

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
November 03, 2016

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

**FORM 10-Q**

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

**For the Quarterly Period Ended September 30, 2016**

**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: 0-13358**

(Exact name of registrant as specified in its charter)

**Florida**

**59-2273542**

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(State or other jurisdiction of incorporation or organization)

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

**217 North Monroe Street, Tallahassee, Florida**  
(Address of principal executive office)

**32301**  
(Zip Code)

**(850) 402-7000**

(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  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if smaller reporting company)

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

At October 31, 2016, 16,807,081 shares of the Registrant's Common Stock, \$.01 par value, were outstanding.

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**CAPITAL CITY BANK GROUP, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2016**

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## INTRODUCTORY NOTE

### Caution Concerning Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words “may,” “could,” “should,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” “target,” “goal,” and similar expressions are used to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements.

Our ability to achieve our financial objectives could be adversely affected by the factors discussed in detail in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Part II, Item 1A. “Risk Factors” in this Quarterly Report on Form 10-Q and the following sections of our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”): (a) “Introductory Note” in Part I, Item 1. “Business”; (b) “Risk Factors” in Part I, Item 1A, as updated in our subsequent quarterly reports filed on Form 10-Q; and (c) “Introduction” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in Part II, Item 7, as well as:

- our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- legislative or regulatory changes, including the Dodd-Frank Act, Basel III, and the ability to repay and qualified mortgage standards;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision, deferred tax asset valuation and pension plan;
- the frequency and magnitude of foreclosure of our loans;
- the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- our ability to declare and pay dividends, the payment of which is now subject to our compliance with heightened capital requirements;

- changes in the securities and real estate markets;
- changes in monetary and fiscal policies of the U.S. Government;
- inflation, interest rate, market and monetary fluctuations;
- the effects of harsh weather conditions, including hurricanes, and man-made disasters;
- our ability to comply with the extensive laws and regulations to which we are subject, including the laws for each jurisdiction where we operate;
- the willingness of clients to accept third-party products and services rather than our products and services and vice versa;
- increased competition and its effect on pricing;
- technological changes;
- negative publicity and the impact on our reputation;
- changes in consumer spending and saving habits;
- growth and profitability of our noninterest income;
- changes in accounting principles, policies, practices or guidelines;
- the limited trading activity of our common stock;
- the concentration of ownership of our common stock;
- anti-takeover provisions under federal and state law as well as our Articles of Incorporation and our Bylaws;
- other risks described from time to time in our filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

However, other factors besides those listed in *Item 1A Risk Factors* or discussed in this Form 10-Q also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

**PART I. FINANCIAL INFORMATION****Item 1.**

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

<i>(Dollars in Thousands)</i>	<b>(Unaudited) September 30, 2016</b>	<b>December 31, 2015</b>
<b>ASSETS</b>		
Cash and Due From Banks	\$ 79,608	\$ 51,288
Federal Funds Sold and Interest Bearing Deposits	144,576	327,617
Total Cash and Cash Equivalents	224,184	378,905
Investment Securities, Available for Sale, at fair value	500,139	451,028
Investment Securities, Held to Maturity, at amortized cost (fair value of \$190,829 and \$187,407)	189,928	187,892
Total Investment Securities	690,067	638,920
Loans Held For Sale	10,510	11,632
Loans, Net of Unearned Income	1,557,512	1,492,275
Allowance for Loan Losses	(13,744)	(13,953)
Loans, Net	1,543,768	1,478,322
Premises and Equipment, Net	96,499	98,819
Goodwill	84,811	84,811
Other Real Estate Owned	12,738	19,290
Other Assets	90,577	87,161
Total Assets	\$ 2,753,154	\$ 2,797,860
<b>LIABILITIES</b>		
Deposits:		
Noninterest Bearing Deposits	\$ 801,671	\$ 758,283
Interest Bearing Deposits	1,513,436	1,544,566
Total Deposits	2,315,107	2,302,849
Short-Term Borrowings	12,113	61,058
Subordinated Notes Payable	52,887	62,887
Other Long-Term Borrowings	21,368	28,265
Other Liabilities	75,055	68,449
Total Liabilities	2,476,530	2,523,508
<b>SHAREOWNERS' EQUITY</b>		
Preferred Stock, \$.01 par value; 3,000,000 shares authorized; no shares issued and outstanding	-	-
Common Stock, \$.01 par value; 90,000,000 shares authorized; 16,807,078 and 17,156,919 shares	168	172

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issued and outstanding at September 30, 2016 and December 31, 2015  
respectively

Additional Paid-In Capital	33,152	38,256
Retained Earnings	264,581	258,181
Accumulated Other Comprehensive Loss, Net of Tax	(21,277)	(22,257)
Total Shareowners' Equity	276,624	274,352
Total Liabilities and Shareowners' Equity	\$ 2,753,154	\$ 2,797,860

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*



**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
<i>(Dollars in Thousands, Except Per Share Data)</i>	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>INTEREST INCOME</b>				
Loans, including Fees	\$ 18,046	\$ 18,214	\$ 54,196	\$ 54,308
Investment Securities:				
Taxable	1,633	1,347	4,591	3,858
Tax Exempt	213	193	643	427
Federal Funds Sold and Interest Bearing Deposits	212	123	892	463
Total Interest Income	20,104	19,877	60,322	59,056
<b>INTEREST EXPENSE</b>				
Deposits	223	220	655	725
Short-Term Borrowings	43	14	91	50
Subordinated Notes Payable	341	344	1,071	1,014
Other Long-Term Borrowings	177	233	599	710
Total Interest Expense	784	811	2,416	2,499
<b>NET INTEREST INCOME</b>	19,320	19,066	57,906	56,557
Provision for Loan Losses	-	413	355	1,081
Net Interest Income After Provision For Loan Losses	19,320	18,653	57,551	55,476
<b>NONINTEREST INCOME</b>				
Deposit Fees	5,373	5,721	16,094	16,944
Bank Card Fees	2,759	2,826	8,467	8,412
Wealth Management Fees	1,774	1,818	5,256	5,640
Mortgage Banking Fees	1,503	1,306	3,800	3,496
Data Processing Fees	360	400	1,042	1,137
Other	1,242	1,157	6,244	5,241
Total Noninterest Income	13,011	13,228	40,903	40,870
<b>NONINTEREST EXPENSE</b>				
Compensation	15,993	16,653	48,285	49,581
Occupancy, net	4,734	4,446	13,777	13,100
Other Real Estate Owned, net	821	1,302	3,306	3,730
Other	6,474	6,763	20,286	20,582
Total Noninterest Expense	28,022	29,164	85,654	86,993
<b>INCOME BEFORE INCOME TAXES</b>	4,309	2,717	12,800	9,353
Income Tax Expense	1,436	1,034	4,350	2,839

<b>NET INCOME</b>	<b>\$ 2,873</b>	<b>\$ 1,683</b>	<b>\$ 8,450</b>	<b>\$ 6,514</b>
<b>BASIC NET INCOME PER SHARE</b>	<b>\$ 0.18</b>	<b>\$ 0.10</b>	<b>\$ 0.50</b>	<b>\$ 0.38</b>
<b>DILUTED NET INCOME PER SHARE</b>	<b>\$ 0.17</b>	<b>\$ 0.09</b>	<b>\$ 0.49</b>	<b>\$ 0.37</b>
Average Common Basic Shares Outstanding	16,804	17,150	17,049	17,317
Average Common Diluted Shares Outstanding	16,871	17,229	17,100	17,379

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
<i>(Dollars in Thousands)</i>	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>NET INCOME</b>	\$ 2,873	\$ 1,683	\$ 8,450	\$ 6,514
<b>Other comprehensive (loss) income, before tax:</b>				
Investment Securities:				
Change in net unrealized gain/loss on securities available for sale	(1,158)	533	1,535	1,562
Amortization of unrealized losses on securities transferred from				
available for sale to held to maturity	21	21	60	56
Total Investment Securities	(1,137)	554	1,595	1,618
<b>Other comprehensive (loss) income, before tax</b>	(1,137)	554	1,595	1,618
Deferred tax (benefit) expense related to other comprehensive				
(loss) income	(439)	214	615	624
<b>Other comprehensive (loss) income, net of tax</b>	(698)	340	980	994
<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 2,175	\$ 2,023	\$ 9,430	\$ 7,508

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY**  
**(Unaudited)**

	Shares	Common	Additional	Retained	Accumulated Other Comprehensive Loss, Net of	
	Outstanding	Stock	Paid-In Capital	Earnings	Taxes	Total
<i>(Dollars In Thousands, Except Share Data)</i>						
<b>Balance, January 1, 2015</b>	17,447,223	\$ 174	\$ 42,569	\$ 251,306	\$ (21,509)	\$ 272,540
Net Income	-	-	-	6,514	-	6,514
Other Comprehensive Income, Net of Tax	-	-	-	-	994	994
Cash Dividends (\$0.0900 per share)	-	-	-	(1,555)	-	(1,555)
Repurchase of Common Stock	(405,228)	(4)	(5,978)	-	-	(5,982)
Stock Based Compensation	-	-	783	-	-	783
Impact of Transactions Under Compensation Plans, net	102,406	1	364	-	-	365
<b>Balance, September 30, 2015</b>	17,144,401	\$ 171	\$ 37,738	\$ 256,265	\$ (20,515)	\$ 273,659
<b>Balance, January 1, 2016</b>	17,156,919	\$ 172	\$ 38,256	\$ 258,181	\$ (22,257)	\$ 274,352
Net Income	-	-	-	8,450	-	8,450
Other Comprehensive Income, Net of Tax	-	-	-	-	980	980
Cash Dividends (\$0.1200 per share)	-	-	-	(2,050)	-	(2,050)
Repurchase of Common Stock	(435,461)	(4)	(6,308)	-	-	(6,312)
Stock Based Compensation	-	-	743	-	-	743
Impact of Transactions Under Compensation Plans, net	85,620	-	461	-	-	461
<b>Balance, September 30, 2016</b>	16,807,078	\$ 168	\$ 33,152	\$ 264,581	\$ (21,277)	\$ 276,624

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

<i>(Dollars in Thousands)</i>	<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 8,450	\$ 6,514
Adjustments to Reconcile Net Income to		
Cash Provided by Operating Activities:		
Provision for Loan Losses	355	1,081
Depreciation	5,198	4,908
Amortization of Premiums, Discounts, and Fees, net	4,642	3,677
Impairment Loss on Security	-	90
Gain on Retirement of Trust Preferred Securities	(2,487)	-
Net Decrease (Increase) in Loans Held-for-Sale	1,122	(272)
Stock Compensation	743	783
Deferred Income Taxes	3,087	2,882
Loss on Sales and Write-Downs of Other Real Estate Owned	2,523	2,138
Loss on Disposal of Premises and Equipment	131	20
Net (Increase) Decrease in Other Assets	(6,610)	1,347
Net Increase in Other Liabilities	6,733	4,792
Net Cash Provided By Operating Activities	23,887	27,960
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities Held to Maturity:		
Purchases	(40,320)	(65,190)
Payments, Maturities, and Calls	37,495	33,859
Securities Available for Sale:		
Purchases	(125,975)	(167,438)
Payments, Maturities, and Calls	74,450	63,278
Net Increase in Loans	(68,775)	(51,385)
Proceeds From Sales of Other Real Estate Owned	7,338	12,122
Purchases of Premises and Equipment	(3,696)	(2,400)
Net Cash Used In Investing Activities	(119,483)	(177,154)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Increase (Decrease) in Deposits	12,258	(31,811)
Net (Decrease) Increase in Short-Term Borrowings	(50,023)	15,930
Redemption of Subordinated Notes	(7,500)	-
Repayment of Other Long-Term Borrowings	(5,819)	(2,055)
Dividends Paid	(2,050)	(1,555)
Payments to Repurchase Common Stock	(6,312)	(5,982)
Issuance of Common Stock Under Compensation Plans	321	315
Net Cash Used In Financing Activities	(59,125)	(25,158)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(154,721)	(174,352)
Cash and Cash Equivalents at Beginning of Period	378,905	385,056

Cash and Cash Equivalents at End of Period	\$	224,184	\$	210,704
<b>Supplemental Cash Flow Disclosures:</b>				
Interest Paid	\$	2,422	\$	2,511
Income Taxes (Refunded) Paid	\$	(355)	\$	1,593
<b>Noncash Investing and Financing Activities:</b>				
Loans and Premises Transferred to Other Real Estate Owned	\$	3,309	\$	4,073
Transfer of Current Portion of Long-Term Borrowings	\$	1,078	\$	-

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Operations.* Capital City Bank Group, Inc. (“CCBG” or the “Company”) provides a full range of banking and banking-related services to individual and corporate clients through its subsidiary, Capital City Bank, with banking offices located in Florida, Georgia, and Alabama. The Company is subject to competition from other financial institutions, is subject to regulation by certain government agencies and undergoes periodic examinations by those regulatory authorities.

*Basis of Presentation.* The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of CCBG and its wholly-owned subsidiary, Capital City Bank (“CCB” or the “Bank” and together with the Company). All material inter-company transactions and accounts have been eliminated. Certain previously reported amounts have been reclassified to conform to the current year’s presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The consolidated statement of financial condition at December 31, 2015 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2015.

**NOTE 2 – INVESTMENT SECURITIES**

*Investment Portfolio Composition.* The amortized cost and related market value of investment securities available-for-sale and held-to-maturity were as follows:

<b>September 30, 2016</b>				<b>December 31, 2015</b>			
Amortized	Unrealized	Unrealized	Market	Amortized	Unrealized	Unrealized	Market
Cost	Gains	Losses	Value	Cost	Gain	Losses	Value

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**Available for Sale**

U.S. Government Treasury	\$272,656	\$ 1,029	\$ -	\$273,685	\$250,458	\$ 101	\$ 213	\$250,346
U.S. Government Agency	129,150	569	203	129,516	101,730	357	263	101,824
States and Political Subdivisions	86,490	189	45	86,634	88,358	103	99	88,362
Mortgage-Backed Securities	1,340	142	-	1,482	1,742	159	-	1,901
Equity Securities <sup>(1)</sup>	8,822	-	-	8,822	8,595	-	-	8,595
Total	\$498,458	\$ 1,929	\$ 248	\$500,139	\$450,883	\$ 720	\$ 575	\$451,028

**Held to Maturity**

U.S. Government Treasury	\$129,323	\$ 530	\$ -	\$129,853	\$134,554	\$ 45	\$ 160	\$134,439
U.S. Government Agency	1,904	1	-	1,905	10,043	7	5	10,045
States and Political Subdivisions	9,983	69	1	10,051	15,693	38	7	15,724
Mortgage-Backed Securities	48,718	366	64	49,020	27,602	4	407	27,199
Total	\$189,928	\$ 966	\$ 65	\$190,829	\$187,892	\$ 94	\$ 579	\$187,407

Total Investment Securities \$688,386 \$ 2,895 \$ 313 \$690,968 \$638,775 \$ 814 \$ 1,154 \$638,435

<sup>(1)</sup> Includes Federal Home Loan Bank, Federal Reserve Bank, and FNBB, Inc. stock recorded at cost of \$3.5 million, \$4.8 million, and \$0.5 million, respectively, at September 30, 2016 and \$3.6 million, \$4.8 million, and \$0.2 million, respectively, at December 31, 2015.

Securities with an amortized cost of \$222.9 million and \$370.1 million at September 30, 2016 and December 31, 2015, respectively, were pledged to secure public deposits and for other purposes.



The Bank, as a member of the Federal Home Loan Bank of Atlanta (“FHLB”), is required to own capital stock in the FHLB based generally upon the balances of residential and commercial real estate loans, and FHLB advances. FHLB stock which is included in equity securities is pledged to secure FHLB advances. No ready market exists for this stock, and it has no quoted market value; however, redemption of this stock has historically been at par value.

*Maturity Distribution.* As of September 30, 2016, the Company's investment securities had the following maturity distribution based on contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations. Mortgage-backed securities and certain amortizing U.S. government agency securities are shown separately because they are not due at a certain maturity date.

	Available for Sale		Held to Maturity	
	Amortized Cost	Market Value	Amortized Cost	Market Value
<i>(Dollars in Thousands)</i>				
Due in one year or less	\$ 146,612	\$ 146,872	\$ 60,424	\$ 60,503
Due after one through five years	252,653	253,644	80,786	81,305
Mortgage-Backed Securities	1,340	1,482	48,718	49,021
U.S. Government Agency	89,031	89,319	-	-
Equity Securities	8,822	8,822	-	-
Total	\$ 498,458	\$ 500,139	\$ 189,928	\$ 190,829

*Unrealized Losses on Investment Securities.* The following table summarizes the investment securities with unrealized losses aggregated by major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
<i>(Dollars in Thousands)</i>						
<b>September 30, 2016</b>						
<b>Available for Sale</b>						
U.S. Government Agency	\$ 36,793	\$ 153	\$ 10,123	\$ 50	\$ 46,916	\$ 203
States and Political Subdivisions	28,831	44	298	1	29,129	45
Total	65,624	197	10,421	51	76,045	248
<b>Held to Maturity</b>						
States and Political Subdivisions	1,252	1	-	-	1,252	1
Mortgage-Backed Securities	2,095	5	7,120	59	9,215	64
Total	\$ 3,347	\$ 6	\$ 7,120	\$ 59	\$ 10,467	\$ 65
<b>December 31, 2015</b>						
<b>Available for Sale</b>						
U.S. Government Treasury	\$ 150,061	\$ 213	\$ -	\$ -	\$ 150,061	\$ 213
U.S. Government Agency	43,508	200	9,644	63	53,152	263

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States and Political Subdivisions	39,608	86	5,066	13	44,674	99
Total	233,177	499	14,710	76	247,887	575

**Held to Maturity**

U.S. Government Treasury	92,339	160	-	-	92,339	160
U.S. Government Agency	5,006	5	-	-	5,006	5
States and Political Subdivisions	3,791	7	-	-	3,791	7
Mortgage-Backed Securities	13,267	185	11,889	222	22,156	407
Total	\$ 114,403	\$ 357	\$ 11,889	\$ 222	\$ 126,292	\$ 579

Management evaluates securities for other than temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, the Company considers, (i) whether it has decided to sell the security, (ii) whether it is more likely than not that the Company will have to sell the security before its market value recovers, and (iii) whether the present value of expected cash flows is sufficient to recover the entire amortized cost basis. When assessing a security's expected cash flows, the Company considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost and (ii) the financial condition and near-term prospects of the issuer. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by rating agencies have occurred, regulatory issues, and analysts' reports.

At September 30, 2016, there were 165 positions (combined Available-for-Sale and Held-to-Maturity) with an unrealized loss totaling \$0.3 million. Of the 165 positions, 69 were Ginnie Mae mortgage-backed securities (GNMA), U.S. Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the U.S. Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. Of these 69 positions, there were 20 GNMA positions and 24 SBA positions in an unrealized loss position for longer than 12 months. Six agency positions were in an unrealized loss position. There were 90 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-" or better. These debt securities are in a loss position because they were acquired when the general level of interest rates was lower than that on September 30, 2016. The Company believes that the unrealized losses in these debt securities are temporary in nature and that the full principal will be collected as anticipated. Because the declines in the market value of these investments are attributable to changes in interest rates and not credit quality and because the Company has the present ability and intent to hold these investments until there is a recovery in fair value, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2016.

### NOTE 3 – LOANS, NET

*Loan Portfolio Composition.* The composition of the loan portfolio was as follows:

<i>(Dollars in Thousands)</i>	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Commercial, Financial and Agricultural	\$ 223,278	\$ 179,816
Real Estate – Construction	54,107	46,484
Real Estate – Commercial Mortgage	497,775	499,813
Real Estate – Residential <sup>(1)</sup>	287,068	290,585
Real Estate – Home Equity	235,433	233,901
Consumer	259,851	241,676
Loans, Net of Unearned Income	\$ 1,557,512	\$ 1,492,275

<sup>(1)</sup> *Includes loans in process with outstanding balances of \$11.8 million and \$8.5 million at September 30, 2016 and December 31, 2015, respectively.*

Net deferred costs included in loans were \$0.4 million at September 30, 2016 and net deferred fees included in loans were \$0.5 million at December 31, 2015.

The Company has pledged a blanket floating lien on all 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity loans to support available borrowing capacity at the FHLB of Atlanta and has pledged a blanket floating lien on all consumer loans, commercial loans, and construction loans to support available borrowing capacity at the Federal Reserve Bank of Atlanta.

*Nonaccrual Loans.* Loans are generally placed on nonaccrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be doubtful. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current or when future payments are reasonably assured.

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days and still on accrual by class of loans.

<i>(Dollars in Thousands)</i>	September 30, 2016		December 31, 2015	
	Nonaccrual	90 + Days	Nonaccrual	90 + Days
Commercial, Financial and Agricultural	\$ 362	\$ -	\$ 96	\$ -
Real Estate – Construction	121	-	97	-
Real Estate – Commercial Mortgage	4,736	-	4,191	-
Real Estate – Residential	2,254	-	4,739	-
Real Estate – Home Equity	958	-	1,017	-
Consumer	183	-	165	-
Total Nonaccrual Loans	\$ 8,614	\$ -	\$ 10,305	\$ -

*Loan Portfolio Aging.* A loan is defined as a past due loan when one full payment is past due or a contractual maturity is over 30 days past due (“DPD”).

The following table presents the aging of the recorded investment in past due loans by class of loans.

<i>(Dollars in Thousands)</i>	30-59 DPD	60-89 DPD	90 + DPD	Total Past Due	Total Current	Total Loans
<b>September 30, 2016</b>						
Commercial, Financial and Agricultural	\$ 59	\$ 307	\$ -	\$ 366	\$ 222,550	\$ 223,278
Real Estate – Construction	-	-	-	-	53,986	54,107
Real Estate – Commercial Mortgage	1,581	148	-	1,729	491,310	497,775
Real Estate – Residential	472	448	-	920	283,894	287,068
Real Estate – Home Equity	446	697	-	1,143	233,332	235,433
Consumer	1,231	278	-	1,509	258,159	259,851
Total Past Due Loans	\$ 3,789	\$ 1,878	\$ -	\$ 5,667	\$ 1,543,231	\$ 1,557,512
<b>December 31, 2015</b>						
Commercial, Financial and Agricultural	\$ 153	\$ 18	\$ -	\$ 171	\$ 179,549	\$ 179,816
Real Estate – Construction	690	-	-	690	45,697	46,484
Real Estate – Commercial Mortgage	754	1,229	-	1,983	493,639	499,813
Real Estate – Residential	567	347	-	914	284,932	290,585
Real Estate – Home Equity	787	97	-	884	232,000	233,901

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Consumer	735	398	-	1,133	240,378	241,676
Total Past Due Loans	\$ 3,686	\$ 2,089	\$ -	\$ 5,775	\$ 1,476,195	\$ 1,492,275

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*Allowance for Loan Losses.* The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of incurred losses within the existing portfolio of loans. Loans are charged-off to the allowance when losses are deemed to be probable and reasonably quantifiable.

The following table details the activity in the allowance for loan losses by portfolio class. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial,		Real Estate		Real Estate	Real Estate	Consumer	Total
	Financial,	Real Estate	Commercial	Real Estate				
(Dollars in Thousands)	Agriculture	Construction	Mortgage	Residential	Home Equity			
<b>Three Months Ended</b>								
<b>September 30, 2016</b>								
Beginning Balance	\$ 1,048	\$ 126	\$ 4,389	\$ 3,835	\$ 2,391	\$ 1,888	\$ 13,677	
Provision for Loan Losses	163	(3)	224	(324)	(307)	247	-	
Charge-Offs	(143)	-	(5)	(96)	(51)	(479)	(774)	
Recoveries	199	-	45	139	237	221	841	
Net Charge-Offs	56	-	40	43	186	(258)	67	
Ending Balance	\$ 1,267	\$ 123	\$ 4,653	\$ 3,554	\$ 2,270	\$ 1,877	\$ 13,744	
<b>Nine Months Ended</b>								
<b>September 30, 2016</b>								
Beginning Balance	\$ 905	\$ 101	\$ 4,498	\$ 4,409	\$ 2,473	\$ 1,567	\$ 13,953	
Provision for Loan Losses	559	22	71	(1,030)	(168)	901	355	
Charge-Offs	(484)	-	(279)	(779)	(412)	(1,356)	(3,310)	
Recoveries	287	-	363	954	377	765	2,746	
Net Charge-Offs	(197)	-	84	175	(35)	(591)	(564)	
Ending Balance	\$ 1,267	\$ 123	\$ 4,653	\$ 3,554	\$ 2,270	\$ 1,877	\$ 13,744	
<b>Three Months Ended</b>								
<b>September 30, 2015</b>								
Beginning Balance	\$ 917	\$ 360	\$ 4,275	\$ 5,654	\$ 2,536	\$ 1,494	\$ 15,236	
Provision for Loan Losses	183	(64)	333	(545)	273	233	413	
Charge-Offs	(365)	-	26	(476)	(370)	(318)	(1,503)	
Recoveries	45	-	86	193	42	225	591	
Net Charge-Offs	(320)	-	112	(283)	(328)	(93)	(912)	
Ending Balance	\$ 780	\$ 296	\$ 4,720	\$ 4,826	\$ 2,481	\$ 1,634	\$ 14,737	
<b>Nine Months Ended</b>								
<b>September 30, 2015</b>								
Beginning Balance	\$ 784	\$ 843	\$ 5,287	\$ 6,520	\$ 2,882	\$ 1,223	\$ 17,539	
Provision for Loan Losses	708	(547)	426	(870)	506	858	1,081	
Charge-Offs	(894)	-	(1,163)	(1,265)	(1,006)	(1,245)	(5,573)	
Recoveries	182	-	170	441	99	798	1,690	

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Net Charge-Offs	(712)	-	(993)	(824)	(907)	(447)	(3,883)
Ending Balance	\$ 780	\$ 296	\$ 4,720	\$ 4,826	\$ 2,481	\$ 1,634	\$ 14,737



The following table details the amount of the allowance for loan losses by portfolio class disaggregated on the basis of the Company's impairment methodology.

	Commercial, Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Total
<i>(Dollars in Thousands)</i>							
<b>September 30, 2016</b>							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 132	\$ -	\$ 2,124	\$ 1,669	\$ 276	\$ 7	\$ 4,208
Loans Collectively							
Evaluated for Impairment	1,135	123	2,529	1,885	1,994	1,870	9,536
Ending Balance	\$ 1,267	\$ 123	\$ 4,653	\$ 3,554	\$ 2,270	\$ 1,877	\$ 13,744
<b>December 31, 2015</b>							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 77	\$ -	\$ 2,049	\$ 2,118	\$ 384	\$ 18	\$ 4,646
Loans Collectively							
Evaluated for Impairment	828	101	2,449	2,291	2,089	1,549	9,307
Ending Balance	\$ 905	\$ 101	\$ 4,498	\$ 4,409	\$ 2,473	\$ 1,567	\$ 13,953
<b>September 30, 2015</b>							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 81	\$ -	\$ 2,001	\$ 2,004	\$ 365	\$ 4	\$ 4,455
Loans Collectively							
Evaluated for Impairment	699	296	2,719	2,822	2,116	1,630	10,282
Ending Balance	\$ 780	\$ 296	\$ 4,720	\$ 4,826	\$ 2,481	\$ 1,634	\$ 14,737

The Company's recorded investment in loans related to each balance in the allowance for loan losses by portfolio class and disaggregated on the basis of the Company's impairment methodology was as follows:

<i>(Dollars in Thousands)</i>	<b>Commercial, Financial,</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Total</b>
	<b>Agricultural</b>	<b>Construction</b>	<b>Commercial Mortgage</b>	<b>Real Estate Residential</b>	<b>Real Estate Home Equity</b>	<b>Consumer</b>	
<b>September 30, 2016</b>							
Individually Evaluated for Impairment	\$ 949	\$ -	\$ 20,794	\$ 16,457	\$ 2,776	\$ 186	\$ 41,162
Collectively Evaluated for Impairment	222,329	54,107	476,981	270,611	232,657	259,665	1,516,350
<b>Total</b>	<b>\$ 223,278</b>	<b>\$ 54,107</b>	<b>\$ 497,775</b>	<b>\$ 287,068</b>	<b>\$ 235,433</b>	<b>\$ 259,851</b>	<b>\$1,557,512</b>
<b>December 31, 2015</b>							
Individually Evaluated for Impairment	\$ 834	\$ 97	\$ 20,847	\$ 18,569	\$ 3,144	\$ 261	\$ 43,752
Collectively Evaluated for Impairment	178,982	46,387	478,966	272,016	230,757	241,415	1,448,523
<b>Total</b>	<b>\$ 179,816</b>	<b>\$ 46,484</b>	<b>\$ 499,813</b>	<b>\$ 290,585</b>	<b>\$ 233,901</b>	<b>\$ 241,676</b>	<b>\$1,492,275</b>
<b>September 30, 2015</b>							
Individually Evaluated for Impairment	\$ 813	\$ 468	\$ 24,170	\$ 18,079	\$ 2,702	\$ 161	\$ 46,393
Collectively Evaluated for Impairment	168,775	49,007	467,564	272,705	229,552	241,187	1,428,790
<b>Total</b>	<b>\$ 169,588</b>	<b>\$ 49,475</b>	<b>\$ 491,734</b>	<b>\$ 290,784</b>	<b>\$ 232,254</b>	<b>\$ 241,348</b>	<b>\$1,475,183</b>

*Impaired Loans.* Loans are deemed to be impaired when, based on current information and events, it is probable that the Company will not be able to collect all amounts due (principal and interest payments), according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

The following table presents loans individually evaluated for impairment by class of loans.

<i>(Dollars in Thousands)</i>	<b>Unpaid Principal Balance</b>	<b>Recorded Investment With No Allowance</b>	<b>Recorded Investment With Allowance</b>	<b>Related Allowance</b>
<b>September 30, 2016</b>				
Commercial, Financial and Agricultural	\$ 949	\$ 217	\$ 732	\$ 132
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	20,794	4,452	16,342	2,124
Real Estate – Residential	16,457	1,863	14,594	1,669
Real Estate – Home Equity	2,776	1,314	1,462	276
Consumer	186	54	132	7
Total	\$ 41,162	\$ 7,900	\$ 33,262	\$ 4,208
<b>December 31, 2015</b>				
Commercial, Financial and Agricultural	\$ 834	\$ 279	\$ 555	\$ 77
Real Estate – Construction	97	97	-	-
Real Estate – Commercial Mortgage	20,847	3,265	17,582	2,049
Real Estate – Residential	18,569	2,941	15,628	2,118
Real Estate – Home Equity	3,144	1,101	2,043	384
Consumer	261	79	182	18
Total	\$ 43,752	\$ 7,762	\$ 35,990	\$ 4,646

The following table summarizes the average recorded investment and interest income recognized by class of impaired loans.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
	Average Recorded	Total Interest	Average Recorded	Total Interest	Average Recorded	Total Interest	Average Recorded	Total Interest
(Dollars in Thousands)	Investment	Income	Investment	Income	Investment	Income	Investment	Income
Commercial, Financial and Agricultural	\$ 871	\$ 12	\$ 942	\$ 12	\$ 847	\$ 37	\$ 1,044	\$ 34
Real Estate – Construction	-	-	389	-	24	-	395	-
Real Estate – Commercial Mortgage	20,692	203	26,959	250	20,757	658	29,343	821
Real Estate – Residential	17,091	197	18,499	215	17,743	602	19,239	626
Real Estate – Home Equity	2,824	29	2,831	20	3,001	84	2,965	64
Consumer	196	2	166	2	215	7	186	6
Total	\$ 41,674	\$ 443	\$ 49,786	\$ 499	\$ 42,587	\$ 1,388	\$ 53,172	\$ 1,551

*Credit Risk Management.* The Company has adopted comprehensive lending policies, underwriting standards and loan review procedures designed to maximize loan income within an acceptable level of risk. Management and the Board of Directors review and approve these policies and procedures on a regular basis (at least annually).

Reporting systems are used to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans. Management and the Credit Risk Oversight Committee periodically review our lines of business to monitor asset quality trends and the appropriateness of credit policies. In addition, total borrower exposure limits are established and concentration risk is monitored. As part of this process, the overall composition of the portfolio is reviewed to gauge diversification of risk, client concentrations, industry group, loan type, geographic area, or other relevant classifications of loans. Specific segments of the loan portfolio are monitored and reported to the Board on a quarterly basis and have strategic plans in place to supplement Board approved credit policies governing exposure limits and underwriting standards. Detailed below are the types of loans within the Company's loan portfolio and risk characteristics unique to each.

Commercial, Financial, and Agricultural – Loans in this category are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral and personal or other guarantees. Lending policy establishes debt service coverage ratio limits that require a borrower's cash flow to be sufficient to cover principal and interest payments on all new and existing debt. The majority of these loans are secured by the assets being financed or other business assets such as accounts receivable, inventory, or equipment. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy guidelines.

Real Estate Construction – Loans in this category consist of short-term construction loans, revolving and non-revolving credit lines and construction/permanent loans made to individuals and investors to finance the acquisition, development, construction or rehabilitation of real property. These loans are primarily made based on identified cash flows of the borrower or project and generally secured by the property being financed, including 1-4 family residential properties and commercial properties that are either owner-occupied or investment in nature. These properties may include either vacant or improved property. Construction loans are generally based upon estimates of costs and value associated with the completed project. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy guidelines. The disbursement of funds for construction loans is made in relation to the progress of the project and as such these loans are closely monitored by on-site inspections.

Real Estate Commercial Mortgage – Loans in this category consists of commercial mortgage loans secured by property that is either owner-occupied or investment in nature. These loans are primarily made based on identified cash flows of the borrower or project with consideration given to underlying real estate collateral and personal guarantees. Lending policy establishes debt service coverage ratios and loan to value ratios specific to the property type. Collateral values are determined based upon third party appraisals and evaluations.

Real Estate Residential – Residential mortgage loans held in the Company’s loan portfolio are made to borrowers that demonstrate the ability to make scheduled payments with full consideration to underwriting factors such as current income, employment status, current assets, and other financial resources, credit history, and the value of the collateral. Collateral consists of mortgage liens on 1-4 family residential properties. Collateral values are determined based upon third party appraisals and evaluations. The Company does not originate sub-prime loans.

Real Estate Home Equity – Home equity loans and lines are made to qualified individuals for legitimate purposes generally secured by senior or junior mortgage liens on owner-occupied 1-4 family homes or vacation homes. Borrower qualifications include favorable credit history combined with supportive income and debt ratio requirements and combined loan to value ratios within established policy guidelines. Collateral values are determined based upon third party appraisals and evaluations.

Consumer Loans – This loan portfolio includes personal installment loans, direct and indirect automobile financing, and overdraft lines of credit. The majority of the consumer loan portfolio consists of indirect and direct automobile loans. Lending policy establishes maximum debt to income ratios, minimum credit scores, and includes guidelines for verification of applicants' income and receipt of credit reports.

*Credit Quality Indicators.* As part of the ongoing monitoring of the Company's loan portfolio quality, management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment performance, credit documentation, and current economic/market trends, among other factors. Risk ratings are assigned to each loan and revised as needed through established monitoring procedures for individual loan relationships over a predetermined amount and review of smaller balance homogenous loan pools. The Company uses the definitions noted below for categorizing and managing its criticized loans. Loans categorized as "Pass" do not meet the criteria set forth for the Special Mention, Substandard, or Doubtful categories and are not considered criticized.

Special Mention – Loans in this category are presently protected from loss, but weaknesses are apparent which, if not corrected, could cause future problems. Loans in this category may not meet required underwriting criteria and have no mitigating factors. More than the ordinary amount of attention is warranted for these loans.

Substandard – Loans in this category exhibit well-defined weaknesses that would typically bring normal repayment into jeopardy. These loans are no longer adequately protected due to well-defined weaknesses that affect the repayment capacity of the borrower. The possibility of loss is much more evident and above average supervision is required for these loans.

Doubtful – Loans in this category have all the weaknesses inherent in a loan categorized as Substandard, with the characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following table presents the risk category of loans by segment.

<i>(Dollars in Thousands)</i>	<b>Commercial, Financial, Agriculture</b>	<b>Real Estate</b>	<b>Consumer</b>	<b>Total Criticized Loans</b>
<b>September 30, 2016</b>				
Special Mention	\$ 4,185	\$ 24,893	\$ 196	\$ 29,274
Substandard	1,607	41,080	541	43,228
Doubtful	-	-	-	-
Total Criticized Loans	\$ 5,792	\$ 65,973	\$ 737	\$ 72,502
<b>December 31, 2015</b>				
Special Mention	\$ 5,938	\$ 27,838	\$ 69	\$ 33,845
Substandard	1,307	51,425	819	53,551
Doubtful	-	-	-	-
Total Criticized Loans	\$ 7,245	\$ 79,263	\$ 888	\$ 87,396

*Troubled Debt Restructurings ("TDRs").* TDRs are loans in which the borrower is experiencing financial difficulty and the Company has granted an economic concession to the borrower that it would not otherwise consider. In these instances, as part of a work-out alternative, the Company will make concessions including the extension of the loan term, a principal moratorium, a reduction in the interest rate, or a combination thereof. The impact of the TDR modifications and defaults are factored into the allowance for loan losses on a loan-by-loan basis as all TDRs are, by definition, impaired loans. Thus, specific reserves are established based upon the results of either a discounted cash flow analysis or the underlying collateral value, if the loan is deemed to be collateral dependent. In the limited circumstances that a loan is removed from TDR classification it is the Company's policy to also remove it from the impaired loan category, but to continue to individually evaluate loan impairment based on the contractual terms specified by the loan agreement.

The following table presents loans classified as TDRs.

<i>(Dollars in Thousands)</i>	<b>September 30, 2016</b>		<b>December 31, 2015</b>	
	<b>Accruing</b>	<b>Nonaccruing</b>	<b>Accruing</b>	<b>Nonaccruing</b>
Commercial, Financial and Agricultural	\$ 792	\$ 42	\$ 897	\$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	16,259	1,253	16,621	1,070
Real Estate – Residential	15,140	507	14,979	1,582
Real Estate – Home Equity	2,672	-	2,914	-
Consumer	183	-	223	35
<b>Total TDRs</b>	<b>\$ 35,046</b>	<b>\$ 1,802</b>	<b>\$ 35,634</b>	<b>\$ 2,687</b>

Loans classified as TDRs during the periods indicated are presented in the table below. The modifications made during the reporting period involved either an extension of the loan term, an interest rate adjustment, or a principal moratorium, and the financial impact of these modifications was not material.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30, 2016</b>			<b>Nine Months Ended September 30, 2016</b>		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	-	\$ -	\$ -	-	\$ -	\$ -
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	1	332	332
Real Estate – Residential	-	-	-	6	589	590
Real Estate – Home Equity	1	17	17	5	205	206
Consumer	-	-	-	-	-	-
<b>Total TDRs</b>	<b>1</b>	<b>\$ 17</b>	<b>\$ 17</b>	<b>12</b>	<b>\$ 1,126</b>	<b>\$ 1,128</b>

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30, 2015</b>			<b>Nine Months Ended September 30, 2015</b>		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	-	\$ -	\$ -	-	\$ -	\$ -
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	2	515	515
Real Estate – Residential	1	49	49	6	717	690
Real Estate – Home Equity	1	50	50	1	50	49
Consumer	-	-	-	-	-	-



Total TDRs	2	\$	99	\$	99	9	\$	1,282	\$	1,254
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For the three and nine months ended September 30, 2016, loans modified as TDRs within the previous 12 months that have subsequently defaulted during the periods indicated are presented in the table below. For the three and nine months ended September 30, 2015, there were no loans modified as TDRs within the previous 12 months that have subsequently defaulted.

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2016</b>	
	Number of Contracts	Post-Modified Recorded Investment <sup>(1)</sup>	Number of Contracts	Post-Modified Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Commercial, Financial and Agricultural	-	\$ -	-	\$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	-
Real Estate – Residential	-	-	1	98
Real Estate – Home Equity	-	-	1	3
Consumer	-	-	1	35
Total TDRs	-	\$ -	3	\$ 136

<sup>(1)</sup> Recorded investment reflects charge-offs and additional funds advanced at time of restructure, if applicable.

The following table provides information on how TDRs were modified during the periods indicated.

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2016</b>	
	Number of Contracts	Recorded Investment <sup>(1)</sup>	Number of Contracts	Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Extended amortization	1	\$ 17	2	\$ 107
Interest rate adjustment	-	-	-	-
Extended amortization and interest rate adjustment	-	-	10	1,021
Total TDRs	1	\$ 17	12	\$ 1,128

	<b>Three Months Ended September 30, 2015</b>		<b>Nine Months Ended September 30, 2015</b>	
	Number of Contracts	Recorded Investment <sup>(1)</sup>	Number of Contracts	Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Extended amortization	1	\$ 49	2	\$ 167
Interest rate adjustment	-	-	1	156
Extended amortization and interest rate adjustment	1	50	6	931

Total TDRs	2	\$	99	9	\$	1,254
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(1) Recorded investment reflects charge-offs and additional funds advanced at time of restructure, if applicable.

#### NOTE 4 – OTHER REAL ESTATE OWNED

The following table presents other real estate owned activity for the periods indicated.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Beginning Balance	\$ 14,622	\$ 30,167	\$ 19,290	\$ 35,680
Additions	890	1,242	3,309	4,072
Valuation Write-downs	(397)	(269)	(1,910)	(1,575)
Sales	(2,377)	(5,921)	(7,951)	(12,684)
Other	-	-	-	(274)
Ending Balance	\$ 12,738	\$ 25,219	\$ 12,738	\$ 25,219

Net expenses applicable to other real estate owned include the following:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Gains from the Sale of Properties	\$ (70)	\$ (31)	\$ (364)	\$ (686)
Losses from the Sale of Properties	216	591	977	1,249
Rental Income from Properties	(34)	(13)	(66)	(244)
Property Carrying Costs	312	486	849	1,836
Valuation Adjustments	397	269	1,910	1,575
Total	\$ 821	\$ 1,302	\$ 3,306	\$ 3,730

As of September 30, 2016 the Company had \$1.6 million of loans secured by residential real estate in the process of foreclosure.

#### **NOTE 5 - EMPLOYEE BENEFIT PLANS**

The Company has a defined benefit pension plan covering substantially all full-time and eligible part-time associates and a Supplemental Executive Retirement Plan (“SERP”) covering its executive officers.

The components of the net periodic benefit cost for the Company's qualified benefit pension plan were as follows:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Service Cost	\$ 1,613	\$ 1,715	\$ 4,839	\$ 5,145
Interest Cost	1,397	1,438	4,191	4,313
Expected Return on Plan Assets	(1,934)	(1,955)	(5,802)	(5,865)
Prior Service Cost Amortization	69	77	207	232
Net Loss Amortization	801	891	2,403	2,673
Net Periodic Benefit Cost	\$ 1,946	\$ 2,166	\$ 5,838	\$ 6,498
Discount Rate	4.52%	4.15%	4.52%	4.15%
Long-term Rate of Return on Assets	7.50%	7.50%	7.50%	7.50%

The components of the net periodic benefit cost for the Company's SERP were as follows:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Interest Cost	\$ 40	\$ 34	\$ 120	\$ 101

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Prior Service Cost Amortization	-	2	-	5
Net Loss Amortization	190	44	570	134
Net Periodic Benefit Cost	\$ 230	\$ 80	\$ 690	\$ 240
Discount Rate	4.13%	4.15%	4.13%	4.15%

Effective December 31, 2015, the Company changed the method used to estimate the service and interest components of net periodic benefit cost for the defined benefit and supplemental executive retirement plans. This new estimation approach discounts the individual expected cash flows underlying the service cost and interest cost using the applicable spot rates derived from the yield curve used to discount the cash flows for the benefit obligations. Historically, the estimated service and interest cost components utilized a single weighted-average discount rate derived from the yield curve used to measure the benefit obligations at the beginning of the period. The Company elected this change to provide a more precise measurement of service and interest costs by improving the correlation between projected benefit cash flows to the corresponding spot yield curve rates. The change was accounted for as a change in accounting estimate that is inseparable from a change in accounting principle and was accounted for prospectively. While the benefit obligations for the plans measured under this approach was unchanged, the more granular application of the spot rates decreased the combined service and interest costs for the defined benefit retirement plan for fiscal 2016 by \$0.7 million and the supplemental executive retirement plans by \$34,000.

**NOTE 6 - COMMITMENTS AND CONTINGENCIES**

*Lending Commitments.* The Company is a party to financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of its clients. These financial instruments consist of commitments to extend credit and standby letters of credit.

The Company's maximum exposure to credit loss under standby letters of credit and commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in establishing commitments and issuing letters of credit as it does for on-balance sheet instruments. The amounts associated with the Company's off-balance sheet obligations were as follows:

<i>(Dollars in Thousands)</i>	<b>September 30, 2016</b>			<b>December 31, 2015</b>		
	<b>Fixed</b>	<b>Variable</b>	<b>Total</b>	<b>Fixed</b>	<b>Variable</b>	<b>Total</b>
Commitments to Extend Credit <sup>(1)</sup>	\$ 62,889	\$ 342,179	\$ 405,068	\$ 57,571	\$ 306,642	\$ 364,213
Standby Letters of Credit	5,529	-	5,529	6,095	-	6,095
Total	\$ 68,418	\$ 342,179	\$ 410,597	\$ 63,666	\$ 306,642	\$ 370,308

<sup>(1)</sup> *Commitments include unfunded loans, revolving lines of credit, and other unused commitments.*

Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities. In general, management does not anticipate any material losses as a result of participating in these types of transactions. However, any potential losses arising from such transactions are reserved for in the same manner as management reserves for its other credit facilities.

For both on- and off-balance sheet financial instruments, the Company requires collateral to support such instruments when it is deemed necessary. The Company evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies, but may include deposits held in financial institutions; U.S. Treasury securities; other marketable securities; real estate; accounts receivable; property, plant and equipment; and inventory.

*Contingencies.* The Company is a party to lawsuits and claims arising out of the normal course of business. In management's opinion, there are no known pending claims or litigation, the outcome of which would, individually or in the aggregate, have a material effect on the consolidated results of operations, financial position, or cash flows of the Company.

*Indemnification Obligation.* The Company is a member of the Visa U.S.A. network. Visa U.S.A member banks are required to indemnify it for potential future settlement of certain litigation (the "Covered Litigation") that relates to several antitrust lawsuits challenging the practices of Visa and MasterCard International. In 2008, the Company, as a member of the Visa U.S.A. network, obtained Class B shares of Visa, Inc. upon its initial public offering. Since its initial public offering, Visa, Inc. has funded a litigation reserve for the Covered Litigation resulting in a reduction in the Class B shares held by the Company. During the first quarter of 2011, the Company sold its remaining Class B shares resulting in a \$3.2 million pre-tax gain. Associated with this sale, the Company entered into a swap contract with the purchaser of the shares that requires a payment to the counterparty in the event that Visa, Inc. makes subsequent revisions to the conversion ratio for its Class B shares. Fixed charges included in the swap liability are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly fixed payments approximate \$72,000. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

## NOTE 7 – FAIR VALUE MEASUREMENTS

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from, or corroborated, by market data by correlation or other means.
- *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

*Securities Available for Sale.* U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, credit information and the bond's terms and conditions, among other things.

In general, the Company does not purchase securities that have a complicated structure. The Company's entire portfolio consists of traditional investments, nearly all of which are U.S. Treasury obligations, federal agency bullet or mortgage pass-through securities, or general obligation or revenue based municipal bonds. Pricing for such instruments is easily obtained. From time to time, the Company will validate, on a sample basis, prices supplied by



the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

*Fair Value Swap.* The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents the amount due and payable to the counterparty based upon the revised share conversion rate, if any, during the period. At September 30, 2016, there were no amounts payable.

A summary of fair values for assets and liabilities consisted of the following:

<i>(Dollars in Thousands)</i>	<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	<b>Total Fair Value</b>
<b>September 30, 2016</b>				
Securities Available for Sale:				
U.S. Government Treasury	\$ 273,685	\$ -	\$ -	\$ 273,685
U.S. Government Agency States and Political Subdivisions	-	129,516 86,634	-	129,516 86,634
Mortgage-Backed Securities	-	1,482	-	1,482
Equity Securities	-	8,822	-	8,822
<b>December 31, 2015</b>				
Securities Available for Sale:				
U.S. Government Treasury	\$ 250,346	\$ -	\$ -	\$ 250,346
U.S. Government Agency States and Political Subdivisions	-	101,824 88,362	-	101,824 88,362
Mortgage-Backed Securities	-	1,901	-	1,901
Equity Securities	-	8,595	-	8,595

### **Assets Measured at Fair Value on a Non-Recurring Basis**

Certain assets are measured at fair value on a non-recurring basis (i.e., the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances). An example would be assets exhibiting evidence of impairment. The following is a description of valuation methodologies used for assets measured on a non-recurring basis.

*Impaired Loans.* Impairment for collateral dependent loans is measured using the fair value of the collateral less selling costs. The fair value of collateral is determined by an independent valuation or professional appraisal in conformance with banking regulations. Collateral values are estimated using Level 3 inputs due to the volatility in the real estate market, and the judgment and estimation involved in the real estate appraisal process. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. Valuation techniques are consistent with those techniques applied in prior periods. Impaired collateral dependent loans had a carrying value of \$6.3 million with a valuation allowance of \$0.7 million at September 30, 2016 and \$8.8 million and \$0.9 million, respectively, at December 31, 2015.

*Loans Held for Sale.* These loans are carried at the lower of cost or fair value and are adjusted to fair value on a non-recurring basis. Fair value is based on observable markets rates for comparable loan products, which is considered a Level 2 fair value measurement.

*Other Real Estate Owned.* During the first nine months of 2016, certain foreclosed assets, upon initial recognition, were measured and reported at fair value through a charge-off to the allowance for loan losses based on the fair value of the foreclosed asset less estimated cost to sell. The fair value of the foreclosed asset is determined by an independent valuation or professional appraisal in conformance with banking regulations. On an ongoing basis, we obtain updated appraisals on foreclosed assets and realize valuation adjustments as necessary. The fair value of foreclosed assets is estimated using Level 3 inputs due to the judgment and estimation involved in the real estate valuation process.

### **Assets and Liabilities Disclosed at Fair Value**

The Company is required to disclose the estimated fair value of financial instruments, both assets and liabilities, for which it is practical to estimate fair value and the following is a description of valuation methodologies used for those assets and liabilities.

*Cash and Short-Term Investments.* The carrying amount of cash and short-term investments is used to approximate fair value, given the short time frame to maturity and as such assets do not present unanticipated credit concerns.

*Securities Held to Maturity.* Securities held to maturity are valued in accordance with the methodology previously noted in this footnote under the caption “Assets and Liabilities Measured at Fair Value on a Recurring Basis – Securities Available for Sale”.

*Loans.* The loan portfolio is segregated into categories and the fair value of each loan category is calculated using present value techniques based upon projected cash flows and estimated discount rates that reflect the credit, interest rate, and liquidity risks inherent in each loan category. The calculated present values are then reduced by an allocation of the allowance for loan losses against each respective loan category.

*Deposits.* The fair value of Noninterest Bearing Deposits, NOW Accounts, Money Market Accounts and Savings Accounts are the amounts payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using present value techniques and rates currently offered for deposits of similar remaining maturities.

*Subordinated Notes Payable.* The fair value of each note is calculated using present value techniques, based upon projected cash flows and estimated discount rates as well as rates being offered for similar obligations.

*Short-Term and Long-Term Borrowings.* The fair value of each note is calculated using present value techniques, based upon projected cash flows and estimated discount rates as well as rates being offered for similar debt.

A summary of estimated fair values of significant financial instruments consisted of the following:

<i>(Dollars in Thousands)</i>	<b>Carrying Value</b>	<b>September 30, 2016</b>		
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>
<b>ASSETS:</b>				
Cash	\$ 79,608	\$ 79,608	\$ -	\$ -
Short-Term Investments	144,576	144,576	-	-
Investment Securities, Available for Sale	500,139	273,685	226,454	-
Investment Securities, Held to Maturity	189,928	129,853	60,976	-
Loans Held for Sale	10,510	-	10,510	-
Loans, Net of Allowance for Loan Losses	1,543,768	-	-	1,547,466
<b>LIABILITIES:</b>				
Deposits	\$ 2,315,107	\$ -	\$ 2,311,870	\$ -
Short-Term Borrowings	12,113	-	12,142	-
Subordinated Notes Payable	52,887	-	42,622	-
Long-Term Borrowings	21,368	-	21,974	-

<i>(Dollars in Thousands)</i>	<b>Carrying Value</b>	<b>December 31, 2015</b>		
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>
<b>ASSETS:</b>				
Cash	\$ 51,288	\$ 51,288	\$ -	\$ -
Short-Term Investments	327,617	327,617	-	-
Investment Securities, Available for Sale	451,028	250,346	200,682	-
Investment Securities, Held to Maturity	187,892	134,439	52,968	-
Loans Held for Sale	11,632	-	11,632	-
Loans, Net of Allowance for Loan Losses	1,478,322	-	-	1,483,926
<b>LIABILITIES:</b>				
Deposits	\$ 2,302,849	\$ -	\$ 2,228,210	\$ -
Short-Term Borrowings	61,058	-	64,947	-
Subordinated Notes Payable	62,887	-	49,230	-
Long-Term Borrowings	28,265	-	30,448	-

All non-financial instruments are excluded from the above table. The disclosures also do not include goodwill. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

**NOTE 8 – OTHER COMPREHENSIVE INCOME**

The amounts allocated to other comprehensive income are presented in the table below. Reclassification adjustments related to securities held for sale are included in net gain/loss on securities transactions in the accompanying consolidated statements of comprehensive income. For the periods presented, reclassifications adjustments related to securities held for sale was not material.

<i>(Dollars in Thousands)</i>	<b>Before Tax Amount</b>	<b>Tax (Expense) Benefit</b>	<b>Net of Tax Amount</b>
<b>Three Months Ended September 30, 2016</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ (1,158)	\$ 447	\$ (711)
Amortization of losses on securities transferred from available for sale to held to maturity	21	(8)	13
Total Other Comprehensive Loss	\$ (1,137)	\$ 439	\$ (698)

**Nine Months Ended September 30, 2016**

Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 1,535	\$ (592)	\$ 943
Amortization of losses on securities transferred from available for sale to held to maturity	60	(23)	37
Total Other Comprehensive Income	\$ 1,595	\$ (615)	\$ 980

<i>(Dollars in Thousands)</i>	<b>Before Tax Amount</b>	<b>Tax (Expense) Benefit</b>	<b>Net of Tax Amount</b>
<b>Three Months Ended September 30, 2015</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 533	\$ (206)	\$ 327
Amortization of losses on securities transferred from available for sale to held to maturity	21	(8)	13
Total Other Comprehensive Income	\$ 554	\$ (214)	\$ 340

**Nine Months Ended September 30, 2015**

Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 1,562	\$ (602)	\$ 960
Amortization of losses on securities transferred from available for sale to held to maturity	56	(22)	34
Total Other Comprehensive Income	\$ 1,618	\$ (624)	\$ 994

Accumulated other comprehensive loss was comprised of the following components:

<i>(Dollars in Thousands)</i>	<b>Securities Available for Sale</b>	<b>Retirement Plans</b>	<b>Accumulated Other Comprehensive Loss</b>
<b>Balance as of January 1, 2016</b>	\$ (127)	\$ (22,130)	\$ (22,257)
Other comprehensive income during the period	980	-	980
<b>Balance as of September 30, 2016</b>	\$ 853	\$ (22,130)	\$ (21,277)
<b>Balance as of January 1, 2015</b>	\$ 59	\$ (21,568)	\$ (21,509)
Other comprehensive income during the period	994	-	994
<b>Balance as of September 30, 2015</b>	\$ 1,053	\$ (21,568)	\$ (20,515)

## NOTE 9 – ACCOUNTING STANDARDS UPDATES

*ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities."* ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-1 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on its financial statements.

*ASU 2016-02, "Leases (Topic 842)."* ASU 2016-02 requires the lease rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-02 is effective for the Company January 1, 2019 and is not expected to have a significant impact on its financial statements.

*ASU 2016-07, "Investments-Equity Method and Joint Ventures (Topic 323) – Simplifying the Transition to the Equity Method of Accounting."* ASU 2016-07 eliminates the requirement that when an investment qualifies for the use of the equity method as a result in the increase in ownership interest, to retroactively apply the equity method of accounting to all previous periods that the investment was held. The amendments require that the equity method investor add the cost of acquiring the additional interest to the current basis of the investment. ASU 2016-07 will be effective for the Company on January 1, 2017 and is not expected to have a significant impact on its financial statements.

*ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."* Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification

(rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective for the Company on January 1, 2017 and is not expected to have a significant impact on its financial statements.

*ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements."* ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company on January 1, 2020. The Company is currently evaluating the potential impact of ASU 2016-13 on its financial statements.

*ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments."* ASU 2016-15 addresses eight classification issues related to the statement of cash flow. The issues are (i) debt prepayment or debt extinguishment costs, (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)), (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on its financial statements.



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

Management's discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The following information should provide a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 2016 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, is referred to as "CCBG," "Company," "we," "us," or "our."

**CAUTION CONCERNING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including this MD&A section, contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," "goal," and similar expressions are intended to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and *Item 1A. Risk Factors* of our 2015 Report on Form 10-K, as updated in our subsequent quarterly reports filed on Form 10-Q, and in our other filings made from time to time with the SEC after the date of this report.

However, other factors besides those listed in our Quarterly Report or in our Annual Report also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

**BUSINESS OVERVIEW**

We are a financial holding company headquartered in Tallahassee, Florida, and we are the parent of our wholly-owned subsidiary, Capital City Bank (the "Bank" or "CCB"). The Bank offers a broad array of products and services through a total of 60 full-service offices located in Florida, Georgia, and Alabama. The Bank offers commercial and retail banking services, as well as trust and asset management, retail securities brokerage and data processing services.

Our profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest and fees received on earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and noninterest income such as deposit fees, wealth management fees, mortgage banking fees, bank card fees, and data processing fees.

A detailed discussion regarding the economic conditions in our markets and our long-term strategic objectives is included as part of the MD&A section of our 2015 Form 10-K.

### NON-GAAP FINANCIAL MEASURE

We present a tangible common equity ratio that removes the effect of goodwill resulting from merger and acquisition activity. We believe this measure is useful to investors because it allows investors to more easily compare our capital adequacy to other companies in the industry. The GAAP to non-GAAP reconciliation is provided below.

	2016				2015	
<i>(Dollars in Thousands)</i>	Third	Second	First	Fourth	Third	Second
<b>TANGIBLE COMMON EQUITY RATIO</b>						
Shareowners' Equity (GAAP)	\$ 276,624	\$ 274,824	\$ 276,833	\$ 274,352	\$ 273,659	\$ 272,038
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811
Tangible Shareowners' Equity (non-GAAP)	A 191,813	190,013	192,022	189,541	188,848	187,227
Total Assets (GAAP)	2,753,154	2,767,636	2,792,186	2,797,860	2,615,094	2,654,144
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811
Tangible Assets (non-GAAP)	B \$ 2,668,343	\$ 2,682,825	\$ 2,707,375	\$ 2,713,049	\$ 2,530,283	\$ 2,569,333
Tangible Common Equity Ratio	A/B 7.19%	7.08%	7.09%	6.99%	7.46%	7.29%

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

	2016				2015		
<i>(Dollars in Thousands, Except Per Share Data)</i>	Third	Second	First	Fourth	Third	Second	First
<b>Summary of Operations:</b>							
Interest Income	\$ 20,104	\$ 20,174	\$ 20,044	\$ 20,602	\$ 19,877	\$ 19,833	\$ 19,833
Interest Expense	784	798	834	808	811	849	849
Net Interest Income	19,320	19,376	19,210	19,794	19,066	18,984	18,984
Provision for Loan Losses	-	(97)	452	513	413	375	375
Net Interest Income After Provision for Loan Losses	19,320	19,473	18,758	19,281	18,653	18,609	18,609
Noninterest Income <sup>(3)(4)</sup>	13,011	15,215	12,677	13,221	13,228	14,794	14,794
Noninterest Expense	28,022	28,702	28,930	28,280	29,164	28,439	28,439
Income Before Income Taxes	4,309	5,986	2,505	4,222	2,717	4,964	4,964
Income Tax Expense	1,436	2,056	858	1,620	1,034	1,119	1,119
Net Income	2,873	3,930	1,647	2,602	1,683	3,845	3,845
Net Interest Income (FTE)	\$ 19,603	\$ 19,617	\$ 19,421	\$ 20,006	\$ 19,253	\$ 19,119	\$ 19,119
<b>Per Common Share:</b>							
Net Income Basic	\$ 0.18	\$ 0.22	\$ 0.10	\$ 0.16	\$ 0.10	\$ 0.22	\$ 0.22
Net Income Diluted	0.17	0.22	0.10	0.16	0.09	0.22	0.22
Cash Dividends Declared	0.04	0.04	0.04	0.04	0.03	0.03	0.03
Diluted Book Value	16.39	16.31	16.04	15.93	15.89	15.80	15.80
Market Price:							
High	15.35	15.96	15.88	16.05	15.75	16.32	16.32
Low	13.32	13.16	12.83	13.56	14.39	13.94	13.94
Close	14.77	13.92	14.59	15.35	14.92	15.27	15.27
<b>Selected Average Balances:</b>							
Loans, Net	\$1,555,889	\$1,531,777	\$1,507,508	\$1,492,521	\$1,483,657	\$1,473,954	\$1,473,954
Earning Assets	2,417,943	2,447,777	2,440,718	2,353,729	2,310,823	2,328,012	2,328,012
Total Assets	2,734,465	2,767,854	2,763,746	2,678,214	2,639,692	2,670,701	2,670,701
Deposits	2,288,741	2,276,553	2,258,600	2,174,718	2,137,433	2,178,399	2,178,399
Shareowners' Equity	277,407	279,532	277,464	275,893	274,956	274,421	274,421
Common Equivalent Average Shares:							
Basic	16,804	17,144	17,202	17,145	17,150	17,296	17,296
Diluted	16,871	17,196	17,235	17,214	17,229	17,358	17,358
<b>Performance Ratios:</b>							
Return on Average Assets	0.42%	0.57%	0.24%	0.39%	0.25%	0.58%	0.58%
Return on Average Equity	4.12	5.65	2.39	3.74	2.43	5.62	5.62
Net Interest Margin (FTE)	3.23	3.22	3.20	3.37	3.31	3.29	3.29
Noninterest Income as % of							
Operating Revenue	40.24	43.99	39.76	40.05	40.96	43.80	43.80
Efficiency Ratio	85.92	82.40	90.13	85.11	89.79	83.85	83.85

**Asset Quality:**

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Allowance for Loan Losses	\$	13,744	\$	13,677	13,613	\$	13,953	\$	14,737	\$	15,236	\$
Allowance for Loan Losses to Loans		0.88%		0.89%	0.90%		0.93%		0.99%		1.03%	
Nonperforming Assets (“NPAs”)		21,352		22,836	26,499		29,595		38,357		45,487	
NPAs to Total Assets		0.78		0.83	0.95		1.06		1.47		1.71	
NPAs to Loans plus OREO		1.35		1.48	1.73		1.94		2.54		3.00	
Allowance to Non-Performing Loans		159.56		166.50	150.44		135.40		112.17		99.46	
Net Charge-Offs to Average Loans		(0.02)		(0.04)	0.21		0.34		0.24		0.33	

**Capital Ratios:**

Tier 1 Capital		15.48%		15.63%	16.39%		16.42%		16.36%		15.83%	
Total Capital		16.28		16.44	17.20		17.25		17.24		16.72	
Common Equity Tier 1 <sup>(1)</sup>		12.55		12.65	12.82		12.84		12.76		12.34	
Leverage		10.12		9.98	10.34		10.65		10.71		10.53	
Tangible Common Equity <sup>(2)</sup>		7.19		7.08	7.09		6.99		7.46		7.29	

<sup>(1)</sup>Not Applicable prior to January 1, 2015.

<sup>(2)</sup>Non-GAAP financial measure. See non-GAAP reconciliation on page 27.

<sup>(3)</sup>Includes \$2.5 million gain on retirement of trust preferred securities in second quarter, 2016.

<sup>(4)</sup>Includes \$1.7 million in bank-owned life insurance proceeds in second quarter, 2015.

## FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

### Results of Operations

- Net income of \$2.9 million, or \$0.17 per diluted share, for the third quarter of 2016 compared to net income of \$3.9 million, or \$0.22 per diluted share, for the second quarter of 2016, and net income of \$1.7 million, or \$0.09 per diluted share for the third quarter of 2015. For the first nine months of 2016, we realized net income of \$8.4 million, or \$0.49 per diluted share, compared to net income of \$6.5 million, or \$0.37 per diluted share, for the same period of 2015.
- Tax equivalent net interest income for the third quarter of 2016 was \$19.6 million comparable to the second quarter of 2016 and \$19.3 million for the third quarter of 2015. During the third quarter of 2016, overnight funds were used to fund growth in the loan and investment portfolios resulting in a positive shift in our earning asset mix. This positive shift was partially offset by some one-time adjustments to interest income. The increase over the third quarter of 2015 primarily reflects growth in the investment portfolio and a higher rate paid on overnight funds, partially offset by a decline in loan fees. For the first nine months of 2016, tax equivalent net interest income totaled \$58.6 million compared to \$57.0 million in 2015. The year-over-year increase was driven by one additional calendar day, and growth in the loan and investment portfolios.
- Total credit costs (loan loss provision plus other real estate owned (“OREO”) expenses) were \$0.8 million, \$1.0 million, and \$1.7 million for the quarters ended September 30, 2016, June 30, 2016, and September 30, 2015, respectively. Total credit costs for the nine month period of 2016 were \$3.7 million compared to \$4.8 million for the same period of 2015. Lower loan charge-offs and strong loan recoveries have favorably impacted our loan loss provision and the reduction in OREO expense reflects lower property valuation adjustments and carrying costs.
- Noninterest income for the third quarter of 2016 totaled \$13.0 million, a decrease of \$2.2 million, or 14.5%, from the second quarter of 2016 and \$0.2 million, or 1.6%, from the third quarter of 2015. For the first nine months of 2016, noninterest income totaled \$40.9 million, unchanged from the prior year. The decrease from the second quarter of 2016 was attributable to a \$2.5 million gain from the partial retirement of our trust preferred securities (“TRUPS”) in the second quarter of 2016, partially offset by higher mortgage banking fees of \$0.2 million and wealth management fees of \$0.1 million. The decrease from the third quarter of 2015 was due to lower deposit fees of \$0.3 million and bank card fees of \$0.1 million, partially offset by higher mortgage banking fees of \$0.2 million.

- Noninterest expense (excluding OREO expense) for the third quarter of 2016 totaled \$27.2 million, a decrease of \$0.4 million, or 1.6%, from the second quarter of 2016 and \$0.7 million, or 2.4%, from the third quarter of 2015. The decrease from the second quarter of 2016 was primarily attributable to lower FDIC insurance expense of \$0.3 million and legal fees of \$0.2 million. The decline from the third quarter of 2015 reflects lower compensation expense of \$0.6 million and FDIC insurance of \$0.3 million, partially offset by higher occupancy expense of \$0.2 million. For the first nine months of 2016, noninterest expense (excluding OREO expense) totaled \$82.3 million, a decrease of \$0.9 million, or 1.1%, from the same period of 2015 primarily due to lower compensation expense of \$1.3 million and FDIC insurance expense of \$0.4 million, that was partially offset by higher occupancy expense of \$0.7 million.

## Financial Condition

- Average earning assets totaled \$2.418 billion for the third quarter of 2016, a decrease of \$29.8 million, or 1.2%, from the second quarter of 2016, and an increase of \$64.2 million, or 2.7%, over the fourth quarter of 2015. The reduction in earning assets from the second quarter of 2016 was attributable to lower overnight funds, which reflects a decline in repurchase agreements. The increase compared to the fourth quarter of 2015 reflects increases in noninterest bearing, NOW, and savings accounts which primarily funded the growth in the loan and investment portfolios.

- Average loans increased by \$24.1 million, or 1.6%, over the second quarter of 2016 and \$63.4 million, or 4.3%, over the fourth quarter of 2015. The increase compared to the second quarter of 2016 reflects growth primarily in institutional, construction, and consumer loans. Growth over the fourth quarter of 2015 was experienced in all loan products, with the exception of commercial mortgages.

- Nonperforming assets totaled \$21.4 million at the end of the third quarter of 2016, a decrease of \$1.4 million from the second quarter of 2016 and \$8.2 million from the fourth quarter of 2015. Nonperforming assets represented 0.78% of total assets at September 30, 2016 compared to 0.83% at June 30, 2016 and 1.06% at December 31, 2015.

- As of September 30, 2016, we were well-capitalized with a risk based capital ratio of 16.28% and a tangible common equity ratio of 7.19% compared to 16.44% and 7.08%, respectively, at June 30, 2016, and 17.25% and 6.99%, respectively, at December 31, 2015. The lower risk based capital ratio compared to the fourth quarter of 2015 reflects the retirement of \$10 million of our TRUPs and the repurchase of 432,000 shares of CCBG common stock. All of our regulatory capital ratios significantly exceed the threshold to be well-capitalized under the Basel III capital standards.

**RESULTS OF OPERATIONS****Net Income**

For the third quarter of 2016, we realized net income of \$2.9 million, or \$0.17 per diluted share, compared to net income of \$3.9 million, or \$0.22 per diluted share for the second quarter of 2016, and net income of \$1.7 million, or \$0.09 per diluted share, for the third quarter of 2015. For the first nine months of 2016, we realized net income of \$8.4 million, or \$0.49 per diluted share, compared to net income of \$6.5 million, or \$0.37 per diluted share for the same period of 2015.

Compared to the second quarter of 2016, performance reflects lower noninterest expense of \$0.7 million and income taxes of \$0.6 million, partially offset by lower noninterest income of \$2.2 million and a \$0.1 million increase in the loan loss provision.

Compared to the third quarter of 2015, the increase in earnings reflects lower noninterest expense of \$1.1 million, higher net interest income of \$0.3 million, and a \$0.4 million reduction in the loan loss provision, partially offset by a \$0.2 million decrease in noninterest income and higher income taxes of \$0.4 million.

The increase in earnings for the first nine months of 2016 versus the comparable period of 2015 was attributable to higher net interest income of \$1.4 million, lower noninterest expense of \$1.3 million, and a \$0.7 million reduction in the loan loss provision, partially offset by higher income taxes of \$1.5 million.

A condensed earnings summary of each major component of our financial performance is provided below:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>		
	<b>September 30, 2016</b>	<b>June 30, 2016</b>	<b>September 30, 2015</b>	<b>September 30, 2016</b>	<b>September 30, 2015</b>
<i>(Dollars in Thousands, except per share data)</i>					
Interest Income	\$ 20,104	\$ 20,174	\$ 19,877	\$ 60,322	\$ 59,056
Taxable Equivalent Adjustments	283	241	187	735	426
Total Interest Income (FTE)	20,387	20,415	20,064	61,057	59,482
Interest Expense	784	798	811	2,416	2,499
Net Interest Income (FTE)	19,603	19,617	19,253	58,641	56,983

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Provision for Loan Losses	-	(97)	413	355	1,081
Taxable Equivalent Adjustments	283	241	187	735	426
Net Interest Income After provision for Loan Losses	19,320	19,473	18,653	57,551	55,476
Noninterest Income	13,011	15,215	13,228	40,903	40,870
Noninterest Expense	28,022	28,702	29,164	85,654	86,993
Income Before Income Taxes	4,309	5,986	2,717	12,800	9,353
Income Tax Expense	1,436	2,056	1,034	4,350	2,839
Net Income	\$ 2,873	\$ 3,930	\$ 1,683	\$ 8,450	\$ 6,514
Basic Net Income Per Share	\$ 0.18	\$ 0.22	\$ 0.10	\$ 0.50	\$ 0.38
Diluted Net Income Per Share	\$ 0.17	\$ 0.22	\$ 0.09	\$ 0.49	\$ 0.37

**Net Interest Income**

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets less interest expense paid on interest bearing liabilities. This information is provided on a "taxable equivalent" basis to reflect the tax-exempt status of income earned on certain loans and investments, the majority of which are state and local government debt obligations. We provide an analysis of our net interest income including average yields and rates in Table I on page 42.

Tax equivalent net interest income was \$19.6 million for both the third quarter of 2016 and the second quarter of 2016 and \$19.3 million for the third quarter of 2015. During the third quarter, overnight funds were used to fund growth in the loan and investment portfolios resulting in a positive shift in our earning asset mix. This positive shift was partially offset by some one-time adjustments to interest income. For the first nine months of 2016, tax equivalent net interest income totaled \$58.6 million compared to \$57.0 million for the same period of 2015. The increase in tax equivalent net interest income compared to the third quarter of 2015 reflects growth in the investment portfolio and a higher rate paid on overnight funds, partially offset by a decline in loan fees. The year over year increase was driven by one additional calendar day, and growth in the loan and investment portfolios.



Although the low interest rate environment continues to put downward pressure on our net interest income, we have been successful in increasing our net interest income year-over-year. Additionally, aggressive lending competition in all markets has impacted the pricing for loans. Low rates and competition, collectively, continue to adversely impact our loan yields. Various loan strategies, which align with our overall risk appetite, continue to be developed and implemented to enhance our performance.

Our net interest margin for the third quarter of 2016 was 3.23%, an increase of one basis point over the second quarter of 2016 and a decrease of eight basis points from the third quarter of 2015. The increase in the margin compared to the second quarter of 2016 was primarily attributable to growth in our loan and investment portfolios, coupled with a slight decline in the level of earning assets. The decrease in the margin compared to the third quarter of 2015 was primarily attributable to lower loan yields. For the first nine months of 2016, the net interest margin declined by seven basis points to 3.22% compared to the same period of 2015 due to a combination of earning asset growth and lower loan yields.

We continue to maintain short duration portfolios on both sides of the balance sheet and believe we are well positioned to respond to changing market conditions. Over time, this strategy has historically produced fairly consistent outcomes and a net interest margin that is significantly above peer comparisons.

### **Provision for Loan Losses**

A loan loss provision was not recorded for the third quarter of 2016 reflecting continued reduction in loan charge-offs as well as strong loan recoveries. This compares to a negative provision expense of \$0.1 million for the second quarter of 2016 and a \$0.4 million provision expense for the third quarter of 2015. For the first nine months of 2016, the loan loss provision totaled \$0.4 million compared to \$1.1 million for the same period of 2015. The decrease in the year-to-date provision reflects continued favorable problem loan migration and lower net loan charge-offs, partially offset by growth in the loan portfolio. We realized net loan recoveries of \$0.1 million (consisting of recoveries of \$0.9 million, less gross charge-offs of \$0.8 million) for the third quarter of 2016. This compares to net recoveries of \$0.2 million (consisting of recoveries of \$1.3 million, less gross charge-offs of \$1.1 million) for the second quarter of 2016. Net loan charge-offs for the third quarter of 2015 totaled \$0.9 million, or 0.24% (annualized) of average loans. For the first nine months of 2016, net charge-offs totaled \$0.6 million, or 0.05% (annualized) of average loans compared to \$3.9 million, or 0.35% (annualized), for the same period of 2015. At quarter-end, the allowance for loan losses of \$13.7 million was 0.88% of outstanding loans (net of overdrafts) and provided coverage of 160% of nonperforming loans compared to 0.89% and 167%, respectively, at June 30, 2016 and 0.93% and 135%, respectively, at December 31, 2015.

Charge-off activity for the respective periods is set forth below:

	Three Months Ended			Nine Months Ended	
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<i>(Dollars in Thousands, except per share data)</i>					
<b>CHARGE-OFFS</b>					
Commercial, Financial and Agricultural	\$ 143	\$ 304	\$ 365	\$ 484	\$ 894
Real Estate - Construction	-	-	-	-	-
Real Estate - Commercial Mortgage	5	-	(26)	279	1,163
Real Estate - Residential	96	205	476	779	1,265
Real Estate - Home Equity	51	146	370	412	1,006
Consumer	479	438	318	1,356	1,245
Total Charge-offs	\$ 774	\$ 1,093	\$ 1,503	\$ 3,310	\$ 5,573
<b>RECOVERIES</b>					
Commercial, Financial and Agricultural	\$ 199	\$ 49	\$ 45	\$ 287	\$ 182
Real Estate - Construction	-	-	-	-	-
Real Estate - Commercial Mortgage	45	237	86	363	170
Real Estate - Residential	139	579	193	954	441
Real Estate - Home Equity	237	81	42	377	99
Consumer	221	308	225	765	798
Total Recoveries	\$ 841	\$ 1,254	\$ 591	\$ 2,746	\$ 1,690
Net (Recoveries) Charge-offs	\$ (67)	\$ (161)	\$ 912	\$ 564	\$ 3,883
Net (Recoveries) Charge-offs (Annualized) as a percent of Average Loans Outstanding, Net of Unearned Income	(0.02)%	(0.04)%	0.24%	0.05%	0.35%

### Noninterest Income

Noninterest income for the third quarter of 2016 totaled \$13.0 million, a decrease of \$2.2 million, or 14.5%, from the second quarter of 2016 and \$0.2 million, or 1.6%, from the third quarter of 2015. The decrease from the second quarter of 2016 was primarily due to lower income of \$2.5 million attributable to a gain from the retirement of our TRUPs in the second quarter of 2016, partially offset by higher mortgage banking fees of \$0.2 million and wealth management fees of \$0.1 million. Compared to the third quarter of 2015, the decrease was attributable to lower deposit fees of \$0.3 million and bank card fees of \$0.1 million, partially offset by higher mortgage banking fees of \$0.2 million. For the first nine months of 2016, noninterest income totaled \$40.9 million, unchanged from the prior year.

Noninterest income represented 40.2% of operating revenues (net interest income plus noninterest income) in the third quarter of 2016 compared to 44.0% in the second quarter of 2016 and 41.0% in the third quarter of 2015. For the first nine months of 2016, noninterest income represented 41.4% of operating revenues compared to 42.0% for the same period of 2015.

The table below reflects the major components of noninterest income.

<i>(Dollars in Thousands)</i>	Three Months Ended			Nine Months Ended	
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Deposit Fees	\$ 5,373	\$ 5,321	\$ 5,721	\$ 16,094	\$ 16,944
Bank Card Fees	2,759	2,855	2,826	8,467	8,412
Wealth Management Fees	1,774	1,690	1,818	5,256	5,640
Mortgage Banking Fees	1,503	1,267	1,306	3,800	3,496
Data Processing Fees	360	335	400	1,042	1,137
Other	1,242	3,747	1,157	6,244	5,241
<b>Total Noninterest Income</b>	<b>\$ 13,011</b>	<b>\$ 15,215</b>	<b>\$ 13,228</b>	<b>\$ 40,903</b>	<b>\$ 40,870</b>

Significant components of noninterest income are discussed in more detail below.

*Deposit Fees.* Deposit fees for the third quarter of 2016 totaled \$5.4 million, an increase of \$0.1 million, or 1.0%, over the second quarter of 2016 and a decrease of \$0.3 million, or 6.1%, from the third quarter of 2015. For the first nine months of 2016, deposit fees totaled \$16.1 million, a decrease of \$0.8 million, or 5.0%, from the comparable period of 2015. The increase from the second quarter of 2016 was primarily due to higher overdraft service fees. The decrease from both prior year periods reflects lower overdraft service fees attributable to a reduction in accounts using this service as well as lower utilization by existing users.

*Wealth Management Fees.* Wealth management fees, which include both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) totaled \$1.8 million for the third quarter of 2016, an increase of \$0.1 million, or 5.0%, over the second quarter of 2016 and unchanged from the third quarter of 2015. For the first nine months of 2016, wealth management fees totaled \$5.3 million, a decrease of \$0.3 million, or 6.8%, from the same period of 2015. The increase over the second quarter was primarily due to higher trust fees. The decrease from the prior year periods was primarily due to lower retail brokerage fees reflecting lower trading volume by our clients, partially offset by higher trust fees reflecting an increase in assets under management. At September 30, 2016, total assets under management were approximately \$1.192 billion compared to \$1.139 billion at December 31, 2015 and \$1.182 billion at September 30, 2015.

*Mortgage Banking Fees.* Mortgage banking fees totaled \$1.5 million for the third quarter of 2016, an increase of \$0.2 million, or 18.6%, over the second quarter of 2016 and an increase of \$0.2 million, or 15.1%, over the third quarter of 2015. For the first nine months of 2016, fees totaled \$3.8 million, an increase of \$0.3 million, or 8.7%, over the same period of 2015. We continue to realize strong residential home sales activity in our markets which drove the increase

for all periods.

*Other.* Other income totaled \$1.2 million for the third quarter of 2016, a decrease of \$2.5 million, or 66.9%, from the second quarter of 2016 and an increase of \$0.1 million, or 7.3%, over the third quarter of 2015. The decrease from the second quarter of 2016 was attributable to a \$2.5 million gain from the retirement of our TRUPs in the second quarter of 2016. The increase compared to the third quarter of 2015 was primarily due to higher working capital finance fees. For the first nine months of 2016, other income increased \$1.0 million, or 19.1%, compared to the same period of 2015 and primarily reflects the \$2.5 million TRUPs gain that was partially offset by lower BOLI income of \$1.7 million.

### **Noninterest Expense**

Noninterest expense for the third quarter of 2016 totaled \$28.0 million, a decrease of \$0.7 million, or 2.4%, from the second quarter of 2016 attributable to lower FDIC insurance expense of \$0.3 million, legal fees of \$0.2 million, and OREO expense of \$0.2 million. Compared to the third quarter of 2015, noninterest expense decreased by \$1.1 million, or 3.9%, primarily attributable to lower compensation expense of \$0.7 million, OREO expense of \$0.5 million, and FDIC insurance expense of \$0.5 million, partially offset by higher occupancy expense of \$0.3 million. For the first nine months of 2016, noninterest expense totaled \$85.7 million, a decrease of \$1.3 million, or 1.5%, from the same period of 2015 reflective of lower compensation expense of \$1.3 million, OREO expense of \$0.4 million, and FDIC insurance expense of \$0.4 million, partially offset by higher occupancy expense of \$0.7 million. Expense management is an important part of our culture and strategic focus and we continue to review and evaluate opportunities to optimize our operations, reduce operating costs and manage our discretionary expenses.

The table below reflects the major components of noninterest expense.

	Three Months Ended			Nine Months Ended	
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<i>(Dollars in Thousands)</i>					
Salaries	\$ 11,796	\$ 11,832	\$ 11,808	\$ 35,562	\$ 36,758
Associate Benefits	4,197	4,219	4,845	12,723	12,823
Total Compensation	15,993	16,051	16,653	48,285	49,581
Premises	2,269	2,276	2,298	6,852	6,755
Equipment	2,465	2,308	2,148	6,925	6,345
Total Occupancy	4,734	4,584	4,446	13,777	13,100
Legal Fees	452	638	599	1,788	1,994
Professional Fees	896	891	849	2,649	2,916
Processing Services	1,747	1,648	1,695	5,097	5,116
Advertising	441	529	342	1,310	987
Travel and Entertainment	230	226	237	653	674
Printing and Supplies	160	191	223	554	612
Telephone	699	469	471	1,637	1,485
Postage	201	223	238	685	754
Insurance - Other	397	633	677	1,658	2,084
Other Real Estate Owned, net	821	1,060	1,302	3,306	3,730
Miscellaneous	1,251	1,559	1,432	4,255	3,960
Total Other	7,295	8,067	8,065	23,592	24,312
<b>Total Noninterest Expense</b>	<b>\$ 28,022</b>	<b>\$ 28,702</b>	<b>\$ 29,164</b>	<b>\$ 85,654</b>	<b>\$ 86,993</b>

Significant components of noninterest expense are discussed in more detail below.

*Compensation.* Compensation expense totaled \$16.0 million for the third quarter of 2016, a decrease of \$0.1 million, or 0.4%, from the second quarter of 2016 primarily due to a reduction in salary expense, specifically lower payroll taxes. Compared to the third quarter of 2015, total compensation expense decreased \$0.7 million, or 4.0%, attributable a reduction in associate benefit expense, primarily pension plan expense. For the first nine months of 2016, compensation expense totaled \$48.3 million, a decrease of \$1.3 million, or 2.6%, from the same period of 2015 due to lower salary expense of \$1.2 million and associate benefit expense of \$0.1 million. The decrease in salary expense was primarily attributable to a higher level of deferred loan costs (which reduces salary expense). The decrease in associate benefit expense reflects a reduction in our pension plan expense.

*Occupancy.* Occupancy expense (including premises and equipment) totaled \$4.7 million for the third quarter of 2016, an increase of \$0.2 million, or 3.3%, over the second quarter of 2016 reflective of higher maintenance agreement expense for furniture/equipment. Compared to the third quarter of 2015, occupancy expense increased \$0.3 million, or 6.5%, and compared to the first nine months of 2015, increased \$0.7 million, or 5.2%. The increase over

both prior year periods primarily reflects higher depreciation expense for technology investment in our banking offices and security infrastructure and, to a lesser extent, higher maintenance costs for building and furniture/equipment.

*Other.* Other noninterest expense decreased \$0.8 million, or 9.6%, from the second quarter of 2016, and \$0.8 million, or 9.5%, from the third quarter of 2015. Compared to the second quarter of 2016, the decrease was primarily attributable to lower OREO expense of \$0.2 million, FDIC insurance expense of \$0.3 million, legal fees of \$0.2 million, and miscellaneous expense of \$0.3 million, partially offset by higher telephone expense of \$0.1 million. The decrease in OREO expense primarily reflects lower property valuation adjustments. The reduction in FDIC insurance expense was attributable to a lower assessment rate structure enacted by the FDIC during the third quarter of 2016. The recovery of legal costs related to a successful problem loan workout drove the decline in legal expense. The decline in miscellaneous expense was attributable to a lower level of debit card losses. The increase in telephone expense reflects one-time costs related to the implementation of a new phone system. Compared to the third quarter of 2015, the decrease was due to lower OREO expense of \$0.5 million, FDIC insurance expense of \$0.3 million, and lower legal fees of \$0.2 million, partially offset by higher telephone expense of \$0.2 million. For the first nine months of 2016, other expense decreased \$0.7 million, or 3.0%, from the same period of 2015, attributable to lower OREO expense of \$0.4 million, FDIC insurance expense of \$0.4 million, and legal fees \$0.2 million, partially offset by higher advertising expense of \$0.3 million. Compared to the three and nine-month periods of 2015, the variance in OREO expense reflects lower property valuation adjustments and property carrying costs. The variances in FDIC insurance expense, legal fees, and telephone expense were due to the same factors noted above for the third quarter. The increase in advertising expense for the nine-month period was due to a higher volume of advertising campaigns related to various bank products.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 85.92% for the third quarter of 2016 compared to 82.40% for the second quarter of 2016 and 89.79% for the third quarter of 2015. For the first nine months of 2016, this ratio was 86.05% compared to 88.90% for the comparable period of 2015.

## **Income Taxes**

We realized income tax expense of \$1.4 million (33% effective rate) for the third quarter of 2016 compared to \$2.0 million (34% effective rate) for the second of 2016 and \$1.0 million (38% effective rate) for the third quarter of 2015. For the first nine months of 2016, income tax expense totaled \$4.3 million (34% effective rate) compared to \$2.8 million (30% effective rate) for the same period of 2015. The receipt of \$1.7 million in BOLI proceeds in the second quarter of 2015 was tax-exempt, therefore income tax expense for the nine-month period of 2015 was favorably impacted.

## **FINANCIAL CONDITION**

Average assets totaled approximately \$2.734 billion for the third quarter of 2016, a decrease of \$33.4 million, or 1.2%, from the second quarter of 2016, and an increase of \$56.3 million, or 2.1%, over the fourth quarter of 2015. Average earning assets were \$2.418 billion for the third quarter of 2016, a decrease of \$29.8 million, or 1.2%, from the second quarter of 2016, and an increase of \$64.2 million, or 2.7%, over the fourth quarter of 2015. The reduction



in earning assets from the second quarter of 2016 was attributable to a reduction in interest-bearing liabilities. The increase compared to the fourth quarter of 2015 reflects increases in noninterest bearing, NOW, and savings accounts which, in conjunction with a reduction in overnight funds, funded the growth in the loan and investment portfolios

### **Investment Securities**

In the third quarter of 2016, our average investment portfolio increased \$34.5 million, or 5.2%, over the second quarter of 2016 and increased \$57.5 million, or 9.0%, over the fourth quarter of 2015. As a percentage of average earning assets, the investment portfolio represented 28.8% in the third quarter of 2016, compared to 27.0% in the second quarter of 2016, and 27.1% in the fourth quarter of 2015. The increase in the average balance of the investment portfolio compared to the second quarter of 2016 was primarily attributable to increased purchases of SBA agency bonds and Ginnie Mae mortgage-backed securities. The increase compared to the fourth quarter of 2015 was primarily attributable to an increase in U.S. Treasury purchases. For the remainder of 2016, it is anticipated that cash flow from the investment portfolio will be reinvested into securities. We plan to continue closely monitoring liquidity levels, as well as look for new investment products that are prudent relative to our risk profile and overall investment strategy.

The investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. Two types of classifications are approved for investment securities which are Available-for-Sale ("AFS") and Held-to-Maturity ("HTM"). During the third quarter of 2016, securities were purchased under both the AFS and HTM designations. As of September 30, 2016, \$500.1 million, or 72.5%, of the investment portfolio was classified as AFS, and \$189.9 million, or 27.5%, classified as HTM.

At acquisition, the classification of the security will be determined based on how the purchase will affect our asset/liability strategy and future business plans and opportunities. Such decisions will be weighed against multiple factors, including regulatory capital requirements, volatility in earnings or other comprehensive income, and liquidity needs. Securities in the AFS portfolio are recorded at fair value with unrealized gains and losses associated with these securities recorded net of tax, in the accumulated other comprehensive income component of shareowners' equity. Securities that are HTM will be acquired or owned with the intent of holding them to maturity (final payment date). HTM investments are measured at amortized cost. It is neither management's current intent nor practice to participate in the trading of investment securities for the purpose of recognizing gains and therefore we do not maintain a trading portfolio.

At September 30, 2016, the investment portfolio had a net pre-tax unrealized gain in the AFS portfolio of \$1.7 million compared to an unrealized gain of \$2.8 million and \$1.6 million at June 30, 2016 and December 31, 2015, respectively. At September 30, 2016, there were 165 positions (combined AFS and HTM) with unrealized losses at quarter end totaling \$0.3 million. Of the 165 positions, 69 were Ginnie Mae mortgage-backed securities (GNMA), U.S. Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the U.S. Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. Of these 69 positions, there were 20 GNMA positions and 24 SBA positions in an unrealized loss position for longer than 12 months, which have unrealized losses totaling \$59k and \$50k, respectively. Six direct debt agency positions had an unrealized loss of \$14k. There were 90 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-" or better, with unrealized losses of \$46k. None of these positions with unrealized losses are considered impaired, and all are expected to mature at par.

The average maturity of the total portfolio at September 30, 2016 was 1.76 years compared to 1.81 years and 1.83 years at June 30, 2016 and December 31, 2015, respectively. The average life of the total portfolio at September 30, 2016 was slightly shorter compared to the prior quarter due primarily to the natural aging of the existing portfolio.

## **Loans**

Average loans increased \$24.1 million, or 1.6% when compared to the second quarter of 2016, and have grown \$63.4 million, or 4.3% when compared to the fourth quarter of 2015. The increase compared to the second quarter of 2016 reflects growth primarily in institutional, construction, and consumer loans. Growth over the fourth quarter of 2015 was experienced in all loan products, with the exception of commercial mortgages.

The resolution of problem loans totaled \$1.7 million for the third quarter of 2016 (\$0.8 million in net charge offs and \$0.9 million transferred to ORE), compared to \$2.3 million for the second quarter of 2016 (\$1.1 million in net charge offs and \$1.2 million transferred to ORE), and \$3.5 million for the fourth quarter 2015 (\$1.9 million in net charge offs and \$1.6 million transferred to ORE). The problem loan resolutions are based on "as of" balances, not averages.

Without compromising our credit standards or taking on inordinate interest rate risk, we continue to make minor modifications on some of our lending programs to try to mitigate the impact that consumer and business deleveraging is having on our portfolio. These programs, coupled with economic improvements in our anchor markets, have helped to increase overall production.

### **Nonperforming Assets**

Nonperforming assets (nonaccrual loans and OREO) totaled \$21.4 million at the end of the third quarter of 2016, a decrease of \$1.4 million, or 6%, from the second quarter of 2016 and \$8.2 million, or 28%, from the fourth quarter of 2015. Nonaccrual loans totaled \$8.6 million at the end of the third quarter of 2016, an increase of \$0.4 million over the second quarter of 2016 and a decrease of \$1.7 million from the fourth quarter of 2015. Nonaccrual loan additions totaled \$2.8 million in the third quarter of 2016 and \$9.1 million for the first nine months of 2016, compared to \$12.1 million for the same period of 2015. The balance of OREO totaled \$12.8 million at the end of the third quarter of 2016, a decrease of \$1.8 million and \$6.5 million, respectively, from the second quarter of 2016 and fourth quarter of 2015. For the third quarter of 2016, we added properties totaling \$0.9 million, sold properties totaling \$2.3 million, and recorded valuation adjustments totaling \$0.4 million. For the first nine months of 2016, we added properties totaling \$3.3 million, sold properties totaling \$7.9 million, and recorded valuation adjustments totaling \$1.9 million. Nonperforming assets represented 0.78% of total assets at September 30, 2016 compared to 0.83% at June 30, 2016 and 1.06% at December 31, 2015.

<i>(Dollars in Thousands)</i>	<b>September 30, 2016</b>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>Nonaccruing Loans:</b>			
Commercial, Financial and Agricultural	\$ 362	\$ 163	\$ 96
Real Estate - Construction	121	123	97
Real Estate - Commercial Mortgage	4,736	4,308	4,191
Real Estate - Residential	2,254	2,701	4,739
Real Estate - Home Equity	958	864	1,017
Consumer	183	55	165
<b>Total Nonperforming Loans (“NPLs”<sup>(1)</sup>)</b>	<b>\$ 8,614</b>	<b>\$ 8,214</b>	<b>\$ 10,305</b>
Other Real Estate Owned	12,738	14,622	19,290
<b>Total Nonperforming Assets (“NPAs”)</b>	<b>\$ 21,352</b>	<b>\$ 22,836</b>	<b>\$ 29,595</b>
Past Due Loans 30 – 89 Days	\$ 5,667	\$ 3,872	\$ 5,775
Past Due Loans 90 Days or More (accruing)	-	-	-
Performing Troubled Debt Restructurings	\$ 35,046	\$ 35,526	\$ 35,634
Nonperforming Loans/Loans	0.55%	0.54%	0.69%
Nonperforming Assets/Total Assets	0.78	0.83	1.06
Nonperforming Assets/Loans Plus OREO	1.35	1.48	1.94
Allowance/Nonperforming Loans	159.56%	166.50%	135.40%

(1) Nonperforming TDRs are included in the Nonaccrual/NPL totals

Activity within our nonperforming asset portfolio is provided in the table below.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>NPA Beginning Balance:</b>	\$ 22,836	\$ 45,487	\$ 29,595	\$ 52,449
<b>Change in Nonaccrual Loans:</b>				
Beginning Balance	8,214	15,320	10,305	16,769
Additions	2,844	1,882	9,120	12,146
Charge-Offs	(414)	(919)	(2,053)	(3,872)
Transferred to OREO	(832)	(1,242)	(3,011)	(2,947)
Paid Off/Payments	(529)	(563)	(1,892)	(4,176)
Restored to Accrual	(669)	(1,340)	(3,855)	(4,782)
<b>Ending Balance</b>	<b>8,614</b>	<b>13,138</b>	<b>8,614</b>	<b>13,138</b>
<b>Change in OREO:</b>				
Beginning Balance	14,622	30,167	19,290	35,680
Additions	890	1,242	3,309	4,072
Valuation Write-downs	(397)	(269)	(1,910)	(1,575)
Sales	(2,377)	(5,921)	(7,951)	(12,684)
Other	-	-	-	(274)
<b>Ending Balance</b>	<b>12,738</b>	<b>25,219</b>	<b>12,738</b>	<b>25,219</b>
<b>NPA Net Change</b>	<b>(1,484)</b>	<b>(7,130)</b>	<b>(8,243)</b>	<b>(14,092)</b>
<b>NPA Ending Balance</b>	<b>\$ 21,352</b>	<b>\$ 38,357</b>	<b>\$ 21,352</b>	<b>\$ 38,357</b>



Activity within our TDR portfolio is provided in the table below.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>TDR Beginning Balance:</b>	\$ 37,539	\$ 44,989	\$ 38,321	\$ 49,154
Additions	17	99	1,128	1,254
Charge-Offs	(10)	(289)	(10)	(1,572)
Paid Off/Payments	(519)	(1,707)	(2,001)	(4,027)
Removal Due to Change in TDR Status	-	(4,704)	-	(4,906)
Transferred to OREO	(179)	-	(590)	(1,515)
<b>TDR Ending Balance<sup>(1)</sup></b>	<b>\$ 36,848</b>	<b>\$ 38,388</b>	<b>\$ 36,848</b>	<b>\$ 38,388</b>

<sup>(1)</sup> Includes performing and nonaccrual TDR loan balances.

### **Allowance for Loan Losses**

We maintain an allowance for loan losses at a level that management believes to be sufficient to provide for probable losses inherent in the loan portfolio as of the balance sheet date. Credit losses arise from borrowers' inability or unwillingness to repay, and from other risks inherent in the lending process, including collateral risk, operations risk, concentration risk and economic risk. All related risks of lending are considered when assessing the adequacy of the loan loss reserve. The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes collection of the principal is unlikely. The allowance for loan losses is based on management's judgment of overall loan quality. This is a significant estimate based on a detailed analysis of the loan portfolio. The balance can and will change based on changes in the assessment of the loan portfolio's overall credit quality. We evaluate the adequacy of the allowance for loan losses on a quarterly basis.

The allowance for loan losses was \$13.7 million at September 30, 2016 unchanged from June 30, 2016 and \$14.0 million at December 31, 2015. The allowance for loan losses was 0.88% of outstanding loans and provided coverage of 160% of nonperforming loans at September 30, 2016 compared to 0.89% and 167%, respectively, at June 30, 2016 and 0.93% and 135%, respectively, at December 31, 2015. The decrease in the allowance from December 31, 2015 was attributable to continued favorable problem loan migration and lower net loan charge-offs, partially offset by growth in the loan portfolio. It is management's opinion that the allowance at September 30, 2016 was adequate to absorb losses inherent in the loan portfolio at quarter-end.

### **Deposits**

Average total deposits were \$2.289 billion for the third quarter of 2016, an increase of \$12.2 million, or 0.5%, over the second quarter of 2016, and an increase of \$114.0 million, or 5.2% over the fourth quarter of 2015. The increase in deposits when compared to the second quarter of 2016 reflects growth in all deposit products except noninterest

bearing checking accounts (primarily due to one large, non-core client), public NOW deposits, and certificates of deposit. Compared to the fourth quarter of 2015, growth was experienced in all product types except money market accounts and certificates of deposit. Seasonal public funds balances are expected to reach the low point of this cycle mid-way through the fourth quarter, and increase late in the fourth quarter 2016. Deposit levels remain strong, as the seasonal decline in public NOW accounts was partially offset by increases in savings and high performance checking accounts during the quarter. Average core deposits continue to experience growth in this low rate environment. Competitive rates continue to be monitored as a prudent pricing discipline remains the key to managing our mix of deposits.

## **MARKET RISK AND INTEREST RATE SENSITIVITY**

### **Market Risk and Interest Rate Sensitivity**

*Overview.* Market risk management arises from changes in interest rates, exchange rates, commodity prices, and equity prices. We have risk management policies to monitor and limit exposure to market risk and do not participate in activities that give rise to significant market risk involving exchange rates, commodity prices, or equity prices. In asset and liability management activities, our policies are designed to minimize structural interest rate risk.

*Interest Rate Risk Management.* Our net income is largely dependent on net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or re-price on a different basis than interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and shareowners' equity.

We have established a comprehensive interest rate risk management policy, which is administered by management's Asset/Liability Management Committee ("ALCO"). The policy establishes limits of risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity ("EVE") at risk) resulting from a hypothetical change in interest rates for maturities from one day to 30 years. We measure the potential adverse impacts that changing interest rates may have on our short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by us. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

We prepare a current base case and several alternative simulations, at least once per quarter, and report the analysis to the Board of Directors. In addition, more frequent forecasts may be produced when interest rates are particularly uncertain or when other business conditions so dictate.

Our interest rate risk management goal is to avoid unacceptable variations in net interest income and capital levels due to fluctuations in market rates. Management attempts to achieve this goal by balancing, within policy limits, the volume of floating-rate liabilities with a similar volume of floating-rate assets, by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched, by maintaining our core deposits as a significant component of our total funding sources, and by adjusting pricing rates to market conditions on a continuing basis.

The balance sheet is subject to testing for interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by plus or minus 100, 200, 300, and 400 basis points ("bp"), although we may elect not to use particular scenarios that we determined are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over a 12-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.



We augment our interest rate shock analysis with alternative external interest rate scenarios on a quarterly basis. These alternative interest rate scenarios may include non-parallel rate ramps.

*Analysis.* Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

#### ESTIMATED CHANGES IN NET INTEREST INCOME <sup>(1)</sup>

Changes in Interest Rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit	-15.0%	-12.5%	-10.0%	-7.5%	-7.5%
September 30, 2016	11.3%	7.9%	4.6%	2.1%	-6.1%
June 30, 2016	10.7%	7.2%	4.1%	1.9%	-5.7%

The Net Interest Income at Risk position improved at the end of the third quarter of 2016 when compared to the prior quarter-end for all rate scenarios with the exception of rates down 100 bps. The unfavorable change from the prior quarter-end in this rate scenario reflects higher rates on the short-end, resulting in increased exposure to falling rates. In addition, this analysis incorporates an instantaneous, parallel shock and assumes we move with market rates and do not lag our deposit rates. All measures of net interest income at risk are within our prescribed policy.

The measures of equity value at risk indicate our ongoing economic value by considering the effects of changes in interest rates on all of our cash flows, and discounting the cash flows to estimate the present value of assets and liabilities. The difference between these discounted values of the assets and liabilities is the economic value of equity, which, in theory, approximates the fair value of our net assets.

#### ESTIMATED CHANGES IN ECONOMIC VALUE OF EQUITY <sup>(1)</sup>

Changes in Interest Rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit	-30.0%	-25.0%	-20.0%	-15.0%	-15.0%
September 30, 2016	54.3%	43.1%	30.4%	16.5%	-35.2%
June 30, 2016	50.9%	40.5%	28.6%	15.5%	-36.8%

As of September 30, 2016, the economic value of equity in all rate scenarios versus the base case was more favorable than it was as of June 30, 2016. The EVE in the rates down 100 bps scenario remains outside of the desired parameters as exposure to falling rates is more extreme due to the low level of current deposit costs and limited capacity to reduce those costs relative to comparable discount benchmarks used to value them. To bring this metric into compliance with our policy limits in the down 100 scenario would require the bank to extend its asset duration considerably, which we do not believe is prudent given the current historically low interest rate environment. Note that if the non-maturity deposit values in a rate down 100 bps scenario are assumed to remain unchanged from the flat rate scenario so as not to be valued above book value, EVE is more favorable and within compliance at 9.0%.

*(1) Down 200 and 300 bp scenarios have been excluded due to the current historically low interest rate environment.*

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies that are formulated and monitored by our ALCO and senior management, and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. Our principal source of funding has been our client deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements, federal funds purchased and FHLB borrowings. We believe that the cash generated from operations, our borrowing capacity and our access to

capital resources are sufficient to meet our future operating capital and funding requirements.

As of September 30, 2016, we had the ability to generate \$1.277 billion in additional liquidity through all of our available resources (this excludes \$145 million in overnight funds sold). In addition to primary borrowing outlets mentioned above, we also have the ability to generate liquidity by borrowing from the Federal Reserve Discount Window and through brokered deposits. We recognize the importance of maintaining liquidity and have developed a Contingency Liquidity Plan, which addresses various liquidity stress levels and our response and action based on the level of severity. We periodically test our credit facilities for access to the funds, but also understand that as the severity of the liquidity level increases that certain credit facilities may no longer be available. A liquidity stress test is completed on a quarterly basis based on events that could potentially occur at the Bank with results reported to ALCO, our Market Risk Oversight Committee, and the Board of Directors. As of September 30, 2016, we believe the liquidity available to us was sufficient to meet our needs.

We view our investment portfolio primarily as a source of liquidity and have the option to pledge the portfolio as collateral for borrowings or deposits, and/or sell selected securities. The portfolio consists of debt issued by the U.S. Treasury, U.S. governmental and federal agencies, and municipal governments. The weighted average life of the portfolio is approximately 1.77 years, and as of September 30, 2016 had a net unrealized pre-tax gain of \$1.7 million in the available-for-sale portfolio.

Our average overnight funds position (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$166.2 million during the third quarter of 2016 compared to an average net overnight funds sold position of \$254.6 million in the second quarter of 2016 and \$222.8 million in the fourth quarter of 2015. The decrease in net overnight funds compared to the second quarter of 2016 reflects an increase in both the investment and loan portfolios, in conjunction with a decline in repurchase agreements. The decrease in net overnight funds compared to the fourth quarter of 2015 primarily reflects growth in the loan and investment portfolios, and a reduction in short-term borrowings, partially offset by growth in deposit balances.

Capital expenditures are estimated to approximate \$5.0 million over the next 12 months, which will consist primarily of office remodeling, office equipment/furniture, and technology purchases. Management believes that these capital expenditures will be funded with existing resources without impairing our ability to meet our on-going obligations.

## **Borrowings**

At September 30, 2016, advances from the FHLB totaled \$22.4 million in outstanding debt consisting of 25 notes. During the first nine months of 2016, the Bank made FHLB advance payments totaling approximately \$5.9 million, which includes paying off four advances totaling \$3.9 million. No additional FHLB advances were obtained. The FHLB notes are collateralized by a blanket floating lien on all of our 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity mortgage loans.

We have issued two junior subordinated deferrable interest notes to our wholly owned Delaware statutory trusts. The first note for \$30.9 million was issued to CCBG Capital Trust I in November 2004, of which \$10 million was retired in April 2016. The second note for \$32.0 million was issued to CCBG Capital Trust II in May 2005. The interest payment for the CCBG Capital Trust I borrowing is due quarterly and adjusts quarterly to a variable rate of three-month LIBOR plus a margin of 1.90%. This note matures on December 31, 2034. The interest payment for the CCBG Capital Trust II borrowing is due quarterly and adjusts annually to a variable rate of three-month LIBOR plus a margin of 1.80%. This note matures on June 15, 2035. The proceeds of these borrowings were used to partially fund acquisitions. Under the terms of each junior subordinated deferrable interest note, in the event of default or if we elect to defer interest on the note, we may not, with certain exceptions, declare or pay dividends or make distributions on our capital stock or purchase or acquire any of our capital stock.

On April 12, 2016, we retired \$10 million in face value of trust preferred securities that were auctioned as part of a liquidation of a pooled collateralized debt obligation fund. The trust preferred securities were originally issued through CCBG Capital Trust I. Our winning bid equated to approximately 75% of the \$10 million par value, with the 25% discount resulting in a pre-tax gain of approximately \$2.5 million. We utilized internal resources and a \$3.75 million draw on a short-term borrowing facility to fund the repurchase.

## **Capital**

Equity capital was \$276.6 million as of September 30, 2016, compared to \$274.8 million as of June 30, 2016 and \$274.4 million as of December 31, 2015. Our leverage ratio was 10.12%, 9.98%, and 10.65%, respectively, for these periods. Further, as of September 30, 2016, our risk-adjusted capital ratio was 16.28% compared to 16.44% and 17.25% at June 30, 2016 and December 31, 2015, respectively. Our common equity tier 1 ratio was 12.55% as of September 30, 2016 compared to 12.65% and 12.84% as of June 30, 2016 and December 31, 2015, respectively. All of our capital ratios significantly exceed the threshold to be designated as “well-capitalized” under the Basel III capital

standards. During the second quarter of 2016 we repurchased 432,000 shares of our common stock at an average price of \$14.50 per share and redeemed \$10 million of our outstanding TRUPs. These transactions unfavorably impacted our regulatory capital ratios by approximately 38 basis points and approximately 50 basis points, respectively.

During the first nine months of 2016, shareowners' equity increased \$2.2 million, or 1.1%, on an annualized basis. During this same period, shareowners' equity was positively impacted by net income of \$8.4 million, stock compensation accretion of \$0.7 million, a \$1.0 million net increase in the unrealized gain on investment securities, and net adjustments totaling \$0.5 million related to transactions under our stock compensation plans. Shareowners' equity was reduced by common stock dividends totaling \$2.1 million and the repurchase of common stock of \$6.3 million.

At September 30, 2016, our common stock had a book value of \$16.39 per diluted share compared to \$16.31 at June 30, 2016 and \$15.93 at December 31, 2015. Book value is impacted by changes in the amount of our net unrealized gain or loss on investment securities available-for-sale and changes to the amount of our unfunded pension liability both of which are recorded through other comprehensive income. At September 30, 2016, the net unrealized gain on investment securities available for sale was \$0.9 million and the amount of our unfunded pension liability was \$22.1 million.

In February 2014, our Board of Directors authorized the repurchase of up to 1,500,000 shares of our outstanding common stock through February 2019. Repurchases may be made in the open market or in privately negotiated transactions; however, we are not obligated to repurchase any specified number of shares. During 2016, we have repurchased 435,000 shares at an average price of \$14.49 per share under the plan of which 427,000 shares were acquired in the second quarter of 2016. The plan had 640,000 shares remaining for repurchase as of September 30, 2016.

## **OFF-BALANCE SHEET ARRANGEMENTS**

We do not currently engage in the use of derivative instruments to hedge interest rate risks. However, we are a party to financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of our clients.

At September 30, 2016, we had \$405.1 million in commitments to extend credit and \$5.5 million in standby letters of credit. Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a client to a third party. We use the same credit policies in establishing commitments and issuing letters of credit as we do for on-balance sheet instruments.

If commitments arising from these financial instruments continue to require funding at historical levels, management does not anticipate that such funding will adversely impact the Company's ability to meet its on-going obligations. In the event these commitments require funding in excess of historical levels, management believes current liquidity, advances available from the FHLB and the Federal Reserve, and investment security maturities provide a sufficient source of funds to meet these commitments.

## **CRITICAL ACCOUNTING POLICIES**

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in our 2015 Form 10-K. The preparation of our Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States ("GAAP") and reporting practices applicable to the banking industry requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

We have identified accounting for (i) the allowance for loan and lease losses, (ii) valuation of goodwill, and (iii) pension benefits as our most critical accounting policies and estimates in that they are important to the portrayal of our financial condition and results, and they require our subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2015 Form 10-K.

**TABLE I**  
**AVERAGE BALANCES & INTEREST**  
**RATES**

(Dollars in Thousands)	Three Months Ended September 30,						Nine Months		
	2016		2015		2016		2016		
	Average Balances	Average Interest	Average Rate	Average Balances	Average Interest	Average Rate	Average Balances	Average Interest	
<b>Assets:</b>									
Loans <sup>(1)(2)</sup>	\$ 1,555,889	\$ 18,216	4.66%	\$ 1,483,657	\$ 18,290	4.89%	\$ 1,531,813	\$ 54,590	
Taxable Securities <sup>(2)</sup>	606,606	1,632	1.07	543,550	1,347	0.98	576,790	4,591	
Tax-Exempt Securities	89,241	327	1.47	92,685	304	1.31	91,399	984	
Funds Sold	166,207	212	0.51	190,931	123	0.26	235,414	892	
Total Earning Assets	2,417,943	20,387	3.35%	2,310,823	20,064	3.45%	2,435,416	61,057	
Cash & Due From Banks	45,139			45,872			46,521		
Allowance For Loan Losses	(14,052)			(15,403)			(14,102)		
Other Assets	285,435			298,400			287,444		
<b>TOTAL ASSETS</b>	<b>\$ 2,734,465</b>			<b>\$ 2,639,692</b>			<b>\$ 2,755,279</b>		
<b>Liabilities:</b>									
NOW Accounts	\$ 774,899	\$ 78	0.04%	\$ 709,130	\$ 60	0.03%	\$ 778,840	\$ 214	
Money Market Accounts	258,183	30	0.05	261,749	31	0.05	255,885	89	
Savings Accounts	297,172	37	0.05	258,752	32	0.05	288,740	107	
Other Time Deposits	165,324	78	0.19	183,976	97	0.21	171,052	245	
Total Interest Bearing Deposits	1,495,578	223	0.06	1,413,607	220	0.06	1,494,517	655	
Short-Term Borrowings	12,162	43	1.39	61,548	14	0.09	44,147	91	
Subordinated Notes Payable	52,887	341	2.52	62,887	344	2.14	56,683	1,071	
Other Long-Term Borrowings	23,629	177	2.98	29,383	233	3.15	26,031	599	
Total Interest Bearing Liabilities	1,584,256	784	0.20%	1,567,425	811	0.21%	1,621,378	2,416	
Noninterest Bearing Deposits	793,163			723,826			780,167		
Other Liabilities	79,639			73,485			75,603		
<b>TOTAL LIABILITIES</b>	<b>2,457,058</b>			<b>2,364,736</b>			<b>2,477,148</b>		
<b>TOTAL SHAREOWNERS' EQUITY</b>	<b>277,407</b>			<b>274,956</b>			<b>278,131</b>		
<b>TOTAL LIABILITIES AND SHAREOWNERS' EQUITY</b>	<b>\$ 2,734,465</b>			<b>\$ 2,639,692</b>			<b>\$ 2,755,279</b>		
Interest Rate Spread			3.15%			3.24%			
Net Interest Income		\$ 19,603			\$ 19,253			\$ 58,641	
Net Interest Margin <sup>(3)</sup>			3.23%			3.31%			

<sup>(1)</sup>Average Balances include nonaccrual loans.

<sup>(2)</sup>Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate.

<sup>(3)</sup>Taxable equivalent net interest income divided by average earnings assets.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

See “Market Risk and Interest Rate Sensitivity” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, above, which is incorporated herein by reference. Management has determined that no additional disclosures are necessary to assess changes in information about market risk that have occurred since December 31, 2015.

**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of September 30, 2016, the end of the period covered by this Form 10-Q, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer each concluded that as of September 30, 2016, the end of the period covered by this Form 10-Q, we maintained effective disclosure controls and procedures.

**Changes in Internal Control over Financial Reporting**

Our management, including the Chief Executive Officer and Chief Financial Officer, has reviewed our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). There have been no significant changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are party to lawsuits arising out of the normal course of business. In management's opinion, there is no known pending litigation, the outcome of which would, individually or in the aggregate, have a material effect on our



consolidated results of operations, financial position, or cash flows.

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our 2015 Form 10-K, as updated in our subsequent quarterly reports. The risks described in our 2015 Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosure**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(A) Exhibits

31.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned Chief Financial Officer hereunto duly authorized.

CAPITAL CITY BANK GROUP, INC.

(Registrant)

/s/ J. Kimbrough Davis

J. Kimbrough Davis

Executive Vice President and Chief Financial  
Officer

(Mr. Davis is the Principal Financial Officer and  
has been duly authorized to sign on behalf of the  
Registrant)

Date: November 3, 2016

Exhibit Index

<u>Exhibit</u>	<u>Description</u>
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