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 September 30, 2018

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 No. 001-38258

MERCHANTS BANCORP
(Exact name of registrant as specified in its charter)

Indiana	20-5747400
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
11555 North Meridian Street, Suite 400 Carmel, Indiana	46032
(Address of principal executive office)	(Zip Code)

(317) 569-7420
(Registrant’s telephone number, including area code)
N/A
(Former name or former address, 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐
Emerging growth company ☒

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 7(a)(2)(B) of the Securities 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 November 9, 2018, the latest practicable date, 28,694,036 shares of the registrant’s common stock, without par value, were issued and outstanding.

Merchants Bancorp

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Part I – Financial Information

Item 1. Financial Statements

Merchants Bancorp
Condensed Consolidated Balance Sheets
September 30, 2018 (Unaudited) and December 31, 2017
(In thousands, except share data)

	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 20,069	$ 18,905
Interest-earning demand accounts	390,687	340,614
Cash and cash equivalents	410,756	359,519
Securities purchased under agreements to resell	6,913	7,043
Trading securities	74,116	140,837
Available for sale securities	269,709	408,371
Federal Home Loan Bank (FHLB) stock	7,608	7,539
Loans held for sale (includes $5,888 at fair value for 2018)	1,004,402	995,319
Loans receivable, net of allowance for loan losses of $11,243 and $8,311, respectively	1,905,859	1,366,349
Premises and equipment, net	10,846	5,354
Mortgage servicing rights	71,490	66,079
Interest receivable	12,289	8,326
Goodwill	5,302	3,902
Intangible assets, net	1,763	1,512
Other assets and receivables	25,896	22,983
Total assets	$ 3,806,949	$ 3,393,133
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$ 336,940	$ 620,700
Interest bearing	2,965,429	2,322,861
Total deposits	3,302,369	2,943,561
Borrowings	67,279	56,612
Deferred and current tax liabilities, net	12,859	12,422
Other liabilities	17,096	13,064
Total liabilities	3,399,603	3,025,659
Commitments and Contingencies		
Shareholders' Equity		
Common stock, without par value		
Authorized - 50,000,000 shares		
Issued and outstanding - 28,694,036 shares at September 30, 2018 and 28,685,167 shares at December 31, 2017	135,021	134,891
Preferred stock - $1,000 per share, without par value		
Authorized - 5,000,000 shares		
Issued and outstanding - 41,625 shares	41,581	41,581
Retained earnings	232,041	192,008
Accumulated other comprehensive loss	(1,297)	(1,006)
Total shareholders' equity	407,346	367,474
Total liabilities and shareholders' equity	$ 3,806,949	$ 3,393,133

See notes to condensed consolidated financial statements.

Merchants Bancorp
Condensed Consolidated Statements of Income (Unaudited)
For the Three and Nine Months Ended September 30, 2018 and 2017
(In thousands, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest Income				
Loans	$ 32,056	$ 22,016	$ 85,458	$ 56,821
Investment securities:				
Trading	1,299	1,300	3,777	4,124
Available for sale	1,541	1,259	4,708	3,175
Federal Home Loan Bank stock	87	80	297	240
Other	2,594	1,351	6,498	3,117
Total interest income	37,577	26,006	100,738	67,477
Interest Expense				
Deposits	11,670	5,659	28,427	14,170
Borrowed funds	2,425	1,957	6,515	5,662
Total interest expense	14,095	7,616	34,942	19,832
Net interest income	23,482	18,390	65,796	47,645
Provision for loan losses	617	592	3,021	1,072
Net Interest Income After Provision for Loan Losses	22,865	17,798	62,775	46,573
Noninterest Income				
Gain on sale of loans	8,825	7,204	27,548	27,813
Loan servicing fees, net	1,851	(83)	4,084	2,301
Mortgage warehouse fees	778	749	1,948	2,007
Other income	453	186	1,270	652
Total noninterest income	11,907	8,056	34,850	32,773
Noninterest Expense				
Salaries and employee benefits	7,842	5,350	21,597	14,417
Loan expenses	1,254	1,119	3,512	3,072
Occupancy and equipment	736	326	2,062	1,080
Professional fees	590	561	1,755	1,091
Deposit insurance expense	269	230	751	704
Technology expense	412	325	996	831
Other expense	1,346	1,031	4,046	2,649
Total noninterest expense	12,449	8,942	34,719	23,844
Income Before Income Taxes	22,323	16,912	62,906	55,502
Provision for income taxes	5,584	6,445	15,454	21,147
Net Income	$ 16,739	$ 10,467	$ 47,452	$ 34,355
Dividends on preferred stock	(833)	(833)	(2,498)	(2,497)
Net Income Allocated to Common Shareholders	15,906	9,634	44,954	31,858
Basic Earnings Per Share	$ 0.55	$ 0.45	$ 1.57	$ 1.50
Diluted Earnings Per Share	$ 0.55	$ 0.45	$ 1.57	$ 1.50
Weighted-Average Shares Outstanding				
Basic	28,694,036	21,310,199	28,692,591	21,180,384
Diluted	28,727,822	21,328,237	28,719,740	21,193,857
Dividends Per Share	$ 0.06	$ 0.05	$ 0.18	$ 0.15

See notes to condensed consolidated financial statements.

Merchants Bancorp
Condensed Consolidated Statements of Comprehensive Income (Unaudited)
For the Three and Nine Months Ended September 30, 2018 and 2017
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Net Income	$ 16,739	$ 10,467	$ 47,452	$ 34,355
Other Comprehensive Income (Loss):				
Net change in unrealized losses on investment securities available for sale, net of (taxes) benefits of $(58), $(57), $(15), and $(105) respectively	173	86	(48)	157
Comprehensive Income	$ 16,912	$ 10,553	$ 47,404	$ 34,512

See notes to condensed consolidated financial statements.

Merchants Bancorp
Condensed Consolidated Statement of Shareholders' Equity (Unaudited)
For the Nine Months Ended September 30, 2018
(In thousands, except share data)

	Common Stock		Preferred Stock		Retained	Accumulated Other Comprehensive	
	Shares	**Amount**	**Shares**	**Amount**	**Earnings**	**Income (Loss)**	**Total**
Balance, January 1, 2018	28,685,167	$ 134,891	41,625	$ 41,581	$ 192,008	$ (1,006)	$ 367,474
Net income	—	—	—	—	47,452	—	47,452
Shares issued for stock compensation plans	8,869	130	—	—	—	—	130
Dividends on preferred stock	—	—	—	—	(2,498)	—	(2,498)
Dividends on common stock, $0.18 per share	—	—	—	—	(5,164)	—	(5,164)
Reclassification of deferred tax asset due to tax reform	—	—	—	—	243	(243)	—
Other comprehensive loss	—	—	—	—	—	(48)	(48)
Balance, September 30, 2018	28,694,036	$ 135,021	41,625	$ 41,581	$ 232,041	$ (1,297)	$ 407,346

For the Nine Months Ended September 30, 2017
(In thousands, except share data)

	Common Stock		Preferred Stock		Retained	Accumulated Other Comprehensive	
	Shares	**Amount**	**Shares**	**Amount**	**Earnings**	**Income (Loss)**	**Total**
Balance, January 1, 2017	21,111,200	$ 20,061	41,625	$ 41,581	$ 145,274	$ (628)	$ 206,288
Net income	—	—	—	—	34,355	—	34,355
Shares issued for stock compensation plans	3,200	42	—	—	—	—	42
Cash paid in lieu of fractional shares in stock split	(4)	—	—	—	—	—	—
Shares issued for RICHMAC acquisition	383,271	8,127	—	—	—	—	8,127
Dividends on preferred stock	—	—	—	—	(2,498)	—	(2,498)
Dividends on common stock, $0.15 per share	—	—	—	—	(3,186)	—	(3,186)
Other comprehensive income	—	—	—	—	—	157	157
Balance, September 30, 2017	21,497,667	$ 28,230	41,625	$ 41,581	$ 173,945	$ (471)	$ 243,285

See notes to condensed consolidated financial statements.

Merchants Bancorp
Condensed Consolidated Statements of Cash Flows (Unaudited)
Nine Months Ended September 30, 2018 and 2017
(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net income	$ 47,452	$ 34,355
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	336	201
Provision for loan losses	3,021	1,072
Gain on sale of loans	(27,548)	(27,813)
Proceeds from sales of loans	13,387,330	14,380,078
Loans and participations originated and purchased for sale	(13,374,161)	(14,394,235)
Change in mortgage servicing rights for paydowns and fair value adjustments	1,854	4,602
Net change in:		
Trading securities	66,721	16,315
Other assets and receivables	(4,718)	11,504
Other liabilities	3,441	4,869
Other	1,050	721
Net cash provided by operating activities	104,778	31,669
Investing activities:		
Net change in securities purchased under agreements to resell	130	(1,688)
Purchases of available-for-sale securities	(36,284)	(148,233)
Proceeds from the sale of available-for-sale securities	6,431	—
Proceeds from calls, maturities and paydowns of available-for-sale securities	171,319	43,779
Purchases of loans	(112,219)	(101,227)
Net change in loans receivable	(403,900)	(166,634)
Purchase of Federal Home Loan Bank stock	(233)	—
Proceeds from sale of Federal Home Loan Bank stock	218	—
Proceeds from sale of assets	10	—
Purchases of premises and equipment	(5,440)	(754)
Purchases of mortgage servicing rights	(790)	(1,209)
Purchase of limited partnership interests	(3,005)	(1,845)
Cash received in acquisition of subsidiary	6,505	363
Other investing activities	(74)	111
Net cash used in investing activities	(377,332)	(377,337)
Financing activities:		
Net change in deposits	321,931	472,843
Proceeds from Federal Home Loan Bank advances	536,367	464,250
Repayment of Federal Home Loan Bank advances	(536,379)	(464,632)
Proceeds from notes payable	9,534	—
Dividends	(7,662)	(5,684)
Net cash provided by financing activities	323,791	466,777
Net Change in Cash and Cash Equivalents	51,237	121,109
Cash and Cash Equivalents, Beginning of Period	359,519	445,701
Cash and Cash Equivalents, End of Period	$ 410,756	$ 566,810
Additional Cash Flows Information:		
Interest paid	$ 31,694	$ 19,258
Income taxes paid	13,023	17,225
The Company purchased all of the capital stock of Joy State Bank on January 2, 2018 and purchased all of the capital stock for RICHMAC on August 15, 2017. In conjunction with the acquisitions, liabilities were assumed as follows:		
Fair value of assets acquired	$ 44,217	$ 12,666
Cash paid for the capital stock/fair value common stock issued	5,472	8,127
Fair value of liabilities assumed	38,745	4,539

See notes to condensed consolidated financial statements.

Merchants Bancorp
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1: Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of Merchants Bancorp, a registered bank holding company (the "Company") and its wholly owned subsidiaries, Joy State Bank (which was renamed Farmers-Merchants Bank of Illinois on October 22, 2018), Merchants Bank of Indiana (the "Bank"), and the Bank's subsidiaries, Merchants Capital Corp. ("MCC," formerly known as P/R Mortgage and Investment Corp. prior to October 1, 2018), Ash Realty Holdings, LLC ("Ash Realty"), Natty Mac Funding, Inc. ("NMF"), MBI Midtown West, LLC ("MMW"), and MCC's subsidiary RICHMAC Funding LLC ("RICHMAC"), (collectively referred to as the "Company").

The accompanying unaudited condensed consolidated balance sheet of the Company as of December 31, 2017, which has been derived from audited financial statements, and unaudited condensed consolidated financial statements of the Company as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017, were prepared in accordance with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Accordingly, these condensed financial statements should be read in conjunction with the audited financial statements and notes thereto of the Company as of and for the year ended December 31, 2017 in its Annual Report on Form 10-K. Reference is made to the accounting policies of the Company described in the Notes to the Financial Statements contained in the Annual Report on Form 10-K.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair presentation of the unaudited financial statements have been included to present fairly the financial position as of September 30, 2018 and the results of operations for the three and nine months ended September 30, 2018 and 2017, and cash flows for the nine months ended September 30, 2018 and 2017. All interim amounts have not been audited and the results of operations for the three and nine months ended September 30, 2018, herein are not necessarily indicative of the results of operations to be expected for the entire year.

Principles of Consolidation

The consolidated financial statements as of and for the period ended September 30, 2018 include the Company, and its wholly owned subsidiaries, the Bank, and Joy State Bank (prior to it being renamed Farmers-Merchants Bank of Illinois, effective October 22, 2018). Also included are the Bank's wholly owned subsidiaries, MCC, MCC's wholly owned subsidiary, RICHMAC, Ash Realty, NMF, and MMW. The consolidated financial statements as of and for the period ended September 30, 2017, include the Company and its wholly owned subsidiary, the Bank, and the Bank's wholly owned subsidiaries, MCC, MCC's wholly owned subsidiary, RICHMAC as of August 15, 2017, Ash Realty, NMF, and MMW. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, loan servicing rights and fair values of financial instruments.

Stock Split

On July 5, 2017, the Company's shareholders approved an increase of authorized common shares to 50.0 million shares, and the Company declared a 2.5-for-1 stock split effective July 6, 2017. The presentation of authorized common

shares has been retrospectively adjusted to give effect to the increase, and all share and per share amounts have been retrospectively adjusted to give effect to the stock split.

Acquisitions

Effective August 15, 2017, the Bank acquired 100% of the equity interests of RICHMAC Funding, LLC, which is a national multi-family housing mortgage lender and servicer. The purchase price was paid in shares of Company common stock with a value of $8.1 million. The Company recorded goodwill and intangible assets totaling $3.8 million and $1.6 million, respectively, in connection with the acquisition. As a result of the acquisition, the Company expanded its product offerings and benefited from economies of scale. The acquisition did not materially impact the Company's financial position, results of operations or cash flows.

On May 8, 2017, the Company entered into a Stock Purchase Agreement to acquire Joy State Bank. The acquisition closed on January 2, 2018 at a total cost of approximately $5.5 million. At December 31, 2017 Joy State Bank had $43 million in assets. The Company recorded goodwill and intangible assets totaling $989,000 and $478,000, respectively, in connection with the acquisition. The intangibles consisted of core deposit intangibles that are being amortized over 10 years on an accelerated basis. The acquired time deposits of $16.7 million were recorded at a fair value of $16.9 million. The fair value premium of $185,000 is being accreted against interest expense over 20 months. The acquired loan portfolio of $27.9 million was recorded at a fair value of $27.5 million. The fair value discount of $458,000 is being accreted to interest income on a straight-line basis over an average of 39 months in accordance with ASC 310-20. While there were some loans identified for potential classification under ASC 310-30, they were not material to the transaction. On October 22, 2018, the Company changed the name of Joy State Bank to Farmers-Merchants Bank of Illinois. Certain fair value measurements and the purchase price allocation are still being evaluated by management and are subject to change during the measurement period. As a result of the acquisition, the Company increased its deposit base and benefited from economies of scale. The acquisition did not materially impact the Company's financial position, results of operations or cash flows.

On October 1, 2018, the Company acquired FM Bancorp, Inc., a bank holding company, and its wholly owned subsidiary, Farmers-Merchants National Bank of Paxton. On that date, FM Bancorp, Inc. ultimately merged with and into the Company, with the Company as the surviving entity, and Farmers-Merchants National Bank of Paxton merged with and into Joy State Bank, with Joy State Bank as the surviving bank. Effective October 22, 2018, Joy State Bank's name changed to Farmers-Merchants Bank of Illinois. Under the terms of the merger agreement, shareholders of the 27,537 outstanding shares of FM Bancorp, Inc. were to be compensated $795.29 per share, for a total purchase price of $21.9 million. As of September 30, 2018, FM Bancorp, Inc. and Farmers-Merchants National Bank of Paxton had total assets of approximately $109.6 million, deposits of approximately $95.7 million, and net loan receivables of approximately $35.0 million. As a result of the acquisition, the Company expects to increase its deposit base and to benefit from economies of scale. The accounting for the business combination is not yet complete and therefore all required disclosures for a business combination have not been provided.

Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the financial statement presentation as of and for the three and nine months ended September 30, 2018. These reclassifications had no effect net income.

Note 2: Securities

Trading Securities

Securities that are held principally for resale in the near term are recorded as trading securities at fair value with changes in fair value recorded in earnings. Trading securities include FHA and conventional Fannie Mae and Freddie Mac participation certificates. The unrealized gains included in trading securities totaled $661,000 and $1.4 million at September 30, 2018 and 2017, respectively.

Securities Available-For-Sale

The amortized cost and approximate fair values, together with gross unrealized gains and losses, of securities are as follows:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
	(In thousands)			
Available-for-sale securities:				
Treasury notes	$ 3,489	$ —	$ 24	$ 3,465
Federal agencies	242,247	—	1,703	240,544
Equities	69	3	—	72
Mortgage-backed - Government-sponsored entity (GSE) - residential	25,628	—	—	25,628
Total available-for-sale securities	$ 271,433	$ 3	$ 1,727	$ 269,709

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
	(In thousands)			
Available-for-sale securities:				
Treasury notes	$ 1,000	$ —	$ 8	$ 992
Federal agencies	376,414	—	1,683	374,731
Municipals	6,688	—	—	6,688
Mortgage-backed - Government-sponsored entity (GSE) - residential	25,960	—	—	25,960
Total available-for-sale securities	$ 410,062	$ —	$ 1,691	$ 408,371

The amortized cost and fair value of available-for-sale securities at September 30, 2018 and December 31, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may

have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	September 30, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Contractual Maturity	(In thousands)			
Within one year	$ 166,208	$ 165,217	$ 164,997	$ 164,321
After one through five years	79,528	78,792	212,905	211,890
After five through ten years	—	—	—	—
After ten years	—	—	6,200	6,200
	245,736	244,009	384,102	382,411
Mortgage-backed - Government-sponsored entity (GSE) - residential	25,628	25,628	25,960	25,960
Equities	69	72	—	—
	$ 271,433	$ 269,709	$ 410,062	$ 408,371

During the three and nine months ended September 30, 2018, $6.4 million of securities available-for-sale were sold, and no gain or loss was recognized. During the three and nine months ended September 30, 2017, no securities available-for-sale were sold.

The following tables show the Company's investments' gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment class and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2018 and December 31, 2017:

	September 30, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)					
Available-for-sale securities:						
Treasury notes	$ 3,465	$ 24	$ —	$ —	$ 3,465	$ 24
Federal agencies	145,651	1,041	94,893	662	240,544	1,703
	$ 149,116	$ 1,065	$ 94,893	$ 662	$ 244,009	$ 1,727

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)					
Available-for-sale securities:						
Treasury notes	$ 992	$ 8	$ —	$ —	$ 992	$ 8
Federal agencies	191,064	903	183,667	780	374,731	1,683
	$ 192,056	$ 911	$ 183,667	$ 780	$ 375,723	$ 1,691

Other-than-temporary Impairment

Unrealized losses on securities have not been recognized to income because the Company has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

Note 3: Loans and Allowance for Loan Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances 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 amortized at cost, interest income is accrued based on the unpaid principal balance.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past-due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is applied to the principal balance until the loan can be returned to an accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

For all loan portfolio segments, the Company promptly charges off loans, or portions thereof, when available information confirms that specific loans are uncollectable based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

When cash payments are received on impaired loans in each loan class, the Company records the payment as interest income unless collection of the remaining recorded principal amount is doubtful, at which time payments are used to reduce the principal balance of the loan. Troubled debt restructured loans recognize interest income on an accrual basis at the renegotiated rate if the loan is in compliance with the modified terms.

Interest earned from the time of funding to the time of sale is recognized as interest income as accrued. Fees earned agreements are recognized when collected as noninterest income.

Loans receivable at September 30, 2018 and December 31, 2017 include:

	September 30, 2018	December 31, 2017
	(In thousands)	
Mortgage warehouse lines of credit	$ 406,287	$ 224,937
Residential real estate	399,970	330,410
Multi-family and healthcare financing	738,879	529,259
Commercial and commercial real estate	290,126	228,668
Agricultural production and real estate	70,280	51,966
Consumer and margin loans	11,560	9,420
	1,917,102	1,374,660
Less		
Allowance for loan losses	11,243	8,311
Loans Receivable	$ 1,905,859	$ 1,366,349

Risk characteristics applicable to each segment of the loan portfolio are described as follows.

Mortgage Warehouse Lines of Credit (MTG WHLOC): Under its warehouse program, the Company provides warehouse financing arrangements to approved mortgage companies for the origination and sale of residential mortgage loans and to a lesser extent multi-family loans. Agency eligible, governmental and jumbo residential mortgage loans that are secured by mortgages placed on existing one to four family dwellings may be originated or purchased and placed on each mortgage warehouse line.

As a secured line of credit, collateral pledged to the Company secures each individual mortgage until the lender sells the loan in the secondary market. A traditional secured warehouse line of credit typically carries a base interest rate of 30 day LIBOR or the Wall Street Journal Prime Rate plus a margin.

Risk is evident if there is a change in the fair value of mortgage loans originated by mortgage bankers in warehouse, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit.

Residential Real Estate Loans (RES RE): The real estate loans are secured by owner-occupied 1-4 family residences. Repayment of residential real estate loans is primarily dependent on the personal income and credit rating of the borrowers.

Multi-Family and Healthcare Financing (MF RE): The Company engages in multi-family and healthcare financing, including construction loans, specializing in originating and servicing loans for multi-family rental and senior living properties. In addition, the Company originates loans secured by an assignment of federal income tax credits by partnerships invested in multi-family real estate projects. Construction and land loans are generally based upon estimates of costs and estimated value of the completed project and include independent appraisal reviews and a financial analysis of the developers and property owners. Sources of repayment of these loans may include permanent loans, sales of developed property or an interim loan commitment from the Bank until permanent agency-eligible financing is obtained. These loans are considered to be higher risk than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and the availability of long-term financing. Credit risk in these loans may be impacted by the creditworthiness of a borrower, property values and the local economy in the Company's market area. Repayment of these loans depends on the successful operation of a business or property and the borrower's cash flows.

Commercial Lending and Commercial Real Estate Loans (CML & CRE): The commercial lending and commercial real estate portfolio includes loans to commercial customers for use in financing working capital needs,

equipment purchases and expansions, as well as loans to commercial customers to finance land and improvements. It also includes loans collateralized by mortgage servicing rights of mortgage warehouse customers. The loans in this category are repaid primarily from the cash flow of a borrower's principal business operation. Credit risk in these loans is driven by creditworthiness of a borrower and the economic conditions that impact the cash flow stability from business operations.

Agricultural Production and Real Estate Loans (AG & AGRE): Agricultural production loans are generally comprised of seasonal operating lines of credit to grain farmers to plant and harvest corn and soybeans and term loans to fund the purchase of equipment. The Company also offers long term financing to purchase agricultural real estate. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry-developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop and other farm assets as considered necessary. The Company is approved to sell agricultural loans in the secondary market through the Federal Agricultural Mortgage Corporation and uses this relationship to manage interest rate risk within the portfolio.

Consumer and Margin Loans (CON & MAR): Consumer loans are those loans secured by household assets. Margin loans are those loans secured by marketable securities. The term and maximum amount for these loans are determined by considering the purpose of the loan, the margin (advance percentage against value) in all collateral, the primary source of repayment, and the borrower's other related cash flow.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

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

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In restructuring the loan, the Company attempts to work out an alternative payment schedule with the borrower in order to optimize collectability of the loan. A troubled debt restructuring (TDR) occurs when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status, and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

Nonaccrual loans, including TDRs that have not met the six month minimum performance criterion, are reported as non-performing loans. For all loan classes, it is the Company's policy to have any restructured loans which are on nonaccrual status prior to being restructured remain on nonaccrual status until nine months of satisfactory borrower performance, at which time management would consider its return to accrual status. A loan is generally classified as nonaccrual when the Company believes that receipt of principal and interest is questionable under the terms of the loan agreement. Most generally, this is at 90 or more days past due.

With regard to determination of the amount of the allowance for credit losses, restructured loans are considered to be impaired. As a result, the determination of the amount of impaired loans for each portfolio segment within troubled debt restructurings is the same as detailed previously above.

The following tables present, by portfolio segment, the activity in the allowance for loan losses for the three and nine months ended September 30, 2018 and 2017 and the recorded investment in loans and impairment method as of September 30, 2018:

	At or For the Three Months Ended September 30, 2018						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Allowance for loan losses							
Balance, beginning of period	$ 646	$ 1,812	$ 4,662	$ 2,803	$ 392	$ 273	$ 10,588
Provision (credit) for loan losses	73	96	240	184	35	(11)	617
Loans charged to the allowance	—	—	—	46	—	28	74
Recoveries of loans previously charged off	—	(16)	—	(1)	—	(19)	(36)
Balance, end of period	$ 719	$ 1,892	$ 4,902	$ 3,032	$ 427	$ 271	$ 11,243
Ending balance: individually evaluated for impairment	$ 175	$ —	$ —	$ 200	$ 20	$ 146	$ 541
Ending balance: collectively evaluated for impairment	$ 544	$ 1,892	$ 4,902	$ 2,832	$ 407	$ 125	$ 10,702
Loans							
Ending balance	$ 406,287	$ 399,970	$ 738,879	$ 290,126	$ 70,280	$ 11,560	$ 1,917,102
Ending balance individually evaluated for impairment	$ 579	$ 1,048	$ 109	$ 6,974	$ 370	$ 187	$ 9,267
Ending balance collectively evaluated for impairment	$ 405,708	$ 398,922	$ 738,770	$ 283,152	$ 69,910	$ 11,373	$ 1,907,835

	For the Three Months Ended September 30, 2017						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Allowance for loan losses							
Balance, beginning of period	$ 281	$ 1,938	$ 2,426	$ 1,845	$ 271	$ 104	$ 6,865
Provision (credit) for loan losses	(8)	(414)	276	688	36	14	592
Loans charged to the allowance	—	—	—	—	—	—	—
Recoveries of loans previously charged off	—	—	—	—	—	—	—
Balance, end of period	$ 273	$ 1,524	$ 2,702	$ 2,533	$ 307	$ 118	$ 7,457

	At or For the Nine Months Ended September 30, 2018						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Allowance for loan losses							
Balance, beginning of period	$ 283	$ 1,587	$ 3,502	$ 2,362	$ 320	$ 257	$ 8,311
Provision for loan losses	436	305	1,400	759	107	14	3,021
Loans charged to the allowance	—	—	—	(89)	—	—	(89)
Recoveries of loans previously charged off	—	—	—	—	—	—	—
Balance, end of period	$ 719	$ 1,892	$ 4,902	$ 3,032	$ 427	$ 271	$ 11,243

	At or For the Nine Months Ended September 30, 2017						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Allowance for loan losses							
Balance, beginning of period	$ 373	$ 2,170	$ 1,962	$ 1,374	$ 269	$ 102	$ 6,250
Provision (credit) for loan losses	(100)	(646)	740	1,058	38	(18)	1,072
Loans charged to the allowance	—	—	—	—	—	—	—
Recoveries of loans previously charged off	—	—	—	101	—	34	135
Balance, end of period	$ 273	$ 1,524	$ 2,702	$ 2,533	$ 307	$ 118	$ 7,457

The following table presents the allowance for loan losses and the recorded investment in loans and impairment method as of December 31, 2017:

	December 31, 2017						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Allowance for loan losses							
Balance, December 31, 2017	$ 283	$ 1,587	$ 3,502	$ 2,362	$ 320	$ 257	$ 8,311
Ending balance: individually evaluated for impairment	$ —	$ —	$ —	$ 200	$ 16	$ 146	$ 362
Ending balance: collectively evaluated for impairment	$ 283	$ 1,587	$ 3,502	$ 2,162	$ 304	$ 111	$ 7,949
Loans							
Ending balance	$ 224,937	$ 330,410	$ 529,259	$ 228,668	$ 51,966	$ 9,420	$ 1,374,660
Ending balance individually evaluated for impairment	$ —	$ 729	$ —	$ 6,179	$ 282	146	$ 7,336
Ending balance collectively evaluated for impairment	$ 224,937	$ 329,681	$ 529,259	$ 222,489	$ 51,684	$ 9,274	$ 1,367,324

Internal Risk Categories

In adherence with policy, the Company uses the following internal risk grading categories and definitions for loans:

Average or above – Loans to borrowers of satisfactory financial strength or better. Earnings performance is consistent with primary and secondary sources of repayment that are well defined and adequate to retire the debt in a

timely and orderly fashion. These businesses would generally exhibit satisfactory asset quality and liquidity with moderate leverage, average performance to their peer group and experienced management in key positions. These loans are disclosed as “Acceptable and Above” in the following table.

Acceptable – Loans to borrowers involving more than average risk and which contain certain characteristics that require some supervision and attention by the lender. Asset quality is acceptable, but debt capacity is modest and little excess liquidity is available. The borrower may be fully leveraged and unable to sustain major setbacks. Covenants are structured to ensure adequate protection. Borrower’s management may have limited experience and depth. This category includes loans which are highly leveraged due to regulatory constraints, as well as loans involving reasonable exceptions to policy. These loans are disclosed as “Acceptable and Above” in the following table.

Special Mention (Watch) – This is a loan that is sound and collectable but contains considerable risk. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following tables present the credit risk profile of the Bank’s loan portfolio based on internal rating category and payment activity as of September 30, 2018 and December 31, 2017:

	September 30, 2018						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
				(In thousands)			
Special Mention (Watch)	$ —	$ 301	$ 45,762	$ 15,714	$ 3,317	$ 1,261	$ 66,355
Substandard	579	1,048	109	6,974	370	187	9,267
Doubtful	—	—	—	—	—	—	—
Acceptable and Above	405,708	398,621	693,008	267,438	66,593	10,112	1,841,480
Total	$ 406,287	$ 399,970	$ 738,879	$ 290,126	$ 70,280	$ 11,560	$ 1,917,102

	December 31, 2017						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
				(In thousands)			
Special Mention (Watch)	$ —	$ —	$ 1,800	$ 12,608	$ 323	$ 1,563	$ 16,294
Substandard	—	729	—	6,179	282	146	7,336
Doubtful	—	—	—	—	—	—	—
Acceptable and Above	224,937	329,681	527,459	209,881	51,361	7,711	1,351,030
Total	$ 224,937	$ 330,410	$ 529,259	$ 228,668	$ 51,966	$ 9,420	$ 1,374,660

The Bank evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made to either during the past year.

The following tables present the Bank's loan portfolio aging analysis of the recorded investment in loans as of September 30, 2018 and December 31, 2017:

	September 30, 2018					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
	(In thousands)					
MTG WHLOC	$ —	$ —	$ 324	$ 324	$ 405,963	$ 406,287
RES RE	1,111	80	359	1,550	398,420	399,970
MF RE	—	—	—	—	738,879	738,879
CML & CRE	109	—	165	274	289,852	290,126
AG & AGRE	71	—	588	659	69,621	70,280
CON & MAR	57	18	153	228	11,332	11,560
	$ 1,348	$ 98	$ 1,589	$ 3,035	$ 1,914,067	$ 1,917,102

	December 31, 2017					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
	(In thousands)					
MTG WHLOC	$ —	$ —	$ —	$ —	$ 224,937	$ 224,937
RES RE	—	194	534	728	329,682	330,410
MF RE	—	—	—	—	529,259	529,259
CML & CRE	—	860	2,061	2,921	225,747	228,668
AG & AGRE	59	—	399	458	51,508	51,966
CON & MAR	—	—	146	146	9,274	9,420
	$ 59	$ 1,054	$ 3,140	$ 4,253	$ 1,370,407	$ 1,374,660

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings.

The following tables present impaired loans and specific valuation allowance information based on class level as of September 30, 2018 and December 31, 2017:

	September 30, 2018						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Impaired loans without a specific allowance:							
Recorded investment	$ 255	$ 1,048	$ 109	$ 4,974	$ 88	$ 41	$ 6,515
Unpaid principal balance	255	1,048	109	4,974	88	41	6,515
Impaired loans with a specific allowance:							
Recorded investment	324	—	—	2,000	282	146	2,752
Unpaid principal balance	324	—	—	2,000	282	146	2,752
Specific allowance	175	—	—	200	20	146	541
Total impaired loans:							
Recorded investment	579	1,048	109	6,974	370	187	9,267
Unpaid principal balance	579	1,048	109	6,974	370	187	9,267
Specific allowance	175	—	—	200	20	146	541

	December 31, 2017						
	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Impaired loans without a specific allowance:							
Recorded investment	$ —	$ 729	$ —	$ 4,119	$ —	$ —	$ 4,848
Unpaid principal balance	—	729	—	4,119	—	—	4,848
Impaired loans with a specific allowance:							
Recorded investment	—	—	—	2,060	282	146	2,488
Unpaid principal balance	—	—	—	2,060	282	146	2,488
Specific allowance	—	—	—	200	16	146	362
Total impaired loans:							
Recorded investment	—	729	—	6,179	282	146	7,336
Unpaid principal balance	—	729	—	6,179	282	146	7,336
Specific allowance	—	—	—	200	16	146	362

The following tables present by portfolio class, information related to the average recorded investment and interest income recognized on impaired loans for the three and nine month periods ended September 30, 2018 and 2017:

	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Three months ended September 30, 2018:							
Average recorded investment in impaired loans	$ 691	$ 1,042	$ 109	$ 7,254	$ 425	$ 187	$ 9,708
Interest income recognized	26	21	6	98	4	—	155
Three months ended September 30, 2017:							
Average recorded investment in impaired loans	$ —	$ 231	$ —	$ 3,133	$ 282	$ —	$ 3,646
Interest income recognized	—	—	—	11	—	—	11

	MTG WHLOC	RES RE	MF RE	CML & CRE	AG & AGRE	CON & MAR	TOTAL
	(In thousands)						
Nine months ended September 30, 2018:							
Average recorded investment in impaired loans	$ 1,030	$ 1,097	$ 113	$ 7,556	$ 525	$ 184	$ 10,505
Interest income recognized	66	51	8	177	43	1	346
Nine months ended September 30, 2017:							
Average recorded investment in impaired loans	$ —	$ 274	$ —	$ 3,275	$ 282	$ —	$ 3,831
Interest income recognized	—	—	—	21	—	—	21

The following table presents the Company's nonaccrual loans and loans past due 90 days or more and still accruing at September 30, 2018 and December 31, 2017.

	September 30, 2018		December 31, 2017	
	Nonaccrual	Total Loans > 90 Days & Accruing	Nonaccrual	Total Loans > 90 Days & Accruing
	(In thousands)			
MTG WHLOC	$ 579	$ —	$ —	$ —
RES RE	263	155	60	475
MF RE	—	—	—	—
CML & CRE	165	—	2,060	—
AG & AGRE	282	307	282	117
CON & MAR	154	—	146	—
	$ 1,443	$ 462	$ 2,548	$ 592

A troubled debt identified as of December 31, 2017, in the amount of $2.0 million, was restructured during the three months ended September 30, 2018. The outstanding balance of this Commercial line of credit was $2.0 million before and after modification and interest due on the loan was current as of September 30, 2018. The original terms of one year at prime rate + 1% have been renewed through July 1, 2019 at the same interest rate. This concession to extend credit longer than the original term reflects the unlikeliness of the borrower being able to obtain a line of credit from another institution at market rates. Additionally, there was one new troubled debt as of September 30, 2018 in the amount of $2.0 million that was restructured during the three months ended September 30, 2018. The outstanding balance of this Commercial secured overdraft was $2.0 million before modification and converted to a $2.0 million secured Commercial amortizing term loan at a fixed rate of 6.0% to mature on July 1, 2023. This concession reflects the unlikeliness of the borrower being able to obtain a line of credit from another institution at market rates.

No loans restructured during the last twelve months defaulted during the three months ended September 30, 2018 or 2017. There were no residential loans in process of foreclosure at September 30, 2018 or December 31, 2017.

Note 4: Regulatory Matters

The Company, the Bank, and Joy State Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by federal and state banking regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company, the Bank, and Joy State Bank must meet specific capital guidelines that involve quantitative measures of the Company's, the Bank, and Joy State Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's, the Bank's, and Joy State Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Furthermore, the Company's, the Bank's, and Joy State Bank's regulators could require adjustments to regulatory capital not reflected in these financial statements.

Quantitative measures established by regulation to ensure capital adequacy require the Company, the Bank, and Joy State Bank to maintain minimum amounts and ratios (set forth in the table below). Management believes, as of September 30, 2018 and December 31, 2017, that the Company, the Bank, and Joy State Bank met all capital adequacy requirements to which they were subject.

As of September 30, 2018 and December 31, 2017, the most recent notifications from the Federal Reserve Board categorized the Company as well capitalized and most recent notifications from the Federal Deposit Insurance Corporation categorized the Bank and Joy State Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, a company must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Company, the Bank, or Joy State Bank's category.

The Company, the Bank, and Joy State and Bank's actual capital amounts and ratios are also presented in the following tables.

	Actual		Minimum Amount Required for Adequately Capitalized[1]		Minimum Amount To Be Well Capitalized[1]	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
September 30, 2018						
Total capital[1] (to risk-weighted assets)						
Company	$ 396,736	12.6 %	$ 251,761	8.0 %	$ —	N/A
Bank	461,120	14.8 %	248,823	8.0 %	311,029	10.0 %
Joy State Bank	4,474	12.4 %	2,876	8.0 %	3,595	10.0 %
Tier 1 capital[1] (to risk-weighted assets)						
Company	385,492	12.2 %	188,821	6.0 %	—	N/A
Bank	449,982	14.5 %	186,617	6.0 %	248,823	8.0 %
Joy State Bank	4,368	12.2 %	2,157	6.0 %	2,876	8.0 %
Common Equity Tier 1 capital[1] (to risk-weighted assets)						
Company	343,911	10.9 %	141,616	4.5 %	—	N/A
Bank	449,982	14.5 %	139,963	4.5 %	202,169	6.5 %
Joy State Bank	4,368	12.2 %	1,618	4.5 %	2,336	6.5 %
Tier 1 capital[1] (to average assets)						
Company	385,492	10.1 %	152,110	4.0 %	—	N/A
Bank	449,982	12.0 %	150,515	4.0 %	188,144	5.0 %
Joy State Bank	4,368	9.3 %	1,878	4.0 %	2,348	5.0 %

	Actual		Minimum Amount Required for Adequately Capitalized[1]		Minimum Amount To Be Well Capitalized[1]	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
December 31, 2017						
Total capital[1] (to risk-weighted assets)						
Company	$ 355,722	13.7 %	$ 207,657	8.0 %	$ —	N/A
Bank	406,638	15.7 %	207,567	8.0 %	259,459	10.0 %
Tier I capital[1] (to risk-weighted assets)						
Company	347,411	13.4 %	155,743	6.0 %	—	N/A
Bank	398,327	15.4 %	155,675	6.0 %	207,567	8.0 %
Common Equity Tier I capital[1] (to risk-weighted assets)						
Company	305,830	11.8 %	116,807	4.5 %	—	N/A
Bank	398,327	15.4 %	116,756	4.5 %	168,648	6.5 %
Tier I capital[1] (to average assets)						
Company	347,411	10.9 %	127,318	4.0 %	—	N/A
Bank	398,327	12.5 %	127,593	4.0 %	159,491	5.0 %

1 As defined by regulatory agencies.

Beginning January 1, 2015, a new Basel III Capital Rule applied to the Bank. The following table lists the capital categories and ratios determined by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation.

Capital Category	Total Risk-based Capital ratio	Tier 1 Risk-based Capital ratio	Common Equity Tier 1 Risk-based Capital ratio	Tier 1 Leverage ratio
Well capitalized	10 %	8 %	6.5 %	5 %
Adequately capitalized	8	6	4.5	4
Undercapitalized	<8	<6	<4.5	<4
Significantly undercapitalized	<6	<4	<3	<3
Critically undercapitalized	Tangible Equity/Total Assets </= 2%			

The Basel III Capital Rules, among other things, (i) introduced a new capital measure called "Common Equity Tier 1" (CET1), (ii) specified that Tier 1 capital consist of CET1 and "Additional Tier 1 Capital" instruments meeting specified requirements, (iii) defined CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments as compared to existing regulations.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, and are being phased in over a four-year period (beginning at 40% on January 1, 2015, and an additional 20% per year thereafter). Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of CET1 capital above its minimum risk-based capital requirements. The implementation of the capital conservation buffer began on January 1, 2016, at the 0.625% level and is being phased in over a four-year period (increasing by that amount on each subsequent January 1 until it reaches 2.5% on January 1, 2019).

Note 5: 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 interest rate locks 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 other assets in the condensed consolidated balance sheets while derivative instruments with a negative fair value are reported in other liabilities in the condensed consolidated balance sheets.

The following table presents the notional amount and fair value of interest rate locks and forward contracts utilized by the Company at September 30, 2018. There were no material derivatives recorded at December 31, 2017.

	Notional Amount	Balance Sheet Location	Fair Value Asset	Fair Value (Liability)
September 30, 2018	(In thousands)		(In thousands)	
Interest rate lock commitments	$ 9,800	Derivative assets/liabilities	$ 68	$ —
Forward contracts	15,320	Derivative assets/liabilities	6	1
Total derivative financial instruments	$ 25,120		$ 74	$ 1

Fair values of derivative financial instruments were estimated using changes in mortgage interest rates from the date the Company entered into the interest rate lock commitment 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 nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
	(In thousands)			
Interest rate lock commitments	$ (95)	$ —	$ 68	$ —
Forward contracts (1)	16	—	(76)	—
Net derivative gains (losses)	$ (79)	$ —	(8)	$ —

(1) Amount includes pair-off settlements

Note 6: Disclosures about Fair Value of Assets and Liabilities

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of 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 supported by little or no market activity and are significant to the fair value of the assets or liabilities

Recurring Measurements

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying 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 September 30, 2018 and December 31, 2017:

		Fair Value Measurements Using		
Assets	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
		(In thousands)		
September 30, 2018				
Trading securities	$ 74,116	$ —	$ 74,116	$ —
Available-for-sale securities:				
Treasury notes	3,465	3,465	—	—
Federal agencies	240,544	—	240,544	—
Equities	72	72	—	—
Municipals	—		—	—
Mortgage-backed - Government-sponsored entity (GSE) - residential	25,628	—	25,628	—
Loans held for sale	5,888	—	5,888	—
Mortgage servicing rights	71,490	—	—	71,490
Derivative assets - interest rate lock commitments	68	—	—	68
Derivative assets - forward contracts	6	—	6	—
Derivative liabilities - interest rate lock commitments	—	—	—	—
Derivative liabilities - forward contracts	1	—	1	—
December 31, 2017				
Trading securities	$ 140,837	$ —	$ 140,837	$ —
Available-for-sale securities:				
Treasury notes	992	992	—	—
Federal agencies	374,731	—	374,731	—
Municipals	6,688	—	—	6,688
Mortgage-backed - Government-sponsored entity (GSE) - residential	25,960	—	25,960	—
Mortgage servicing rights	66,079	—	—	66,079

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 balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the three months ended September 30, 2018 and the year ended December 31, 2017. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Trading and Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2

of the valuation hierarchy including federal agencies, mortgage-backed securities, U.S. Treasuries, Equities, and Federal Housing Administration participation certificates. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

Loans Held for Sale

Certain loans held for sale at fair value are saleable into the secondary mortgage markets and their fair values are estimated using observable quoted market or contracted prices, or market price equivalents, which would be used by other market participants. These saleable loans are considered Level 2.

Mortgage Servicing Rights

Mortgage servicing rights do not trade in an active, open market with readily observable prices. Accordingly, fair value is estimated using discounted cash flow models having significant inputs of discount rate, prepayment speed and default rate. Due to the nature of the valuation inputs, mortgage servicing rights are classified within Level 3 of the hierarchy.

The Chief Financial Officer’s (CFO) office contracts with a pricing specialist to generate fair value estimates on a quarterly basis. The CFO’s office challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States.

Derivative Financial Instruments

The Company estimates the fair value of interest rate lock commitments based on the value of the underlying mortgage loan, quoted mortgage backed security prices, estimates of the fair value of the mortgage servicing rights, and an estimate of the probability that the mortgage loan will fund within the terms of the interest rate lock commitment, net of expenses. The Company estimates the fair value of forward sales commitments based on market quotes of mortgage backed security prices for securities similar to the ones used, which are considered Level 2. With respect to its interest rate lock commitments, management determined that a Level 3 classification was most appropriate based on the various significant unobservable inputs utilized in estimating the fair value of its interest rate lock commitments. Changes in fair value of the Company’s derivative financial instruments are recognized through noninterest income on its condensed consolidated statement of income.

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheets using significant unobservable (Level 3) inputs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)		(In thousands)	
Mortgage servicing rights				
Balance, beginning of period	$ 70,085	$ 57,557	$ 66,079	$ 53,670
Additions				
Originated and purchased servicing	1,563	3,015	7,265	8,984
Acquisition of RICHMAC	—	3,970	—	3,970
Subtractions				
Paydowns	(658)	(1,083)	(3,267)	(3,813)
Changes in fair value due to changes in valuation inputs or assumptions used in the valuation model	500	(1,437)	1,413	(789)
Balance, end of period	$ 71,490	$ 62,022	$ 71,490	$ 62,022
Available-for-sale securities - Municipals				
Balance, beginning of period	$ 6,431	$ —	$ 6,688	$ —
Additions				
Purchased securities	—	—	—	—
Subtractions				
Paydowns	—	—	(257)	—
Sales	(6,431)	—	(6,431)	—
Unrealized gains (losses) included in other comprehensive income	—	—	—	—
Balance, end of period	$ —	$ —	$ —	$ —
Derivative Assets - interest rate lock commitments				
Balance, beginning of period	$ 170	$ —	$ —	$ —
Purchases	—	—	—	—
Changes in fair value	(102)	—	68	—
Balance, end of period	$ 68	$ —	$ 68	$ —
Derivative Liabilities - interest rate lock commitments				
Balance, beginning of period	$ 7	$ —	$ —	$ —
Purchases	—	—	—	—
Changes in fair value	(7)	—	—	—
Balance, end of period	$ —	$ —	$ —	$ —

Nonrecurring Measurements

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2018 and December 31, 2017.

		Fair Value Measurements Using		
Assets	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
		(In thousands)		
September 30, 2018				
Impaired loans (collateral-dependent)	$ 149	$ —	$ —	$ 149
December 31, 2017				
Impaired loans (collateral-dependent)	$ 2,126	$ —	$ —	$ 2,126

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheet, as well as the general classification of such assets pursuant to the valuation hierarchy. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Collateral-Dependent Impaired Loans, Net of Allowance for Loan Losses

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by the Bank’s Chief Credit Officer’s (CCO) office. Appraisals are reviewed for accuracy and consistency by the CCO’s office. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by the CCO’s office by comparison to historical results.

Unobservable (Level 3) Inputs:

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

	Fair Value (In thousands)	Valuation Technique	Unobservable Inputs	Range
At September 30, 2018:				
Collateral-dependent impaired loans	$ 149	Market comparable properties	Marketability discount	60%
Mortgage servicing rights	$ 71,490	Discounted cash flow	Discount rate	8% - 13%
			Constant prepayment rate	1% - 29%
Derivative assets - interest rate lock commitments	$ 68	Discounted cash flow	loan closing rates	73-99%
Derivative liabilities - interest rate lock commitments	$ —	Discounted cash flow	loan closing rates	73-99%
At December 31, 2017:				
Collateral-dependent impaired loans	$ 2,126	Market comparable properties	Marketability discount	5% - 47%
Mortgage servicing rights	$ 66,079	Discounted cash flow	Discount rate	8% - 13%
			Constant prepayment rate	1% - 36%

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Mortgage Servicing Rights

The significant unobservable inputs used in the fair value measurement of the Company's mortgage servicing rights are discount rates and constant prepayment rates. Significant increases or decreases in any of those inputs in isolation would result in a significantly different fair value measurement.

Fair Value of Financial Instruments

The following table presents the carrying amount and estimated fair values of the Company's financial instruments not carried at fair value and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2018 and December 31, 2017.

			Fair Value Measurements Using		
Assets	**Carrying Value**	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
			(In thousands)		
September 30, 2018					
Financial assets:					
Cash and cash equivalents	$ 410,756	$ 410,756	$ 410,756	$ —	$ —
Securities purchased under agreements to resell	6,913	6,913	—	6,913	—
FHLB stock	7,608	7,608	—	7,608	—
Loans held for sale	998,514	998,514	—	998,514	—
Loans, net	1,905,859	1,913,120	—	—	1,913,120
Interest receivable	12,289	12,289	—	12,289	—
Financial liabilities:					
Deposits	3,302,369	3,301,588	2,712,109	589,479	—
Line of credit	25,000	25,000	—	25,000	—
Short-term subordinated debt	39,534	39,534	—	39,534	—
FHLB advances	2,745	2,723	—	2,723	—
Interest payable	6,064	6,064	—	6,064	—
December 31, 2017					
Financial assets:					
Cash and cash equivalents	$ 359,519	$ 359,519	$ 359,519	$ —	$ —
Securities purchased under agreements to resell	7,043	7,043	—	7,043	—
FHLB stock	7,539	7,539	—	7,539	—
Loans held for sale	995,319	995,319	—	995,319	—
Loans, net	1,366,349	1,364,568	—	—	1,364,568
Interest receivable	8,326	8,326	—	8,326	—
Financial liabilities:					
Deposits	2,943,561	2,943,173	2,534,605	408,568	—
Line of credit	25,000	25,000	—	25,000	—
Short-term subordinated debt	30,000	30,000	—	30,000	—
FHLB advances	1,612	1,620	—	1,620	—
Interest payable	2,817	2,817	—	2,817	—

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

Cash and Cash Equivalents and Securities Purchased Under Agreement to Resell

The carrying amount approximates fair value.

Federal Home Loan Bank Stock

The fair value of Federal Home Loan Bank of Indianapolis ("FHLBI") stock is based on the price at which it may be sold to the FHLBI.

Loans Held For Sale

The carrying amount approximates fair value due to the insignificant time between origination and date of sale.

Loans

Fair value is estimated by discounting the future cash flows using the market rates at which similar notes would be made to borrowers with similar credit ratings and for the same remaining maturities. The market rates used are based on current rates the Company would impose for similar loans and reflect a market participant assumption about risks associated with nonperformance, illiquidity, and the structure and term of the loans along with local economic and market conditions.

Interest Receivable and Payable

The carrying amount approximates fair value. The carrying amount is determined using the interest rate, balance and last payment date.

Deposits

The fair values of noninterest-bearing demand and savings accounts are equal to the amount payable on demand at the balance sheet date. Fair values for fixed-rate certificates and time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of expected monthly maturities on such time deposits.

Line of Credit and Short-term Subordinated Debt

The carrying amount approximates fair value.

Federal Home Loan Bank Advances

Fair value is estimated by discounting the future cash flows using rates of similar advances with similar maturities. These rates were obtained from current rates offered by the FHLBI.

Off-Balance Sheet Commitments

Commitments include commitments to purchase and originate mortgage loans, commitments to sell mortgage loans and standby letters of credit and are generally of a short-term nature. The fair value of such commitments are based on fees currently charged to similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments to extend credit and letters of credit is not presented in the previous table since the fair value is considered to be insignificant.

Merchants Bancorp
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 7: Earnings Per Share

Earnings per share were computed as follows:

	Three Month Periods Ended September 30,					
	2018			2017		
	Net Income (In thousands)	Weighted-Average Shares	Per Share Amount	Net Income (In thousands)	Weighted-Average Shares	Per Share Amount
Net income	$ 16,739			$ 10,467		
Dividends on preferred stock	(833)			(833)		
Net income allocated to common shareholders	$ 15,906			$ 9,634		
Basic earnings per share		28,694,036	$ 0.55		21,310,199	$ 0.45
Effect of dilutive securities-restricted stock awards		33,786			18,038	
Diluted earnings per share		28,727,822	$ 0.55		21,328,237	$ 0.45

	Nine Month Periods Ended September 30,					
	2018			2017		
	Net Income (In thousands)	Weighted-Average Shares	Per Share Amount	Net Income (In thousands)	Weighted-Average Shares	Per Share Amount
Net income	$ 47,452			$ 34,355		
Dividends on preferred stock	(2,498)			(2,497)		
Net income allocated to common shareholders	$ 44,954			$ 31,858		
Basic earnings per share		28,692,591	$ 1.57		21,180,384	$ 1.50
Effect of dilutive securities-restricted stock awards		27,149			13,473	
Diluted earnings per share		28,719,740	$ 1.57		21,193,857	$ 1.50

Note 8: Share-Based Payment Plans

During 2016, the Board of Directors adopted an incentive restricted stock plan for certain executive officers of the Company (the "2016 Plan"). Annual awards under the 2016 Plan could be earned subject to certain performance metrics and the participating executive officer could elect annually to receive the plan benefit in the form of Company common shares or a combination of 50% each of common shares and cash. During the three months ended September 30, 2018 and September 30, 2017, the Company did not issue any shares pursuant to the 2016 Plan. During the nine months ended September 30, 2018 and September 30, 2017, the Company issued 7,039 and 3,200 shares, respectively, under the 2016 Plan pursuant to the satisfactions of conditions for prior awards. No additional awards will be made under the 2016 Plan. On July 5, 2017, the Company's shareholders approved, and the Company adopted the Merchants Bancorp 2017 Equity Incentive Plan (the "2017 Plan"). The Company began granting awards under the 2017 Plan in early 2018, but as of September 30,2018 no shares have been issued under the 2017 Plan.

During 2018, the Compensation Committee of the Board of Directors approved a plan for non-executive directors to receive a portion of their annual fees in the form of common stock equal to $10,000, rounded up to the nearest whole share. Accordingly, there were 1,830 total shares issued during the nine months ended September 30, 2018, reflecting $50,000 in expenses. No shares were issued to directors during the three months ended September 30, 2018.

Note 9: Segment Information

Our business segments are defined as Multi-family Mortgage Banking, Mortgage Warehousing, and Banking. The reportable business segments are consistent with the internal reporting and evaluation of the principal lines of business of the Company. The Multi-family Mortgage Banking segment originates and services government sponsored mortgages

for multi-family and healthcare facilities. The Mortgage Warehousing segment funds agency eligible residential loans from origination or purchase to sale in the secondary market, as well as commercial loans to non-depository financial institutions. The Banking segment provides a wide range of financial products and services to consumers and businesses, including retail banking, commercial lending, agricultural lending, retail and correspondent residential mortgage banking, and Small Business Administration ("SBA") lending. Other includes general and administrative expenses that provide services to all segments; internal funds transfer pricing offsets resulting from allocations to/from the other segments; certain elimination entries and investments in qualified affordable housing limited partnerships. All operations are domestic.

The tables below present selected business segment financial information for the three and nine months ended September 30, 2018 and 2017.

	Multi-family Mortgage Banking	Mortgage Warehousing	Banking	Other	Total
			(In thousands)		
Three Months Ended September 30, 2018					
Total interest income	$ 201	$ 16,335	$ 20,341	$ 700	$ 37,577
Total interest expense	—	7,289	7,835	(1,029)	14,095
Net interest income	201	9,046	12,506	1,729	23,482
Provision for loan losses	—	227	390	—	617
Net interest income after provision for loan losses	201	8,819	12,116	1,729	22,865
Total noninterest income	10,874	779	818	(564)	11,907
Noninterest expense	4,346	1,998	3,740	2,365	12,449
Income before income taxes	6,729	7,600	9,194	(1,200)	22,323
Income taxes	1,866	1,946	2,093	(321)	5,584
Net income (loss)	$ 4,863	$ 5,654	$ 7,101	$ (879)	$ 16,739
Total assets	$ 152,035	$ 1,624,375	$ 2,010,485	$ 20,054	$ 3,806,949

	Multi-family Mortgage Banking	Mortgage Warehousing	Banking	Other	Total
			(In thousands)		
Three Months Ended September 30, 2017					
Total interest income	$ 101	$ 13,795	$ 12,110	$ —	$ 26,006
Total interest expense	—	3,657	4,102	(143)	7,616
Net interest income	101	10,138	8,008	143	18,390
Provision for loan losses	—	(155)	747	—	592
Net interest income after provision for loan losses	101	10,293	7,261	143	17,798
Total noninterest income	6,636	776	644	—	8,056
Noninterest expense	2,713	2,109	2,510	1,610	8,942
Income before income taxes	4,024	8,960	5,395	(1,467)	16,912
Income taxes	1,534	3,414	2,056	(559)	6,445
Net income (loss)	$ 2,490	$ 5,546	$ 3,339	$ (908)	$ 10,467
Total assets	$ 135,530	$ 1,192,377	$ 1,964,083	$ (54,505)	$ 3,237,485

	Multi-family Mortgage Banking	Mortgage Warehousing	Banking	Other	Total
			(In thousands)		
Nine Months Ended September 30, 2018					
Total interest income	$ 472	$ 42,850	$ 56,122	$ 1,294	$ 100,738
Total interest expense	—	16,499	20,748	(2,305)	34,942
Net interest income	472	26,351	35,374	3,599	65,796
Provision for loan losses	—	1,185	1,836	—	3,021
Net interest income after provision for loan losses	472	25,166	33,538	3,599	62,775
Total noninterest income	32,000	1,949	2,333	(1,432)	34,850
Noninterest expense	11,946	5,919	10,373	6,481	34,719
Income before income taxes	20,526	21,196	25,498	(4,314)	62,906
Income taxes	5,414	5,138	5,932	(1,030)	15,454
Net income	$ 15,112	$ 16,058	$ 19,566	$ (3,284)	$ 47,452
Total assets	$ 152,035	$ 1,624,375	$ 2,010,485	$ 20,054	$ 3,806,949

	Multi-family Mortgage Banking	Mortgage Warehousing	Banking	Other	Total
			(In thousands)		
Nine Months Ended September 30, 2017					
Total interest income	$ 280	$ 36,307	$ 30,890	$ —	$ 67,477
Total interest expense	—	9,738	10,444	(350)	19,832
Net interest income	280	26,569	20,446	350	47,645
Provision for loan losses	—	250	822	—	1,072
Net interest income after provision for loan losses	280	26,319	19,624	350	46,573
Total noninterest income	29,084	2,079	1,610	—	32,773
Noninterest expense	7,085	5,839	7,028	3,892	23,844
Income before income taxes	22,279	22,559	14,206	(3,542)	55,502
Income taxes	8,489	8,595	5,413	(1,350)	21,147
Net income	$ 13,790	$ 13,964	$ 8,793	$ (2,192)	$ 34,355
Total assets	$ 135,530	$ 1,192,377	$ 1,964,083	$ (54,505)	$ 3,237,485

Note 10: Recent Accounting Pronouncements

The Company is an emerging growth company and as such will be subject to the effective dates noted for the private companies if they differ from the effective dates noted for public companies.

FASB ASU 2014-09, Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers,” which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In March 2016 the FASB issued ASU 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net),” which clarifies the guidance in determining revenue recognition as principal versus agent. In April 2016, the FASB issued ASU 2016-10, “Identifying Performance Obligations and Licensing,” which provides guidance in accounting for immaterial

performance obligations and shipping and handling. In May 2016, the FASB issued ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients," which provides clarification on assessing the collectability criterion, presentation of sales taxes, measurement date for noncash consideration and completed contracts at transition. This ASU also provides a practical expedient for contract modifications.

As an emerging growth company, these amendments are effective for annual reporting periods beginning after December 15, 2018, and for interim periods within annual periods beginning after December 15, 2019. The Company's revenue is primarily comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09. The Company has evaluated the impact of adopting ASU 2014-09, but does not expect the impact to have a material impact on the Company's financial position or results of operations.

FASB ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." For public business entities, the amendments in this update include the elimination of the requirement to disclose the method(s) and significant assumptions used to estimate fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, the requirement to use the exit price notion when measuring fair value of financial instruments for disclosure purposes, the requirement to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, the requirement for separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or accompanying notes to the financial statements, and the amendments clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. An entity should apply the amendments to this update by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption.

As an emerging growth company, the amendments in this update are effective for fiscal years beginning after December 15, 2018, and interim periods within years beginning after December 15, 2019. Early adoption of the amendments in the update is not permitted, except that early application by public business entities to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance, are permitted as of the beginning of the fiscal year of adoption for the following amendment: An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability at fair value in accordance with the fair value option for financial instruments. An entity should apply the amendments to this update by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The Company is continuing to evaluate the impact of adopting this new guidance on its consolidated financial statements, but the adoption of ASU 2016-01 is not expected to have a material impact on the Company's financial position or results of operation.

FASB ASU 2016-02, Leases

In February 2016, the FASB issued ASU 2016-02, "Leases." Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:

- A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and
- A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term.

Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, "Revenue from Contracts

with Customers." The new lease guidance simplified the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees will no longer be provided with a source of off-balance sheet financing. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach.

The amendments in ASU 2016-02 are effective, as an emerging growth company, beginning after December 15, 2019, and for interim periods for years beginning after January 1, 2020. Management is in the process of gathering documentation on current lease agreements to assess the impact of adopting this guidance on the Company's financial statements, but its impact is not expected to be material.

FASB ASU 2016-09, Share-Based Payments

In March 2016, the FASB issued ASU 2016-09 "Share-Based Payments." The guidance in this ASU simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them to apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value.

For emerging growth companies, the amendments are effective for annual periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018. Management does not expect to make material changes to its accounting for share-based payments and implementation of ASU 2016-09 is not expected to have a material effect on the Company's financial position and results of operations. Additionally, Merchants share-based compensation plan awards have been classified as equity awards, whereby available elections to switch to intrinsic value measurement do not apply.

FASB ASU 2016-13, Financial Instruments—Credit Losses

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses". The amendments in this ASU replace the incurred loss model with a methodology that reflects expected credit losses over the life of the loan and requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. ASU 2016-13 replaces the incurred loss impairment methodology with a new methodology that reflects expected credit losses over the lives of the loans and requires consideration of a broader range of information to form credit loss estimates. The ASU requires an organization to estimate all expected credit losses for financial assets measured at amortized cost, including loans and held-to-maturity debt securities, based on historical experience, current conditions, and reasonable and supportable forecasts. Additional disclosures are required.

As an emerging growth company, ASU 2016-13 is effective, for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years beginning after December 15, 2021. The Company has established a cross-functional committee that is developing a project plan to review modeling data currently available and technology needed to ensure compliance of this standard. The committee has also met with multiple vendors to potentially assist in generating specific loan level details within our core systems, as well as compiling peer and industry data that would be useful in our modeling forecasts. While the Company generally expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, the Company cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the Company's consolidated financial statements. Management continues to expect that the implementation of this ASU may increase the balance of the allowance for loan losses and is continuing to evaluate the potential impact on the Company's financial position and results of operations.

FASB ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350)

In January 2017, the FASB issued ASU 2017-04, "Intangibles—Goodwill and Other (Topic 350)." This ASU simplifies the test for goodwill impairment. Specifically, these amendments eliminate Step 2 from the goodwill impairment test, and also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test.

As an emerging growth company, the amendments in this ASU are effective for annual goodwill impairment tests in fiscal years beginning after December 15, 2021. Management continues to believe that the changes will not have a material effect on the Company's financial position and results of operations.

FASB ASU 2017-08, Premium Amortization on Purchased Callable Debt

In March 2017, the FASB issued ASU 2017-08, "Premium Amortization on Purchased Callable Debt." This ASU applies to all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). The ASU requires the premium to be amortized to the earliest call date, not the maturity date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

As an emerging growth company, ASU 2017-08 is effective as to the Company for years beginning after December 15, 2019 and interim periods within years beginning after December 15, 2020. Early adoption is permitted. Management is still in the process of evaluating the impact of adopting this guidance, but does not expect the ASU to have a material effect on the Company's financial position or results of operations.

FASB ASU No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB has issued ASU No. 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments in this ASU allow a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments in this ASU also require certain disclosures about stranded tax effects.

The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this ASU is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this ASU should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. At December 31, 2017, the Company had approximately $243,000 stranded tax effects included in AOCI. The Company adopted this ASU in the first quarter of 2018.

Forward-Looking Statements

Certain statements in this Form 10-Q, including, but not limited to, statements within Management's Discussion and Analysis of Financial Condition and Results of Operations, are "forward-looking statements" within the meaning of the rules and regulations of the Securities and Exchange Commission ("SEC"). These forward looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "might," "should," "could," "predict," "potential," "believe," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "projection," "goal," "target," "outlook," "aim," "would," "annualized" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

A number of important factors could cause our actual results to differ materially from those indicated in these forward-looking statements, including those factors identified in "Item 1A - Risk Factors" or "Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations" or the following:

- business and economic conditions, particularly those affecting the financial services industry and our primary market areas;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for loan loss;
- factors that can impact the performance of our loan portfolio, including real estate values and liquidity in our primary market areas, the financial health of our commercial borrowers and the success of construction projects that we finance, including any loans acquired in acquisition transactions;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Act and others relating to banking, consumer protection, securities and tax matters;
- our ability to maintain licenses required in connection with multi-family mortgage origination, sale and servicing operations;
- our ability to identify and address cyber-security risks, fraud and systems errors;
- our ability to effectively execute our strategic plan and manage our growth;
- changes in our senior management team and our ability to attract, motivate and retain qualified personnel;
- governmental monetary and fiscal policies, and changes in market interest rates;
- liquidity issues, including fluctuations in the fair value and liquidity of the securities we hold for sale and our ability to raise additional capital, if necessary;
- incremental costs and obligations associated with operating as a public company;
- effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;

- the impact of any claims or legal actions to which we may be subject, including any effect on our reputation; and

- changes in federal tax law or policy.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Form 10-Q. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis of the financial condition at September 30, 2018 and results of operations for the three and nine months ended September 30, 2018 and 2017, is intended to assist in understanding the financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto, appearing in Part I, Item 1 of this Form 10-Q.

The words "the Company," "we," "our" and "us" refer to Merchants Bancorp and its consolidated subsidiaries, unless we indicate otherwise.

Introduction

We are a diversified bank holding company headquartered in Carmel, Indiana and registered under the Bank Holding Company Act of 1956, as amended. We currently operate multiple lines of business with a focus on Federal Housing Administration ("FHA") multi-family housing and healthcare facility financing and servicing, mortgage warehouse financing, retail and correspondent residential mortgage banking, agricultural lending and traditional community banking.

Our business consists primarily of funding low risk loans that sell within 90 days of origination. The sale of loans and servicing fees generated from the multi-family rental real estate loans servicing portfolio contribute to noninterest income. The funding source is primarily from mortgage custodial, municipal, and retail and commercial deposits. We believe that the combination of net interest income and noninterest income from the sale of low risk profile assets results in lower than industry charge offs and a lower expense base serving to maximize net income and shareholder return.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates are based upon historical experience and on various other assumptions that management believes are reasonable under the current circumstances. These estimates form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Jumpstart Our Business Startups Act of 2012 ("JOBS Act") contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As an "emerging growth company" we may delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies. We are taking advantage of the benefits of this extended transition period. Accordingly, our financial statements may not be comparable to companies that comply with such new or revised accounting standards.

The estimates and judgments that management believes have the most effect on its reported financial position and results of operations are set forth within "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. There have been no significant changes in critical accounting policies or the assumptions and judgments utilized in applying these policies since those reported for the year ended December 31, 2017.

Financial Condition

As of September 30, 2018, we had approximately $3.8 billion in total assets, $3.3 billion in deposits, and $407.3 million in total shareholders' equity. Total assets as of September 30, 2018, included approximately $410.8 million of cash and cash equivalents, $1.0 billion of loans held for sale and $1.9 billion of loans held for investment. It also

includes $74.1 million of trading securities that represent pre-sold multi-family rental real estate loan originations in primarily Government National Mortgage Association ("GNMA") mortgage backed securities pending settlements that typically occur within 30 days. There are $269.7 million of available for sale securities that are match funded with related custodial deposits. There are restrictions on the types of securities, as these are funded by certain custodial deposits where we set the cost of deposits based on the yield of the related securities. Mortgage servicing rights were $71.5 million at September 30, 2018 based on the fair value of the multi-family rental real estate loan servicing, which are primarily GNMA servicing rights with 10-year call protection.

Comparison of Financial Condition at September 30, 2018 and December 31, 2017

Total Assets. Total assets increased $413.8 million, or 12%, to $3.8 billion at September 30, 2018 from $3.4 billion at December 31, 2017. The increase was due primarily to increases in net loans receivable of $539.5 million, which were partially offset by decreases in available for sale securities of $138.7 million and trading securities of $66.7 million.

Cash and Cash Equivalents. Cash and cash equivalents increased $51.2 million, or 14%, to $410.8 million at September 30, 2018 from $359.5 million at December 31, 2017.

Trading Securities. Trading securities decreased $66.7 million, or 47%, to $74.1 million at September 30, 2018, from $140.8 million at December 31, 2017. The trading securities represent loans that our banking subsidiary, Merchants Bank of Indiana (the "Bank"), has funded and are held pending settlement, primarily as GNMA mortgage-backed securities with a firm investor commitment to purchase the securities.

Securities Available-for-Sale. Investment securities available-for-sale decreased $138.7 million, or 34%, to $269.7 million at September 30, 2018 from $408.4 million at December 31, 2017. The decrease in securities available-for-sale was primarily due to calls, maturities, sales, and repayments of securities totaling $177.8 million during the period, partially offset by purchases of $36.3 million. The decrease reflects a strategic decision to replace some securities with reciprocal deposits that provide FDIC insurance for our customers, which allows us to utilize funds more effectively to fund loans. We invest in available for sale securities primarily using funds from escrow deposits held at the Bank received in connection with our multi-family mortgage servicing activities.

The available for sale securities are funded by, and paired with as to interest rates, escrow custodial deposits held at the Bank on loans serviced by us. This portfolio of securities is structured to achieve a favorable interest rate spread. The balance of these securities closely approximates the balances of the escrow custodial accounts on an ongoing basis.

Loans Held for Sale. Loans held for sale, comprised primarily of single-family residential real estate loan participations, increased $9.1 million, or 1%, to $1.0 billion at September 30, 2018 from $995.3 million at December 31, 2017. The increase in loans held for sale was due primarily to a $100.7 million increase in balances at the Bank, partially offset by a $91.6 million decrease at the Bank's subsidiary, Natty Mac Funding, Inc. ("NMF"). The increase in capital from our initial public offering has allowed us to reduce loan participation activity through NMF and hold more loans at the Bank.

Loans Receivable, Net. Loans receivable, net, which are comprised of loans held for investment, increased $539.5 million, or 39%, to $1.9 billion at September 30, 2018 compared to December 31, 2017. The increase in net loans was comprised primarily of:

- an increase of $209.6 million, or 40%, in multi-family and healthcare financing loans, to $738.9 million at September 30, 2018,
- an increase of $181.4 million, or 81%, in mortgage warehouse lines of credit, to $406.3 million at September 30, 2018,

- an increase of $69.6 million, or 21%, increase in residential real estate loans, to $400.0 million at September 30, 2018, and
- an increase of $61.5 million, or 27%, in commercial and commercial real estate loans, to $290.1 million at September 30, 2018.

The increase in multi-family and healthcare financing was due to higher origination volume during the nine months ended September 30, 2018. The increase in mortgage warehouse lines of credit was despite an industry decline in volume. There was a 3.4% industry decline in single-family residential loan volumes from the nine months ended September 30, 2017 to the nine months ended September 30, 2018, according to the Mortgage Bankers Association. This compares to the 0.3% increase in mortgage warehouse volumes we reported during the same period. The increase in residential real estate was primarily due to a $56.1 million, or 25%, increase in our first-lien home equity line of credit (HELOC) product line, which grew from $222.7 million at December 31, 2017, to $278.8 million at September 30, 2018. The increase in commercial loans was due primarily to an increase in warehouse lending related loans secured by mortgage servicing rights or other assets.

Mortgage Servicing Rights. Mortgage servicing rights increased $5.4 million, or 8%, to $71.5 million at September 30, 2018 compared to December 31, 2017. During the nine months ended September 30, 2018, additions included originated and purchased servicing of $7.3 million, and a fair value increase of $1.4 million. These increases were partially offset by a reduction for paydowns of $3.3 million. Mortgage servicing rights are recognized in connection with sales of multi-family loans when we retain servicing of the sold loans, as well as upon purchases of loan servicing portfolios. The mortgage servicing rights are recorded and carried at fair value.

Deposits. Deposits increased $358.8 million, or 12%, to $3.3 billion at September 30, 2018 from $2.9 billion at December 31, 2017. Interest bearing deposits increased $642.6 million, or 28%, to $3.0 billion at September 30, 2018, and noninterest bearing deposits decreased $283.8 million, or 46%, to $336.9 million at September 30, 2018. Demand deposits increased $299.1 million, or 23%, to $1.6 billion at September 30, 2018, savings deposits decreased $121.6 million, or 10%, to $1.1 billion at September 30, 2018, while certificates of deposit accounts increased $181.3 million, or 44%, to $590.3 million at September 30, 2018. The change in certificates of deposit accounts was largely due to the level of brokered deposits outstanding period to period. Brokered certificates of deposit accounts increased $180.0 million, or 52%, to $527.0 million at September 30, 2018 from $347.0 million at December 31, 2017. Brokered savings deposits decreased $117.3 million, or 30%, to $272.2 million at September 30, 2018 from $389.5 million at December 31, 2017. In total, brokered deposits decreased $97.8 million, or 10%, to $843.7 million at September 30, 2018 from $941.5 million at December 31, 2017. Brokered deposits represented 26% of total deposits at September 30, 2018, compared with 32% at December 31, 2017.

Borrowings. Borrowings totaled $67.3 million at September 30, 2018, an increase of $10.7 million, or 19%, from December 31, 2017, in order to maintain an appropriate level of cash to fund our businesses.

Total Shareholders' Equity. Total shareholders' equity increased $39.9 million, or 11%, to $407.3 million at September 30, 2018 from $367.5 million at December 31, 2017. The increase resulted primarily from net income of $47.5 million, which was partially offset by dividends paid on preferred and common shares of $2.5 million and $5.2 million, respectively, during the period.

Comparison of Operating Results for the Three Months Ended September 30, 2018 and 2017

General. Net income for the three months ended September 30, 2018 was $16.7 million, an increase of $6.3 million, or 60%, from net income of $10.5 million for the three months ended September 30, 2017. The increase was due primarily to a $5.1 million increase in net interest income, a $3.9 million increase in noninterest income, and a $861,000 decrease in the provision for income taxes, which were partially offset by a $3.5 million increase in non-interest expense.

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Interest Income. Interest income increased $11.6 million, or 44%, to $37.6 million for the three months ended September 30, 2018, compared with the three months ended September 30, 2017. This increase was primarily attributable to a $10.0 million increase in interest on loans and loans held for sale, a $1.2 million increase in interest on other interest-earning deposits, and a $282,000 increase in interest on available-for-sale securities.

The average balance of loans, including loans held for sale, during the three months ended September 30, 2018 increased $577.4 million, or 27%, to $2.7 billion from $2.1 billion for the three months ended September 30, 2017, while the average yield on loans increased 59 basis points, to 4.75%, for the three months ended September 30, 2018, compared to 4.16% for the three months ended September 30, 2017. The increase in the average yield on loans was due to the overall increase in interest rates in the economy period to period.

The average balance of other interest-earning assets increased $97.5 million, or 24%, to $510.1 million for the three months ended September 30, 2018 from $412.7 million for the three months ended September 30, 2017, while the average yield increased 71 basis points to 2.09% for the three months ended September 30, 2018.

The average balance of available-for-sale securities decreased $51.0 million, or 13%, to $355.6 million for the three months ended September 30, 2018, compared with $406.5 million for the three months ended September 30, 2017, and the average yield increased 49 basis points to 1.72% for the three months ended September 30, 2018.

The average balance of trading securities decreased $15.5 million, or 10%, to $137.4 million for the three months ended September 30, 2018, compared to $152.8 million for the three months ended September 30, 2017, while the average yield increased 37 basis points to 3.75% for the three months ended September 30, 2018.

Interest Expense. Total interest expense increased $6.5 million, or 85%, to $14.1 million for the three months ended September 30, 2018, compared with the three months ended September 30, 2017.

Interest expense on deposits increased $6.0 million, or 106%, to $11.7 million for the three months ended September 30, 2018 from the three months ended September 30, 2017. The increase was attributable to a 75 basis point increase in the average cost of interest-bearing deposits, to 1.80% for the three months ended September 30, 2018 from 1.05% for the same period in 2017, and an increase in the average balance of interest-bearing deposits of $444.6 million, or 21%, to $2.6 billion for the three months ended September 30, 2018. The increase in the cost of deposits was primarily due to the overall increase in interest rates in the economy period to period and growth in the volume of certificates of deposits.

Interest expense on borrowings increased $468,000, or 24%, to $2.4 million for the three months ended September 30, 2018 from $2.0 million for the three months ended September 30, 2017. The increase was due primarily to a $9.7 million, or 15%, increase in the average balance of borrowings outstanding and a 92 basis point increase in the average cost of borrowings of 12.96%, compared to 12.04% for the three months ended September 30, 2017. The higher cost of borrowings was primarily due to a higher level of short-term subordinated debt in the mix during the three months ended September 30, 2018, compared with the three months ended September 30, 2017. These debt instruments carry a higher cost than our other categories of borrowing. The terms of our subordinated debt include a variable interest rate equal to the one-month LIBOR rate plus an applicable margin. Additionally, our warehouse structured financing agreements provide for an additional interest payment for a portion of the earnings generated. As a result of these payments, the effective cost of borrowings increased from 4.71% and 3.06%, to 12.96% and 12.04% for the three months ended September 30, 2018 and 2017, respectively.

Net Interest Income. Net interest income increased $5.1 million, or 28%, to $23.5 million for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was due to the overall growth in our interest-earning assets period to period, partially offset by a 4 basis point decrease in our interest rate spread, to 1.94%, for the three months ended September 30, 2018 from 1.98% for the three months ended September 30, 2017. Our net interest margin increased to 2.53% for the three months ended September 30, 2018 from 2.38% for the three months ended September 30, 2017.

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The following table presents, for the periods indicated, information about (i) average balances, the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) average balances, the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rates; (iii) net interest income; (iv) the interest rate spread; and (v) the net interest margin. Yields have been calculated on a pre-tax basis. Nonaccrual loans are included in loans and loans held for sale.

	Three Months Ended September 30,					
	2018			2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(Dollars in thousands)					
Assets:						
Interest bearing deposits, and other	$ 510,115	$ 2,681	2.09 %	$ 412,663	$ 1,431	1.38 %
Securities available for sale	355,564	1,541	1.72 %	406,517	1,259	1.23 %
Trading securities	137,351	1,299	3.75 %	152,799	1,300	3.38 %
Loans and loans held for sale	2,677,449	32,056	4.75 %	2,100,028	22,016	4.16 %
Total interest earning assets	3,680,479	37,577	4.05 %	3,072,007	26,006	3.36 %
Allowance for loan losses	(10,695)			(7,073)		
Noninterest-earning assets	159,388			113,953		
Total assets	$ 3,829,172			$ 3,178,887		
Liabilities/Equity:						
Interest bearing checking	$ 853,066	4,471	2.08 %	$ 623,893	1,757	1.12 %
Savings deposits	148,348	109	0.29 %	344,922	223	0.26 %
Money market	997,046	4,294	1.71 %	866,010	2,787	1.28 %
Certificates of deposit	577,233	2,796	1.92 %	296,288	892	1.19 %
Total deposits	2,575,693	11,670	1.80 %	2,131,113	5,659	1.05 %
Borrowings	74,227	2,425	12.96 %	64,509	1,957	12.04 %
Total interest bearing liabilities	2,649,920	14,095	2.11 %	2,195,622	7,616	1.38 %
Noninterest bearing deposits	748,312			715,346		
Noninterest bearing liabilities	27,183			30,910		
Total liabilities	3,425,415			2,941,878		
Equity	403,757			237,009		
Total liabilities and equity	$ 3,829,172			$ 3,178,887		
Net interest income		$ 23,482			$ 18,390	
Interest rate spread			1.94 %			1.98 %
Net interest-earning assets	$ 1,030,559			$ 876,385		
Net interest margin			2.53 %			2.38 %
Average interest-earning assets to average interest-bearing liabilities			138.89 %			139.92 %

Provision for Loan Losses. We recorded a provision for loan losses of $617,000 for the three months ended September 30, 2018, an increase of $25,000, over the three months ended September 30, 2017. The allowance for loan losses was $11.2 million, or 0.59% of total loans, at September 30, 2018, compared to $8.3 million, or 0.60% of total loans, at December 31, 2017 and $7.5 million, or 0.62%, at September 30, 2017. Total nonperforming loans (nonaccrual and greater than 90 days late but still accruing) were $1.9 million at September 30, 2018, compared to $3.1 million at December 31, 2017 and $2.9 million at September 30, 2017. Special Mention (Watch) loans were $66.4 million at September 30, 2018, compared to $16.3 million at December 31, 2017 and $14.9 million at September 30, 2017. The increase compared to December 31, 2017 and September 30, 2017 primarily reflected the active monitoring of certain construction projects with cost over-runs that were funded by the borrowers. The loan payments on these projects have remained current. Classified (substandard, doubtful and loss) loans were $9.3 million at September 30, 2018, $7.3

million at December 31, 2017 and $5.0 million at September 30, 2017. Total loans greater than 30 days past due were $3.0 million at September 30, 2018, $4.3 million at December 31, 2017 and $10.6 million at September 30, 2017. We had $74,000 reversal of charge-offs and $36,000 reversal of recoveries during the three months ended September 30, 2018. For the three months ended September 30, 2017, there were no charge-offs or recoveries. As a percentage of nonperforming loans, the allowance for loan losses was 590.2% at September 30, 2018 compared to 264.7% at December 31, 2017 and 259.4% at September 30, 2017. The increase compared to December 31, 2017 and September 30, 2017 was primarily due to the decrease in nonperforming loans.

Noninterest Income. Noninterest income increased $3.9 million, or 48%, to $11.9 million for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was primarily due to an increase of $1.9 million in net loan servicing fees and an increase of $1.6 million in gain on sale of loans. Loan servicing fees included a $500,000 increase in the fair value of mortgage servicing rights for the three months ended September 30, 2018, compared with a decrease of $1.4 million for the three months ended September 30, 2017. The gain on sale of loans amounted to $8.8 million during the three months ended September 30, 2018, compared to $7.2 million in the year earlier period, an increase of 23%, due primarily to an increase in the volume of multi-family rental real estate loan sales in the secondary market. The higher gain on sale, relative to volume of secondary market loans, reflected a mix of business with a higher concentration of originated loans than acquired loans during the three months ended September 30, 2018.

Noninterest Expense. Noninterest expense increased $3.5 million, or 39%, to $12.4 million for the three months ended September 30, 2018 compared with $8.9 million for the three months ended September 30, 2017. The increase was due primarily to a $2.5 million, or 47% increase in salaries and employee benefits. The increase in salaries and employee benefits was due primarily to an increase in the number of employees resulting from business growth, higher commissions related to higher multi-family volume, and additional hiring associated with becoming a publicly traded company. Despite the increase in salaries and benefits, the efficiency ratio was at 35.2% in the second quarter of 2018, compared with 33.8% the second quarter of 2017.

Income Taxes. Income tax expense decreased $861,000, or 13%, to $5.6 million for the three months ended September 30, 2018 from the three months ended September 30, 2017. The decrease was due primarily to the lower tax rates under the recent federal income tax reform legislation, partially offset by a 32% increase in pretax income period to period. The effective tax rate was 25.0% for the three months ended September 30, 2018 and 38.1% for the three months ended September 30, 2017.

Comparison of Operating Results for the Nine Months Ended September 30, 2018 and 2017

General. Net income for the nine months ended September 30, 2018 was $47.5 million, an increase of $13.1 million, or 38%, from net income of $34.4 million for the nine months ended September 30, 2017. The increase was due primarily to a $18.2 million increase in net interest income, a $5.7 million decrease in the provision for income taxes, and a $2.1 million increase in noninterest income, which were partially offset by a $10.9 million increase in non-interest expense, and a $1.9 million increase in the provision for loan losses.

Interest Income. Interest income increased $33.3 million, or 49%, to $100.7 million for the nine months ended September 30, 2018 from $67.5 million for the nine months ended September 30, 2017. This increase was primarily attributable to a $28.6 million increase in interest on loans and loans held for sale, a $3.4 million increase in interest on other interest-earning deposits, and a $1.5 million increase in interest on available-for-sale securities, which were partially offset by a $347,000 decrease in interest on trading securities.

The average balance of loans, including loans held for sale, during the nine months ended September 30, 2018 increased $605.2 million, or 33%, to $2.5 billion from $1.8 billion for the nine months ended September 30, 2017, while the average yield on loans increased 55 basis points to 4.66% for the nine months ended September 30, 2018 compared to 4.11% for the nine months ended September 30, 2017. The increase in the average yield on loans was due to the overall increase in interest rates in the economy period to period.

The average balance of other interest-earning assets increased $87.4 million, or 21%, to $495.2 million for the nine months ended September 30, 2018 from $407.8 million for the nine months ended September 30, 2017, while the average yield increased 73 basis points to 1.83% for the nine months ended September 30, 2018.

The average balance of available-for-sale securities increased $26.4 million, or 7%, to $393.0 million for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, and the average yield increased 44 basis points to 1.60% for the nine months ended September 30, 2018.

The average balance of trading securities decreased $25.4 million, or 15%, to $144.8 million for the nine months ended September 30, 2018 compared to $170.2 million for the nine months ended September 30, 2017, while the average yield increased 25 basis points to 3.49% for the nine months ended September 30, 2018.

Interest Expense. Total interest expense increased $15.1 million, or 76%, to $34.9 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Interest expense on deposits increased $14.3 million, or 101%, to $28.4 million for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. The increase was primarily due to a 58 basis point increase in the average cost of interest-bearing deposits, to 1.55% for the nine months ended September 30, 2018 from 0.97% for the same period in 2017, and an increase in the average balance of interest-bearing deposits of $502.1 million, or 26%, to $2.5 billion for the nine months ended September 30, 2018. The increase in average balances was primarily due to the addition of certificates of deposit and interest bearing checking customers. The increase in the cost of deposits was due to the overall increase in interest rates in the economy period to period.

Interest expense on borrowings increased $853,000, or 15%, to $6.5 million for the nine months ended September 30, 2018 from $5.7 million for the nine months ended September 30, 2017. The increase was due primarily to a $7.8 million, or 13%, increase in the average balance outstanding period to period, and a 27 basis point increase in the average cost of borrowings to 12.48%, compared to 12.21% for the nine months ended September 30, 2017. The higher cost of borrowings was primarily due to a higher level of short-term subordinated debt in the mix during the nine months ended September 30, 2018, compared with the nine months ended September 30, 2017. These debt instruments carry a higher cost than our other categories of borrowing. The terms of our subordinated debt include a variable interest rate equal to the one-month LIBOR rate plus an applicable margin. Additionally, our warehouse structured financing agreements provide for an additional interest payment for a portion of the earnings generated. As a result of these payments, the effective cost of borrowings increased from 6.67% and 5.36%, to 12.48% and 12.21% for the nine months ended September 30, 2018 and 2017, respectively.

Net Interest Income. Net interest income increased $18.2 million, or 38%, to $65.8 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase was due to a 9 basis point increase in our interest rate spread, to 2.01%, for the nine months ended September 30, 2018 from 1.92% for the nine months ended September 30, 2017, coupled with the overall growth in our interest-earning assets period to period. Our net interest margin increased to 2.52% for the nine months ended September 30, 2018 from 2.28% for the nine months ended September 30, 2017.

Merchants Bancorp

The following table presents, for the periods indicated, information about (i) average balances, the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) average balances, the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rates; (iii) net interest income; (iv) the interest rate spread; and (v) the net interest margin. Yields have been calculated on a pre-tax basis. Nonaccrual loans are included in loans and loans held for sale.

	Nine Months Ended September 30,					
	2018			2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(Dollars in thousands)					
Assets:						
Interest bearing deposits, and other	$ 495,217	$ 6,795	1.83 %	$ 407,803	$ 3,357	1.10 %
Securities available for sale	393,029	4,708	1.60 %	366,604	3,175	1.16 %
Trading securities	144,812	3,777	3.49 %	170,210	4,124	3.24 %
Loans and loans held for sale	2,453,830	85,458	4.66 %	1,848,631	56,821	4.11 %
Total interest earning assets	3,486,888	100,738	3.86 %	2,793,248	67,477	3.23 %
Allowance for loan losses	(9,925)			(6,746)		
Noninterest-earning assets	150,898			109,241		
Total assets	$ 3,627,861			$ 2,895,743		
Liabilities/Equity:						
Interest bearing checking	$ 763,274	10,192	1.79 %	$ 555,632	4,362	1.05 %
Savings deposits	264,391	513	0.26 %	323,953	617	0.25 %
Money market	877,682	10,446	1.59 %	853,221	7,515	1.18 %
Certificates of deposit	553,111	7,276	1.76 %	223,590	1,676	1.00 %
Total deposits	2,458,458	28,427	1.55 %	1,956,396	14,170	0.97 %
Borrowings	69,811	6,515	12.48 %	62,005	5,662	12.21 %
Total interest bearing liabilities	2,528,269	34,942	1.85 %	2,018,401	19,832	1.31 %
Noninterest bearing deposits	682,998			623,399		
Noninterest bearing liabilities	26,834			30,119		
Total liabilities	3,238,101			2,671,919		
Equity	389,760			223,824		
Total liabilities and equity	$ 3,627,861			$ 2,895,743		
Net interest income		$ 65,796			$ 47,645	
Interest rate spread			2.01 %			1.92 %
Net interest-earning assets	$ 958,619			$ 774,847		
Net interest margin			2.52 %			2.28 %
Average interest-earning assets to average interest-bearing liabilities			137.92 %			138.39 %

Provision for Loan Losses. We recorded a provision for loan losses of $3.0 million for the nine months ended September 30, 2018, an increase of $1.9 million, over the nine months ended September 30, 2017. The allowance for loan losses was $11.2 million, or 0.59% of total loans, at September 30, 2018, compared to $8.3 million, or 0.60% of total loans, at December 31, 2017 and $7.5 million, or 0.62%, at September 30, 2017. Total nonperforming loans (nonaccrual and greater than 90 days late but still accruing) were $1.9 million at September 30, 2018, compared to $3.1 million at December 31, 2017 and $2.9 million at September 30, 2017. Special Mention (Watch) loans were $66.4 million at September 30, 2018, compared to $16.3 million at December 31, 2017 and $14.9 million at September 30, 2017. The increase compared to December 31, 2017 and September 30, 2017 primarily reflected the active monitoring of

certain construction projects with cost over-runs that were funded by the borrowers. The loan payments on these projects have remained current. Classified (substandard, doubtful and loss) loans were $9.3 million at September 30, 2018, $7.3 million at December 31, 2017 and $5.0 million at September 30, 2017. Total loans greater than 30 days past due were $3.0 million at September 30, 2018, $4.3 million at December 31, 2017 and $10.6 million at September 30, 2017. We had $89,000 charge-offs and no recoveries during the nine months ended September 30, 2018 and $135,000 in recoveries and no charge-offs for the nine months ended September 30, 2017. As a percentage of nonperforming loans, the allowance for loan losses was 590.2% at September 30, 2018 compared to 264.7% at December 31, 2017 and 259.4% at September 30, 2017. The increase compared to December 31, 2017 and September 30, 2017 was primarily due to the decrease in nonperforming loans.

Noninterest Income. Noninterest income increased $2.1 million, or 6%, to $34.9 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017, primarily due to an increase of $1.8 million in loan servicing fees, partially offset by a $265,000 decrease in gain on sale of loans. The gain on sale of loans amounted to $27.5 million during the nine months ended September 30, 2018, compared to $27.8 million in the year earlier period, a decrease of 1%, due primarily to a decrease in the volume of multi-family rental real estate loan sales in the secondary market. The lower gain on sale, relative to volume of secondary market loans, reflected a mix of business with a higher concentration of acquired loans than originated loans during the nine months ended September 30, 2018. Noninterest income for the nine months ended September 30, 2018 included a $1.4 million increase in the fair value of mortgage servicing rights, compared to a $789,000 decrease for the nine months ended September 30, 2017.

Noninterest Expense. Noninterest expense increased $10.9 million, or 46%, to $34.7 million for the nine months ended September 30, 2018 compared to $23.8 million for the nine months ended September 30, 2017. The increase was due primarily to a $7.2 million, or 50% increase in salaries and employee benefits. The increase in salaries and employee benefits was due primarily to an increase in the number of employees resulting from business growth, higher commissions related to higher multi-family volume, and additional hiring associated with becoming a publicly traded company. Despite the increase in salaries and benefits, the efficiency ratio was 34.5% for the nine months ended September 30, 2018, compared with 29.7% for the nine months ended September 30, 2017.

Income Taxes. Income tax expense decreased $5.7 million, or 27%, to $15.5 million for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. The decrease was due primarily to the lower tax rates under the recent federal income tax reform legislation, partially offset by a 13% increase in pretax income period to period. The effective tax rate was 24.6% for the nine months ended September 30, 2018 and 38.1% for the nine months ended September 30, 2017.

Our Segments

We operate in three primary segments: Multi-family Mortgage Banking, Mortgage Warehousing, and Banking. We believe that the Bank's subsidiary, Merchants Mortgage Corp. ("MCC"), which operates in our Multi-Family Mortgage Banking segment, is one of the largest FHA lenders and GNMA servicers in the country based on aggregate loan principal value. MCC originated and acquired $1.8 billion loans during the nine months ended September 30, 2018 and services $8.6 billion as of September 30, 2018. The servicing portfolio is primarily GNMA and is a significant source of our noninterest income and deposits.

Our Mortgage Warehousing segment funds agency eligible loans for non-depository financial institutions from the date of origination or purchase until the date of sale to an investor, which typically takes less than 30 days and is a significant source of our net interest income, loans, and deposits. Mortgage Warehousing has grown to fund over $20 billion of loan principal annually since 2015. Mortgage Warehousing also provides commercial loans and deposits related to the mortgage escrow accounts of its customers.

The Banking segment includes retail banking, commercial lending, agricultural lending, retail and correspondent residential mortgage banking, and SBA lending. Banking operates primarily in the Indianapolis metropolitan and Randolph County Indiana markets except for correspondent mortgage banking which, like Multi-family Mortgage

Banking and Mortgage Warehousing, is a national business. The Banking segment has a well-diversified customer and borrower base and has experienced significant growth over the past three years. These segments diversify the net income of the Bank and provide synergies across the segments. The strategic opportunities include that MCC loans are funded by the Banking segment and the Banking segment provides GNMA custodial services to MCC. The securities available for sale funded by MCC custodial deposits are pledged to the FHLBI to provide advance capacity during periods of high residential loan volume for mortgage warehousing. Mortgage Warehousing provides leads to correspondent residential lending in the banking segment. Retail and commercial customers provide cross selling opportunities within the banking segment. These and other synergies form a part of our strategic plan.

For the three months ended September 30, 2018 and 2017, we had total net income of $16.7 million and $10.5 million, respectively, and for the nine months ended September 30, 2018 and 2017, we had total net income of $47.5 million and $34.4 million, respectively. Net income for our three segments for the respective periods was as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Multi-family Mortgage Banking	$ 4,863	$ 2,490	$ 15,112	$ 13,790
Mortgage Warehousing	5,654	5,546	16,058	13,964
Banking	7,101	3,339	19,566	8,793
Other	(879)	(908)	(3,284)	(2,192)
Total	$ 16,739	$ 10,467	$ 47,452	$ 34,355

Multi-family Mortgage Banking. The Multi-family Mortgage Banking segment reported net income for the three months ended September 30, 2018, of $4.9 million, an increase of $2.4 million, or 95%, from the $2.5 million reported for the three months ended September 30, 2017. The increase was primarily due to a $4.2 million increase in noninterest income, primarily associated with an increase in loan servicing fees and gain on sale of loans, partially offset by a $1.6 increase in noninterest expenses, reflecting higher salaries and employee benefits and higher commissions related to higher volume. The volume of loans originated and acquired for sale in the secondary market increased by $70.9 million, or 50%, to $211.8 million for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The higher gain on sale, relative to volume of secondary market loans, reflected a mix of business with a higher concentration of originated loans than acquired loans during the three months ended September 30, 2018. During the three months ended September 30, 2018, noninterest income included a $500,000 increase in the fair value of the mortgage servicing rights asset, compared with a $1.4 million decrease for the three months ended September 30, 2017.

The Multi-family Mortgage Banking segment reported net income for the nine months ended September 30, 2018, of $15.1 million, an increase of $1.3 million, or 10%, from the $13.8 million reported for the nine months ended September 30, 2017. The increase was primarily due to a decrease of $3.1 million in income taxes and a $2.9 million increase in noninterest income associated with higher loan servicing fees, partially offset by a $4.9 million increase in noninterest expense. The increase in noninterest expense was primarily due to an increase in the number of employees associated with business growth and higher commissions related to higher volume. The volume of loans originated and acquired for sale in the secondary market increased by $126.5 million, or 19%, to $796.0 million for the nine months ended September 30, 2018, compared with the nine months ended September 30, 2017. The lower gain on sale portion of noninterest income, relative to volume of secondary market loans, reflected a mix of business with a higher concentration of acquired loans than originated loans during the nine months ended September 30, 2018. Noninterest income also included a $1.4 million fair value increase to our mortgage servicing rights asset for the nine months ended September 30, 2018, compared with a $789,000 decrease for the nine months ended September 30, 2017.

Mortgage Warehousing. The Mortgage Warehousing segment reported net income for the three months ended September 30, 2018, of $5.7 million, an increase of $108,000, or 2%, over the $5.5 million reported for the three months ended September 30, 2017. The increase was comprised primarily of a $1.5 million decrease in income taxes due to tax

reform, partially offset by a $1.1 million, or 11%, decrease in net interest income, primarily associated with higher costs of deposits. The volume of loans funded during the three months ended September 30, 2018 amounted to $6.5 billion, an increase of $251.8 million, or 4.0%, compared to the same period in 2017. This compared favorably to the 3.0% industry decline in single-family residential loan volumes from the three months ended September 30, 2017 to the three months ended September 30, 2018, according to the Mortgage Bankers Association.

The Mortgage Warehousing segment reported net income for the nine months ended September 30, 2018, of $16.1 million, an increase of $2.1 million, or 15%, over the $14.0 million reported for the nine months ended September 30, 2017. The increase was comprised primarily of a $3.5 million decrease in income tax expense due to tax reform, partially offset by a $935,000 increase in the provision for loan losses and a $218,000 decrease net interest income, primarily associated with higher costs of deposits. The volume of loans funded during the nine months ended September 30, 2018 amounted to $17.4 billion, an increase of $57.6 million, or 0.3%, compared to the same period in 2017. This compared favorably to the 3.4% industry decline in single-family residential loan volumes from the nine months ended September 30, 2017 to the nine months ended September 30, 2018, according to the Mortgage Bankers Association.

Banking. The Banking segment reported net income for the three months ended September 30, 2018, of $7.1 million, an increase of $3.8 million, or 113%, over the three months ended September 30, 2017. The increase was comprised primarily of a $4.5 million increase in net interest income, including an increase in both the average loan balance outstanding, particularly in multi-family loans, and the average yield on loans. The growth in net interest income was partially offset by an increase of $1.2 million of noninterest expenses associated with higher salaries and benefits. The results of Joy State Bank in the Banking segment during the three months ended September 30, 2018 did not make a material contribution to the increase in net income compared to the three months ended September 30, 2017.

The Banking segment reported net income for the nine months ended September 30, 2018, of $19.6 million, an increase of $10.8 million, or 123%, over the $8.8 million reported for the nine months ended September 30, 2017. The increase was primarily due to a $14.9 million increase in net interest income, including an increase in both the average loan balance outstanding, particularly in multi-family loans, and the average yield on loans. Also contributing to the increase was a $723,000 increase in noninterest income. The increase in net interest income and noninterest income was partially offset by a $3.3 million increase in noninterest expense associated with higher salaries and employee benefits, and a $1.0 million increase in the provision for loan losses. The results of Joy State Bank in the Banking segment during the nine months ended September 30, 2018 did not make a material contribution to the increase in net income compared to the nine months ended September 30, 2017.

Liquidity and Capital Resources

Our primary sources of funds are business and consumer deposits, escrow and custodial deposits, principal and interest payments on loans, and proceeds from sale of loans. While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by market interest rates, economic conditions, and competition. Our most liquid assets are cash, short-term investments, including interest-bearing demand deposits, trading securities and loans held for sale. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period. Our cash flows are comprised of three primary classifications: cash flows from operating activities, investing activities, and financing activities. Net cash provided by (used in) operating activities was $104.8 million and $31.7 million for the nine months ended September 30, 2018 and 2017, respectively. Net cash provided by (used in) investing activities, which consists primarily of net change in loans receivable and purchases, sales and maturities of investment securities, was $(377.3) million and $(377.3) million for the nine months ended September 30, 2018 and 2017, respectively. Net cash provided by financing activities, which is comprised primarily of net change in deposits and borrowings, was $323.8 million and $466.8 million for the nine months ended September 30, 2018 and 2017, respectively.

At September 30, 2018, we had outstanding commitments to originate loans of $430.5 million, unused lines of credit of $138.3 million and outstanding letters of credit of $25.7 million. We anticipate that we will have sufficient funds available to meet our current loan origination commitments. Certificates of deposit that are scheduled to mature in

less than one year from September 30, 2018 totaled $572.5 million. Management expects that a substantial portion of the maturing certificates of deposit will be renewed. However, if a substantial portion of these deposits is not retained, we may decide to utilize FHLBI advances or raise interest rates on deposits to attract new accounts, which may result in higher levels of interest expense. At September 30, 2018, based on available collateral and our ownership of FHLBI stock we had access to additional FHLBI advances of up to $685.6 million.

At September 30, 2018, the Bank exceeded all of its regulatory capital requirements with a Tier 1 leverage capital level of $450.0 million, or 12.0% of adjusted total assets, which is above the required level of $150.5 million, or 4.0%; total risk-based capital of $461.1 million, or 14.8% of risk-weighted assets, which is above the required level of $248.8 million, or 8.0%; and common equity Tier 1 capital of $450.0 million, or 14.5% of risk-weighted assets, which is above the required level of $140.0 million, or 4.5% of risk-weighted assets. Accordingly, the Bank was categorized as well capitalized at September 30, 2018. Management is not aware of any conditions or events since the most recent notification that would change the Bank's category.

At September 30, 2018, Joy State Bank exceeded all of its regulatory capital requirements with a Tier 1 leverage capital level of $4.4 million, or 9.3% of adjusted total assets, which is above the required level of $1.9 million, or 4.0%; total risk-based capital of $4.5 million, or 12.4% of risk-weighted assets, which is above the required level of $2.9 million, or 8.0%; and common equity Tier 1 capital of $4.4 million, or 12.2% of risk-weighted assets, which is above the required level of $1.6 million, or 4.5% of risk-weighted assets. Accordingly, Joy State Bank was categorized as well capitalized at September 30, 2018. Management is not aware of any conditions or events since the most recent notification that would change Joy State Bank's category.

At September 30, 2018, the Company exceeded all of its regulatory capital requirements with a Tier 1 leverage capital level of $385.5 million, or 10.1% of adjusted total assets, which is above the required level of $152.1 million, or 4.0%; total risk-based capital of $396.7 million, or 12.6% of risk-weighted assets, which is above the required level of $251.8 million, or 8.0%; and common equity Tier 1 capital of $343.9 million, or 10.9% of risk-weighted assets, which is above the required level of $141.6 million, or 4.5% of risk-weighted assets. Management is not aware of any conditions or events since the most recent notification that would change the Company's category.

On November 21, 2017, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation finalized a joint proposal and adopted a final rule (the "Transitions Rule") pursuant to which the current regulatory capital treatment for mortgage servicing rights ("MSRs"), certain temporary difference deferred tax assets, and significant investments in the capital of unconsolidated financial institutions will be indefinitely extended in anticipation of a subsequent notice of proposed rulemaking by such regulators to simplify the regulatory capital treatment of such items. The extension of the capital rules with respect to MSRs is the only portion of the Transitions Rule that is material to the Company.

If the Transitions Rule had not been enacted, beginning January 1, 2018, the Company would have been required to make certain additional deductions and increases to its risk-weighting for the purposes of the Company's capital calculations, which would have resulted in the Company reporting a lower amount of capital. As a result of the Transitions Rule, there were no and will not be any such adjustments to our capital.

Quantitative and Qualitative Disclosures About Market Risk

Market Risk. Market risk represents the risk of loss due to changes in market values of assets and liabilities. We incur market risk in the normal course of business through exposures to market interest rates, equity prices, and credit spreads. We have identified two primary sources of market risk: interest rate risk and price risk.

Interest Rate Risk

Income Simulation and Economic Value Analysis. Interest rate risk measurement is calculated and reported to the ALCO at least quarterly. The information reported includes period-end results and identifies any policy limits exceeded,

along with an assessment of the policy limit breach and the action plan and timeline for resolution, mitigation, or assumption of the risk.

We use two approaches to model interest rate risk: Net Interest Income at Risk (NII at Risk) and Economic Value of Equity (EVE). Under NII at Risk, net interest income is modeled utilizing various assumptions for assets, liabilities, and derivatives. EVE measures the period end market value of assets minus the market value of liabilities and the change in this value as rates change. EVE is a period end measurement.

We report NII at Risk to isolate the change in income related solely to interest earning assets and interest-bearing liabilities. The NII at Risk results reflect the analysis used quarterly by management. It models gradual -200, -100, +100 and +200 basis point parallel shifts in market interest rates, implied by the forward yield curve over the next one-year period. The following table presents NII at Risk as of September 30, 2018 and December 31, 2017.

	Net Interest Income Sensitivity Twelve Months Forward			
	- 200	**- 100**	**+ 100**	**+ 200**
		(Dollars in thousands)		
September 30, 2018				
Dollar change	$ (24,134)	$ (11,177)	$ 11,089	$ 22,143
Percent change	(20.8)%	(9.6)%	9.5 %	19.0 %
December 31, 2017				
Dollar change	$ (22,500)	$ (14,336)	$ 11,578	$ 23,134
Percent change	(22.9)%	(14.6)%	11.8 %	23.6 %

Our interest rate risk management policy limits the change in our net interest income to -15% for a 100 basis point move in interest rates, and -20% for a 200 basis point move in rates. At September 30, 2018 we estimated that a -200 basis point change in rates would have caused a greater than 20% decline in net interest income, over the forward 12 month period. However, these estimates were based on a constant-sized balance sheet. Mortgage volumes typically would increase in a -100 or -200 basis point scenario, which would increase net interest and noninterest income. Management determined these dynamics are sufficient mitigating factors. Management may also remediate situations where we are not within our policy limits by buying or selling assets, buying or selling participations in assets, and changing asset and liability pricing. The results reported as of September 30, 2018 show an asset sensitive position.

The EVE results included in the table below reflect the analysis used quarterly by management. It models immediate -100, +100 and +200 basis point parallel shifts in market interest rates.

	Economic Value of Equity Sensitivity (Shock) Immediate Change in Rates			
	- 200	**- 100**	**+ 100**	**+ 200**
		(Dollars in thousands)		
September 30, 2018				
Dollar change	$ 9,855	$ 5,303	$ (7,532)	$ (15,177)
Percent change	2.1 %	1.1 %	(1.6)%	(3.2)%
December 31, 2017				
Dollar change	$ 5,816	$ 3,524	$ (6,718)	$ (14,803)
Percent change	1.4 %	0.9 %	(1.6)%	(3.6)%

Our interest rate risk management policy limits the change in our EVE to -15% for a 100 basis point move in interest rates, and -20% for a 200 basis point move in rates. We are within policy limits set by our board of directors for the -200, -100, +100 and +200 basis point scenarios. The EVE reported at September 30, 2018 projects that as interest

rates increase (decrease) immediately, the economic value of equity position will be expected to decrease (increase). When interest rates rise, fixed rate assets generally lose economic value; the longer the duration, the greater the value lost. The opposite is true when interest rates fall.

ITEM 3 Quantitative and Qualitative Disclosures About Market Risk

The information required under this item is included as part of "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-Q under the headings "Liquidity and Capital Resources" and "Interest Rate Risk."

ITEM 4 Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Form 10-Q. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2018, the Company's disclosure controls and procedures were effective.

(b) Changes in internal control.

There has been no change made in the Company's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Merchants Bancorp
Part II
Other Information

ITEM 1. Legal Proceedings

None.

ITEM 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the "Risk Factors" section included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

Exhibit Number	Description
3.1	First Amended and Restated Articles of Incorporation of Merchants Bancorp (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1, as amended (File No. 333-220623) filed on September 25, 2017)
3.2	Second Amended and Restated By-Laws of Merchants Bancorp (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on November 20, 2017)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Written Statement of Chief Executive Officer and Chief Financial Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Merchants Bancorp

SIGNATURES

Pursuant to the requirements 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.

Merchants Bancorp

Date: November 14, 2018

By: /s/ Michael F. Petrie
Michael F. Petrie
Chief Executive Officer

Date: November 14, 2018

By: /s/ John F. Macke
John F. Macke
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michael F. Petrie, the Chief Executive Officer of Merchants Bancorp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Merchants Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(1)

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 14, 2018	/s/Michael F. Petrie
Date	Michael F. Petrie Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, John F. Macke, the Principal Financial Officer of Merchants Bancorp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Merchants Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
(2)

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
(3)

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 14, 2018	/s/John F. Macke
Date	John F. Macke Principal Financial Officer

EXHIBIT 32

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Michael F. Petrie, Chief Executive Officer, and John F. Macke, Principal Financial Officer, of Merchants Bancorp (the "Registrant"), each hereby certify, in their capacity as an officer of the Registrant that he has reviewed the quarterly report of the Registrant on Form 10-Q for the quarter ended September 30, 2018 (the "Report"), and that to the best of his knowledge:

(1) The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

November 14, 2018	/s/ Michael F. Petrie
Date	Michael F. Petrie Chief Executive Officer
November 14, 2018	/s/John F. Macke
Date	John F. Macke Principal Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Registrant and will be retained by the Registrant and furnished to the SEC or its staff upon request.