FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
November 09, 2015

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended 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 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 37-1103704<br>(I.R.S. employer identification no.) |
| 1421 Charleston Avenue,<br>Mattoon, Illinois<br>(Address of principal executive offices) | 61938<br>(Zip code) |

(217) 234-7454
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, 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 [X ] No [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer [ ] | Accelerated filer [X] |

| | |
|---|---|
| Non-accelerated filer [ ]<br>(Do not check if a smaller reporting company) | Smaller reporting company [ ] |

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). [ ] Yes [X] No

As of November 6, 2015, 8,974,818 common shares, $4.00 par value, were outstanding.

PART I

ITEM 1. FINANCIAL STATEMENTS

First Mid-Illinois Bancshares, Inc.

| Condensed Consolidated Balance Sheets | (Unaudited) | |
|---|---|---|
| (In thousands, except share data) | September 30, 2015 | December 31, 2014 |
| Assets | | |
| Cash and due from banks: | | |
| Non-interest bearing | $41,077 | $40,716 |
| Interest bearing | 173,894 | 10,520 |
| Federal funds sold | 492 | 494 |
| Cash and cash equivalents | 215,463 | 51,730 |
| Certificates of deposit investments | 12,930 | — |
| Investment securities: | | |
| Available-for-sale, at fair value | 490,556 | 377,856 |
| Held-to-maturity, at amortized cost (estimated fair value of $50,030 and $53,937 at September 30, 2015 and December 31, 2014, respectively) | 49,105 | 53,650 |
| Loans held for sale | 1,346 | 1,958 |
| Loans | 1,235,403 | 1,060,448 |
| Less allowance for loan losses | (14,228) | (13,682) |
| Net loans | 1,221,175 | 1,046,766 |
| Interest receivable | 7,620 | 6,828 |
| Other real estate owned | 320 | 263 |
| Premises and equipment, net | 31,582 | 27,352 |
| Goodwill, net | 39,768 | 25,753 |
| Intangible assets, net | 7,594 | 1,844 |
| Other assets | 14,569 | 13,103 |
| Total assets | $2,092,028 | $1,607,103 |
| Liabilities and Stockholders' Equity | | |
| Deposits: | | |
| Non-interest bearing | $331,206 | $222,116 |
| Interest bearing | 1,400,654 | 1,049,961 |
| Total deposits | 1,731,860 | 1,272,077 |
| Securities sold under agreements to repurchase | 108,499 | 121,869 |
| Interest payable | 381 | 285 |
| FHLB borrowings | 20,000 | 20,000 |
| Junior subordinated debentures | 20,620 | 20,620 |
| Dividends payable | 1,100 | 530 |
| Other liabilities | 5,759 | 6,806 |
| Total liabilities | 1,888,219 | 1,442,187 |
| Stockholders' Equity: | | |
| Convertible preferred stock, no par value; authorized 1,000,000 shares; issued 5,500 shares in 2015 and 2014 | 27,400 | 27,400 |
| Common stock, $4 par value; authorized 18,000,000 shares; issued 8,421,472 shares in 2015 and 7,529,815 shares in 2014 | 37,880 | 32,119 |
| Additional paid-in capital | 79,033 | 55,607 |
| Retained earnings | 70,135 | 61,956 |
| Deferred compensation | 3,086 | 3,329 |
| Accumulated other comprehensive income (loss) | 1,861 | (875) |

| | | |
|---|---|---|
| Less treasury stock at cost, 548,642 shares in 2015 and 496,497 shares in 2014 | (15,586 ) | (14,620 ) |
| Total stockholders' equity | 203,809 | 164,916 |
| Total liabilities and stockholders' equity | $2,092,028 | $1,607,103 |

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Income (unaudited)

| (In thousands, except per share data) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Interest income: | | | | |
| Interest and fees on loans | $12,198 | $11,391 | $34,974 | $33,242 |
| Interest on investment securities | 2,682 | 2,392 | 7,473 | 7,460 |
| Interest on certificates of deposit investments | 6 | — | 6 | — |
| Interest on deposits with other financial institutions | 57 | 24 | 101 | 67 |
| Total interest income | 14,943 | 13,807 | 42,554 | 40,769 |
| Interest expense: | | | | |
| Interest on deposits | 645 | 586 | 1,690 | 1,778 |
| Interest on securities sold under agreements to repurchase | 14 | 11 | 43 | 33 |
| Interest on FHLB borrowings | 155 | 78 | 465 | 211 |
| Interest on other borrowings | 1 | — | 14 | 1 |
| Interest on subordinated debentures | 132 | 130 | 390 | 385 |
| Total interest expense | 947 | 805 | 2,602 | 2,408 |
| Net interest income | 13,996 | 13,002 | 39,952 | 38,361 |
| Provision for loan losses | 481 | 44 | 889 | 495 |
| Net interest income after provision for loan losses | 13,515 | 12,958 | 39,063 | 37,866 |
| Other income: | | | | |
| Trust revenues | 795 | 813 | 2,575 | 2,594 |
| Brokerage commissions | 329 | 265 | 913 | 748 |
| Insurance commissions | 459 | 448 | 1,568 | 1,447 |
| Service charges | 1,536 | 1,412 | 4,003 | 3,909 |
| Securities gains, net | 1 | (20) | 231 | 714 |
| Mortgage banking revenue, net | 172 | 185 | 549 | 441 |
| ATM / debit card revenue | 1,200 | 958 | 3,224 | 2,933 |
| Other | 517 | 341 | 1,282 | 1,087 |
| Total other income | 5,009 | 4,402 | 14,345 | 13,873 |
| Other expense: | | | | |
| Salaries and employee benefits | 6,522 | 6,216 | 18,875 | 18,323 |
| Net occupancy and equipment expense | 2,424 | 2,056 | 6,329 | 6,319 |
| Net other real estate owned (income) expense | (1) | 41 | — | 23 |
| FDIC insurance | 236 | 199 | 641 | 604 |
| Amortization of intangible assets | 155 | 162 | 466 | 487 |
| Stationery and supplies | 180 | 152 | 475 | 480 |
| Legal and professional | 660 | 514 | 1,842 | 1,753 |
| Marketing and donations | 296 | 246 | 790 | 755 |
| Other | 2,410 | 1,504 | 5,498 | 4,520 |
| Total other expense | 12,882 | 11,090 | 34,916 | 33,264 |
| Income before income taxes | 5,642 | 6,270 | 18,492 | 18,475 |
| Income taxes | 1,979 | 2,355 | 6,634 | 6,924 |
| Net income | 3,663 | 3,915 | 11,858 | 11,551 |
| Dividends on preferred shares | 550 | 1,105 | 1,650 | 3,313 |
| Net income available to common stockholders | $3,113 | $2,810 | $10,208 | $8,238 |

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First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Income (unaudited) (continued)

| (In thousands, except per share data) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Per share data: | | | | |
| Basic net income per common share available to common stockholders | $0.37 | $0.48 | $1.35 | $1.40 |
| Diluted net income per common share available to common stockholders | $0.37 | $0.47 | $1.33 | $1.38 |
| Cash dividends declared per common share | — | — | 0.29 | 0.26 |

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Comprehensive Income (unaudited)

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income | $3,663 | $3,915 | $11,858 | $11,551 |
| Other Comprehensive Income | | | | |
| Unrealized gains on available-for-sale securities, net of taxes of $(1,709) and $(1,073) for three months ended September 30, 2015 and 2014, respectively and $(1,662) and $(4,605) for nine months ended September 30, 2015 and 2014, respectively. | 2,676 | 1,679 | 2,601 | 7,209 |
| Amortized holding losses on held-to-maturity securities transferred from available-for-sale, net of taxes of $(51) and $540 for three months ended September 30, 2015 and 2014, respectively and $(176) and $540 for nine months ended September 30, 2015 and 2014, respectively. | 80 | (844) | 276 | (844) |
| Less: reclassification adjustment for realized (gains) losses included in net income net of taxes of $0 and $(8) for three months ended September 30, 2015 and 2014, respectively and $90 and $278 for nine months ended September 30, 2015 and 2014, respectively. | (1) | 12 | (141) | (436) |
| Other comprehensive income, net of taxes | 2,755 | 847 | 2,736 | 5,929 |
| Comprehensive income | $6,418 | $4,762 | $14,594 | $17,480 |

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.

| Condensed Consolidated Statements of Cash Flows (unaudited) | Nine months ended September 30, | |
|---|---|---|
| (In thousands) | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net income | $11,858 | $11,551 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 889 | 495 |
| Depreciation, amortization and accretion, net | 2,908 | 3,010 |
| Stock-based compensation expense | 264 | 312 |
| Gains on investment securities, net | (231) | (714) |
| (Gain) loss on sales of other real property owned, net | (32) | 41 |
| Loss on write down of fixed assets | 166 | 85 |
| Gains on sale of loans held for sale, net | (586) | (455) |
| Increase in accrued interest receivable | (298) | (362) |
| (Decrease) increase in accrued interest payable | (29) | 34 |
| Origination of loans held for sale | (43,106) | (33,125) |
| Proceeds from sale of loans held for sale | 44,304 | 32,414 |
| Increase in other assets | (2,327) | (1,961) |
| Decrease in other liabilities | (1,500) | (861) |
| Net cash provided by operating activities | 12,280 | 10,464 |
| Cash flows from investing activities: | | |
| Purchases of certificates of deposit investments | (12,930) | — |
| Proceeds from sales of securities available-for-sale | 9,453 | 75,618 |
| Proceeds from maturities of securities available-for-sale | 55,057 | 48,889 |
| Proceeds from maturities of securities held-to-maturity | 10,000 | — |
| Purchases of securities available-for-sale | (168,820) | (55,399) |
| Purchases of securities held-to-maturity | (10,000) | — |
| Net increase in loans | (23,068) | (57,421) |
| Purchases of premises and equipment | (1,380) | (989) |
| Proceeds from sales of other real property owned | 113 | 524 |
| Cash received related to acquisition, net of cash and cash equivalents acquired | 279,468 | — |
| Net cash provided by investing activities | 137,893 | 11,222 |
| Cash flows from financing activities: | | |
| Net increase in deposits | 6,136 | 11,224 |
| Decrease in repurchase agreements | (17,167) | (31,121) |
| Proceeds from FHLB advances | 5,000 | 5,000 |
| Repayment of FHLB advances | (5,000) | (10,000) |
| Proceeds from other borrowings | 2,000 | 1,000 |
| Repayment of other borrowings | (2,000) | (1,000) |
| Proceeds from issuance of common stock | 28,165 | 493 |
| Conversion of preferred stock | — | (5) |
| Purchase of treasury stock | (1,041) | (1,650) |
| Dividends paid on preferred stock | (1,001) | (2,024) |
| Dividends paid on common stock | (1,532) | (1,133) |
| Net cash provided by (used in) financing activities | 13,560 | (29,216) |
| Increase (decrease) in cash and cash equivalents | 163,733 | (7,530) |
| Cash and cash equivalents at beginning of period | 51,730 | 65,102 |
| Cash and cash equivalents at end of period | $215,463 | $57,572 |

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| First Mid-Illinois Bancshares, Inc. | | |
|---|---|---|
| Condensed Consolidated Statements of Cash Flows (unaudited) (continued) | Nine months ended September 30, | |
| (In thousands) | 2015 | 2014 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | $2,506 | $2,374 |
| Income taxes | 6,961 | 6,685 |
| Supplemental disclosures of noncash investing and financing activities | | |
| Securities transferred from available-for-sale to held-to-maturity | — | 53,594 |
| Loans transferred to other real estate owned | 167 | 344 |
| Dividends reinvested in common stock | 597 | 576 |
| Net tax benefit related to option and deferred compensation plans | 85 | 101 |

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 -- Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. (“Company”) and its wholly-owned subsidiaries: First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”), Mid-Illinois Data Services, Inc. (“MIDS”) and The Checkley Agency, Inc. doing business as First Mid Insurance Group (“First Mid Insurance”). All significant intercompany balances and transactions have been eliminated in consolidation. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended September 30, 2015 and 2014, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year’s consolidated financial statements have been reclassified to conform to the September 30, 2015 presentation and there was no impact on net income or stockholders’ equity. The results of the interim period ended September 30, 2015 are not necessarily indicative of the results expected for the year ending December 31, 2015. The Company operates as a one-segment entity for financial reporting purposes.

The 2014 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2014 Annual Report on Form 10-K.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission (“SEC”) can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

Branch Purchase and Assumption Agreement

On January 30, 2015, First Mid Bank, a wholly-owned subsidiary of the Company, entered into a Purchase and Assumption Agreement (the “Purchase Agreement”) with Old National Bank, a national banking association having its principal office in Evansville, Indiana, pursuant to which First Mid Bank purchased certain assets and assume certain liabilities of 12 branch offices of Old National Bank in Southern Illinois (the “ONB Branches”). Pursuant to the terms of the Purchase Agreement, First Mid Bank agreed to assume certain deposit liabilities and to acquire certain loans, as well as cash, real property, furniture, and other fixed operating assets associated with the ONB Branches. The book value of loan and deposit balances assumed was approximately $156 million and $453 million, respectively. First Mid Bank also agreed to assume certain leases, and entered into certain subleases, relating to the ONB Branches. The completion of the Purchase was subject to regulatory approval required by the Office of the Comptroller of the Currency and normal customary closing conditions, including First Mid Bank, in conjunction with the Company, obtaining financing in connection with the acquisition. Following satisfaction of these conditions, First Mid Bank and Old National Bank closed the acquisition on August 14, 2015.

Capital Raise

On June 18, 2015, the Company entered into a securities purchase agreement with a limited number of institutional investors to sell, and accepted from certain other accredited investors, including certain directors of the Company, subscriptions for, an aggregate total of 1,392,859 newly issued shares of the Company's common stock at a purchase price of $21.00 per share, for an aggregate gross purchase price of approximately $29,250,039 (the "Offering"). The Offering closed on June 19, 2015. The Company used the net proceeds of the Offering to provide capital support for the purchase of the ONB Branches and for general corporate purposes.

Rights Agreement

On January 21, 2015, the Company entered into an Amendment No. 1 to the Rights Agreement (the "Rights Agreement"), dated as of September 22, 2009, by and between the Company and Computershare Trust Company, N.A., as rights agent. This amendment accelerated the expiration of the Company's common stock purchase rights (the “Rights”) from 5:00 p.m., Mattoon, Illinois time, on September 22, 2019, to 5:00 p.m., Mattoon, Illinois time, on January 21, 2015, and had the effect of terminating the Rights Agreement on that date. At the time of the termination of the Rights Agreement, all of the Rights distributed to holders of the Company's common stock pursuant to the Rights Agreement expired.

NASDAQ Listing

On May 12, 2014, the Company's common stock began trading on The NASDAQ Stock Market under the ticker "FMBH." Prior to the listing of the Company's common stock on NASDAQ, the common stock was traded on the OTC Bulletin Board.

Stock Plans

At the Annual Meeting of Stockholders held May 23, 2007, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2007 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 1997 Stock Incentive Plan, which had a ten-year term that expired October 21, 2007. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of common stock of the Company on the terms and conditions established in the SI Plan.

On September 27, 2011, the Board of Directors passed a resolution relating to the SI Plan whereby they authorized and approved the Executive Long-Term Incentive Plan (“LTIP”). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards to select senior executives of the Company or any Subsidiary.

A maximum of 300,000 shares of common stock may be issued under the SI Plan. As of September 30, 2015, the Company had awarded 59,500 shares as stock options under the SI plan. There were no stock options awarded in 2015 or 2014. The Company awarded 16,604 shares as Stock Unit Awards and 14,770 as 50% Stock Awards and 50% Stock Unit Awards during 2015 and 2014, respectively, under the SI plan.

Convertible Preferred Stock

Series B Convertible Preferred Stock. During 2009, the Company sold to certain accredited investors including directors, executive officers, and certain major customers and holders of the Company’s common stock, $24,635,000, in the aggregate, of a newly authorized series of its preferred stock designated as Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the “Series B Preferred Stock”). The Series B Preferred Stock had an issue price of $5,000 per share and no par value per share. The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

On September 23, 2014, the Board of Directors of the Company approved the mandatory conversion of all of the Company's issued and outstanding 4,926 shares of Series B Preferred Stock into shares of the Company’s common stock. On September 24, 2014, notices were sent to the shareholders of the Series B Preferred Stock regarding the mandatory conversion. On November 17, 2014, the Company completed the mandatory conversion. The conversion ratio for each share of the Preferred Stock was computed by dividing $5,000 (the issuance price per share of the Series B Preferred Stock) by $21.62 (then current conversion price). The conversion ratio, therefore, was 231.267 shares of the Company's common stock for each share of Series B Preferred Stock. This resulted in the issuance of approximately 1,139,195 shares of common stock in the aggregate. As a result of the conversion, dividends ceased to accrue on the Series B Preferred Stock and certificates for shares of Series B Preferred Stock only represent the right to receive the appropriate number of shares of common stock, together with net accrued but unpaid dividends on the Preferred Stock, and cash in lieu of fractional share interests.

Series C Convertible Preferred Stock. On February 11, 2011, the Company accepted from certain accredited investors, including directors, executive officers, and certain major customers and holders of the Company's common stock (collectively, the "Investors"), subscriptions for the purchase of $27,500,000, in the aggregate, of a newly authorized series of preferred stock designated as Series C 8% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series C Preferred Stock"). As of February 11, 2011, $11,010,000 of the Series C Preferred Stock had been issued and sold by the Company to certain Investors. On March 2, 2011, three investors subsequently completed the required bank regulatory process and an additional $2,750,000 of Series C Preferred Stock was issued and sold by the Company to these investors. On May 13, 2011, four additional investors received the required bank regulatory approval and an additional $5,490,000 of Series C Preferred Stock was issued and sold by the Company to these investors. On June 28, 2012, the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to Investors following their receipt of the required bank regulatory approval, for a total of $27,500,000 of outstanding Series C Preferred Stock. All of the Series C Preferred Stock subscribed for by investors has been issued.

The Series C Preferred Stock has an issue price of $5,000 per share and no par value per share. The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

The Series C Preferred Stock pays non-cumulative dividends semiannually in arrears, when, as and if authorized by the Board of Directors of the Company, at a rate of 8% per year. Holders of the Series C Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the Series C Preferred Stock and certain other matters. In addition, if dividends on the Series C Preferred Stock are not paid in full for four dividend periods, whether consecutive or not, the holders of the Series C Preferred Stock, acting as a class with any other of the Company's securities having similar voting rights, including the Company's Series B Preferred Stock, will have the right to elect two directors to the Company's Board of Directors. The terms of office of these directors will end when the Company has paid or set aside for payment full semi-annual dividends for four consecutive dividend periods.

Each share of the Series C Preferred Stock may be converted at any time at the option of the holder into shares of the Company's common stock. The number of shares of common stock into which each share of the Series C Preferred Stock is convertible is the $5,000 liquidation preference per share divided by the Conversion Price of $20.29. The Conversion Price is subject to adjustment from time to time pursuant to the terms of the Series C Certificate of Designation. If at the time of conversion, there are any authorized, declared and unpaid dividends with respect to a converted share of Series C Preferred Stock, the holder will receive cash in lieu of the dividends, and a holder will receive cash in lieu of fractional shares of common stock following conversion.

After May 13, 2016 the Company may, at its option but subject to the Company's receipt of any required prior approvals from the Board of Governors of the Federal Reserve System or any other regulatory authority, redeem the Series C Preferred Stock. Any redemption will be in exchange for cash in the amount of $5,000 per share, plus any authorized, declared and unpaid dividends, without accumulation of any undeclared dividends.

The Company also has the right at any time after May 13, 2016 to require the conversion of all (but not less than all) of the Series C Preferred Stock into shares of common stock if, on the date notice of mandatory conversion is given to holders, (a) the tangible book value per share of the Company's common stock equals or exceeds 115% of the tangible book value per share of the Company's common stock at December 31, 2010, and (b) the NASDAQ Bank Index (denoted by CBNK:IND) equals or exceeds 115% of the NASDAQ Bank Index at December 31, 2010. "Tangible book value per share of our common stock" at any date means the result of dividing the Company's total common stockholders equity at that date, less the amount of goodwill and intangible assets, determined in accordance with U.S. generally accepted accounting principles, by the number of shares of common stock then outstanding, net of any shares held in the treasury. The tangible book value of the Company's common stock at December 31, 2010 was $9.38, and 115% of this amount is approximately $10.79. The NASDAQ Bank Index value at December 31, 2010 was 1,847.35 and 115% of this amount is approximately 2,124.45. The tangible book value of the Company’s common stock at September 30, 2015 was $15.32 and the NASDAQ Bank Index value at September 30, 2015 was 2,770.27.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income included in stockholders' equity as of September 30, 2015 and December 31, 2014 are as follows (in thousands):

| | Unrealized Gain (Loss) on Securities | Securities with Other-Than-Temporary Impairment Losses | Total |
|---|---|---|---|
| September 30, 2015 | | | |
| Net unrealized gains on securities available-for-sale | $4,967 | $ — | $4,967 |
| Unamortized losses on held-to-maturity securities transferred from available-for-sale | (876) | — | (876) |
| Securities with other-than-temporary impairment losses | — | (1,042) | (1,042) |
| Tax benefit | (1,594) | 406 | (1,188) |
| Balance at September 30, 2015 | $2,497 | $ (636) | $1,861 |
| December 31, 2014 | | | |
| Net unrealized gains on securities available-for-sale | $2,829 | $— | $2,829 |
| Unamortized losses on held-to-maturity securities transferred from available-for-sale | (1,328) | — | (1,328) |
| Securities with other-than-temporary impairment losses | — | (2,936) | (2,936) |
| Tax benefit (expense) | (586) | 1,146 | 560 |
| Balance at December 31, 2014 | $915 | $(1,790) | $(875) |

Amounts reclassified from accumulated other comprehensive income and the affected line items in the statements of income during the nine months ended September 30, 2015 and 2014, were as follows (in thousands):

| | Amounts Reclassified from Other Comprehensive Income | | Affected Line Item in the Statements of Income |
|---|---|---|---|
| | 2015 | 2014 | |
| Unrealized gains on available-for-sale securities | $231 | 714 | Securities gains, net |
| | | | (Total reclassified amount before tax) |
| | (90) | (278) | Income taxes |
| Total reclassifications out of accumulated other comprehensive income | $141 | $436 | Net reclassified amount |

See "Note 3 – Investment Securities" for more detailed information regarding unrealized losses on available-for-sale securities.

Adoption of New Accounting Guidance

Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers ("ASU 2014-09"). In May 2014, FASB issued ASU 2014-09 which creates a new topic in the FASB Accounting Standards Codification(R) ("ASC"), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASU 2014-09 establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the ASC, Other Assets and Deferred Costs: Contracts with Customers ("ASC 340-40"), to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantee other than product or service warranties, and non-monetary exchanges between entities in the same line of business to facilitate sales to customers. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. In August 2015, FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606)-Deferral of the Effective Date which provides a one year deferral of ASU 2014-09. The adoption of this guidance is not expected to have a material impact on the Company’s financial statements.

Accounting Standards Update 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures ("ASU 2014-11"). In June 2014, FASB issued ASU 2014-11 which changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements to secured borrowing accounting. ASU 2014-11 also requires enhanced disclosures about repurchase agreements and other similar transactions. The accounting changes in this update are effective for the first interim or annual period beginning after December 31, 2014. The disclosure for transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014; the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods after December 15, 2014, and interim periods after March 15, 2015. Early application is not permitted. The adoption of this amendment did not have a material effect on the Company's financial statements.

Note 2 -- Earnings Per Share

Basic net income per common share available to common stockholders is calculated as net income less preferred stock dividends divided by the weighted average number of common shares outstanding. Diluted net income per common share available to common stockholders is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's convertible preferred stock and the Company's stock options, unless anti-dilutive.

The components of basic and diluted net income per common share available to common stockholders for the three and nine-month period ended September 30, 2015 and 2014 were as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Basic Net Income per Common Share Available to Common Stockholders: | | | | |
| Net income | $3,663,000 | $3,915,000 | $11,858,000 | $11,551,000 |
| Preferred stock dividends | (550,000) | (1,105,000) | (1,650,000) | (3,313,000) |
| Net income available to common stockholders | $3,113,000 | $2,810,000 | $10,208,000 | $8,238,000 |
| Weighted average common shares outstanding | 8,421,397 | 5,881,681 | 7,553,468 | 5,881,974 |
| Basic earnings per common share | $0.37 | $0.48 | $1.35 | $1.40 |
| Diluted Net Income per Common Share Available to Common Stockholders: | | | | |
| Net income available to common stockholders | $3,113,000 | $2,810,000 | $10,208,000 | $8,238,000 |
| Effect of assumed preferred stock conversion | 550,000 | 1,105,000 | 1,650,000 | 3,313,000 |
| Net income applicable to diluted earnings per share | $3,663,000 | $3,915,000 | $11,858,000 | $11,551,000 |
| Weighted average common shares outstanding | 8,421,397 | 5,881,681 | 7,553,468 | 5,881,974 |
| Dilutive potential common shares: | | | | |
| Restricted stock awarded | 7,788 | 9,892 | 7,788 | 9,892 |
| Assumed conversion of preferred stock | 1,355,348 | 2,494,569 | 1,355,348 | 2,494,642 |
| Dilutive potential common shares | 1,363,136 | 2,504,461 | 1,363,136 | 2,504,534 |
| Diluted weighted average common shares outstanding | 9,784,533 | 8,386,142 | 8,916,604 | 8,386,508 |
| Diluted earnings per common share | $0.37 | $0.47 | $1.33 | $1.38 |

The following shares were not considered in computing diluted earnings per share for the three and nine-month periods ended September 30, 2015 and 2014 because they were anti-dilutive:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Stock options to purchase shares of common stock | 45,500 | 128,750 | 45,500 | 128,750 |

Note 3 -- Investment Securities

The amortized cost, gross unrealized gains and losses and estimated fair values for available-for-sale and held-to-maturity securities by major security type at September 30, 2015 and December 31, 2014 were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
|---|---|---|---|---|
| September 30, 2015 | | | | |
| Available-for-sale: | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations & agencies | $127,239 | $368 | $(156) | $127,451 |
| Obligations of states and political subdivisions | 95,354 | 2,354 | (207) | 97,501 |
| Mortgage-backed securities: GSE residential | 256,836 | 3,156 | (551) | 259,441 |
| Trust preferred securities | 3,167 | — | (1,042) | 2,125 |
| Other securities | 4,035 | 35 | (32) | 4,038 |
| Total available-for-sale | $486,631 | $5,913 | $(1,988) | $490,556 |
| Held-to-maturity: | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations & agencies | $49,105 | $931 | $(6) | $50,030 |
| | | | | |
| December 31, 2014 | | | | |
| Available-for-sale: | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations & agencies | $101,224 | $91 | $(1,358) | $99,957 |
| Obligations of states and political subdivisions | 75,589 | 2,608 | (113) | 78,084 |
| Mortgage-backed securities: GSE residential | 193,814 | 2,548 | (961) | 195,401 |
| Trust preferred securities | 3,300 | — | (2,936) | 364 |
| Other securities | 4,036 | 26 | (12) | 4,050 |
| Total available-for-sale | $377,963 | $5,273 | $(5,380) | $377,856 |
| Held-to-maturity: | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations & agencies | $53,650 | $299 | $(12) | $53,937 |

During the third quarter of 2014, management evaluated its available-for-sale portfolio and transferred obligations of U.S. government corporations & agencies securities with a fair value of $53.6 million from available-for-sale to held-to-maturity to reduce price volatility. Management determined it has both the intent and ability to hold these securities to maturity. Transfers of investment securities into the held-to-maturity category from available-for-sale are made at fair value on the date of transfer. There were no gains or losses recognized as a result of this transfer. The related $1.4 million of unrealized holding loss that was included in the transfer is retained in the carrying value of the held-to-maturity securities and in other comprehensive income net of deferred taxes. These amounts are being amortized into net interest income over the remaining life of the related securities as a yield adjustment, resulting in no impact on future net income.

Trust preferred securities represent one trust preferred pooled security issued by First Tennessee Financial (“FTN”). The unrealized loss of this security, which has a remaining maturity of twenty-two years, is primarily due to its long-term nature, a lack of demand or inactive market for the security, and concerns regarding the underlying financial institutions that have issued the trust preferred security. See the heading “Trust Preferred Securities” for further information regarding this security.

Realized gains and losses resulting from sales of securities were as follows during the nine months ended September 30, 2015 and 2014 (in thousands):

| | September 30, 2015 | September 30, 2014 |
|---|---|---|
| Gross gains | $231 | $1,451 |
| Gross losses | — | (737) |

The following table indicates the expected maturities of investment securities classified as available-for-sale presented at fair value, and held-to-maturity presented at amortized cost, at September 30, 2015 and the weighted average yield for each range of maturities (dollars in thousands):

| | One year or less | After 1 through 5 years | After 5 through 10 years | After ten years | Total |
|---|---|---|---|---|---|
| Available-for-sale: | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $85,648 | $41,803 | $— | $— | $127,451 |
| Obligations of state and political subdivisions | 5,669 | 44,125 | 47,278 | 429 | 97,501 |
| Mortgage-backed securities: GSE residential | 795 | 210,986 | 47,660 | — | 259,441 |
| Trust preferred securities | — | — | — | 2,125 | 2,125 |
| Other securities | — | 3,977 | — | 61 | 4,038 |
| Total available-for-sale investments | $92,112 | $300,891 | $94,938 | $2,615 | $490,556 |
| Weighted average yield | 1.74 % | 2.39 % | 2.80 % | 1.46 % | 2.32 % |
| Full tax-equivalent yield | 1.90 % | 2.73 % | 3.90 % | 1.72 % | 2.73 % |
| Held to Maturity: | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $29,647 | $14,585 | $4,873 | $— | $49,105 |
| Weighted average yield | 2.11 % | 2.11 % | 2.53 % | — % | 2.15 % |
| Full tax-equivalent yield | 2.11 % | 2.11 % | 2.53 % | — % | 2.15 % |

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent yields have been calculated using a 35% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer, the book value of which exceeded 10% of stockholders' equity at September 30, 2015.

Investment securities carried at approximately $363 million and $330 million at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

The following table presents the aging of gross unrealized losses and fair value by investment category as of September 30, 2015 and December 31, 2014 (in thousands):

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2015 | | | | | | |
| Available-for-sale: | | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $22,215 | $(31) | $28,973 | $(125) | $51,188 | $(156) |
| Obligations of states and political subdivisions | 10,444 | (145) | 1,185 | (62) | 11,629 | (207) |
| Mortgage-backed securities: GSE residential | 18,219 | (86) | 21,001 | (465) | 39,220 | (551) |
| Trust preferred securities | — | — | 2,125 | (1,042) | 2,125 | (1,042) |
| Other securities | 1,968 | (32) | — | — | 1,968 | (32) |
| Total | $52,846 | $(294) | $53,284 | $(1,694) | $106,130 | $(1,988) |
| Held-to-maturity: | | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $4,994 | $(6) | $— | $— | $4,994 | $(6) |
| December 31, 2014 | | | | | | |
| Available-for-sale: | | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $7,289 | $(46) | $75,030 | $(1,312) | $82,319 | $(1,358) |
| Obligations of states and political subdivisions | 3,586 | (19) | 4,416 | (94) | 8,002 | (113) |
| Mortgage-backed securities: GSE residential | 19,565 | (159) | 37,224 | (802) | 56,789 | (961) |
| Trust preferred securities | — | — | 364 | (2,936) | 364 | (2,936) |
| Other securities | — | — | 1,988 | (12) | 1,988 | (12) |
| Total | $30,440 | $(224) | $119,022 | $(5,156) | $149,462 | $(5,380) |
| Held-to-maturity: | | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $4,853 | $(12) | $— | $— | $4,853 | $(12) |

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At September 30, 2015, there were six available-for sale U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of $28,973,000 and unrealized losses of $125,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2014 there were sixteen available-for-sale U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of $75,030,000 and unrealized losses of $1,312,000 in a continuous unrealized loss position for twelve months or more. At September 30, 2015 and December 31, 2014 there were no held-to-maturity U.S. Treasury securities and obligations of U.S. government corporations and agencies in a continuous unrealized loss position for twelve months or more.

Obligations of states and political subdivisions. At September 30, 2015 there were two obligations of states and political subdivisions with a fair value of $1,185,000 and unrealized losses of $62,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2014, there were ten obligations of states and political subdivisions with a fair value of $4,416,000 and unrealized losses of $94,000 in a continuous unrealized loss position for twelve months or more.

Mortgage-backed Securities: GSE Residential. At September 30, 2015 there were seven mortgage-backed securities with a fair value of $21,001,000 and unrealized losses of $465,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2014, there were eleven mortgage-backed securities with a fair value of $37,224,000 and unrealized losses of $802,000 in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At September 30, 2015, there was one trust preferred security with a fair value of $2,125,000 and unrealized loss of $1,042,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2014, there was one trust preferred security with a fair value of $364,000 and unrealized loss of $2,936,000 in a continuous unrealized loss position for twelve months or more. The unrealized loss was primarily due to the long-term nature of the trust preferred security, a lack of demand or inactive market for the security, the impending change to the regulatory treatment of these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities.
The Company recorded no other-than-temporary impairment (OTTI) for these securities during 2015 or 2014. Because it is not more-likely-than-not that the Company will be required to sell the remaining security before recovery of its new, lower amortized cost basis, which may be maturity, the Company does not consider the remainder of the investment to be other-than-temporarily impaired at September 30, 2015. However, future downgrades or additional deferrals and defaults in this security, could result in additional OTTI and consequently, have a material impact on future earnings.

Following are the details for the currently impaired trust preferred security (in thousands):

| | Book Value | Market Value | Unrealized Gains (Losses) | Other-than-temporary Impairment Recorded To-date |
|---|---|---|---|---|
| PreTSL XXVIII | $3,167 | $2,125 | $(1,042) | $(1,111) |

Other securities. At September 30, 2015 and December 31, 2014, there were no corporate bonds in a continuous unrealized loss position for twelve months or more.

The Company does not believe any other individual unrealized loss as of September 30, 2015 represents OTTI. However, given the continued disruption in the financial markets, the Company may be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

Other-than-temporary Impairment. Upon acquisition of a security, the Company determines whether it is within the scope of the accounting guidance for investments in debt and equity securities or whether it must be evaluated for impairment under the accounting guidance for beneficial interests in securitized financial assets.

The Company conducts periodic reviews to evaluate its investment securities to determine whether OTTI has occurred. While all securities are considered, the securities primarily impacted by OTTI evaluation are pooled trust preferred securities. For the pooled trust preferred security currently in the investment portfolio, an extensive review is conducted to determine if any additional OTTI has occurred. The Company utilizes an independent third-party to perform the OTTI evaluation. The Company's management reviews the assumption inputs and methodology with the third-party to obtain an understanding of them and determine if they are appropriate for the evaluation. Economic models are used to project future cash flows for the security based on current assumptions for discount rate, prepayments, default and deferral rates and recoveries. These assumptions are determined based on the structure of the issuance, the specific collateral underlying the security, historical performance of trust preferred securities and general state of the economy. The OTTI test compares the present value of the cash flows from quarter to quarter to determine if there has been an adverse change which could indicate additional OTTI.

The discount rate assumption used in the cash flow model is equal to the current yield used to accrete the beneficial interest. The Company's current trust preferred security investment has a floating rate coupon of 3-month LIBOR plus 90 basis points. Since the estimate of 3-month LIBOR is based on the forward curve on the measurement date, and is therefore variable, the discount assumption for this security is a range of projected coupons over the expected life of the security.

The Company considers the likelihood that issuers will prepay their securities which changes the amount of expected cash flows. Factors such as the coupon rates of collateral, economic conditions and regulatory changes, such as the Dodd-Frank Act and Basel III, are considered.

The trust preferred security includes collateral issued by financial institutions and insurance companies. To identify bank issuers with a high risk of near term default or deferral, a credit model developed by the third-party is utilized that scores each bank issuer based on 29 different ratios covering capital adequacy, asset quality, earnings, liquidity, the Texas Ratio, and sensitivity to interest rates. To account for longer term bank default risk not captured by the credit model, it is assumed that banks will default at a rate of 2% annually for the first two years of the cash flow projection, and 36 basis points in each year thereafter. To project defaults for insurance issuers, each issuer's credit rating is mapped to its idealized default rate, which is AM Best's estimate of the historical default rate for insurance companies with that rating.

Lastly, it is assumed that trust preferred securities issued by banks that have already failed will have no recoveries, and that banks projected to default will have recoveries of 10%. Additionally, the 10% recovery assumption, incorporates the potential for cures by banks that are currently in deferral.

If the Company determines that a given pooled trust preferred security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

Credit Losses Recognized on Investments. As described above, the Company's investment in trust preferred security has experienced fair value deterioration due to credit losses but is not otherwise other-than-temporarily impaired. The following table provides information about the trust preferred security for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the nine months ended September 30, 2015 and 2014 (in thousands).

| | Accumulated Credit Losses | |
|---|---|---|
| | September 30, 2015 | September 30, 2014 |
| Credit losses on trust preferred securities held | | |
| Beginning of period | $1,111 | $1,111 |
| Additions related to OTTI losses not previously recognized | — | — |
| Reductions due to sales / (recoveries) | — | — |
| Reductions due to change in intent or likelihood of sale | — | — |
| Additions related to increases in previously recognized OTTI losses | — | — |
| Reductions due to increases in expected cash flows | — | — |
| End of period | $1,111 | $1,111 |

Note 4 – Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding net of unearned discounts, unearned income and allowance for loan losses. Unearned income includes deferred loan origination fees reduced by loan origination costs and is amortized to interest income over the life of the related loan using methods that approximated the effective interest rate method. Interest on substantially all loans is credited to income based on the principal amount outstanding. A summary of loans at September 30, 2015 and December 31, 2014 follows (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Construction and land development | $33,426 | $21,627 |
| Agricultural real estate | 120,431 | 110,158 |
| 1-4 Family residential properties | 234,273 | 179,886 |
| Multifamily residential properties | 54,961 | 53,129 |
| Commercial real estate | 378,665 | 380,173 |
| Loans secured by real estate | 821,756 | 744,973 |
| Agricultural loans | 65,520 | 68,225 |
| Commercial and industrial loans | 296,334 | 223,633 |
| Consumer loans | 44,041 | 15,118 |
| All other loans | 11,202 | 8,736 |
| Gross loans | 1,238,853 | 1,060,685 |
| Less: | | |
| Net deferred loan fees, premiums and discounts | 3,450 | 237 |
| Allowance for loan losses | 14,228 | 13,682 |
| Net loans | $1,221,175 | $1,046,766 |

Loans expected to be sold are classified as held for sale in the consolidated financial statements and are recorded at the lower of aggregate cost or market value, taking into consideration future commitments to sell the loans. These loans are primarily for 1-4 family residential properties. The balance of loans held for sale, excluded from the balances above, were $1,346,000 and $1,958,000 at September 30, 2015 and December 31, 2014, respectively.

Most of the Company's business activities are with customers located within central Illinois. At September 30, 2015, the Company's loan portfolio included $186.0 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $154.8 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased $7.5 million from $178.5 million at December 31, 2014 while loans concentrated in other grain farming decreased $0.3 million from $155.1 million at December 31, 2014 due to seasonal paydowns based upon timing of cash flow requirements. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has $60.5 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has $106.9 million of loans to lessors of non-residential buildings and $68.0 million of loans to lessors of residential buildings and dwellings.

The structure of the Company's loan approval process is based on progressively larger lending authorities granted to individual loan officers, loan committees, and ultimately the Board of Directors. Outstanding balances to one borrower or affiliated borrowers are limited by federal regulation; however, limits well below the regulatory thresholds are generally observed. The vast majority of the Company's loans are to businesses located in the geographic market areas served by the Company's branch bank system. Additionally, a significant portion of the collateral securing the loans in the portfolio is located within the Company's primary geographic footprint. In general, the Company adheres to loan underwriting standards consistent with industry guidelines for all loan segments.

The Company's lending can be summarized into the following primary areas:

Commercial Real Estate Loans. Commercial real estate loans are generally comprised of loans to small business entities to purchase or expand structures in which the business operations are housed, loans to owners of real estate who lease space to non-related commercial entities, loans for construction and land development, loans to hotel operators, and loans to owners of multi-family residential structures, such as apartment buildings. Commercial real estate loans are underwritten based on historical and projected cash flows of the borrower and secondarily on the underlying real estate pledged as collateral on the debt. For the various types of commercial real estate loans, minimum criteria have been established within the Company's loan policy regarding debt service coverage while maximum limits on loan-to-value and amortization periods have been defined. Maximum loan-to-value ratios range from 65% to 80% depending upon the type of real estate collateral, while the desired minimum debt coverage ratio is 1.20x. Amortization periods for commercial real estate loans are generally limited to twenty years. The Company's commercial real estate portfolio is well below the thresholds that would designate a concentration in commercial real estate lending, as established by the federal banking regulators.

Commercial and Industrial Loans. Commercial and industrial loans are primarily comprised of working capital loans used to purchase inventory and fund accounts receivable that are secured by business assets other than real estate. These loans are generally written for one year or less. Also, equipment financing is provided to businesses with these loans generally limited to 80% of the value of the collateral and amortization periods limited to seven years. Commercial loans are often accompanied by a personal guaranty of the principal owners of a business. Like commercial real estate loans, the underlying cash flow of the business is the primary consideration in the underwriting process. The financial condition of commercial borrowers is monitored at least annually with the type of financial information required determined by the size of the relationship. Measures employed by the Company for businesses with higher risk profiles include the use of government-assisted lending programs through the Small Business Administration and U.S. Department of Agriculture.

Agricultural and Agricultural Real Estate Loans. Agricultural loans are generally comprised of seasonal operating lines to cash grain farmers to plant and harvest corn and soybeans and term loans to fund the purchase of equipment. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop. Loan-to-value ratios on loans secured by farmland generally do not exceed 65% and have amortization periods limited to twenty five years. Federal government-assistance lending programs through the Farm Service Agency are used to mitigate the level of credit risk when deemed appropriate.

Residential Real Estate Loans. Residential real estate loans generally include loans for the purchase or refinance of residential real estate properties consisting of one-to-four units and home equity loans and lines of credit. The Company sells the vast majority of its long-term fixed rate residential real estate loans to secondary market investors. The Company also releases the servicing of these loans upon sale. The Company retains all residential real estate loans with balloon payment features. Balloon periods are limited to five years. Residential real estate loans are typically underwritten to conform to industry standards including criteria for maximum debt-to-income and loan-to-value ratios as well as minimum credit scores. Loans secured by first liens on residential real estate held in the portfolio typically do not exceed 80% of the value of the collateral and have amortization periods of twenty five years or less. The Company does not originate subprime mortgage loans.

Consumer Loans. Consumer loans are primarily comprised of loans to individuals for personal and household purposes such as the purchase of an automobile or other living expenses. Minimum underwriting criteria have been established that consider credit score, debt-to-income ratio, employment history, and collateral coverage. Typically, consumer loans are set up on monthly payments with amortization periods based on the type and age of the collateral.

Other Loans. Other loans consist primarily of loans to municipalities to support community projects such as infrastructure improvements or equipment purchases. Underwriting guidelines for these loans are consistent with those established for commercial loans with the additional repayment source of the taxing authority of the municipality.

Allowance for Loan Losses

The allowance for loan losses represents the Company's best estimate of the reserve necessary to adequately account for probable losses existing in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by the Company as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, the Company relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by the overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified, the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. The Company considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by the Company in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and troubled debt restructurings, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates. The Company estimates the appropriate level of allowance for loan losses by separately evaluating large impaired loans, large adversely classified loans and nonimpaired loans.

Impaired loans

The Company individually evaluates certain loans for impairment. In general, these loans have been internally identified via the Company's loan grading system as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns. This evaluation considers expected future cash flows, the value of collateral and also other factors that may impact the borrower's ability to make payments when due. For loans greater than $250,000 in the commercial, commercial real estate, agricultural, agricultural real estate segments, impairment is individually measured each quarter using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price, if available; or (3) the fair value of the collateral less costs to sell for collateral dependent loans and loans for which foreclosure is deemed to be probable. A specific allowance is assigned when expected cash flows or collateral do not justify the carrying amount of the loan. The carrying value of the loan reflects reductions from prior charge-offs.

Adversely classified loans

A detailed analysis is also performed on each adversely classified (substandard or doubtful rated) borrower with an aggregate, outstanding balance greater than $250,000. This analysis includes commercial, commercial real estate, agricultural, and agricultural real estate borrowers who are not currently identified as impaired but pose sufficient risk to warrant in-depth review. Estimated collateral shortfalls are then calculated with allocations for each loan segment based on the five-year historical average of collateral shortfalls adjusted for environmental factors including changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is periodically assessed and adjusted when appropriate. Consumer loans are evaluated for adverse classification based primarily on the Uniform Retail Credit Classification and Account Management Policy established by the federal banking regulators. Classification standards are generally based on delinquency status, collateral coverage, bankruptcy and the presence of fraud.

Non-classified and Watch loans

For loans, in all segments of the portfolio, that are considered to possess levels of risk commensurate with a pass rating, management establishes base loss estimations which are derived from historical loss experience. Use of a five-year historical loss period eliminates the effect of any significant losses that can be attributed to a single event or borrower during a given reporting period. The base loss estimations for each loan segment are adjusted after consideration of several environmental factors influencing the level of credit risk in the portfolio. In addition, loans rated as watch are further segregated in the commercial / commercial real estate and agricultural / agricultural real estate segments. These loans possess potential weaknesses that, if unchecked, may result in deterioration to the point of becoming a problem asset. Due to the elevated risk inherent in these loans, an allocation of twice the adjusted base loss estimation of the applicable loan segment is determined appropriate.

Due to weakened economic conditions during recent years, the Company established allocations for each of the loan segments at levels above the base loss estimations. Some of the economic factors included the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer’s ability to pay. Each of these economic uncertainties was taken into consideration in developing the level of the reserve.

The Company has not materially changed any aspect of its overall approach in the determination of the allowance for loan losses. However, on an on-going basis the Company continues to refine the methods used in determining management's best estimate of the allowance for loan losses.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method for the three and nine-months ended September 30, 2015 and 2014 and for the year ended December 31, 2014 (in thousands):

| | Commercial/ Commercial Real Estate | Agricultural/ Agricultural Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| Three months ended September 30, 2015 | | | | | | |
| Allowance for loan losses: | | | | | | |