offset by a decline of 14 bps in the cost of other borrowed funds. The increase in the average balance of other borrowed funds was primarily due to the average balance of Federal Home Loan Bank advances increasing \$213.1 million, or 143.6%, as the

Company used Federal Home Loan Bank advances to supplement deposit growth and to manage interest rate risk.

Net interest margin (“NIM”) was 2.43% for the second quarter 2017 compared to 2.39% for the second quarter 2016. The increase in NIM for the second quarter 2017 compared to the second quarter 2016 was driven primarily by the increase of 16 bps in the yield earned on interest-earning assets, partially offset by an increase of 11 bps in the cost of interest-bearing liabilities. On a fully-taxable equivalent basis, NIM was 2.53% for the second quarter 2017 compared to 2.43% for the second quarter 2016.

Net interest income for the six months ended June 30, 2017 was \$24.4 million, an increase of \$6.0 million, or 32.4%, compared to \$18.4 million for the six months ended June 30, 2016. The increase in net interest income was the result of a \$10.7 million, or 40.1%, increase in total interest income to \$37.4 million for the six months ended June 30, 2017 from \$26.7 million for the six months ended June 30, 2016. The increase in total interest income was partially offset by a \$4.7 million, or 57.4%, increase in total interest expense to \$12.9 million for the six months ended June 30, 2017 from \$8.2 million for the six months ended June 30, 2016.

The increase in total interest income from the six months ended June 30, 2017 compared to the six months ended June 30, 2016 was due primarily to an increase in interest earned on loans resulting from an increase of \$389.9 million, or 36.6%, in the average balance of loans, including loans held-for-sale, partially offset by a decline of 7 bps in the yield on loans, including loans held-for-sale. The yield earned on the loan portfolio was impacted by strong growth in public finance lending, which carries lower tax-exempt rates, and growth in portfolio mortgage loans. In addition, the average balance of securities increased \$196.1 million, or 67.2%, and the yield earned on the securities portfolio increased 23 bps for the six months ended June 30, 2017 compared to the six months ended June 30, 2016.

The increase in total interest expense was driven primarily by an increase of \$363.4 million, or 31.4%, in the average balance of interest-bearing deposits for the six months ended June 30, 2017 compared to the six months ended June 30, 2016, as well as a 15 bp increase in the cost of funds related to interest-bearing deposits. The increase in the cost of interest-bearing deposits was primarily due to a \$346.3 million, 50.9%, increase in average certificates of deposits balances and a 9 bp increase in the related cost of those deposits. Interest expense related to other borrowed funds also contributed to the increase in total interest expense due to a \$157.3 million, or 90.7%, increase in the average balance of other borrowed funds for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 as well as an increase of 16 bps in the cost of other borrowed funds. Included in the increase of the average balance of other borrowed funds was the Company's issuance of \$25.0 million of subordinated notes during September 2016 with a fixed rate of 6.00%. Additionally, the average balance of the Federal Home Loan Bank advances increased \$133.4 million, or 83.1%, compared to the six months ended June 30, 2016, as the Company used Federal Home Loan Bank advances to supplement deposit growth and to manage interest rate risk.

Net interest margin ("NIM") was 2.46% for the six months ended June 30, 2017 compared to 2.57% for the six months ended June 30, 2016. The decline in NIM for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 was driven primarily by an increase of 17 bps in the cost of interest-bearing liabilities compared to only a 6 bp increase in the yield earned on interest-earning assets. On a fully-taxable equivalent basis, NIM was 2.55% for the six months ended June 30, 2017 compared to 2.60% for the six months ended June 30, 2016.

Noninterest Income

The following table presents noninterest income for the five most recent quarters and the six months ended June 30, 2017 and 2016.

(dollars in thousands)	Three Months Ended				Six Months Ended		
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2017	June 30, 2016	June 30, 2016
Service charges and fees	\$220	\$ 211	\$ 196	\$ 207	\$ 215	\$431	\$ 415
Mortgage banking activities	2,155	1,616	2,407	4,442	3,295	3,771	5,549
Gain on sale of securities	—	—	—	—	177	—	177
Other	361	304	288	249	61	665	147
Total noninterest income	\$2,736	\$ 2,131	\$ 2,891	\$ 4,898	\$ 3,748	\$ 4,867	\$ 6,288

During the second quarter 2017, noninterest income was \$2.7 million, representing a decrease of \$1.0 million, or 27.0%, compared to \$3.7 million for the second quarter 2016. The decrease in noninterest income was primarily driven by a decrease of \$1.1 million, or 34.6%, in revenue from mortgage banking activities. The decrease in mortgage banking revenue was due mainly to a decline of 32.5% in the dollar volume of mortgages held-for-sale (“HFS”) commitments/lock activity during the second quarter 2017 as compared to second quarter 2016.

During the six months ended June 30, 2017, noninterest income was \$4.9 million, representing a decrease of \$1.4 million, or 22.6%, compared to \$6.3 million for the six months ended June 30, 2016. The decrease in noninterest income was due primarily to a decline of \$1.8 million, or 32.0%, in revenue from mortgage banking activities. The decrease in mortgage banking revenue was driven principally by a decline of 35.0% in the dollar volume of mortgages held-for-sale (“HFS”) commitments/lock activity during the six month period ended June 30, 2017 as compared to the six month period ended June 30, 2016.

Historically, a large percentage of the mortgages originated by the Company have been conventional 15- and 30- year fixed rate mortgages, which are sold in the secondary market. With the increase in conventional mortgage interest rates since fourth quarter 2016, the Company has seen a shift in consumer behavior as an increased percentage of customers are selecting adjustable rate mortgages, which are typically held for investment on the balance sheet. During both the second quarter 2017 and the six months ended June 30, 2017, portfolio mortgage originations increased relative to the comparable period in 2016 while mortgages HFS volume declined, resulting in the declines in revenue from mortgage banking activities.

Noninterest Expense

The following table presents noninterest expense for the five most recent quarters and the six months ended June 30, 2017 and 2016.

(dollars in thousands)	Three Months Ended				Six Months Ended	
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2017	June 30, 2016
Salaries and employee benefits	\$5,193	\$ 5,073	\$ 4,610	\$ 4,550	\$ 4,329	\$10,266
Marketing, advertising and promotion	544	518	471	454	434	1,062
Consulting and professional services	764	813	709	901	895	1,577
Data processing	245	237	292	286	275	482
Loan expenses	248	214	267	240	200	462
Premises and equipment	1,025	953	955	983	963	1,978
Deposit insurance premium	300	315	344	420	215	615
Other	604	575	510	579	564	1,179
Total noninterest expense	\$8,923	\$ 8,698	\$ 8,158	\$ 8,413	\$ 7,875	\$17,621

Noninterest expense for the second quarter 2017 was \$8.9 million, compared to \$7.9 million for the second quarter 2016. The increase of \$1.0 million, or 13.3%, compared to the second quarter 2016 was primarily due to an increase of \$0.9 million in salaries and employee benefits. The increase in salaries and employee benefits primarily resulted from personnel growth.

Noninterest expense for the six months ended June 30, 2017 was \$17.6 million, compared to \$14.9 million for the six months ended June 30, 2016. The increase of \$2.7 million, or 18.4%, compared to the six months ended June 30, 2016 was primarily due to an increase of \$2.0 million in salaries and employee benefits, an increase of \$0.2 million in deposit insurance premium, an increase of \$0.2 million in premises and equipment and an increase of \$0.2 million in marketing, advertising and promotion. The increase in salaries and employee benefits resulted from personnel growth and higher claims experience related to medical, prescription drug and dental insurance. The increase in deposit insurance premium was due to the new methodology implemented by the FDIC as of July 1, 2016, which places a heavier weighting on year-over-year asset growth used to determine the cost of FDIC deposit insurance. The increase in premises and equipment was due to the Company's build out of its corporate headquarters facility and further investments in technology. The increase in marketing, advertising and promotion was primarily driven by mortgage lead generation activities.

Income tax provision was \$1.5 million for the second quarter 2017, resulting in an effective tax rate of 26.8%, compared to \$1.4 million and an effective tax rate of 33.4% for the second quarter 2016. Income tax provision was \$2.5 million for the six months ended June 30, 2017, resulting in an effective tax rate of 26.7%, compared to \$2.7 million and an effective tax rate of 34.1% for the six month ended June 30, 2016. The decrease in the effective tax rate was due primarily to an increase in tax-exempt earning assets resulting from growth in the municipal bond portfolio and public finance loan portfolio.

Financial Condition

The following table presents summary balance sheet data for the last five quarters.
(dollars in thousands)

Balance Sheet Data:	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Total assets	\$2,381,271	\$2,052,803	\$ 1,854,335	\$ 1,824,196	\$ 1,702,468
Loans	1,698,421	1,433,190	1,250,789	1,198,932	1,111,622
Securities available-for-sale	489,775	470,065	456,700	470,978	433,806
Securities held-to-maturity	19,215	19,218	16,671	5,500	—
Loans held-for-sale	27,335	13,202	27,101	32,471	44,503
Noninterest-bearing deposits	36,636	34,427	31,166	32,938	28,066
Interest-bearing deposits	1,695,476	1,522,692	1,431,701	1,460,663	1,360,867
Total deposits	1,732,112	1,557,119	1,462,867	1,493,601	1,388,933
Total shareholders' equity	163,830	157,491	153,942	137,154	135,679

Total assets increased \$526.9 million, or 28.4%, to \$2.4 billion at June 30, 2017 compared to \$1.9 billion at December 31, 2016. Balance sheet expansion during the 2017 period was primarily driven by strong loan growth as loan balances increased \$447.6 million, or 35.8%, compared to December 31, 2016.

Loan Portfolio Analysis

The following table presents a detailed listing of the Company's loan portfolio for the last five quarters.

(dollars in thousands)	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Commercial loans					
Commercial and industrial	\$110,379	6.5 % \$97,487	6.8 % \$102,437	8.2 % \$107,250	8.9 % \$111,130
Owner-occupied commercial real estate	66,952	4.0 % 62,887	4.4 % 57,668	4.6 % 45,540	3.8 % 46,543
Investor commercial real estate	10,062	0.6 % 8,510	0.6 % 13,181	1.1 % 12,752	1.1 % 12,976
Construction	45,931	2.7 % 49,618	3.5 % 53,291	4.3 % 56,391	4.7 % 53,368
Single tenant lease financing	747,790	44.0 % 665,382	46.4 % 606,568	48.5 % 571,972	47.6 % 500,937
Public finance	179,873	10.6 % 77,995	5.4 % —	0.0 % —	0.0 % —
Total commercial loans	1,160,987	68.4 % 961,879	67.1 % 833,145	66.7 % 793,905	66.1 % 724,954
Consumer loans					
Residential mortgage	292,997	17.3 % 246,014	17.2 % 205,554	16.4 % 200,889	16.8 % 202,107
Home equity	33,312	2.0 % 34,925	2.4 % 35,036	2.8 % 37,849	3.2 % 38,981
Other consumer	208,602	12.2 % 188,191	13.1 % 173,449	13.8 % 163,158	13.6 % 141,756
Total consumer loans	534,911	31.5 % 469,130	32.7 % 414,039	33.0 % 401,896	33.6 % 382,844

Edgar Filing: First Internet Bancorp - Form 10-Q

Deferred loan origination costs and premiums and discounts on purchased loans	2,523	0.1 %	2,181	0.2 %	3,605	0.3 %	3,131	0.3 %	3,824	0.3 %
Total loans	1,698,421	100.0%	1,433,190	100.0%	1,250,789	100.0%	1,198,932	100.0%	1,111,622	100.0%
Allowance for loan losses	(13,194)		(11,894)		(10,981)		(10,561)		(10,016)	
Net loans	\$1,685,227		\$1,421,296		\$1,239,808		\$1,188,371		\$1,101,606	

Total loans were \$1.7 billion as of June 30, 2017, an increase of \$447.6 million, or 35.8%, compared to December 31, 2016. The growth in commercial loan balances was impacted by production in the Company's new public finance lending area with balances totaling \$179.9 million at June 30, 2017. Furthermore, production in single tenant lease financing remained strong as balances increased \$141.2 million, or 23.3%, compared to December 31, 2016. The growth in consumer loans was primarily driven by the recent rise in conventional mortgage interest rates, leading to a shift in consumer behavior with a preference for adjustable rate mortgages ("ARMs") since late 2016. The Company's residential mortgage portfolio, which includes ARMs, increased \$87.4 million, or 42.5%, compared to December 31, 2016. Furthermore, other consumer loan balances increased \$35.2 million, or 20.3%, compared to December 31, 2016, driven primarily by increased production in trailer, recreational vehicle and home improvement loans.

Asset Quality

Nonperforming loans are comprised of nonaccrual loans and loans 90 days past due and accruing. Nonperforming assets include nonperforming loans, other real estate owned and other nonperforming assets, which consist of repossessed assets. The following table provides a detailed listing of the Company's nonperforming assets for the last five quarters.

(dollars in thousands)	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Nonaccrual loans					
Commercial loans:					
Commercial and industrial	\$1,850	\$2,147	\$ —	\$ —	\$4,716
Total commercial loans	1,850	2,147	—	—	4,716
Consumer loans:					
Residential mortgage	1,209	1,209	1,024	1,025	844
Other consumer	29	55	59	108	74
Total consumer loans	1,238	1,264	1,083	1,133	918
Total nonaccrual loans	3,088	3,411	1,083	1,133	5,634
Past Due 90 days and accruing loans					
Consumer loans:					
Residential mortgage	341	—	—	—	—
Other consumer	9	—	—	—	5
Total consumer loans	350	—	—	—	5
Total past due 90 days and accruing loans	350	—	—	—	5
Total nonperforming loans	3,438	3,411	1,083	1,133	5,639
Other real estate owned					
Investor commercial real estate	4,488	4,488	4,488	4,488	4,488
Residential mortgage	—	—	45	45	—
Total other real estate owned	4,488	4,488	4,533	4,533	4,488
Other nonperforming assets	26	93	85	69	46
Total nonperforming assets	\$7,952	\$7,992	\$ 5,701	\$ 5,735	\$10,173
Total nonperforming loans to total loans	0.20	% 0.24	% 0.09	% 0.90	% 0.51
Total nonperforming assets to total assets	0.33	% 0.39	% 0.31	% 0.31	% 0.60
Allowance for loan losses to total loans	0.78	% 0.83	% 0.88	% 0.88	% 0.90

Edgar Filing: First Internet Bancorp - Form 10-Q

Allowance for loan losses to nonperforming loans	383.8	%	348.7	%	1,013.9	%	932.1	%	177.6	%
--	-------	---	-------	---	---------	---	-------	---	-------	---

38

Troubled Debt Restructurings

The following table provides a summary of troubled debt restructurings for the last five quarters.

(dollars in thousands)	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Troubled debt restructurings – nonaccrual	\$ 1,762	\$ —	\$ —	\$ 1	\$ —
Troubled debt restructurings – performing	\$ 487	\$ 496	\$ 757	\$ 1,067	\$ 1,082
Total troubled debt restructurings	\$ 2,249	\$ 496	\$ 757	\$ 1,068	\$ 1,082

The increase of \$2.3 million, or 39.5%, in total nonperforming assets as of June 30, 2017 compared to December 31, 2016 was due primarily to an increase in nonaccrual loans. Total nonperforming loans increased \$2.4 million, or 217.5%, to \$3.4 million as of June 30, 2017 compared to \$1.1 million as of December 31, 2016. This increase was primarily driven by a \$1.9 million commercial and industrial credit that was placed on nonaccrual status during the prior quarter. As a result, the ratio of nonperforming loans to total loans increased to 0.20% as of June 30, 2017 compared to 0.09% as of December 31, 2016. The ratio of nonperforming assets to total assets also increased to 0.33% as of June 30, 2017 compared to 0.31% as of December 31, 2016 due primarily to the increase in nonaccrual loans.

As of June 30, 2017 and December 31, 2016, the Company had one commercial property in other real estate owned with a carrying value of \$4.5 million. This property consists of two buildings which are residential units adjacent to a university campus. Improvements to the property have been made in collaboration with the university and the property continues to be occupied. As of December 31, 2016, the Company also had residential mortgage other real estate owned of less than \$0.1 million.

Allowance for Loan Losses

The following table provides a rollforward of the allowance for loan losses for the last five quarters and the six months ended June 30, 2017 and 2016.

(dollars in thousands)	Three Months Ended					Six Months Ended	
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016
Balance, beginning of period	\$11,894	\$10,981	\$10,561	\$10,016	\$9,220	\$10,981	\$8,351
Provision charged to expense	1,322	1,035	256	2,204	924	2,357	1,870
Losses charged off	(170)	(223)	(71)	(1,737)	(232)	(393)	(381)
Recoveries	148	101	235	78	104	249	176
Balance, end of period	\$13,194	\$11,894	\$10,981	\$10,561	\$10,016	\$13,194	\$10,016
Net charge-offs (recoveries) to average loans	0.01 %	0.04 %	(0.05)%	0.57 %	0.05 %	0.02 %	0.04 %

The allowance for loan losses was \$13.2 million as of June 30, 2017, compared to \$11.0 million as of December 31, 2016. The increase of \$2.2 million, or 20.2%, was due primarily to the growth in single tenant lease financing, public finance and residential mortgage loan balances. During the second quarter 2017, the Company recorded net charge-offs of less than \$0.1 million, compared to net charge-offs of \$0.1 million during the second quarter 2016. The net charge-offs for both the second quarter 2017 and 2016 were primarily driven by charge-offs in other consumer loans. During the six months ended June 30, 2017, the Company recorded net charge-offs of \$0.1 million, compared to net charge-offs of \$0.2 million during the six months ended June 30, 2016. The net charge-offs for both the six months ended June 30, 2017 and 2016 were primarily driven by charge-offs in other consumer loans.

Edgar Filing: First Internet Bancorp - Form 10-Q

The allowance for loan losses as a percentage of total loans decreased to 0.78% as of June 30, 2017, compared to 0.88% as of December 31, 2016. The decline in the allowance as a percentage of total loans was due to the growth in the public finance and residential mortgage portfolios as these loan categories have lower loss reserve factors than all other commercial and most consumer loan types. Due to the increase in nonaccrual loans, the allowance for loan losses as a percentage of nonperforming loans decreased to 383.8% as of June 30, 2017, compared to 1,013.9% as of December 31, 2016.

Investment Securities

The following tables present the amortized cost and approximate fair value of our investment portfolio by security type for the last five quarters.

(dollars in thousands)

Amortized Cost	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Securities available-for-sale					
U.S. Government-sponsored agencies	\$129,926	\$113,933	\$ 92,599	\$ 85,630	\$75,133
Municipal securities	97,508	97,578	97,647	96,665	78,594
Mortgage-backed securities	231,591	235,879	238,354	244,780	233,886
Asset-backed securities	9,946	9,873	19,470	19,464	19,457
Corporate securities	27,118	23,107	20,000	20,000	20,000
Other securities	3,000	3,000	3,000	3,000	3,000
Total available-for-sale	499,089	483,370	471,070	469,539	430,070
Securities held-to-maturity					
Municipal securities	10,168	10,169	10,171	—	—
Corporate securities	9,047	9,049	6,500	5,500	—
Total held-to-maturity	19,215	19,218	16,671	5,500	—
Total securities	\$518,304	\$502,588	\$ 487,741	\$ 475,039	\$430,070

(dollars in thousands)

Approximate Fair Value	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Securities available-for-sale					
U.S. Government-sponsored agencies	\$129,682	\$113,287	\$ 91,896	\$ 85,990	\$75,678
Municipal securities	95,071	92,428	91,886	97,501	80,798
Mortgage-backed securities	226,114	229,436	231,641	246,085	235,911
Asset-backed securities	10,000	10,000	19,534	19,496	19,332
Corporate securities	25,960	21,982	18,811	18,880	19,074
Other securities	2,948	2,932	2,932	3,026	3,013
Total available-for-sale	489,775	470,065	456,700	470,978	433,806
Securities held-to-maturity					
Municipal securities	9,847	9,703	9,673	—	—
Corporate securities	9,157	9,101	6,524	5,578	—
Total held-to-maturity	19,004	18,804	16,197	5,578	—
Total securities	\$508,779	\$488,869	\$ 472,897	\$ 476,556	\$433,806

The approximate fair value of investment securities available-for-sale increased \$33.1 million, or 7.2%, to \$489.8 million as of June 30, 2017 compared to \$456.7 million as of December 31, 2016. The increase was due primarily to increases of \$37.8 million in U.S. Government-sponsored agencies and \$7.1 million in corporate securities, offset by a decline of \$9.5 million in asset-backed securities. The increases in U.S. Government-sponsored agencies and corporate securities were due primarily to purchases of floating rate instruments during the quarter. The decline in asset-backed securities was due to certain securities that were called by the issuer during the 2017 period. As of June 30, 2017, the Company had securities with an amortized cost basis of \$19.2 million designated as held-to-maturity compared to \$16.7 million as of December 31, 2016.

Deposits

The following table presents the composition of the Company's deposit base for the last five quarters.

(dollars in thousands)	June 30, 2017			March 31, 2017			December 31, 2016			September 30, 2016			June 30, 2016		
Noninterest-bearing deposits	\$36,636	2.1	%	\$34,427	2.2	%	\$31,166	2.1	%	\$32,938	2.2	%	\$28,066	2.0	%
Interest-bearing demand deposits	94,726	5.5	%	94,461	6.1	%	93,074	6.4	%	84,939	5.7	%	83,031	6.0	%
Regular savings accounts	35,764	2.1	%	31,291	2.0	%	27,955	1.9	%	27,661	1.8	%	28,900	2.1	%
Money market accounts	386,224	22.3	%	371,115	23.8	%	340,240	23.3	%	364,517	24.4	%	373,932	26.9	%
Certificates of deposits	1,176,230	67.9	%	1,023,294	65.7	%	964,819	65.9	%	970,684	65.0	%	862,150	62.1	%
Brokered deposits	2,532	0.1	%	2,531	0.2	%	5,613	0.4	%	12,862	0.9	%	12,854	0.9	%
Total deposits	\$1,732,112	100.0	%	\$1,557,119	100.0	%	\$1,462,867	100.0	%	\$1,493,601	100.0	%	\$1,388,933	100.0	%

Total deposits increased \$269.2 million, or 18.4%, to \$1.7 billion as of June 30, 2017 compared to \$1.5 billion as of December 31, 2016. This increase was due primarily to increases of \$211.4 million, or 21.9%, in certificates of deposits, \$46.0 million, or 13.5%, in money market accounts, \$7.8 million, or 27.9%, in regular savings accounts, \$5.5 million, or 17.6%, in noninterest-bearing deposits and \$1.7 million, or 1.8%, in interest-bearing demand deposits.

Recent Common Stock Offerings

In May 2016, the Company and the Bank entered into a Sales Agency Agreement with Sandler O'Neill & Partners, L.P. ("Sandler") to sell shares (the "ATM Shares") of the Company's common stock having an aggregate gross sales price of up to \$25.0 million, from time to time, through an "at-the-market" equity offering program (the "ATM Program"). The sales, if any, of the ATM Shares, may be made in sales deemed to be "at-the-market offerings" as defined in Rule 415 under the Securities Act of 1933, as amended, including sales made directly on or through The NASDAQ Stock Market, or another market for the Company's common stock, sales made to or through a market maker other than on an exchange or otherwise, in negotiated transactions at market prices prevailing at the time of sale or at negotiated prices, or as otherwise agreed with Sandler. Subject to the terms and conditions of the Sales Agency Agreement, upon its acceptance of written instructions from the Company, Sandler will use its commercially reasonable efforts to sell on the Company's behalf all of the designated ATM Shares. The Sales Agency Agreement provides for the Company to pay Sandler a commission of up to 3.0% of the gross sales price per share sold through it as sales agent under the Sales Agency Agreement. The Company may also sell ATM Shares under the Sales Agency Agreement to Sandler, as principal for its own account, at a price per share agreed upon at the time of sale. Actual sales will depend on a variety of factors to be determined by the Company from time to time. The Company has no obligation to sell any of the ATM Shares under the Sales Agency Agreement, and may at any time suspend solicitation and offers under the Sales Agency Agreement. In addition, the Company has agreed to indemnify Sandler against certain liabilities on customary terms. The Company has sold a total of 139,811 ATM Shares through the ATM Program for gross proceeds of approximately \$3.4 million.

As of June 30, 2017, approximately \$21.6 million remained available for sale under the ATM Program.

In May 2016, the Company and the Bank separately entered into an Underwriting Agreement with Sandler, pursuant to which the Company sold an additional 895,955 shares of common stock at \$24.00 per share, resulting in gross proceeds to the Company of \$21.5 million.

In December 2016, the Company and the Bank also entered into an Underwriting Agreement with Keefe, Bruyette & Woods, a Stifel Company, pursuant to which the Company sold 945,000 shares of common stock at \$26.50 per share, resulting in gross proceeds to the Company of \$25.0 million.

The net proceeds to the Company from the above offerings after deducting underwriting discounts and commissions and offering expenses were \$46.2 million.

Recent Debt Offerings

In September 2016, the Company issued \$25.0 million aggregate principal amount of 6.0% Fixed-to-Floating Rate Subordinated Notes due 2026 (the “2026 Notes”) in a public offering. The 2026 Notes initially bear a fixed interest rate of 6.00% per year to, but excluding September 30, 2021, and thereafter at a floating rate equal to the then-current three-month LIBOR rate plus 485 basis points. All interest on the 2026 Notes is payable quarterly. The 2026 Notes are scheduled to mature on September 30, 2026. The 2026 Notes are unsecured subordinated obligations of the Company and may be repaid, without penalty, on any interest payment date on or after September 30, 2021. The 2026 Notes are intended to qualify as Tier 2 capital under regulatory guidelines. The 2026 Notes are listed on The NASDAQ Global Select Market under the symbol “INBKL.”

Capital

The Company and the Bank are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Basel III Capital Rules became effective for the Company and the Bank on January 1, 2015, subject to a phase-in period for certain provisions. Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios of Common Equity Tier 1 capital, Tier 1 capital and Total capital, as defined in the regulations, to risk-weighted assets, and of Tier 1 capital to adjusted quarterly average assets (“Leverage Ratio”).

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain: 1) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of 4.5%, plus a 2.5% “capital conservation buffer” (resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of 7.0% upon full implementation); 2) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, plus the capital conservation buffer (resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); 3) a minimum ratio of Total capital to risk-weighted assets of 8.0%, plus the capital conservation buffer (resulting in a minimum Total capital ratio of 10.5% upon full implementation); and 4) a minimum Leverage Ratio of 4.0%.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period increasing by increments of that amount on each subsequent January 1 until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Failure to maintain the minimum Common Equity Tier 1 capital ratio plus the capital conservation buffer will result in potential restrictions on a banking institution’s ability to pay dividends, repurchase stock and/or pay discretionary compensation to its employees.

Edgar Filing: First Internet Bancorp - Form 10-Q

The following tables present actual and required capital ratios as of June 30, 2017 and December 31, 2016 for the Company and the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of June 30, 2017 and December 31, 2016 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

(dollars in thousands)	Actual		Minimum Capital Required - Basel III Phase-In Schedule		Minimum Capital Required - Basel III Fully Phased-In		Minimum Capital Required to be Considered Well Capitalized	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
As of June 30, 2017:								
Common equity tier 1 capital to risk-weighted assets								
Consolidated	\$164,902	9.74 %	\$97,372	5.75 %	\$118,540	7.00 %	N/A	N/A
Bank	183,101	10.84 %	97,160	5.75 %	118,282	7.00 %	\$109,834	6.50 %
Tier 1 capital to risk-weighted assets								
Consolidated	164,902	9.74 %	122,773	7.25 %	143,941	8.50 %	N/A	N/A
Bank	183,101	10.84 %	122,507	7.25 %	143,628	8.50 %	135,180	8.00 %
Total capital to risk-weighted assets								
Consolidated	214,748	12.68 %	156,642	9.25 %	177,809	10.50 %	N/A	N/A
Bank	196,295	11.62 %	156,302	9.25 %	177,423	10.50 %	168,975	10.00 %
Leverage ratio								
Consolidated	164,902	7.50 %	88,006	4.00 %	88,006	4.00 %	N/A	N/A
Bank	183,101	8.34 %	87,859	4.00 %	87,859	4.00 %	109,824	5.00 %

(dollars in thousands)	Actual		Minimum Capital Required - Basel III Phase-In Schedule		Minimum Capital Required - Basel III Fully Phased-In		Minimum Capital Required to be Considered Well Capitalized	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
As of December 31, 2016:								
Common equity tier 1 capital to risk-weighted assets								
Consolidated	\$158,479	11.54 %	\$70,366	5.13 %	\$96,110	7.00 %	N/A	N/A
Bank	162,617	11.88 %	70,145	5.13 %	95,807	7.00 %	\$88,964	6.50 %
Tier 1 capital to risk-weighted assets								
Consolidated	158,479	11.54 %	90,961	6.63 %	116,705	8.50 %	N/A	N/A
Bank	162,617	11.88 %	90,675	6.63 %	116,337	8.50 %	109,494	8.00 %
Total capital to risk-weighted assets								
Consolidated	206,038	15.01 %	118,421	8.63 %	144,165	10.50 %	N/A	N/A
Bank	173,598	12.68 %	118,048	8.63 %	143,711	10.50 %	136,868	10.00 %
Leverage ratio								
Consolidated	158,479	8.65 %	73,311	4.00 %	73,311	4.00 %	N/A	N/A

Edgar Filing: First Internet Bancorp - Form 10-Q

Bank	162,617	8.89	%	73,186	4.00	%	73,186	4.00	%	91,483	5.00	%
------	---------	------	---	--------	------	---	--------	------	---	--------	------	---

43

Shareholders' Dividends

The Company's Board of Directors declared a cash dividend of \$0.06 per share of common stock payable July 17, 2017 to shareholders of record as of June 30, 2017. The Company expects to continue to pay cash dividends on a quarterly basis; however, the declaration and amount of any future cash dividends will be subject to the sole discretion of the Board of Directors and will depend upon many factors, including its results of operations, financial condition, capital requirements, regulatory and contractual restrictions (including with respect to the Company's outstanding subordinated debt), business strategy and other factors deemed relevant by the Board of Directors.

As of June 30, 2017, the Company had \$38.0 million principal amount of subordinated debt outstanding pursuant to the 2021 Debenture, the 2025 Note, and the 2026 Notes. The agreements under which subordinated debt was issued prohibit the Company from paying any dividends on its common stock or making any other distributions to shareholders at any time when there shall have occurred and be continuing an event of default under the applicable agreement. If an event of default were to occur and the Company did not cure it, the Company would be prohibited from paying any dividends or making any other distributions to shareholders or from redeeming or repurchasing any common stock.

Capital Resources

While the Company believes it has sufficient liquidity and capital resources to meet its cash and capital expenditure requirements for at least the next twelve months, including any cash dividends it may pay, the Company intends to continue pursuing its growth strategy, which may require additional capital. If the Company is unable to secure such capital at favorable terms, its ability to execute its growth strategy could be adversely affected.

Liquidity

Liquidity management is the process used by the Company to manage the continuing flow of funds necessary to meet its financial commitments on a timely basis and at a reasonable cost while also maintaining safe and sound operations. Liquidity, represented by cash and investment securities, is a product of the Company's operating, investing and financing activities. The primary sources of funds are deposits, principal and interest payments on loans and investment securities, maturing loans and investment securities, access to wholesale funding sources and collateralized borrowings. While scheduled payments and maturities of loans and investment securities are relatively predictable sources of funds, deposit flows are greatly influenced by interest rates, general economic conditions and competition. Therefore, the Company supplements deposit growth and enhances interest rate risk management through borrowings, which are generally advances from the Federal Home Loan Bank.

The Company maintains cash and investment securities that qualify as liquid assets to maintain adequate liquidity to ensure safe and sound operations and meet its financial commitments. At June 30, 2017, on a consolidated basis, the Company had \$556.0 million in cash and cash equivalents, interest-bearing time deposits and investment securities available-for-sale and \$27.3 million in loans held-for-sale that were generally available for its cash needs. The Company can also generate funds from wholesale funding sources and collateralized borrowings. At June 30, 2017, the Bank had the ability to borrow an additional \$49.7 million in advances from the Federal Home Loan Bank, the Federal Reserve and correspondent bank Fed Funds lines of credit.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. The Company's primary sources of funds are cash maintained at the holding company level and dividends from the Bank, the payment of which is subject to regulatory limits. At June 30, 2017, the Company, on an unconsolidated basis, had \$13.9 million in cash generally available for its cash needs, which is in

excess of its current annual regular shareholder dividend and operating expenses.

The Company uses its sources of funds primarily to meet ongoing financial commitments, including withdrawals by depositors, credit commitments to borrowers, operating expenses and capital expenditures. At June 30, 2017, approved outstanding loan commitments, including unused lines of credit and standby letters of credit, amounted to \$197.5 million. Certificates of deposits scheduled to mature in one year or less at June 30, 2017 totaled \$619.0 million. Generally, the Company believes that a majority of maturing deposits will remain with the Bank.

Management is not aware of any other events or regulatory requirements that, if implemented, are likely to have a material effect on either the Company's or the Bank's liquidity.

Reconciliation of Non-GAAP Financial Measures

This Management's Discussion and Analysis contains financial information determined by methods other than in accordance with GAAP. Non-GAAP financial measures, specifically tangible common equity, tangible assets, average tangible common equity, tangible book value per common share, return on average tangible common equity and tangible common equity to tangible assets, net interest income - FTE and net interest margin - FTE are used by the Company's management to measure the strength of its capital and analyze profitability, including its ability to generate earnings on tangible capital invested by its shareholders. The Company also believes that it is a standard practice in the banking industry to present net interest margin and net income on a fully-taxable equivalent basis as those measures provide useful information for peer comparisons. Although the Company believes these non-GAAP measures provide a greater understanding of its business, they should not be considered a substitute for financial measures determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures are included in the following table for the past five quarters and the six months ended June 30, 2017 and 2016.

(dollars in thousands, except share and per share data)	Three Months Ended					Six Months Ended	
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016
Total equity - GAAP	\$163,830	\$157,491	\$153,942	\$137,154	\$135,679	\$163,830	\$135,679
Adjustments:							
Goodwill	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)
Tangible common equity	\$159,143	\$152,804	\$149,255	\$132,467	\$130,992	\$159,143	\$130,992
Total assets - GAAP	\$2,381,271	\$2,052,803	\$1,854,335	\$1,824,196	\$1,702,468	\$2,381,271	\$1,702,468
Adjustments:							
Goodwill	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)	(4,687)
Tangible assets	\$2,376,584	\$2,048,116	\$1,849,648	\$1,819,509	\$1,697,781	\$2,376,584	\$1,697,781
Total common shares outstanding	6,513,577	6,497,662	6,478,050	5,533,050	5,533,050	6,513,577	5,533,050
Book value per common share	\$25.15	\$24.24	\$23.76	\$24.79	\$24.52	\$25.15	\$24.52
Effect of goodwill	(0.72)	(0.72)	(0.72)	(0.85)	(0.85)	(0.72)	(0.85)
Tangible book value per common	\$24.43	\$23.52	\$23.04	\$23.94	\$23.67	\$24.43	\$23.67

share

Total shareholders' equity to assets ratio	6.88	%	7.67	%	8.30	%	7.52	%	7.97	%	6.88	%	7.97	%
Effect of goodwill	(0.18)	)%	(0.21)	)%	(0.23)	)%	(0.24)	)%	(0.25)	)%	(0.18)	)%	(0.25)	)%
Tangible common equity to tangible assets ratio	6.70	%	7.46	%	8.07	%	7.28	%	7.72	%	6.70	%	7.72	%
Total average equity - GAAP	\$161,228		\$154,798		\$135,974		\$133,666		\$117,913		\$158,030		\$112,096	
Adjustments:														
Average goodwill	(4,687)	)	(4,687)	)	(4,687)	)	(4,687)	)	(4,687)	)	(4,687)	)	(4,687)	)
Average tangible common equity	\$156,541		\$150,111		\$131,287		\$128,979		\$113,226		\$153,343		\$107,409	
Return on average shareholders' equity	9.95	%	7.42	%	10.85	%	9.08	%	9.67	%	8.72	%	9.45	%
Effect of goodwill	0.30	%	0.23	%	0.39	%	0.33	%	0.40	%	0.27	%	0.41	%
Return on average tangible common equity	10.25	%	7.65	%	11.24	%	9.41	%	10.07	%	8.99	%	9.86	%

45

Edgar Filing: First Internet Bancorp - Form 10-Q

(dollars in thousands, except share and per share data)	Three Months Ended					Six Months Ended		
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016	
Net interest income	\$12,974	\$11,457	\$10,904	\$10,338	\$9,306	\$24,431	\$18,447	
Adjustments:								
Fully-taxable equivalent adjustments ¹	543	306	256	239	144	849	213	
Net interest income - FTE	\$13,517	\$11,763	\$11,160	\$10,577	\$9,450	\$25,280	\$18,660	
Net interest margin	2.43	% 2.50	% 2.42	% 2.42	% 2.39	% 2.46	% 2.57	%
Effect of fully-taxable equivalent adjustments ¹	0.10	% 0.07	% 0.06	% 0.05	% 0.04	% 0.09	% 0.03	%
Net interest margin - FTE	2.53	% 2.57	% 2.48	% 2.47	% 2.43	% 2.55	% 2.60	%

¹ Assuming a 35% tax rate

Critical Accounting Policies and Estimates

There have been no material changes in the Company's critical accounting policies or estimates from those disclosed in its Annual Report on Form 10-K for the year ended December 31, 2016.

Recent Accounting Pronouncements

Refer to Note 12 of the condensed consolidated financial statements.

Off-Balance Sheet Arrangements

In the ordinary course of business, the Company enters into financial transactions to extend credit and forms of commitments that may be considered off-balance sheet arrangements. The Company enters into forward contracts related to its mortgage banking business to hedge the exposures from commitments to extend new residential mortgage loans to customers and from its mortgage loans held-for-sale. At June 30, 2017 and December 31, 2016, the Company had commitments to sell residential real estate loans of \$63.0 million and \$61.0 million, respectively. These contracts mature in less than one year. The Company does not believe that off-balance sheet arrangements have had or are reasonably likely to have a material effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, foreign exchange rates and equity prices. The primary source of market risk for the Company is interest rate risk. Interest rate risk is the risk to earnings and the value of the Company's equity resulting from changes in market interest rates and arises in the normal course of business to the extent that there are timing and volume differences between the amount of interest-earning assets and the amount of interest-bearing liabilities that are prepaid, withdrawn, re-priced or mature in specified periods. The Company seeks to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates.

The Company monitors its interest rate risk position using income simulation models and economic value of equity ("EVE") sensitivity analysis that capture both short-term and long-term interest rate risk exposure. Income simulation involves forecasting net interest income ("NII") under a variety of interest rate scenarios. The Company uses EVE sensitivity analysis to understand the impact of changes in interest rates on long-term cash flows, income and capital.

EVE is calculated by discounting the cash flows for all balance sheet instruments under different interest-rate scenarios. Modeling the sensitivity of NII and EVE to changes in market interest rates is highly dependent on the assumptions incorporated into the modeling process. The Company continually reviews and refines the assumptions used in its interest rate risk modeling.

Presented below is the estimated impact on the Company's NII and EVE position as of June 30, 2017, assuming parallel shifts in interest rates:

	% Change from Base Case for Parallel Changes in Rates		
	-100 Basis Points 1	+100 Basis Points	+200 Basis Points
NII - next twelve months	1.50%	0.02 %	0.00 %
EVE	6.50%	(14.57)%	(26.62)%

¹ Because certain current interest rates are at or below 1.00%, the 100 basis point downward shock assumes that certain corresponding interest rates approach an implied floor that, in effect, reflects a decrease of less than the full 100 basis point downward shock.

The Company's objective is to manage the balance sheet with a bias toward asset sensitivity while simultaneously balancing the potential earnings impact of this strategy. A "risk-neutral" position refers to the absence of a strong bias toward either asset or liability sensitivity. An "asset sensitive" position refers to when the characteristics of the balance sheet are expected to generate higher net interest income when interest rates, primarily short-term rates, increase as rates earned on interest-earning assets would reprice upward more quickly or in greater quantities than rates paid on interest-bearing liabilities would reprice. A "liability sensitive" position refers to when the characteristics of the balance sheet are expected to generate lower net interest income when short-term interest rates increase as rates paid on interest-bearing liabilities would reprice upward more quickly or in greater quantities than rates earned on interest-earning assets.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information it is required to disclose in reports that it files or submits under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the time period specified in SEC rules and forms. These controls and procedures are also designed to ensure that such information is accumulated and communicated to management, including the principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, the Company has recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Management is required to apply judgment in evaluating its controls and procedures.

The Company performed an evaluation under the supervision and with the participation of management, including the principal executive and principal financial officers, to assess the effectiveness of the design and operation of its disclosure controls and procedures under the Exchange Act. Based on that evaluation, the principal executive and principal financial officers concluded that the disclosure controls and procedures were effective as of June 30, 2017.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the three months ended June 30, 2017 that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

Neither we nor any of our subsidiaries are party to any material legal proceedings. From time to time, the Bank is a party to legal actions arising from its normal business activities.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A, of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 4, 2017, the Company issued a net amount of 15,915 shares of our common stock pursuant to an exercise by the holder of a warrant to purchase 48,750 shares of our common stock at a price of \$19.33 per share. The holder satisfied the exercise price by instructing the company to withhold 32,835 of the shares of common stock in accordance with the warrant's cashless exercise feature. The shares issued were exempt from registration as a transaction by an issuer not involving a public offering under Section 4(a)(2) of the Securities Act of 1933, as amended, and, in particular, the safe harbor provisions afforded by Rule 506 of Regulation D, as promulgated thereunder.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Unless otherwise indicated, all documents incorporated into this quarterly report on Form 10-Q by reference to a document filed with the SEC pursuant to the Exchange Act are located under SEC file number 1-35750.

Exhibit No.	Description
3.1	Articles of Incorporation of First Internet Bancorp (incorporated by reference to Exhibit 3.1 to registration statement filed on Form 10 filed November 30, 2012)
3.2	Amended and Restated Bylaws of First Internet Bancorp as amended March 18, 2013 (incorporated by reference to Exhibit 3.2 to annual report on Form 10-K for the year ended December 31, 2012)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certifications
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase
101.DEF XBRL Taxonomy Extension Definition Linkbase
101.LAB XBRL Taxonomy Extension Label Linkbase
101.PRE XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST INTERNET BANCORP

Date: August 3, 2017 By/s/ David B. Becker
David B. Becker,
Chairman, President and Chief Executive Officer
(on behalf of Registrant)

Date: August 3, 2017 By/s/ Kenneth J. Lovik
Kenneth J. Lovik,
Executive Vice President and Chief Financial Officer (principal financial officer)

EXHIBIT INDEX

Exhibit No.	Description	Method of Filing
3.1	Articles of Incorporation of First Internet Bancorp	Incorporated by Reference
3.2	Amended and Restated Bylaws of First Internet Bancorp as amended March 18, 2013	Incorporated by Reference
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32.1	Section 1350 Certifications	Filed Electronically
101.INS	XBRL Instance Document	Filed Electronically
101.SCH	XBRL Taxonomy Extension Schema	Filed Electronically
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	Filed Electronically
101.DEF	XBRL Taxonomy Extension Definition Linkbase	Filed Electronically
101.LAB	XBRL Taxonomy Extension Label Linkbase	Filed Electronically
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	Filed Electronically