

SOUTHSIDE BANCSHARES INC

Form 10-Q

April 30, 2019

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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 March 31, 2019

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: 0-12247

SOUTHSIDE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of incorporation or organization)

75-1848732

(I.R.S. Employer Identification No.)

1201 S. Beckham Avenue, Tyler, Texas

(Address of principal executive offices)

903-531-7111

(Registrant's telephone number, including area code)

75701

(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 13(a) of the Exchange Act.

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

Yes No

The number of shares of the issuer's common stock, par value \$1.25, outstanding as of April 24, 2019 was 33,718,079 shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except share amounts)

	March 31, 2019	December 31, 2018
ASSETS		
Cash and due from banks	\$81,981	\$ 87,375
Interest earning deposits	184,612	23,884
Federal funds sold	3,350	9,460
Total cash and cash equivalents	269,943	120,719
Securities:		
Securities available for sale, at estimated fair value	1,876,255	1,989,436
Securities held to maturity, at carrying value (estimated fair value of \$147,666 and \$159,781, respectively)	147,431	162,931
FHLB stock, at cost	35,269	32,583
Equity investments	12,182	12,093
Loans held for sale	384	601
Loans:		
Loans	3,305,110	3,312,799
Less: Allowance for loan losses	(24,155)	(27,019)
Net loans	3,280,955	3,285,780
Premises and equipment, net	138,290	135,972
Operating lease right-of-use assets	9,455	—
Goodwill	201,116	201,116
Other intangible assets, net	16,600	17,779
Interest receivable	20,017	27,287
Deferred tax asset, net	491	9,776
Unsettled trades to sell securities	95,482	—
Unsettled issuances of brokered certificates of deposit	—	15,236
Bank owned life insurance	98,704	98,160
Other assets	14,622	14,025
Total assets	\$6,217,196	\$ 6,123,494
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	\$1,038,116	\$ 994,680
Interest bearing	3,529,777	3,430,350
Total deposits	4,567,893	4,425,030
Federal funds purchased and repurchase agreements	8,637	36,810
FHLB borrowings	619,861	719,065
Subordinated notes, net of unamortized debt issuance costs	98,448	98,407
Trust preferred subordinated debentures, net of unamortized debt issuance costs	60,247	60,246
Unsettled trades to purchase securities	55,826	6,378
Operating lease liabilities	9,811	—
Other liabilities	38,440	46,267

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Total liabilities	5,459,163	5,392,203
Off-balance-sheet arrangements, commitments and contingencies (Note 14)		
Shareholders' equity:		
Common stock: (\$1.25 par value, 80,000,000 shares authorized, 37,855,789 shares issued at March 31, 2019 and 37,845,224 shares issued at December 31, 2018)	47,320	47,307
Paid-in capital	763,582	762,470
Retained earnings	57,023	64,797
Treasury stock: (shares at cost, 4,137,710 at March 31, 2019 and 4,120,475 at December 31, 2018)	(94,119)	(93,055)
Accumulated other comprehensive loss	(15,773)	(50,228)
Total shareholders' equity	758,033	731,291
Total liabilities and shareholders' equity	\$6,217,196	\$ 6,123,494
The accompanying notes are an integral part of these consolidated financial statements.		

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share data)

	Three Months Ended March 31,	
	2019	2018
Interest income:		
Loans	\$41,619	\$38,830
Investment securities – taxable	28	227
Investment securities – tax-exempt	4,118	6,381
Mortgage-backed securities	12,474	10,894
FHLB stock and equity investments	355	414
Other interest earning assets	433	448
Total interest income	59,027	57,194
Interest expense:		
Deposits	11,241	7,451
FHLB borrowings	4,457	3,632
Subordinated notes	1,400	1,398
Trust preferred subordinated debentures	729	569
Other borrowings	75	11
Total interest expense	17,902	13,061
Net interest income	41,125	44,133
Provision for loan losses	(918)	3,735
Net interest income after provision for loan losses	42,043	40,398
Noninterest income:		
Deposit services	5,986	6,179
Net gain (loss) on sale of securities available for sale	256	(827)
Gain on sale of loans	93	115
Trust income	1,541	1,760
Bank owned life insurance income	544	632
Brokerage services	517	450
Other	601	1,301
Total noninterest income	9,538	9,610
Noninterest expense:		
Salaries and employee benefits	18,046	18,559
Net occupancy expense	3,175	3,583
Acquisition expense	—	832
Advertising, travel & entertainment	847	685
ATM expense	180	346
Professional fees	1,314	1,070
Software and data processing expense	1,076	1,023
Telephone and communications	487	538
FDIC insurance	422	497
Amortization expense on intangibles	1,179	1,378
Other	2,901	3,156
Total noninterest expense	29,627	31,667

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Income before income tax expense	21,954	18,341
Income tax expense	3,137	2,090
Net income	\$18,817	\$16,251

Earnings per common share – basic	\$0.56	\$0.46
Earnings per common share – diluted	\$0.56	\$0.46
Cash dividends paid per common share	\$0.30	\$0.28

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

	Three Months Ended March 31,	
	2019	2018
Net income	\$18,817	\$16,251
Other comprehensive income (loss):		
Securities available for sale and transferred securities:		
Change in unrealized holding gain (loss) on available for sale securities during the period	46,626	(37,783)
Unrealized net gain on securities transferred from held to maturity to available for sale under the transition guidance enumerated in ASU 2017-12	—	11,881
Change in net unrealized loss on securities transferred from held to maturity to available for sale	—	401
Reclassification adjustment for amortization related to available for sale and held to maturity debt securities	491	138
Reclassification adjustment for net (gain) loss on sale of available for sale securities, included in net income	(256)	827
Derivatives:		
Change in net unrealized (loss) gain on effective cash flow hedge interest rate swap derivatives	(3,120)	4,245
Reclassification adjustment of net gain related to derivatives designated as cash flow hedge	(668)	(127)
Pension plans:		
Amortization of net actuarial loss and prior service credit, included in net periodic benefit cost	541	473
Other comprehensive income (loss), before tax	43,614	(19,945)
Income tax (expense) benefit related to items of other comprehensive income (loss)	(9,159)	4,188
Other comprehensive income (loss), net of tax	34,455	(15,757)
Comprehensive income	\$53,272	\$494

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

(in thousands, except share and per share data)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2017	\$ 47,253	\$ 757,439	\$ 32,851	\$ (47,105)	\$ (36,298)	\$ 754,140
Cumulative effect of accounting change	—	—	(85)	—	85	—
Adjusted beginning balance	47,253	757,439	32,766	(47,105)	(36,213)	754,140
Net income	—	—	16,251	—	—	16,251
Other comprehensive loss	—	—	—	—	(15,757)	(15,757)
Issuance of common stock for dividend reinvestment plan (10,035 shares)	12	341	—	—	—	353
Stock compensation expense	—	456	—	—	—	456
Net issuance of common stock under employee stock plans (42,179 shares)	—	417	(25)	369	—	761
Cash dividends paid on common stock (\$0.28 per share)	—	—	(9,808)	—	—	(9,808)
Balance at March 31, 2018	\$ 47,265	\$ 758,653	\$ 39,184	\$ (46,736)	\$ (51,970)	\$ 746,396
Balance at December 31, 2018	\$ 47,307	\$ 762,470	\$ 64,797	\$ (93,055)	\$ (50,228)	\$ 731,291
Cumulative effect of accounting change	—	—	(16,452)	—	—	(16,452)
Adjusted beginning balance	47,307	762,470	48,345	(93,055)	(50,228)	714,839
Net income	—	—	18,817	—	—	18,817
Other comprehensive income	—	—	—	—	34,455	34,455
Issuance of common stock for dividend reinvestment plan (10,565 shares)	13	342	—	—	—	355
Purchase of common stock (40,852 shares)	—	—	—	(1,325)	—	(1,325)
Stock compensation expense	—	661	—	—	—	661
Net issuance of common stock under employee stock plans (23,617 shares)	—	109	(32)	261	—	338
Cash dividends paid on common stock (\$0.30 per share)	—	—	(10,107)	—	—	(10,107)
Balance at March 31, 2019	\$ 47,320	\$ 763,582	\$ 57,023	\$ (94,119)	\$ (15,773)	\$ 758,033

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Three Months Ended March 31,	
	2019	2018
OPERATING ACTIVITIES:		
Net income	\$18,817	\$16,251
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and net amortization	3,023	3,566
Securities premium amortization (discount accretion), net	3,448	4,058
Loan (discount accretion) premium amortization, net	(438)	(1,057)
Provision for loan losses	(918)	3,735
Stock compensation expense	661	456
Deferred tax expense (benefit)	126	(255)
Net (gain) loss on sale of securities available for sale	(256)	827
Net loss on premises and equipment	5	35
Gross proceeds from sales of loans held for sale	4,244	5,600
Gross originations of loans held for sale	(4,027)	(5,602)
Net (gain) loss on other real estate owned	(92)	67
Net change in:		
Interest receivable	7,270	7,827
Other assets	3,305	1,875
Interest payable	(321)	(1,219)
Other liabilities	(14,373)	5,501
Net cash provided by operating activities	20,474	41,665
INVESTING ACTIVITIES:		
Securities available for sale:		
Purchases	(372,465)	(138,581)
Sales	436,182	237,526
Maturities, calls and principal repayments	30,077	53,717
Securities held to maturity:		
Maturities, calls and principal repayments	15,405	1,222
Proceeds from redemption of FHLB stock and other investments	8,788	13,377
Purchases of FHLB stock and other investments	(11,551)	(638)
Net loan paydowns (originations)	5,868	(15,154)
Purchases of premises and equipment	(4,040)	(2,018)
Proceeds from sales of premises and equipment	2	1,903
Proceeds from sales of other real estate owned	470	91
Proceeds from sales of repossessed assets	137	198
Net cash provided by investing activities	108,873	151,643

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED) (continued)
(in thousands)

	Three Months Ended March 31,	
	2019	2018
FINANCING ACTIVITIES:		
Net change in deposits	\$ 157,991	\$ 126,372
Net decrease in federal funds purchased and repurchase agreements	(28,173)	(1,673)
Proceeds from FHLB borrowings	1,556,293	1,110,000
Repayment of FHLB borrowings	(1,655,495)	(1,355,194)
Proceeds from stock option exercises	412	801
Cash paid to tax authority related to tax withholding on share-based awards	(74)	(40)
Purchase of common stock	(1,325)	—
Proceeds from the issuance of common stock for dividend reinvestment plan	355	353
Cash dividends paid	(10,107)	(9,808)
Net cash provided by (used in) financing activities	19,877	(129,189)
Net increase in cash and cash equivalents	149,224	64,119
Cash and cash equivalents at beginning of period	120,719	198,692
Cash and cash equivalents at end of period	\$ 269,943	\$ 262,811
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	\$ 18,224	\$ 14,280
Income taxes paid	\$ —	\$ —
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Loans transferred to other repossessed assets and real estate through foreclosure	\$ 336	\$ 649
Transfer of held to maturity securities to available for sale securities	\$ —	\$ 743,421
Adjustment to pension liability	\$(541)	\$(473)
Unsettled trades to purchase securities	\$(55,826)	\$(3,646)
Unsettled trades to sell securities	\$ 95,482	\$ 35,307

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting and Reporting Policies

Basis of Presentation

In this report, the words “the Company,” “we,” “us,” and “our” refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries, including Southside Bank. The words “Southside” and “Southside Bancshares” refer to Southside Bancshares, Inc. The words “Southside Bank” and “the Bank” refer to Southside Bank. “Omni” refers to OmniAmerican Bancorp, Inc., a bank holding company, and its wholly-owned subsidiary, OmniAmerican Bank, acquired by Southside on December 17, 2014. “Diboll” refers to Diboll State Bancshares, Inc., a bank holding company and its wholly-owned subsidiary, First Bank & Trust East Texas, acquired by Southside on November 30, 2017.

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States (“U.S.”) generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, not all information required by GAAP for complete financial statements is included in these interim statements. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. The preparation of these consolidated financial statements in accordance with GAAP requires the use of management’s estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2018.

Accounting Changes and Reclassifications

Certain prior period amounts may be reclassified to conform to current year presentation.

Debt Securities

We adopted Accounting Standards Update (“ASU”) 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” on January 1, 2019, the effective date of the guidance. Under previous GAAP, premiums on callable debt securities were generally amortized over the contractual life of the security. ASU 2017-08 requires the premium on callable debt securities to be amortized to the earliest call date. If the debt security is not called at the earliest call date, the holder of the debt security would be required to reset the effective yield on the debt security based on the payment terms required by the debt security. The guidance requires companies to apply the requirements on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Adoption of this guidance on January 1, 2019, resulted in a cumulative-effect adjustment to reduce retained earnings by \$16.5 million, before tax. Subsequent to January 1, 2019, we sold the majority of the securities impacted by ASU 2017-08, and thus, the standard did not materially impact our consolidated net income.

Leases

We evaluate our contracts at inception to determine if an arrangement is or contains a lease. Operating leases are included in operating lease right-of-use (“ROU”) assets and operating lease liabilities in our consolidated balance sheets. The Company has no finance leases.

ROU assets represent our right to use an underlying asset for the lease term, and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. Our leases do not provide an implicit rate, so we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The incremental borrowing rate is reevaluated upon lease modification. The operating lease ROU asset also includes any initial direct costs and prepaid lease payments made less any lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably

certain that we will exercise that option.

We adopted ASU 2016-02, "Leases (Topic 842)," on January 1, 2019, the effective date of the guidance, using the practical expedient transition method whereby we did not revise comparative period information or disclosure. The new standard requires lessees to record assets and liabilities on the balance sheet for all leases with terms longer than 12 months. We elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allows us to carryforward the historical lease classification. We also elected certain optional practical expedients including the hindsight practical expedient under which we considered the actual outcomes of lease renewals and terminations when measuring the lease term at adoption, and we made an accounting policy election to keep leases with an initial term of 12 months or less off of the balance sheet. We recognize these lease payments in the consolidated statements of income on a straight-line basis over the lease

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term. We have lease agreements with lease and non-lease components, and we have elected the practical expedient to account for these as a single lease component.

Our operating leases relate primarily to bank branches and office space. In conjunction with the adoption on January 1, 2019, we recognized operating lease liabilities of \$10.1 million and related lease assets of \$9.8 million on our balance sheet. The difference between the lease assets and lease liabilities primarily consists of deferred rent liabilities reclassified upon adoption to reduce the measurement of the lease assets. The standard did not materially impact our consolidated net income and had no impact on cash flows.

Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. ASU 2016-13 also modifies the impairment model for AFS debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The guidance requires companies to apply the requirements in the year of adoption through a cumulative-effect adjustment with some aspects of the update requiring a prospective transition approach. We are currently evaluating the potential impact of the pending adoption of ASU 2016-13 on our consolidated financial statements. We plan to adopt on January 1, 2020, the effective date. We have developed a project plan and have assigned a project team to complete the analysis needed to implement the guidance. We are also currently working with a third party vendor solution to assist with the application of ASU 2016-13. The team is currently completing the data collection and anticipates running parallel models during 2019.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 is intended to simplify goodwill impairment testing by eliminating the second step of the analysis which requires the calculation of the implied fair value of goodwill to measure a goodwill impairment charge. The update requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit’s fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for annual and interim goodwill impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The guidance requires companies to apply the requirements prospectively in the year of adoption. ASU 2017-04 is not expected to have a material impact on our consolidated financial statements.

2. Acquisition

On November 30, 2017, we acquired 100% of the outstanding stock of Diboll State Bancshares, Inc. and its wholly-owned subsidiary First Bank & Trust East Texas (collectively, “Diboll”) headquartered in Diboll, Texas. Diboll operated 17 banking offices in Diboll and surrounding areas. We acquired Diboll to further expand our presence in the East Texas market. The total merger consideration for the Diboll merger was \$224.3 million. The operations of Diboll were merged into the Company as of the date of the acquisition.

The fair value of assets acquired, adjusted for subsequent measurement period adjustments, excluding goodwill, totaled \$1.03 billion, including total loans of \$621.3 million and total investment securities of \$234.4 million. Total fair value of the liabilities assumed totaled \$910.7 million, including deposits of \$899.3 million. We recognized goodwill of \$109.6 million associated with Diboll acquisition. The goodwill resulting from the acquisition represents the value expected from the expansion of our markets into the Southeast Texas region and the enhancement of our operations through customer synergies and efficiencies, thereby providing enhanced customer service. Goodwill was \$201.1 million as of March 31, 2019 and December 31, 2018 and is not expected to be deductible for tax purposes. We recognized a core deposit intangible of \$14.7 million and a trust relationship intangible of \$5.4 million which we are amortizing using an accelerated method over a 9- and 13-year weighted average amortization period, respectively, consistent with expected future cash flows.

The Diboll acquisition was accounted for using the acquisition method of accounting and accordingly, purchased assets, including identifiable intangible assets and assumed liabilities, were recorded at their respective acquisition date fair values. For more information concerning the fair value of the assets acquired and liabilities assumed in relation to the acquisition of Diboll, see “Note 2 - Acquisition” in our Annual Report on Form 10-K for the year ended December 31, 2018.

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3. Earnings Per Share

Earnings per share on a basic and diluted basis are calculated as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2019	2018
Basic and Diluted Earnings:		
Net income	\$18,817	\$16,251
Basic weighted-average shares outstanding	33,697	35,022
Add: Stock awards	149	178
Diluted weighted-average shares outstanding	33,846	35,200
Basic earnings per share:		
Net Income	\$0.56	\$0.46
Diluted earnings per share:		
Net Income	\$0.56	\$0.46

For the three months ended March 31, 2019 and 2018, there were approximately 490,000 and 186,000 anti-dilutive shares, respectively.

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4. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) by component are as follows (in thousands):

	Three Months Ended March 31, 2019				
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Pension Plans Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	\$ (31,120)	\$ 7,146	\$ (139)	\$ (26,115)	\$ (50,228)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	46,626	(3,120)	—	—	43,506
Reclassified from accumulated other comprehensive income (loss)	235	(668)	(1)	542	108
Income tax (expense) benefit	(9,840)	795	—	(114)	(9,159)
Net current-period other comprehensive income (loss), net of tax	37,021	(2,993)	(1)	428	34,455
Ending balance, net of tax	\$ 5,901	\$ 4,153	\$ (140)	\$ (25,687)	\$ (15,773)
	Three Months Ended March 31, 2018				
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Pension Plans Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	\$ (16,295)	\$ 6,399	\$ (133)	\$ (26,269)	\$ (36,298)
Cumulative effect of ASU 2016-01 ⁽¹⁾	85	—	—	—	85
Adjusted beginning balance, net of tax	(16,210)	6,399	(133)	(26,269)	(36,213)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	(25,501)	4,245	—	—	(21,256)
Reclassified from accumulated other comprehensive income (loss)	965	(127)	(2)	475	1,311
Income tax benefit (expense)	5,152	(865)	1	(100)	4,188
Net current-period other comprehensive (loss) income, net of tax	(19,384)	3,253	(1)	375	(15,757)
Ending balance, net of tax	\$ (35,594)	\$ 9,652	\$ (134)	\$ (25,894)	\$ (51,970)

(1) The Company adopted ASU 2016-01 on January 1, 2018. This amount includes a reclassification for the cumulative adjustment to retained earnings of \$107,000 (\$85,000, net of tax).

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

	Three Months Ended March 31, 2019 2018	
Unrealized losses on securities transferred:		
Amortization of unrealized losses ⁽¹⁾	\$(491)	\$(138)
Tax benefit	103	29
Net of tax	\$(388)	\$(109)
Unrealized gains and losses on available for sale securities:		
Realized net gain (loss) on sale of securities ⁽²⁾	\$256	\$(827)
Tax (expense) benefit	(54)	174
Net of tax	\$202	\$(653)
Derivatives:		
Realized net gain on interest rate swap derivatives ⁽³⁾	\$646	\$106
Tax expense	(136)	(22)
Net of tax	\$510	\$84
Amortization of unrealized gains on terminated interest rate swap derivatives ⁽³⁾	\$22	\$21
Tax expense	(5)	(4)
Net of tax	\$17	\$17
Amortization of pension plan:		
Net actuarial loss ⁽⁴⁾	\$(542)	\$(475)
Prior service credit ⁽⁴⁾	1	2
Total before tax	(541)	(473)
Tax benefit	114	99
Net of tax	(427)	(374)
Total reclassifications for the period, net of tax	\$(86)	\$(1,035)

(1) Included in interest income on the consolidated statements of income.

(2) Listed as net gain (loss) on sale of securities available for sale on the consolidated statements of income.

(3) Included in interest expense for FHLB borrowings on the consolidated statements of income.

(4) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (income) presented in "Note 9 - Employee Benefit Plans."

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5. Securities

Debt securities

The amortized cost, gross unrealized gains and losses and estimated fair value of investment and mortgage-backed securities available for sale and held to maturity as of March 31, 2019 and December 31, 2018 are reflected in the tables below (in thousands):

	March 31, 2019			
	Amortized	Gross Unrealized	Gross Unrealized	Estimated
AVAILABLE FOR SALE	Cost	Gains	Losses	Fair Value
Investment securities:				
State and political subdivisions	\$446,006	\$ 9,130	\$ 1,865	\$453,271
Other stocks and bonds	3,000	—	79	2,921
Mortgage-backed securities: ⁽¹⁾				
Residential	999,201	8,669	4,168	1,003,702
Commercial	416,618	910	1,167	416,361
Total	\$1,864,825	\$ 18,709	\$ 7,279	\$1,876,255
HELD TO MATURITY				
Investment securities:				
State and political subdivisions	\$3,025	\$ 29	\$ —	\$3,054
Mortgage-backed securities: ⁽¹⁾				
Residential	59,720	962	413	60,269
Commercial	84,686	514	857	84,343
Total	\$147,431	\$ 1,505	\$ 1,270	\$147,666

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	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
AVAILABLE FOR SALE				
Investment securities:				
State and political subdivisions	\$728,142	\$ 6,115	\$ 17,656	\$716,601
Other stocks and bonds	3,000	—	291	2,709
Mortgage-backed securities: ⁽¹⁾				
Residential	738,585	3,498	9,111	732,972
Commercial	543,758	941	7,545	537,154
Total	\$2,013,485	\$ 10,554	\$ 34,603	\$ 1,989,436
HELD TO MATURITY				
Investment securities:				
State and political subdivisions	\$3,083	\$ 5	\$ 42	\$3,046
Mortgage-backed securities: ⁽¹⁾				
Residential	59,655	154	1,140	58,669
Commercial	100,193	201	2,328	98,066
Total	\$162,931	\$ 360	\$ 3,510	\$159,781

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.

From time to time, we have transferred securities from AFS to HTM due to overall balance sheet strategies. The remaining net unamortized, unrealized loss on the transferred securities included in AOCI in the accompanying balance sheets totaled \$4.0 million (\$3.1 million, net of tax) at March 31, 2019 and \$15.3 million (\$12.1 million, net of tax) at December 31, 2018. Any net unrealized gain or loss on the transferred securities included in AOCI at the time of transfer will be amortized over the remaining life of the underlying security as an adjustment to the yield on those securities. Securities transferred with losses included in AOCI continue to be included in management's assessment for other-than-temporary impairment for each individual security. There were no securities transferred from AFS to HTM during the three months ended March 31, 2019 or the year ended December 31, 2018.

On January 1, 2019, we adopted ASU 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities," and in conjunction with the adoption recognized a cumulative effect adjustment to reduce retained earnings by \$16.5 million, before tax, related to premiums on callable debt securities. Prior to January 1, 2019, premiums were amortized over the contractual life of the security. With the adoption of ASU 2017-08, premiums on debt securities will be amortized to the earliest call date.

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The following tables represent the estimated fair value and unrealized loss on investment and mortgage-backed securities AFS and HTM as of March 31, 2019 and December 31, 2018 (in thousands):

March 31, 2019						
	Less Than 12 Months	More Than 12 Months	Total			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment securities:						
State and political subdivisions	\$241	\$ —	\$91,310	\$ 1,865	\$91,551	\$ 1,865
Other stocks and bonds	2,921	79	—	—	2,921	79
Mortgage-backed securities:						
Residential	14,666	83	314,543	4,085	329,209	4,168
Commercial	—	—	186,267	1,167	186,267	1,167
Total	\$17,828	\$ 162	\$592,120	\$ 7,117	\$609,948	\$ 7,279
HELD TO MATURITY						
Mortgage-backed securities:						
Residential	\$1,213	\$ 18	\$4,759	\$ 395	\$5,972	\$ 413
Commercial	—	—	44,916	857	44,916	857
Total	\$1,213	\$ 18	\$49,675	\$ 1,252	\$50,888	\$ 1,270
December 31, 2018						
	Less Than 12 Months	More Than 12 Months	Total			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment securities:						
State and political subdivisions	\$98,112	\$ 899	\$399,205	\$ 16,757	\$497,317	\$ 17,656
Other stocks and bonds	2,709	291	—	—	2,709	291
Mortgage-backed securities:						
Residential	5,552	27	488,334	9,084	493,886	9,111
Commercial	9,529	30	457,704	7,515	467,233	7,545
Total	\$115,902	\$ 1,247	\$1,345,243	\$ 33,356	\$1,461,145	\$ 34,603
HELD TO MATURITY						
Investment securities:						
State and political subdivisions	\$235	\$ 1	\$2,022	\$ 41	\$2,257	\$ 42
Mortgage-backed securities:						
Residential	4,826	60	51,046	1,080	55,872	1,140
Commercial	399	2	89,168	2,326	89,567	2,328
Total	\$5,460	\$ 63	\$142,236	\$ 3,447	\$147,696	\$ 3,510

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We review those securities in an unrealized loss position for significant differences between fair value and the cost basis to evaluate if a classification of other-than-temporary impairment is warranted. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. We consider an other-than-temporary impairment to have occurred when there is an adverse change in expected cash flows. When it is determined that a decline in fair value of AFS and HTM securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and a charge to other comprehensive income for the noncredit portion. Based upon the length of time and the extent to which fair value is less than cost, we believe that none of the securities with an unrealized loss have other-than-temporary impairment at March 31, 2019.

The majority of the securities in an unrealized loss position are highly rated Texas municipal securities and U.S. Agency MBS where the unrealized loss is a direct result of the change in interest rates and spreads. For those securities in an unrealized loss position, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the securities before the anticipated recovery of their amortized cost basis. To the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and MBS portfolio with an other-than-temporary impairment at March 31, 2019.

The following table reflects interest income recognized on securities for the periods presented (in thousands):

	Three Months Ended March 31,	
	2019	2018
U.S. Treasury	\$—	\$ 108
U.S. government agency debentures	—	89
State and political subdivisions	4,118	6,381
Other stocks and bonds	28	30
Mortgage-backed securities	12,474	10,894
Total interest income on securities	\$ 16,620	\$ 17,502

There was a \$256,000 net realized gain from the AFS securities portfolio for the three months ended March 31, 2019, which consisted of \$5.0 million in realized gains and \$4.8 million in realized losses. There was an \$827,000 net realized loss from the AFS securities portfolio for the three months ended March 31, 2018, which consisted of \$1.8 million in realized losses and \$941,000 in realized gains. There were no sales from the HTM portfolio during the three months ended March 31, 2019 or 2018. We calculate realized gains and losses on sales of securities under the specific identification method.

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The amortized cost and estimated fair value of AFS and HTM securities at March 31, 2019, are presented below by contractual maturity (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. MBS are presented in total by category due to the fact that MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the security holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	March 31, 2019	
	Amortized Cost	Fair Value
AVAILABLE FOR SALE		
Investment securities:		
Due in one year or less	\$3,827	\$3,866
Due after one year through five years	7,743	7,741
Due after five years through ten years	29,416	30,332
Due after ten years	408,020	414,253
	449,006	456,192
Mortgage-backed securities	1,415,819	1,420,063
Total	\$1,864,825	\$1,876,255

	March 31, 2019	
	Amortized Cost	Fair Value
HELD TO MATURITY		
Investment securities:		
Due in one year or less	\$115	\$115
Due after one year through five years	1,663	1,676
Due after five years through ten years	1,247	1,263
Due after ten years	—	—
	3,025	3,054
Mortgage-backed securities:	144,406	144,612
Total	\$147,431	\$147,666

Investment securities and MBS with carrying values of \$1.03 billion and \$1.08 billion were pledged as of March 31, 2019 and December 31, 2018, respectively, to collateralize Federal Home Loan Bank of Dallas (“FHLB”) borrowings, repurchase agreements and public funds or for other purposes as required by law.

Equity Investments

Equity investments on our consolidated balance sheets include Community Reinvestment Act funds with a readily determinable fair value as well as equity investments without readily determinable fair values. At March 31, 2019 and December 31, 2018, we had equity investments recorded in our consolidated balance sheets of \$12.2 million and \$12.1 million, respectively.

Any realized and unrealized gains and losses on equity investments are reported in income. Equity investments without readily determinable fair values are recorded at cost less any impairment, if any.

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The following is a summary of unrealized and realized gains and losses on equity investments recognized in other noninterest income in the consolidated statements of income during the three months ended March 31, 2019 (in thousands):

	Three Months Ended March 31, 2019	2018
Net gains (losses) recognized during the period on equity investments	\$76	\$(92)
Less: Net gains (losses) recognized during the period on equity investments sold during the period	—	—
Unrealized gains (losses) recognized during the reporting period on equity investments still held at the reporting date	\$76	\$(92)

Equity investments are assessed quarterly for other-than-temporary impairment. Based upon that evaluation, management does not consider any of our equity investments to be other-than-temporarily impaired at March 31, 2019.

Federal Home Loan Bank Stock

Our FHLB stock, which has limited marketability, is carried at cost.

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6. Loans and Allowance for Probable Loan Losses

Loans in the accompanying consolidated balance sheets are classified as follows (in thousands):

	March 31, 2019	December 31, 2018
Real estate loans:		
Construction	\$603,411	\$ 507,732
1-4 family residential	786,198	794,499
Commercial	1,104,378	1,194,118
Commercial loans	367,995	356,649
Municipal loans	343,026	353,370
Loans to individuals	100,102	106,431
Total loans	3,305,110	3,312,799
Less: Allowance for loan losses ⁽¹⁾	24,155	27,019
Net loans	\$3,280,955	\$ 3,285,780

⁽¹⁾ The allowance for loan loss recorded on purchased credit impaired (“PCI”) loans totaled \$250,000 and \$302,000 as of March 31, 2019 and December 31, 2018, respectively.

Construction Real Estate Loans

Our construction loans are collateralized by property located primarily in or near the market areas we serve. A number of our construction loans will be owner occupied upon completion. Construction loans for non-owner occupied projects are financed, but these typically have cash flows from leases with tenants, secondary sources of repayment, and in some cases, additional collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. Speculative and commercial construction loans are subject to underwriting standards similar to that of the commercial portfolio. Owner occupied 1-4 family residential construction loans are subject to the underwriting standards of the permanent loan.

1-4 Family Residential Real Estate Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner occupied 1-4 family residences. Substantially all of our 1-4 family residential originations are secured by properties located in or near our market areas.

Our 1-4 family residential loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan. Our 1-4 family residential loans are made at both fixed and adjustable interest rates.

Underwriting for 1-4 family residential loans includes debt-to-income analysis, credit history analysis, appraised value and down payment considerations. Changes in the market value of real estate can affect the potential losses in the portfolio.

Commercial Real Estate Loans

Commercial real estate loans as of March 31, 2019 consisted of \$1.05 billion of owner and non-owner occupied real estate, \$34.9 million of loans secured by multi-family properties and \$17.3 million of loans secured by farmland. Commercial real estate loans primarily include loans collateralized by retail, commercial office buildings, multi-family residential buildings, medical facilities and offices, senior living, assisted living and skilled nursing facilities, warehouse facilities, hotels and churches. Management does not consider there to be a risk in any one industry type. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are

made at both fixed and adjustable interest rates for terms generally up to 20 years.

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Commercial Loans

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type. In our commercial loan underwriting, we assess the creditworthiness, ability to repay and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

Municipal Loans

We have a specific lending department that makes loans to municipalities and school districts primarily throughout the state of Texas, with a small percentage originating outside of the state. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service. Lending money directly to these municipalities allows us to earn a higher yield than we could if we purchased municipal securities for similar durations.

Loans to Individuals

Substantially all originations of our loans to individuals are made to consumers in our market areas. The majority of loans to individuals are collateralized by titled equipment, which are primarily automobiles. Loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant's payment history on other debts, with the greatest weight being given to payment history with us and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes assists in limiting our exposure.

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, we utilize historical net charge-off data to establish general reserve amounts for each class of loans. The historical charge-off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements not reflected in the historical data. Second, our lenders have the primary responsibility for identifying problem loans based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the special assets department and the loan review department on a monthly basis. Third, the loan review department independently reviews the portfolio on an annual basis. The loan review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The loan review scope, as it relates to size, focuses more on larger dollar loan relationships, typically aggregate debt of \$500,000 or greater. The loan review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If at the time of the review we determine it is probable we will not collect the principal and interest cash flows contractually due on the loan, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowance. The internal loan review department maintains a list ("Watch List") of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of \$150,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loans.

We calculate historical loss ratios for pools of loans with similar characteristics based on the proportion of actual charge-offs experienced, consistent with the characteristics of remaining loans, to the total population of loans in the pool. The historical gross loss ratios are updated quarterly based on actual charge-off experience and adjusted for qualitative factors. All loans are subject to individual analysis if determined to be impaired with the exception of consumer loans and loans secured by 1-4 family residential loans.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of our loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may occur as a result of various factors beyond

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our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit worthiness of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions and geographic and industry loan concentration.

Credit Quality Indicators

We categorize loans into risk categories on an ongoing basis based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. We use the following definitions for risk ratings:

Pass (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, consists of acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Pass, if deficiencies are in the process of correction. These loans are not included in the Watch List.

Pass Watch (Rating 5) – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified; however, particular attention is warranted to characteristics such as:

A lack of, or abnormally extended payment program;

A heavy degree of concentration of collateral without sufficient margin;

A vulnerability to competition through lesser or extensive financial leverage; and

A dependence on a single or few customers or sources of supply and materials without suitable substitutes or alternatives.

Special Mention (Rating 6) – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in our credit position at some future date. Special Mention loans are not adversely classified and do not expose us to sufficient risk to warrant adverse classification.

Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

All accruing loans are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses. Loans to individuals and 1-4 family residential loans, including loans not accruing, are collectively evaluated and included in the general portion of the allowance for loan losses. All loans considered troubled debt restructurings ("TDR") are evaluated individually for impairment.

The general portion of the loan loss allowance is reflective of historical charge-off levels for similar loans adjusted for changes in current conditions and other relevant factors. These factors are likely to cause estimated losses to differ from historical loss experience and include:

Changes in lending policies or procedures, including underwriting, collection, charge-off and recovery procedures;

Changes in local, regional and national economic and business conditions, including entry into new markets;

Changes in the volume or type of credit extended;

Changes in the experience, ability and depth of lending management;

Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans;

Changes in charge-off trends;

Changes in loan review or Board oversight;

- Changes in the level of concentrations of credit; and
- Changes in external factors, such as competition and legal and regulatory requirements.

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These factors are also considered for the non-PCI purchased loan portfolio specifically in regards to changes in credit quality, past due, nonaccrual and charge-off trends.

The following tables detail activity in the allowance for loan losses by portfolio segment for the periods presented (in thousands):

	Three Months Ended March 31, 2019						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	\$3,597	\$ 3,844	\$ 13,968	\$ 3,974	\$ 525	\$ 1,111	\$27,019
Provision (reversal) for loan losses ⁽²⁾	662	(447)	(2,112)	734	(17)	262	(918)
Loans charged off	—	(18)	(1,215)	(451)	—	(601)	(2,285)
Recoveries of loans charged off	—	3	19	30	—	287	339
Balance at end of period	\$4,259	\$ 3,382	\$ 10,660	\$ 4,287	\$ 508	\$ 1,059	\$24,155

	Three Months Ended March 31, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period ⁽¹⁾	\$3,676	\$ 2,445	\$ 10,821	\$ 2,094	\$ 860	\$ 885	\$20,781
Provision (reversal) for loan losses ⁽²⁾	(65)	(82)	3,266	333	(9)	292	3,735
Loans charged off	(14)	—	—	(85)	—	(668)	(767)
Recoveries of loans charged off	—	14	2	43	—	412	471
Balance at end of period	\$3,597	\$ 2,377	\$ 14,089	\$ 2,385	\$ 851	\$ 921	\$24,220

(1) Loans acquired with the Diboll acquisition were measured at fair value on November 30, 2017 with no carryover of allowance for loan loss.

Of the \$918,000 reversal of provision for loan losses for the three months ended March 31, 2019, \$52,000 related (2) to provision expense reversed on PCI loans. Of the \$3.7 million recorded in provision for loan losses for the three months ended March 31, 2018, none related to provision expense on PCI loans.

The following tables present the balance in the allowance for loan losses by portfolio segment based on impairment method (in thousands):

	March 31, 2019						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment ⁽¹⁾	\$13	\$ 83	\$ 3,100	\$ 403	\$ 1	\$ 150	\$3,750
Ending balance – collectively evaluated for impairment	4,246	3,299	7,560	3,884	507	909	20,405
Balance at end of period	\$4,259	\$ 3,382	\$ 10,660	\$ 4,287	\$ 508	\$ 1,059	\$24,155

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	December 31, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment ⁽¹⁾	\$ 13	\$ 40	\$ 5,337	\$ 368	\$ 1	\$ 149	\$ 5,908
Ending balance – collectively evaluated for impairment	3,584	3,804	8,631	3,606	524	962	21,111
Balance at end of period	\$3,597	\$ 3,844	\$ 13,968	\$ 3,974	\$ 525	\$ 1,111	\$ 27,019

(1) The allowance for loan loss on PCI loans totaled \$250,000 and \$302,000 as of March 31, 2019 and December 31, 2018, respectively.

The following tables present the recorded investment in loans by portfolio segment based on impairment method (in thousands):

	March 31, 2019						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	\$ 8	\$ 1,295	\$ 23,282	\$ 1,914	\$ 429	\$ 142	\$ 27,070
Loans collectively evaluated for impairment	603,257	776,725	1,049,049	364,363	342,597	99,618	3,235,609
Purchased credit impaired loans	146	8,178	32,047	1,718	—	342	42,431
Total ending loan balance	\$603,411	\$ 786,198	\$ 1,104,378	\$ 367,995	\$ 343,026	\$ 100,102	\$ 3,305,110
	December 31, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	\$ 12	\$ 1,215	\$ 33,013	\$ 1,394	\$ 429	\$ 184	\$ 36,247
Loans collectively evaluated for impairment	507,564	782,614	1,128,220	353,036	352,941	105,775	3,230,150
Purchased credit impaired loans	156	10,670	32,885	2,219	—	472	46,402
Total ending loan balance	\$507,732	\$ 794,499	\$ 1,194,118	\$ 356,649	\$ 353,370	\$ 106,431	\$ 3,312,799

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The following tables set forth credit quality indicators by class of loans for the periods presented (in thousands):

March 31, 2019						
	Pass	Pass Watch (1)	Special Mention (1)	Substandard (1)	Doubtful (1)	Total
Real estate loans:						
Construction	\$603,239	\$23	\$—	\$ 149	\$—	\$603,411
1-4 family residential	780,827	35	98	4,439	799	786,198
Commercial	1,004,085	25,844	26,948	47,341	160	1,104,378
Commercial loans	360,398	1,131	3,251	3,129	86	367,995
Municipal loans	343,026	—	—	—	—	343,026
Loans to individuals	99,504	—	2	414	182	100,102
Total	\$3,191,079	\$27,033	\$30,299	\$55,472	\$1,227	\$3,305,110
December 31, 2018						
	Pass	Pass Watch (1)	Special Mention (1)	Substandard (1)	Doubtful (1)	Total
Real estate loans:						
Construction	\$507,529	\$163	\$—	\$ 28	\$ 12	\$507,732
1-4 family residential	787,516	37	100	5,489	1,357	794,499
Commercial	1,067,874	11,479	26,490	87,767	508	1,194,118
Commercial loans	349,495	520	3,189	2,988	457	356,649
Municipal loans	353,370	—	—	—	—	353,370
Loans to individuals	105,536	4	4	678	209	106,431
Total	\$3,171,320	\$12,203	\$29,783	\$96,950	\$2,543	\$3,312,799

Includes PCI loans comprised of \$21,000 pass watch, \$308,000 special mention, \$2.9 million substandard and (1)\$317,000 doubtful as of March 31, 2019. Includes PCI loans comprised of \$22,000 pass watch, \$859,000 special mention, \$3.9 million substandard and \$1.2 million doubtful as of December 31, 2018.

Nonperforming Assets and Past Due Loans

Nonaccrual loans are loans 90 days or more delinquent and collection in full of both the principal and interest is not expected. Additionally, some loans that are not delinquent or that are delinquent less than 90 days may be placed on nonaccrual status if it is probable that we will not receive contractual principal and interest payments in accordance with the terms of the respective loan agreement. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Payments received on nonaccrual loans are applied to the outstanding principal balance. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower, are considered in judgments as to potential loan loss.

Nonaccrual loans and accruing loans past due more than 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

PCI loans are recorded at fair value at acquisition date. Although the PCI loans may be contractually delinquent, we do not classify these loans as past due or nonperforming when the timing and amount of expected cash flows can be

reasonably estimated, as the loans were written down to fair value at the acquisition date and the accretable yield is recognized in interest income over the remaining life of the loan. However, subsequent to acquisition, we reassess PCI loans for additional impairment and record additional impairment in the event we conclude it is probable that we will be unable to collect all cash flows originally expected to be collected at acquisition plus any additional cash flows expected to be collected due to changes in estimates after acquisition. All such PCI loans for which we recognize subsequent impairment are reported as impaired loans in the financial statements.

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The following table sets forth nonperforming assets for the periods presented (in thousands):

	March 31, December 31,	
	2019	2018
Nonaccrual loans ⁽¹⁾ ⁽²⁾	\$ 17,691	\$ 35,770
Accruing loans past due more than 90 days ⁽¹⁾ ⁽³⁾	7,927	—
Restructured loans ⁽⁴⁾	11,490	5,930
Other real estate owned	978	1,206
Reposessed assets	25	—
Total nonperforming assets	\$ 38,111	\$ 42,906

(1) Excludes PCI loans measured at fair value at acquisition if the timing and amount of cash flows expected to be collected from those sales can be reasonably estimated.

(2) Includes \$10.7 million and \$10.9 million of restructured loans as of March 31, 2019 and December 31, 2018, respectively.

(3) The relationship comprising this figure subsequently paid off in the second quarter of 2019.

(4) Includes \$719,000 and \$3.1 million in PCI loans restructured as of March 31, 2019 and December 31, 2018, respectively.

Foreclosed assets include other real estate owned and reposessed assets. For 1-4 family residential real estate properties, a loan is recognized as a foreclosed property once legal title to the real estate property has been received upon completion of foreclosure or the borrower has conveyed all interest in the residential property through a deed in lieu of foreclosure. There were \$155,000 and \$147,000 in loans secured by 1-4 family residential properties for which formal foreclosure proceedings were in process as of March 31, 2019 and December 31, 2018, respectively.

The following table sets forth the recorded investment in nonaccrual loans by class of loans for the periods presented (in thousands). The table excludes PCI loans measured at fair value at acquisition:

	Nonaccrual Loans	
	March 31, 2019	December 31, 2018
Real estate loans:		
Construction	\$ 8	\$ 12
1-4 family residential	1,395	2,202
Commercial	15,266	32,599
Commercial loans	758	639
Loans to individuals	264	318
Total	\$ 17,691	\$ 35,770

Loans are considered impaired if, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for larger loans. The measurement of loss on impaired loans is generally based on the fair value of the collateral less selling costs if repayment is expected solely from the collateral or the present value of the expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions, such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation. Loans that are evaluated and determined not to meet the definition of an impaired loan are reserved for at the general reserve rate for its appropriate class.

At the time a loss is probable in the collection of contractual amounts, specific reserves are allocated. Loans are charged off to the liquidation value of the collateral net of liquidation costs, if any, when deemed uncollectible or as soon as collection by liquidation is evident.

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The following tables set forth impaired loans by class of loans, including the unpaid contractual principal balance, the recorded investment and the allowance for loan losses for the periods presented (in thousands). Impaired loans include restructured and nonaccrual loans for which the allowance was measured in accordance with section 310-10 of ASC Topic 310, "Receivables." There were no impaired loans recorded without an allowance as of March 31, 2019 or December 31, 2018.

	March 31, 2019		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real estate loans:			
Construction	\$ 169	\$ 136	\$ 13
1-4 family residential	8,742	7,576	83
Commercial	26,333	24,965	3,100
Commercial loans	3,139	2,527	403
Municipal loans	429	429	1
Loans to individuals	636	484	150
Total ⁽¹⁾	\$39,448	\$ 36,117	\$ 3,750

	December 31, 2018		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real estate loans:			
Construction	\$ 182	\$ 148	\$ 13
1-4 family residential	6,507	5,923	40
Commercial	36,457	34,744	5,337
Commercial loans	2,874	2,366	368
Municipal loans	429	429	1
Loans to individuals	825	657	149
Total ⁽¹⁾	\$47,274	\$ 44,267	\$ 5,908

(1) Includes \$9.0 million and \$8.0 million of PCI loans that experienced deterioration in credit quality subsequent to the acquisition date as of March 31, 2019 and December 31, 2018, respectively.

The following tables present the aging of the recorded investment in past due loans by class of loans (in thousands):

	March 31, 2019					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current ⁽¹⁾	Total
Real estate loans:						
Construction	\$5,894	\$72	\$—	\$5,966	\$597,445	\$603,411

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1-4 family residential	11,506	270	305	12,081	774,117	786,198
Commercial	895	—	7,939	8,834	1,095,544	1,104,378
Commercial loans	1,722	492	503	2,717	365,278	367,995
Municipal loans	—	—	—	—	343,026	343,026
Loans to individuals	1,144	206	62	1,412	98,690	100,102
Total	\$21,161	\$1,040	\$8,809	\$31,010	\$3,274,100	\$3,305,110

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	December 31, 2018					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current ⁽¹⁾	Total
Real estate loans:						
Construction	\$627	\$307	\$—	\$934	\$506,798	\$507,732
1-4 family residential	7,441	1,258	1,335	10,034	784,465	794,499
Commercial	10,663	7,655	—	18,318	1,175,800	1,194,118
Commercial loans	1,946	705	591	3,242	353,407	356,649
Municipal loans	—	—	—	—	353,370	353,370
Loans to individuals	1,289	351	146	1,786	104,645	106,431
Total	\$21,966	\$10,276	\$2,072	\$34,314	\$3,278,485	\$3,312,799

(1) Includes PCI loans measured at fair value at acquisition if the timing and amount of cash flows expected to be collected from those sales can be reasonably estimated.

The following table sets forth average recorded investment and interest income recognized on impaired loans by class of loans for the periods presented (in thousands). The table excludes PCI loans measured at fair value at acquisition that have not experienced further deterioration in credit quality subsequent to the acquisition date:

	Three Months Ended			
	March 31, 2019		March 31, 2018	
	Average Recorded Investment	Average Interest Income Recognized	Average Recorded Investment	Average Interest Income Recognized
Real estate loans:				
Construction	\$170	\$ 5	\$78	\$ —
1-4 family residential	5,336	79	3,923	41
Commercial	35,951	277	11,970	3
Commercial loans	2,602	31	1,623	17
Municipal loans	429	6	502	7
Loans to individuals	589	9	211	2
Total	\$45,077	\$ 407	\$18,307	\$ 70

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Troubled Debt Restructurings

The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, restructuring amortization schedules and other actions intended to minimize potential losses. We may provide a combination of concessions which may include an extension of the amortization period, interest rate reduction and/or converting the loan to interest-only for a limited period of time.

The following tables set forth the recorded balance of loans considered to be TDRs that were restructured and the type of concession by class of loans during the periods presented (dollars in thousands):

	Three Months Ended March 31, 2019				Number of Loans
	Extend Amortization Period	Interest Rate Reductions	Combination	Total Modifications	
Real estate loans:					
1-4 family residential	\$—	\$	—\$ 113	\$ 113	1
Commercial	7,627	—	—	7,627	1
Commercial loans	57	—	—	57	1
Loans to individuals	—	—	15	15	2
Total	\$7,684	\$	—\$ 128	\$ 7,812	5

	Three Months Ended March 31, 2018				Number of Loans
	Extend Amortization Period	Interest Rate Reductions	Combination	Total Modifications	
Commercial loans	\$207	\$	—\$	—\$ 207	3
Loans to individuals	104	—	—	104	1
Total	\$311	\$	—\$	—\$ 311	4

The majority of loans restructured as TDRs during the three months ended March 31, 2019 and 2018 were modified with maturity extensions. Interest continues to be charged on principal balances outstanding during the extended term. Therefore, the financial effects of the recorded investment of loans restructured as TDRs during the three months ended March 31, 2019 and 2018 were not significant. Generally, the loans identified as TDRs were previously reported as impaired loans prior to restructuring, and therefore, the modification did not impact our determination of the allowance for loan losses.

On an ongoing basis, the performance of the TDRs is monitored for subsequent payment default. Payment default for TDRs is recognized when the borrower is 90 days or more past due. For the three months ended March 31, 2019 and 2018, the amount of TDRs in default was not significant. Payment defaults for TDRs did not significantly impact the determination of the allowance for loan loss in either period presented.

At March 31, 2019 and 2018, there were no commitments to lend additional funds to borrowers whose terms had been modified in TDRs.

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Purchased Credit Impaired Loans

The following table presents the outstanding principal balance and carrying value for PCI loans for the periods presented (in thousands):

	March 31, December 31,	
	2019	2018
Outstanding principal balance	\$ 47,034	\$ 51,388
Carrying amount	\$ 42,431	\$ 46,402

The following table presents the changes in the accretable yield during the periods for PCI loans (in thousands):

	Three Months Ended March 31,	
	2019	2018
Balance at beginning of period	\$ 15,054	\$ 18,721
Changes in expected cash flows not affecting non-accretable differences	—	(1,445)
Reclassifications (to) from nonaccretable discount	262	(320)
Accretion	(796)	(1,138)
Balance at end of period	\$ 14,520	\$ 15,818

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7. Borrowing Arrangements

Information related to borrowings is provided in the table below (dollars in thousands):

	March 31, 2019	December 31, 2018		
Federal funds purchased and repurchase agreements:				
Balance at end of period	\$8,637	\$36,810		
Average amount outstanding during the period ⁽¹⁾	16,788	10,880		
Maximum amount outstanding during the period ⁽²⁾	28,354	36,810		
Weighted average interest rate during the period ⁽³⁾	1.8	% 1.4	%	
Interest rate at end of period ⁽⁴⁾	1.1	% 2.1	%	
FHLB borrowings:				
Balance at end of period	\$619,861	\$719,065		
Average amount outstanding during the period ⁽¹⁾	816,389	720,785		
Maximum amount outstanding during the period ⁽²⁾	1,004,997	957,231		
Weighted average interest rate during the period ⁽³⁾	2.2	% 1.8	%	
Interest rate at end of period ⁽⁴⁾	2.4	% 2.3	%	

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.

(2) The maximum amount outstanding at any month-end during the period.

The weighted average interest rate during the period was computed by dividing the actual interest expense (3) (annualized for interim periods) by the average amount outstanding during the period. The weighted average interest rate on the FHLB borrowings includes the effect of interest rate swaps.

(4) Stated rate.

Maturities of the obligations associated with our borrowing arrangements based on scheduled repayments at March 31, 2019 are as follows (in thousands):

	Payments Due by Period						Total
	Less than 1 Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Thereafter	
Federal funds purchased and repurchase agreements	\$8,505	\$132	\$—	\$—	—\$	—\$ —	\$8,637
FHLB borrowings	462,665	145,429	6,000	—	—	5,767	619,861
Total obligations	\$471,170	\$145,561	\$6,000	\$—	—\$	—\$ 5,767	\$628,498

FHLB borrowings represent borrowings with fixed and floating interest rates ranging from 1.37% to 4.799% and with remaining maturities of 5 days to 9.3 years at March 31, 2019. FHLB borrowings may be collateralized by FHLB stock, nonspecified loans and/or securities.

Southside Bank has entered into various variable rate advance agreements with the FHLB. These advance agreements totaled \$310.0 million at both March 31, 2019 and December 31, 2018. Three of the variable rate advance agreements have interest rates tied to three-month LIBOR and the remaining agreements have interest rates tied to one-month LIBOR. In connection with \$270.0 million of these variable rate advance agreements, Southside Bank also entered into various interest rate swap contracts that are treated as cash flow hedges under ASC Topic 815, "Derivatives and Hedging" that effectively convert the variable rate advance agreements to fixed interest rates that average 1.58% with an average weighted maturity of 4.6 years at March 31, 2019. Refer to "Note 10 - Derivative Financial Instruments and Hedging Activities" in our consolidated financial statements included in this report for a detailed description of our hedging policy and methodology related to derivative instruments.

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Southside Bank has three unsecured lines of credit for the purchase of overnight federal funds at prevailing rates with Frost Bank, TIB – The Independent Bankers Bank and Comerica Bank for \$40.0 million, \$15.0 million and \$7.5 million, respectively. There were no federal funds purchased at March 31, 2019. There were \$28.0 million federal funds purchased at December 31, 2018. Southside Bank has a \$5.0 million line of credit with Frost Bank to be used to issue letters of credit, and at March 31, 2019, we had one outstanding letter of credit for \$195,000. At March 31, 2019, the amount of additional funding Southside Bank could obtain from FHLB, collateralized by securities, FHLB stock and nonspecified loans and securities, was approximately \$1.34 billion, net of FHLB stock purchases required. Southside Bank currently has no outstanding letters of credit from FHLB held as collateral for its public fund deposits.

Southside Bank enters into sales of securities under agreements to repurchase (“repurchase agreements”). These repurchase agreements totaled \$8.6 million and \$8.8 million at March 31, 2019 and December 31, 2018, respectively, and had maturities of less than two years. These repurchase agreements are secured by investment securities and are stated at the amount of cash received in connection with the transaction.

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8. Long-term Debt

	March 31, 2019	December 31, 2018
	(in thousands)	
Subordinated notes:		
(1)		
5.50% Subordinated		
Notes, net of		
unamortized debt	\$ 98,448	\$ 98,407
issuance costs (2)		
Total Subordinated	98,448	98,407
notes		
Trust preferred		
subordinated		
debentures: (3)		
Southside Statutory		
Trust III, net of	20,555	20,554
unamortized debt		
issuance costs (4)		
Southside Statutory		
Trust IV	23,196	23,196
Southside Statutory		
Trust V	12,887	12,887
Magnolia Trust		
Company I	3,609	3,609
Total Trust preferred		
subordinated	60,247	60,246
debentures		
Total Long-term debt	\$ 158,695	\$ 158,653

(1) This debt consists of subordinated notes with a remaining maturity greater than one year that qualify under the risk-based capital guidelines as Tier 2 capital, subject to certain limitations.

(2) The unamortized discount and debt issuance costs reflected in the carrying amount of the subordinated notes totaled approximately \$1.6 million at March 31, 2019 and December 31, 2018.

(3) This debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.

(4) The unamortized debt issuance costs reflected in the carrying amount of the Southside Statutory Trust III junior subordinated debentures totaled \$64,000 at March 31, 2019 and \$65,000 at December 31, 2018.

As of March 31, 2019, the details of the subordinated notes and the trust preferred subordinated debentures are summarized below (dollars in thousands):

	Date Issued	Amount Issued	Fixed or Floating Rate	Interest Rate	Maturity Date
5.50% Subordinated Notes	September 19, 2016	\$ 100,000	Fixed-to-Floating	5.50%	September 30, 2026
Southside Statutory Trust III	September 4, 2003	\$ 20,619	Floating	3 month LIBOR + 2.94%	September 4, 2033
	August 8, 2007	\$ 23,196	Floating		October 30, 2037

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Southside Statutory Trust IV				3 month LIBOR + 1.30%	
Southside Statutory Trust V	August 10, 2007	\$12,887	Floating	3 month LIBOR + 2.25%	September 15, 2037
Magnolia Trust Company I ⁽¹⁾	October 10, 2007	\$3,609	Floating	3 month LIBOR + 1.80%	November 23, 2035

(1) On October 10, 2007, as part of an acquisition we assumed \$3.6 million of floating rate junior subordinated debentures issued in 2005 to Magnolia Trust Company I.

On September 19, 2016, the Company issued \$100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes that mature on September 30, 2026. This debt initially bears interest at a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points. The proceeds from the sale of the subordinated notes were used for general corporate purposes, which included advances to the Bank to finance its activities.

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9. Employee Benefit Plans

The components of net periodic benefit cost (income) related to our employee benefit plans are as follows (in thousands):

	Three Months Ended March 31,					
	Defined Benefit Pension Plan		Defined Benefit Pension Plan Acquired		Restoration Plan	
	2019	2018	2019	2018	2019	2018
Service cost	\$316	\$384	\$ —	\$ —	\$ 60	\$ 63
Interest cost	908	857	41	41	161	133
Expected return on assets	(1,504)	(1,620)	(73)	(73)	—	—
Net loss amortization	443	384	—	—	99	91
Prior service (credit) cost amortization	(3)					