MIDSOUTH BANCORP INC
Form 10-Q
November 06, 2015

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

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 1-11826

MIDSOUTH BANCORP, INC.
(Exact name of registrant as specified in its charter)

Louisiana	72 –1020809
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

102 Versailles Boulevard, Lafayette, Louisiana 70501
(Address of principal executive offices, including zip code)
(337) 237-8343
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.
Large accelerated filer Accelerated filer Non-accelerated filer Small reporting company

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

As of November 6, 2015, there were 11,362,149 shares of the registrant's Common Stock, par value $0.10 per share, outstanding.

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Part I – Financial Information

Item 1. Financial Statements.
MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets
(dollars in thousands, except share data)

	September 30, 2015 (unaudited)	December 31, 2014 (audited)
Assets		
Cash and due from banks, including required reserves of $8,782 and $10,019, respectively	$38,386	$45,142
Interest-bearing deposits in banks	82,538	39,031
Federal funds sold	4,513	2,699
Securities available-for-sale, at fair value (cost of $281,885 at September 30, 2015 and $272,588 at December 31, 2014)	285,485	276,984
Securities held-to-maturity (fair value of $122,488 at September 30, 2015 and $141,593 at December 31, 2014)	121,043	141,201
Other investments	12,063	9,990
Loans	1,301,452	1,284,431
Allowance for loan losses	(18,939)	(11,226)
Loans, net	1,282,513	1,273,205
Bank premises and equipment, net	68,718	69,958
Accrued interest receivable	6,655	6,635
Goodwill	42,171	42,171
Intangibles	6,004	6,834
Cash surrender value of life insurance	13,548	13,659
Other real estate	4,661	4,234
Other assets	6,010	4,997
Total assets	$1,974,308	$1,936,740
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$406,118	$390,863
Interest-bearing	1,137,303	1,194,371
Total deposits	1,543,421	1,585,234
Securities sold under agreements to repurchase	92,085	62,098
Short-term Federal Home Loan Bank advances	70,000	25,000
Long-term Federal Home Loan Bank advances	25,958	26,277
Junior subordinated debentures	22,167	22,167
Other liabilities	6,713	6,952
Total liabilities	1,760,344	1,727,728
Commitments and contingencies		
Shareholders' equity:		
Series B Preferred stock, no par value; 5,000,000 shares authorized, 32,000 shares issued and outstanding at September 30, 2015 and December 31, 2014	32,000	32,000
Series C Preferred stock, no par value; 100,000 shares authorized, 91,256 shares issued and outstanding at September 30, 2015 and 93,680 shares issued and	9,126	9,368

outstanding at December 31, 2014		
Common stock, $0.10 par value; 30,000,000 shares authorized, 11,361,839 and 11,340,736 shares issued and outstanding, respectively	1,136	1,149
Additional paid-in capital	110,482	112,744
Unearned ESOP shares	(1,155)	(250)
Accumulated other comprehensive income	2,340	2,857
Treasury stock – 0 and 150,967 shares at September 30, 2015 and December 31, 2014, respectively	—	(3,295)
Retained earnings	60,035	54,439
Total shareholders' equity	213,964	209,012
Total liabilities and shareholders' equity	$1,974,308	$1,936,740

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Earnings (unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest income:				
Loans, including fees	$17,992	$18,273	$54,314	$53,525
Securities and other investments:				
Taxable	1,850	1,965	5,628	6,164
Nontaxable	536	652	1,679	2,007
Federal funds sold	1	2	5	4
Time and interest bearing deposits in other banks	40	15	112	42
Other investments	113	109	273	268
Total interest income	20,532	21,016	62,011	62,010
Interest expense:				
Deposits	883	859	2,751	2,588
Securities sold under agreements to repurchase	249	210	721	588
Other borrowings and payables	109	108	309	320
Junior subordinated debentures	150	327	451	994
Total interest expense	1,391	1,504	4,232	4,490
Net interest income	19,141	19,512	57,779	57,520
Provision for loan losses	3,800	1,175	10,900	2,925
Net interest income after provision for loan losses	15,341	18,337	46,879	54,595
Non-interest income:				
Service charges on deposits	2,231	2,556	6,488	7,385
Gain on sale of securities, net	—	—	1,243	128
ATM and debit card income	1,823	1,808	5,529	5,375
Income from death benefit on BOLI/executive officer life insurance	—	—	160	3,000
Other charges and fees	786	1,830	2,553	3,484
Total non-interest income	4,840	6,194	15,973	19,372
Non-interest expenses:				
Salaries and employee benefits	7,653	8,287	23,792	25,588
Occupancy expense	3,815	3,834	11,365	11,314
FDIC insurance	391	269	1,003	783
Other	4,705	5,467	13,696	14,997
Total non-interest expenses	16,564	17,857	49,856	52,682
Income before income taxes	3,617	6,674	12,996	21,285
Income tax expense	1,028	2,202	3,817	5,839
Net earnings	2,589	4,472	9,179	15,446
Dividends on preferred stock	172	174	517	524
Net earnings available to common shareholders	$2,417	$4,298	$8,662	$14,922
Earnings per share:				

Basic	$0.22	$0.38	$0.77	$1.32
Diluted	$0.21	$0.37	$0.75	$1.28
Weighted average number of shares outstanding:				
Basic	11,312	11,314	11,321	11,283
Diluted	11,831	11,955	11,848	11,904
Dividends declared per common share	$0.09	$0.09	$0.27	$0.26

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (unaudited)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net earnings	$2,589	$4,472	$9,179	$15,446
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on securities available-for-sale:				
Unrealized holding gains (losses) arising during the year	1,717	(405)	447	4,116
Less: reclassification adjustment for gains on sales of securities available-for-sale	—	—	(1,243)	(128)
Total other comprehensive income (loss), before tax	1,717	(405)	(796)	3,988
Income tax effect related to items of other comprehensive income (loss)	(601)	142	279	(1,396)
Total other comprehensive income (loss), net of tax	1,116	(263)	(517)	2,592
Total comprehensive income	$3,705	$4,209	$8,662	$18,038

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statement of Shareholders' Equity (unaudited)
For the Nine Months Ended September 30, 2015
(in thousands, except share and per share data)

	Preferred Stock Shares	Amount	Common Stock Shares	Amount	Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
Balance - December 31, 2014	125,680	$41,368	11,491,703	$1,149	$112,744	$(250)	$2,857	$(3,295)	$54,439	$209,012
Net earnings	—	—	—	—	—	—	—	—	9,179	9,179
Dividends on Series B and Series C preferred stock	—	—	—	—	—	—	—	—	(517)	(517)
Dividends on common stock, $0.27 per share	—	—	—	—	—	—	—	—	(3,066)	(3,066)
Conversion of Series C preferred stock to common stock	(2,424)	(242)	13,448	1	241	—	—	—	—	—
Reclassification of treasury stock per the LBCA [1]	—	—	(150,967)	(15)	(3,280)			3,295		—
Increase in ESOP obligation, net of repayments	—	—	—	—	—	(905)	—	—	—	(905)
Exercise of stock options	—	—	7,655	1	98	—	—	—	—	99
Tax benefit resulting from distribution from Directors Deferred Compensation Plan	—	—	—	—	420	—	—	—	—	420
Stock option and restricted stock compensation expense	—	—	—	—	259	—	—	—	—	259
Change in accumulated other	—	—	—	—	—	—	(517)	—	—	(517)

comprehensive income										
Balance – September 30, 2015	123,256	$41,126	11,361,839	$1,136	$110,482	$(1,155)	$2,340	$—	$60,035	$213,964

See notes to unaudited consolidated financial statements.

(1) See Note 1 for an explanation of the elimination of treasury stock under the Louisiana Business Corporation Act.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)
(in thousands)

	For the Nine Months Ended September 30, 2015	2014
Cash flows from operating activities:		
Net earnings	$9,179	$15,446
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	4,652	4,518
Accretion of purchase accounting adjustments	(1,003)	(1,924)
Provision for loan losses	10,900	2,925
Deferred tax (benefit) expense	(1,633)	2,034
Amortization of premiums on securities, net	2,141	2,432
(Accretion) amortization of other investments	(1)	4
Stock option expense	253	355
Restricted stock expense	6	—
Net gain on sale of investment securities	(1,243)	(128)
Net gain on sale of other real estate owned	(13)	(1,081)
Net write down of other real estate owned	111	31
Net (gain) loss on sale/disposal of premises and equipment	(8)	232
Income recognized from death benefit on bank owned life insurance	(160)	—
Change in accrued interest receivable	(20)	45
Change in accrued interest payable	(48)	(240)
Change in other assets & other liabilities, net	481	(2,006)
Net cash provided by operating activities	23,594	22,643
Cash flows from investing activities:		
Proceeds from maturities and calls of securities available-for-sale	55,874	33,466
Proceeds from maturities and calls of securities held-to-maturity	19,299	10,778
Proceeds from sale of securities available-for-sale	40,277	22,153
Purchases of securities available-for-sale	(105,486)	—
Purchases of securities held-to-maturity	—	(1,104)
Proceeds from redemptions of other investments	—	150
Redemption of Capital Securities related to MidSouth Statutory Trust I	—	217
Proceeds from sale of other investments	898	—
Purchases of other investments	(2,970)	(567)
Net change in loans	(20,669)	(111,329)
Proceeds from bank owned life insurance death benefit	498	—
Purchases of premises and equipment	(3,439)	(4,265)
Proceeds from sale of premises and equipment	35	743
Proceeds from sale of other real estate owned	857	3,315
Purchase of other real estate owned	(351)	—
Net cash used in investing activities	(15,177)	(46,443)
Cash flows from financing activities:		
Change in deposits	(41,728)	2,244
Change in securities sold under agreements to repurchase	29,987	17,048
Borrowings on Federal Home Loan Bank advances	150,000	10,000

Repayments of Federal Home Loan Bank advances	(105,047)	(45)
Redemption of MidSouth Statutory Trust I	—	(7,217)
Repayments of notes payable	—	(1,000)
Purchase of treasury stock	—	(9)
Proceeds and tax benefit from exercise of stock options	99	611
Tax benefit resulting from distribution from Directors Deferred Compensation Plan	420	—
Payment of dividends on preferred stock	(519)	(530)
Payment of dividends on common stock	(3,064)	(2,818)
Net cash provided by financing activities	30,148	18,284
Net increase (decrease) in cash and cash equivalents	38,565	(5,516)
Cash and cash equivalents, beginning of period	86,872	59,731
Cash and cash equivalents, end of period	$125,437	$54,215
Supplemental cash flow information:		
Interest paid	$4,280	$4,730
Income taxes paid	5,180	5,815
Noncash investing and financing activities:		
Transfer of loans to other real estate	1,031	317
Change in accrued common stock dividends	3	121
Change in accrued preferred stock dividends	(2)	(6)
Financed sales of other real estate	—	84
Net change in loan to ESOP	(905)	(267)

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements
September 30, 2015
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America ("GAAP"), the financial position of MidSouth Bancorp, Inc. (the "Company") and its subsidiaries as of September 30, 2015 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company's 2014 Annual Report on Form 10-K.

The results of operations for the nine-month period ended September 30, 2015 are not necessarily indicative of the results to be expected for the entire year.

Use of Estimates — The preparation of financial statements in conformity with GAAP 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 consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Summary of Significant Accounting Policies — The accounting and reporting policies of the Company conform with GAAP and general practices within the banking industry. There have been no material changes or developments in the application of accounting principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our 2014 Annual Report on Form 10-K.

Recent Accounting Pronouncements — ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items was issued as part of the FASB's simplification initiative. ASU 2015-01 eliminates the concept of extraordinary items. The effective date of this Update is for fiscal years beginning on or after December 15, 2015 and interim periods within those annual periods. Adoption of this Update is not expected to have a material effect on the Company's consolidated financial statements or the interim notes to the consolidated financial statements.

ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs was also issued as part of the FASB's simplification initiative. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Currently, debt issuance costs are presented as an asset on the balance sheet. The FASB notes within the ASU, capitalized debt issuance costs do not meet the definition of an asset and are more akin to a debt discount, thereby reducing the carrying amount of the proceeds received. The effective date of this Update is for fiscal years beginning on or after December 15, 2015 and interim periods within those annual periods. Adoption of this Update is not expected to have a material effect on the Company's consolidated financial statements or the interim notes to the consolidated financial statements.

Louisiana Business Corporation Act — Effective January 1, 2015, companies incorporated under Louisiana law became subject to the Louisiana Business Corporation Act. Provisions of the Louisiana Business Corporation Act eliminate the concept of treasury stock. Rather, shares purchased by the Company constitute authorized but unissued shares. Accounting principles generally accepted in the United States of America state that accounting for treasury stock shall conform to state law. The Company's consolidated financial statements as of September 30, 2015 reflect this change. The cost of shares purchased by the Company has been allocated to common stock and additional paid-in capital balances.

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2. Investment Securities

The portfolio of investment securities consisted of the following (in thousands):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of state and political subdivisions	$36,500	$979	$48	$37,431
GSE mortgage-backed securities	88,813	2,981	55	91,739
Collateralized mortgage obligations: residential	148,819	690	927	148,582
Collateralized mortgage obligations: commercial	5,653	9	45	5,617
Mutual funds	2,100	16	—	2,116
	$281,885	$4,675	$1,075	$285,485

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government sponsored enterprises	$10,339	$—	$112	$10,227
Obligations of state and political subdivisions	43,079	1,555	29	44,605
GSE mortgage-backed securities	106,208	3,183	288	109,103
Collateralized mortgage obligations: residential	62,093	266	1,520	60,839
Collateralized mortgage obligations: commercial	24,462	190	107	24,545
Other asset-backed securities	24,041	321	19	24,343
Collateralized debt obligation	266	952	—	1,218
Mutual funds	2,100	4	—	2,104
	$272,588	$6,471	$2,075	$276,984

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$43,933	$552	$38	$44,447
GSE mortgage-backed securities	58,420	1,212	82	59,550
Collateralized mortgage obligations: residential	11,284	—	250	11,034
Collateralized mortgage obligations: commercial	7,406	51	—	7,457
	$121,043	$1,815	$370	$122,488

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$45,914	$267	$192	$45,989
GSE mortgage-backed securities	67,268	1,080	164	68,184

Collateralized mortgage obligations: residential	12,709	—	479	12,230
Collateralized mortgage obligations: commercial	15,310	53	173	15,190
	$141,201	$1,400	$1,008	$141,593

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With the exception of two private-label collateralized mortgage obligations ("CMOs") with a combined balance remaining of $34,000 at September 30, 2015, all of the Company's CMOs are government-sponsored enterprise ("GSE") securities.

The amortized cost and fair value of debt securities at September 30, 2015 by contractual maturity are shown in the following table (in thousands) with the exception of other asset-backed securities, mortgage-backed securities, CMOs, and the collateralized debt obligation. Expected maturities may differ from contractual maturities for mortgage-backed securities and CMOs because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	$5,074	$5,114
Due after one year through five years	19,498	20,120
Due after five years through ten years	9,540	9,832
Due after ten years	2,388	2,365
Mortgage-backed securities and collateralized mortgage obligations:		
Residential	237,632	240,321
Commercial	5,653	5,617
Mutual funds	2,100	2,116
	$281,885	$285,485

	Amortized Cost	Fair Value
Held-to-maturity:		
Due in one year or less	$473	$475
Due after one year through five years	2,923	2,960
Due after five years through ten years	11,105	11,273
Due after ten years	29,432	29,739
Mortgage-backed securities and collateralized mortgage obligations:		
Residential	69,704	70,584
Commercial	7,406	7,457
	$121,043	$122,488

Details concerning investment securities with unrealized losses are as follows (in thousands):

	September 30, 2015 Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Available-for-sale:						
Obligations of state and political subdivisions	$3,190	$48	$—	$—	$3,190	$48
GSE mortgage-backed securities	15,860	45	3,754	10	19,614	55

Collateralized mortgage obligations: residential	33,689	128	31,772	799	65,461	927
Collateralized mortgage obligations: commercial	—	—	3,073	45	3,073	45
	$52,739	$221	$38,599	$854	$91,338	$1,075

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	December 31, 2014 Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Available-for-sale:						
U.S. Government sponsored enterprises	$4,973	$32	$5,254	$80	$10,227	$112
Obligations of state and political subdivisions	2,029	29	—	—	2,029	29
GSE mortgage-backed securities	6,668	25	21,538	263	28,206	288
Collateralized mortgage obligations: residential	9,366	53	37,997	1,467	47,363	1,520
Collateralized mortgage obligations: commercial	—	—	3,747	107	3,747	107
Other asset-backed securities	6,401	19	—	—	6,401	19
	$29,437	$158	$68,536	$1,917	$97,973	$2,075

	September 30, 2015 Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	$6,544	$19	$1,302	$19	$7,846	$38
GSE mortgage-backed securities	—	—	7,309	82	7,309	82
Collateralized mortgage obligations: residential	—	—	11,034	250	11,034	250
	$6,544	$19	$19,645	$351	$26,189	$370

	December 31, 2014 Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	$11,761	$35	$13,263	$157	$25,024	$192
GSE mortgage-backed securities	—	—	8,142	164	8,142	164
Collateralized mortgage obligations: residential	—	—	12,230	479	12,230	479
Collateralized mortgage obligations: commercial	7,599	173	—	—	7,599	173
	$19,360	$208	$33,635	$800	$52,995	$1,008

Management evaluates each quarter whether unrealized losses on securities represent impairment that is other than temporary. For debt securities, the Company considers its intent to sell the securities or if it is more likely than not the Company will be required to sell the securities. If such impairment is identified, based upon the intent to sell or the more likely than not threshold, the carrying amount of the security is reduced to fair value with a charge to earnings. Upon the result of the aforementioned review, management

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then reviews for potential other than temporary impairment based upon other qualitative factors. In making this evaluation, management considers changes in market rates relative to those available when the security was acquired, changes in market expectations about the timing of cash flows from securities that can be prepaid, performance of the debt security, and changes in the market's perception of the issuer's financial health and the security's credit quality. If determined that a debt security has incurred other than temporary impairment, then the amount of the credit related impairment is determined. If a credit loss is evident, the amount of the credit loss is charged to earnings and the non-credit related impairment is recognized through other comprehensive income.

As of September 30, 2015, 42 securities had unrealized losses totaling 1.21% of the individual securities' amortized cost basis and 0.36% of the Company's total amortized cost basis. Of the 42 securities, 20 had been in an unrealized loss position for over twelve months at September 30, 2015. These 20 securities had an amortized cost basis and unrealized loss of $59.4 million and $1.2 million, respectively. The unrealized losses on debt securities at September 30, 2015 resulted from changing market interest rates over the yields available at the time the underlying securities were purchased. Management identified no impairment related to credit quality. At September 30, 2015, management had the intent and ability to hold impaired securities and no impairment was evaluated as other than temporary. As a result, no other than temporary impairment losses were recognized during the three months ended September 30, 2015.

During the nine months ended September 30, 2015, the Company sold 21 securities classified as available-for-sale at a net gain of $1.2 million. Of the 21 securities sold, 11 were sold with gains totaling $1.4 million and 10 securities were sold at a loss of $135,000. During the nine months ended September 30, 2014, the Company sold 4 securities classified as available-for-sale at a net gain of $128,000. All of the securities were sold at a gain.

Securities with an aggregate carrying value of approximately $287.2 million and $279.8 million at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public funds on deposit and for other purposes required or permitted by law.

3. Credit Quality of Loans and Allowance for Loan Losses

The loan portfolio consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Commercial, financial and agricultural	$482,452	$467,147
Real estate - construction	74,279	68,577
Real estate – commercial	473,319	467,172
Real estate – residential	151,667	154,602
Installment loans to individuals	113,199	119,328
Lease financing receivable	4,790	4,857
Other	1,746	2,748
	1,301,452	1,284,431
Less allowance for loan losses	(18,939)	(11,226)
	$1,282,513	$1,273,205

The Company monitors loan concentrations and evaluates individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity for each major standard industry classification segment. At September 30, 2015, one industry segment concentration, the oil and gas industry, constituted more than 10% of the loan portfolio. The Company's exposure in the oil and gas industry, including related service and manufacturing industries, totaled approximately $295.6 million, or 22.7% of total loans. Additionally, the Company's exposure to loans secured by commercial real estate is monitored. At September 30, 2015, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately $529.0 million. Of the $529.0 million, $473.3 million represent CRE loans, 53% of which are secured by owner-occupied commercial properties. Of the $529.0 million in loans secured by commercial real estate, $20.0 million, or 3.8%, were on nonaccrual status at September 30, 2015.

Allowance for Loan Losses

The allowance for loan losses is a valuation account available to absorb probable losses on loans. All losses are charged to the allowance for loan losses when the loss actually occurs or when a determination is made that a loss is likely to occur. Recoveries

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are credited to the allowance for loan losses at the time of recovery. Quarterly, the probable level of losses in the existing portfolio is estimated through consideration of various factors. Based on these estimates, the allowance for loan losses is increased by charges to earnings and decreased by charge offs (net of recoveries).

The allowance is composed of general reserves and specific reserves. General reserves are determined by applying loss percentages to segments of the portfolio. The loss percentages are based on each segment's historical loss experience, generally over the past twelve to eighteen months, and adjustment factors derived from conditions in the Company's internal and external environment. All loans considered to be impaired are evaluated on an individual basis to determine specific reserve allocations in accordance with GAAP. Loans for which specific reserves are provided are excluded from the calculation of general reserves.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans; however, the estimate of loss is based on the unpaid principal balance and then compared to any remaining unaccreted purchase discount. To the extent that the calculated loss is greater than the remaining unaccreted purchase discount, an allowance is recorded for such difference.

The Company has an internal loan review department that is independent of the lending function to challenge and corroborate the loan grade assigned by the lender and to provide additional analysis in determining the adequacy of the allowance for loan losses.

A rollforward of the activity within the allowance for loan losses by loan type and recorded investment in loans for the nine months ended September 30, 2015 and 2014 is as follows (in thousands):

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	September 30, 2015							
		Real Estate						
	Coml, Fin, and Agric	Constru-ction	Commercial	Residential	Installment loans to individuals	Lease financing receivable	Other	Total
Allowance for loan losses:								
Beginning balance	$5,729	$954	$2,402	$810	$1,311	$16	$4	$11,226
Charge-offs	(2,310)	(76)	(169)	(45)	(883)	—	—	(3,483)
Recoveries	185	1	20	10	80	—	—	296
Provision	8,016	(62)	2,107	(104)	923	13	7	10,900
Ending balance	$11,620	$817	$4,360	$671	$1,431	$29	$11	$18,939
Ending balance: individually evaluated for impairment	$2,569	$26	$1,739	$147	$216	$—	$—	$4,697
Ending balance: collectively evaluated for impairment	$9,051	$791	$2,621	$524	$1,215	$29	$11	$14,242
Loans:								
Ending balance	$482,452	$74,279	$473,319	$151,667	$113,199	$4,790	$1,746	$1,301,452
Ending balance: individually evaluated for impairment	$29,185	$212	$19,928	$1,796	$386	$—	$—	$51,507
Ending balance: collectively evaluated for impairment	$453,267	$74,067	$452,758	$149,788	$112,813	$4,790	$1,746	$1,249,229
Ending balance: loans acquired with deteriorated credit quality	$—	$—	$633	$83	$—	$—	$—	$716

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	September 30, 2014							
		Real Estate						
	Coml, Fin, and Agric	Constr-uction	Commercial	Residential	Installment loans to individuals	Lease financing receivable	Other	Total
Allowance for loan losses:								
Beginning balance	$3,906	$1,046	$1,389	$1,141	$1,273	$21	$3	$8,779
Charge-offs	(2,084)	(1)	(93)	(188)	(566)	—	—	(2,932)
Recoveries	101	—	398	44	110	—	—	653
Provision	2,731	103	(345)	(8)	450	(6)	—	2,925
Ending balance	$4,654	$1,148	$1,349	$989	$1,267	$15	$3	$9,425
Ending balance: individually evaluated for impairment	$853	$3	$55	$87	$140	$—	$—	$1,138
Ending balance: collectively evaluated for impairment	$3,801	$1,145	$1,294	$902	$1,127	$15	$3	$8,287
Loans:								
Ending balance	$452,065	$86,315	$430,930	$153,915	$116,340	$5,285	$3,523	$1,248,373
Ending balance: individually evaluated for impairment	$2,662	$106	$3,312	$1,073	$426	$—	$—	$7,579
Ending balance: collectively evaluated for impairment	$449,403	$86,209	$426,942	$152,742	$115,914	$5,285	$3,523	$1,240,018
Ending balance: loans acquired with deteriorated credit quality	$—	$—	$676	$100	$—	$—	$—	$776

Non-Accrual and Past Due Loans

Loans are considered past due if the required principal and interest payment have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the probability of collection of interest is deemed insufficient to warrant further accrual. For loans placed on non-accrual status, the accrual of interest is discontinued and subsequent payments received are applied to the principal balance. Interest income is recorded after principal has been satisfied and as payments are received. Non-accrual loans may be returned to accrual status if all principal and interest amounts contractually owed are reasonably assured of repayment within a reasonable period and there is a period of at least six months to one year of repayment performance by the borrower depending on the contractual payment terms.

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An age analysis of past due loans (including both accruing and non-accruing loans) is as follows (in thousands):

	September 30, 2015						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	$4,065	$3,124	$3,879	$11,068	$471,384	$482,452	$23
Commercial real estate - construction	93	99	12	204	55,484	55,688	—
Commercial real estate - other	7,252	2,745	16,999	26,996	446,323	473,319	—
Residential - construction	—	—	172	172	18,419	18,591	—
Residential - prime	1,383	264	1,378	3,025	148,642	151,667	—
Consumer - credit card	38	11	27	76	5,683	5,759	27
Consumer - other	1,228	162	329	1,719	105,721	107,440	32
Lease financing receivable	—	—	—	—	4,790	4,790	—
Other loans	148	—	—	148	1,598	1,746	—
	$14,207	$6,405	$22,796	$43,408	$1,258,044	$1,301,452	$82

	December 31, 2014						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	$2,179	$654	$2,556	$5,389	$461,758	$467,147	$26
Commercial real estate - construction	15	—	105	120	43,390	43,510	97
Commercial real estate - other	4,989	270	2,464	7,723	459,449	467,172	—
Residential - construction	431	—	—	431	24,636	25,067	—
Residential - prime	1,843	523	704	3,070	151,532	154,602	—
Consumer - credit card	5	19	18	42	5,970	6,012	18
Consumer - other	671	392	107	1,170	112,146	113,316	46
Lease financing receivable	—	—	—	—	4,857	4,857	—
Other loans	134	—	—	134	2,614	2,748	—
	$10,267	$1,858	$5,954	$18,079	$1,266,352	$1,284,431	$187

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Non-accrual loans are as follows (in thousands):

	September 30, 2015	December 31, 2014
Commercial, financial, and agricultural	$29,171	$2,642
Commercial real estate – construction	39	54
Commercial real estate - other	19,952	6,429
Residential - construction	172	—
Residential - prime	1,896	1,194
Consumer - credit card	—	—
Consumer - other	386	382
Lease financing receivable	—	—
Other	—	—
	$51,616	$10,701

The amount of interest that would have been recorded on non-accrual loans, had the loans not been classified as non-accrual, totaled approximately $1.3 million and $392,000 for the nine months ended September 30, 2015 and 2014, respectively. Interest actually received on non-accrual loans subsequent to their transfer to non-accrual status totaled at September 30, 2015 and 2014 was $19,000 and $93,000, respectively.

Impaired Loans

Loans are considered impaired when, based upon current information, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans classified as special mention, substandard, or doubtful, based on credit risk rating factors, are reviewed to determine whether impairment testing is appropriate. An allowance for each impaired loan is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate or at the loan's observable market price or the fair value of the collateral if the loan is collaterally dependent. All impaired loans are reviewed, at a minimum, on a quarterly basis. Existing valuations are reviewed to determine if additional discounts or new appraisals are required. After this review, when comparing the resulting collateral valuation to the outstanding loan balance, if the discounted collateral value exceeds the loan balance no specific allocation is reserved. Acquired impaired loans are generally not subject to individual evaluation for impairment and are not reported with impaired loans or troubled debt restructurings, even if they would otherwise qualify for such treatment.

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Loans that are individually evaluated for impairment are as follows (in thousands):

	September 30, 2015				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial, financial, and agricultural	$22,149	$22,412	$—	$21,863	$703
Commercial real estate – construction	39	39	—	40	—
Commercial real estate – other	5,440	5,440	—	6,244	47
Residential – prime	1,144	1,164	—	1,211	11
Residential – construction	55	55	—	273	1
Consumer – other	30	30	—	33	—
Subtotal:	28,857	29,140	—	29,664	762
With an allowance recorded:					
Commercial, financial, and agricultural	7,036	7,036	2,569	4,604	159
Commercial real estate – other	14,488	14,488	1,739	12,932	33
Residential – prime	652	652	147	599	5
Residential – construction	118	118	26	59	—
Consumer – other	356	371	216	322	4
Subtotal:	22,650	22,665	4,697	18,516	201
Totals:					
Commercial	49,152	49,415	4,308	45,683	942
Residential	1,969	1,989	173	2,142	17
Consumer	386	401	216	355	4
Grand total:	$51,507	$51,805	$4,697	$48,180	$963

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	December 31, 2014				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial, financial, and agricultural	$438	$521	$—	$554	$—
Commercial real estate – construction	54	54	—	58	—
Commercial real estate – other	1,921	1,921	—	1,885	17
Residential – prime	543	543	—	534	15
Consumer – other	78	78	—	72	—
Subtotal:	3,034	3,117	—	3,103	32
With an allowance recorded:					
Commercial, financial, and agricultural	2,218	2,333	1,010	1,394	35
Commercial real estate – construction	—	—	—	19	—
Commercial real estate – other	4,467	4,467	1,484	2,416	220
Residential – prime	529	548	68	452	3
Consumer – other	299	313	179	252	4
Subtotal:	7,513	7,661	2,741	4,533	262
Totals:					
Commercial	9,098	9,296	2,494	6,326	272
Residential	1,072	1,091	68	986	18
Consumer	377	391	179	324	4
Grand total:	$10,547	$10,778	$2,741	$7,636	$294

Credit Quality

The Company manages credit risk by observing written underwriting standards and lending policy established by the Board of Directors and management to govern all lending activities. The risk management program requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by a loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors.

Loans can be classified into the following three risk rating grades: pass, special mention, and substandard/doubtful. Factors considered in determining a risk rating grade include debt service capacity, capital structure/liquidity, management, collateral quality, industry risk, company trends/operating performance, repayment source, revenue diversification/customer concentration, quality of financial information, and financing alternatives. Pass grade signifies the highest quality of loans to loans with reasonable credit risk, which may include borrowers with marginally adequate financial performance, but have the ability to repay the debt. Special mention loans have potential weaknesses that warrant extra attention from the loan officer and other management personnel, but still have the ability to repay the debt. Substandard classification includes loans with well-defined weaknesses with risk of potential loss. Loans classified as doubtful are considered to have little recovery value and are charged off.

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The following tables present the classes of loans by risk rating (in thousands):

Commercial Credit Exposure Credit Risk Profile by Creditworthiness Category	September 30, 2015				
	Commercial, financial, and agricultural	Commercial real estate - construction	Commercial real estate - other	Total	% of Total
Pass	$417,600	$55,525	$417,095	$890,220	88.02 %
Special mention	23,104	34	20,277	43,415	4.29 %
Substandard	41,521	129	35,947	77,597	7.67 %
Doubtful	227	—	—	227	0.02 %
	$482,452	$55,688	$473,319	$1,011,459	100.00 %

Residential Credit Exposure Credit Risk Profile by Creditworthiness Category	Residential - construction	Residential - prime	Total	% of Total
Pass	$18,419	$147,721	$166,140	97.58 %
Special mention	—	1,326	1,326	0.78 %
Substandard	172	2,620	2,792	1.64 %
	$18,591	$151,667	$170,258	100.00 %

Consumer and Commercial Credit Exposure Credit Risk Profile Based on Payment Activity	Consumer - credit card	Consumer - other	Lease financing receivable	Other	Total	% of Total
Performing	$5,721	$107,022	$4,790	$1,746	$119,279	99.62 %
Nonperforming	38	418	—	—	456	0.38 %
	$5,759	$107,440	$4,790	$1,746	$119,735	100.00 %

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December 31, 2014

Commercial Credit Exposure
Credit Risk Profile by
Creditworthiness Category

	Commercial, financial, and agricultural	Commercial real estate - construction	Commercial real estate - other	Total	% of Total
Pass	$456,221	$43,320	$440,281	$939,822	96.11 %
Special mention	4,861	132	7,120	12,113	1.24 %
Substandard	5,541	58	19,771	25,370	2.60 %
Doubtful	524	—	—	524	0.05 %
	$467,147	$43,510	$467,172	$977,829	100.00 %

Residential Credit Exposure
Credit Risk Profile by
Creditworthiness Category

	Residential - construction	Residential - prime	Total	% of Total
Pass	$25,067	$150,664	$175,731	97.81 %
Special mention	—	1,184	1,184	0.66 %
Substandard	—	2,754	2,754	1.53 %
	$25,067	$154,602	$179,669	100.00 %

Consumer and Commercial
Credit Exposure
Credit Risk Profile Based on
Payment Activity

	Consumer - credit card	Consumer - other	Lease financing receivable	Other	Total	% of Total
Performing	$5,995	$112,893	$4,857	$2,748	$126,493	99.65 %
Nonperforming	17	423	—	—	440	0.35 %
	$6,012	$113,316	$4,857	$2,748	$126,933	100.00 %

Troubled Debt Restructurings

A troubled debt restructuring ("TDR") is a restructuring of a debt made by the Company to a debtor for economic or legal reasons related to the debtor's financial difficulties that it would not otherwise consider. The Company grants the concession in an attempt to protect as much of its investment as possible.

Information about the Company's TDRs is as follows (in thousands):

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	September 30, 2015			
	Current	Past Due Greater Than 30 Days	Nonaccrual TDRs	Total TDRs
Commercial, financial and agricultural	$18	$—	$21,324	$21,342
Real estate - commercial	—	150	—	150
	$18	$150	$21,324	$21,492

	December 31, 2014			
	Current	Past Due Greater Than 30 Days	Nonaccrual TDRs	Total TDRs
Commercial, financial and agricultural	$21	$—	$234	$255
Real estate - commercial	155	—	—	155
	$176	$—	$234	$410

During the three months ended September 30, 2015, there were no loans identified as a TDR. There was one TDR totaling $21.1 million that defaulted on the modified terms during the three months ended September 31, 2015. During the three months ended September 30, 2014, there were no loans identified as a TDR, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the nine months ended September 30, 2015, there was one loan relationship with a pre-modification balance of $21.4 million identified as a TDR after conversion of the loans to interest only for a limited amount of time. There was one TDR totaling $21.1 million that defaulted on the modified terms during the nine months ended September 31, 2015. During the nine months ended September 30, 2014, there was one loan relationship with a pre-modification balance of $1.2 million identified as a TDR through a modification of the original loan terms, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. For purposes of the determination of an allowance for loan losses on these TDRs, as an identified TDR, the Company considers a loss probable on the loan and, as a result is reviewed for specific impairment in accordance with the Company’s allowance for loan loss methodology. If it is determined losses are probable on such TDRs, either because of delinquency or other credit quality indicator, the Company establishes specific reserves for these loans. As of September 30, 2015, there were no commitments to lend additional funds to debtors owing sums to the Company whose terms have been modified in TDRs.

4. Intangibles

A summary of core deposit intangible assets as of September 30, 2015 and December 31, 2014 is as follows (in thousands):

	September 30, 2015	December 31, 2014
Gross carrying amount	$11,674	$11,674
Less accumulated amortization	(5,670)	(4,840)
Net carrying amount	$6,004	$6,834

5. Other Comprehensive Income

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The following is a summary of the tax effects allocated to each component of other comprehensive income (loss) (in thousands):

	Three Months Ended September 30, 2015			2014		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive income (loss):						
Securities available-for-sale:						
Change in unrealized gains (losses) during period	$1,717	$(601)	$1,116	$(405)	$142	$(263)
Reclassification adjustment for gains included in net income	—	—	—	—	—	—
Total other comprehensive income (loss)	$1,717	$(601)	$1,116	$(405)	$142	$(263)

	Nine Months Ended September 30, 2015			2014		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive (loss) income:						
Securities available-for-sale:						
Change in unrealized gains during period	$447	$(156)	$291	$4,116	$(1,441)	$2,675
Reclassification adjustment for gains included in net income	(1,243)	435	(808)	(128)	45	(83)
Total other comprehensive (loss) income	$(796)	$279	$(517)	$3,988	$(1,396)	$2,592

The reclassifications out of accumulated other comprehensive income into net income are presented below (in thousands):

	Three Months Ended September 30, 2015		2014	
Details about Accumulated Other Comprehensive Income Components	Reclassifications Out of Accumulated Other Comprehensive Income	Income Statement Line Item	Reclassifications Out of Accumulated Other Comprehensive Income	Income Statement Line Item
Unrealized gains and losses on securities available-for-sale:				
	$—	Gain on sale of securities, net	$—	Gain on sale of securities, net
	—	Tax expense	—	Tax expense
	$—	Net of tax	$—	Net of tax

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Details about Accumulated Other Comprehensive Income Components	Nine Months Ended September 30, 2015 Reclassifications Out of Accumulated Other Comprehensive Income	Income Statement Line Item	2014 Reclassifications Out of Accumulated Other Comprehensive Income	Income Statement Line Item
Unrealized gains and losses on securities available-for-sale:				
	$(1,243)	Gain on sale of securities, net	$(128)	Gain on sale of securities, net
	435	Tax expense	45	Tax expense
	$(808)	Net of tax	$(83)	Net of tax

6. Declaration of Dividends

A first quarter dividend of $0.09 per share for holders of common stock of record on March 13, 2015 was declared on January 21, 2015, and was paid on April 1, 2015. On January 21, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on April 1, 2015, which was paid on April 15, 2015. On April 15, 2015, the Company declared a second quarter dividend of $0.09 per share for holders of common stock of record on June 15, 2015, and was paid on July 1, 2015. On April 15, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on July 1, 2015, which was paid on July 15, 2015. On July 15, 2015, the Company declared a third quarter dividend of $0.09 per share for holders of common stock of record on September 15, 2015 to be paid on October 1, 2015. On July 15, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on October 1, 2015 to be paid on October 15, 2015. On October 21, 2015, the Company declared a fourth quarter dividend of $0.09 per share for holders of common stock of record on December 15, 2015 to be paid on January 4, 2016. On October 21, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on January 4, 2016 to be paid on January 15, 2016.

7. Earnings Per Common Share

Following is a summary of the information used in the computation of earnings per common share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net earnings available to common shareholders	$2,417	$4,298	$8,662	$14,922
Dividends on Series C preferred stock	92	94	277	284
Adjusted net earnings available to common shareholders	$2,509	$4,392	$8,939	$15,206
Weighted average number of common shares outstanding used in computation of basic earnings per common share	11,312	11,314	11,321	11,283
Effect of dilutive securities:				
Stock options	12	92	20	77
Convertible preferred stock and warrants	507	549	507	544
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share	11,831	11,955	11,848	11,904

Options and warrants on 234,206 shares of common stock and 11,250 shares of restricted stock were not included in computing diluted earnings per share for the quarter and nine months ended September 30, 2015 because the effects of these shares were anti-dilutive as a result of the exercise price of such options. Options to acquire 7,355 and 24,855 shares of common stock were not included in computing diluted earnings per share for the quarter and nine months ended September 30, 2014, respectively, because the effects of these shares were anti-dilutive as a result of the exercise price of such options.

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8. Fair Value Measurement

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities which are either recorded or disclosed at fair value.

Cash and Due From Banks, Interest-Bearing Deposits in Banks and Federal Funds Sold—The carrying value of these short-term instruments is a reasonable estimate of fair value.

Securities Available-for-Sale—Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Securities are classified as Level 2 within the valuation hierarchy when the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things. Level 2 inputs are used to value U.S. Agency securities, mortgage-backed securities, asset-backed securities, municipal securities, single issue trust preferred securities, certain pooled trust preferred securities, collateralized debt obligations and certain equity securities that are not actively traded.

Securities Held-to-Maturity—The fair value of securities held-to-maturity is estimated using the same measurement techniques as securities available-for-sale.

Other Investments—The carrying value of other investments is a reasonable estimate of fair value.

Loans—For disclosure purposes, the fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. The Company does not record loans at fair value on a recurring basis. No adjustment to fair value is taken related to illiquidity discounts. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management uses one of three methods to measure impairment, which, include collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral or where the loan balance has been charged down to fair value require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and adjusts the appraisal value by taking an additional discount for market conditions and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

For non-performing loans, collateral valuations currently in file are reviewed for acceptability in terms of timeliness and applicability. Although each determination is made based on the facts and circumstances of each credit, generally valuations are no longer considered acceptable when there has been physical deterioration of the property from when it was last appraised, or there has been a significant change in the underlying assumptions of the appraisal. If the valuation is deemed to be unacceptable,

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a new appraisal is ordered. New appraisals are typically received within 4-6 weeks. While awaiting new appraisals, the valuation in the file is utilized, net of discounts. Discounts are derived from available relevant market data, selling costs, taxes, and insurance. Any perceived collateral deficiency utilizing the discounted value is specifically reserved (as required by ASC Topic 310) until the new appraisal is received or charged off. Thus, provisions or charge-offs are recognized in the period the credit is identified as non-performing.

The following sources are utilized to set appropriate discounts: in-market real estate agents, current local sales data, bank history for devaluation of similar property, Sheriff's valuations and buy/sell contracts. If a real estate agent is used to market and sell the property, values are discounted 10% for selling costs. Additional discounts may be applied if research from the above sources indicates a discount is appropriate given devaluation of similar property from the time of the initial valuation.

Other Real Estate—Other real estate ("ORE") properties are adjusted to fair value upon transfer of the loans to other real estate, and annually thereafter to insure other real estate assets are carried at the lower of carrying value or fair value. Exceptions to obtaining initial appraisals are properties where a buy/sell agreement exists for the loan value or greater, or where a Sheriff's valuation has been received for properties liquidated through a Sheriff sale. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the ORE as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and adjusts the appraisal value by taking an additional discount for market conditions and there is no observable market prices, the Company records the ORE asset as nonrecurring Level 3.

Cash Surrender Value of Life Insurance Policies—Fair value for life insurance cash surrender value is based on cash surrender values indicated by the insurance companies.

Deposits—The fair value of demand deposits, savings accounts, NOW accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. The estimated fair value does not include customer related intangibles.

Securities Sold Under Agreements to Repurchase—The fair value approximates the carrying value of securities sold under agreements to repurchase due to their short-term nature.

Short-term Federal Home Loan Bank Advances—The fair value approximates the carrying value of short-term FHLB advances due to their short-term nature.

Long-term Federal Home Loan Bank Advances—The fair value of long-term FHLB advances is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar types of borrowings with similar terms.

Junior Subordinated Debentures—For junior subordinated debentures that bear interest on a floating basis, the carrying amount approximates fair value. For junior subordinated debentures that bear interest on a fixed rate basis, the fair value is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar types of borrowings.

Commitments to Extend Credit, Standby Letters of Credit and Credit Card Guarantees—Because commitments to extend credit and standby letters of credit are generally short-term and made using variable rates, the carrying value and estimated fair value associated with these instruments are immaterial.

Assets Recorded at Fair Value

The table below presents information about certain assets and liabilities measured at fair value on a recurring basis (in thousands):

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Description	Assets / Liabilities Measured at Fair Value at September 30, 2015	Fair Value Measurements at September 30, 2015 Level 1	Level 2	Level 3
Available-for-sale securities:				
Obligations of state and political subdivisions	$37,431	$—	$37,431	$—
GSE mortgage-backed securities	91,739	—	91,739	—
Collateralized mortgage obligations: residential	148,582	—	148,582	—
Collateralized mortgage obligations: commercial	5,617	—	5,617	—
Mutual funds	2,116	2,116	—	—

Description	Assets / Liabilities Measured at Fair Value at December 31, 2014	Fair Value Measurements at December 31, 2014 Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Government sponsored enterprises	$10,227	$—	$10,227	$—
Obligations of state and political subdivisions	44,605	—	44,605	—
GSE mortgage-backed securities	109,103	—	109,103	—
Collateralized mortgage obligations: residential	60,839	—	60,839	—
Collateralized mortgage obligations: commercial	24,545	—	24,545	—
Other asset-backed securities	24,343	—	24,343	—
Collateralized debt obligation	1,218	—	1,218	—
Mutual funds	2,104	2,104	—	—

Certain assets and liabilities are measured at fair value on a nonrecurring basis and are included in the table below (in thousands). Impaired loans are Level 2 assets measured using appraisals from external parties of the collateral less any prior liens. Other real estate properties are also Level 2 assets measured using appraisals from external parties.

Description	Assets / Liabilities Measured at Fair Value at September 30, 2015	Fair Value Measurements at September 30, 2015 Level 1	Level 2	Level 3
Impaired loans	$14,966	$—	$14,966	$—
Other real estate	4,661	—	4,661	—

Description	Assets / Liabilities Measured at Fair Value at December 31, 2014	Fair Value Measurements at December 31, 2014 Level 1	Level 2	Level 3
Impaired loans	$5,051	$—	$5,051	$—
Other real estate	4,234	—	4,234	—

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company’s holdings of a particular financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on many judgments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows at September 30, 2015 and December 31, 2014 (in thousands):

		Fair Value Measurements at September 30, 2015 Using:		
	Carrying Value	Level 1	Level 2	Level 3
Financial assets:				
Cash and due from banks, interest-bearing deposits in banks and federal funds sold	$125,437	$125,437	$—	$—
Securities available-for-sale	285,485	2,116	283,369	—
Securities held-to-maturity	121,043	—	122,488	—
Other investments	12,063	12,063	—	—
Loans, net	1,282,513	—	14,966	1,282,506