

CAPITAL CITY BANK GROUP INC
Form 10-K
March 15, 2012

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-K

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from _____ to _____

(Exact name of Registrant as specified in its charter)

Florida
(State of Incorporation)

0-13358
(Commission File Number)

59-2273542
(IRS Employer Identification No.)

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

32301
(Zip Code)

(850) 671-0300
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition 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

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

The aggregate market value of the registrant's common stock, \$0.01 par value per share, held by non-affiliates of the registrant on June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$99,090,273 (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person known to the registrant to own 10% or more of the outstanding voting power of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a determination for other purposes.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 29, 2012
Common Stock, \$0.01 par value per share	17,182,087 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Proxy Statement for the Annual Meeting of Shareowners to be held on April 24, 2012, are incorporated by reference in Part III.

CAPITAL CITY BANK GROUP, INC.
ANNUAL REPORT FOR 2011 ON FORM 10-K

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INTRODUCTORY NOTE

This Annual Report on Form 10-K 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 words 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.

In addition to those risks discussed in this Annual Report under Item 1A Risk Factors, factors that could cause our actual results to differ materially from those in the forward-looking statements, include, without limitation:

- § our need and our ability to incur additional debt or equity financing;
- § the accuracy of our financial statement estimates and assumptions, including the estimate for our loan loss provision;
- § continued depression of the market value of the Company that could result in an impairment of goodwill;
- § 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;
- § 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;
- § the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- § restrictions on our operations, including the inability to pay dividends without our regulators' consent;
- § the effects of the health and soundness of other financial institutions, including the FDIC's need to increase Deposit Insurance Fund assessments;
- § our ability to declare and pay dividends;
- § 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;
- § 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;
- § the effects of security breaches and computer viruses that may affect our computer systems;
- § changes in consumer spending and saving habits;
- § growth and profitability of our noninterest income;
- § changes in accounting principles, policies, practices or guidelines;

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- § 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 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.

PART I

Item 1. Business

About Us

General

Capital City Bank Group, Inc. (CCBG) is a bank holding company headquartered in Tallahassee, Florida. CCBG was incorporated under Florida law on December 13, 1982, to acquire five national banks and one state bank that all subsequently became part of CCBG's bank subsidiary, Capital City Bank (CCB or the Bank). In this report, the terms Company , we , us , or our mean CCBG and all subsidiaries included in our consolidated financial statements.

We provide traditional deposit and credit services, asset management, trust, mortgage banking, merchant services, bank cards, data processing, and securities brokerage services through 70 full-service banking locations in Florida, Georgia, and Alabama. CCB operates these banking locations. The majority of our revenue, approximately 78%, is derived from our Florida market areas while approximately 21% and 1% of our revenue are derived from our Georgia and Alabama market areas, respectively.

At December 31, 2011, we had total consolidated assets of approximately \$2.641 billion, total deposits of approximately \$2.173 billion and shareowners' equity was approximately \$251.9 million. Our total assets at year-end 2010 were \$2.622 billion and for year-end 2009 totaled \$2.517 billion. Total revenue and net income/(loss) for the last three fiscal years were \$158.3 million and \$4.9 million, respectively for 2011, \$167.3 million and (\$0.4 million), respectively for 2010, and \$180.2 million and (\$3.5 million), respectively for 2009. Our financial condition and results of operations are more fully discussed in our management discussion and analysis on page 34 and our consolidated financial statements on page 65.

Dividends and management fees received from the Bank are our primary source of income. Dividend payments by the Bank to us depend on the capitalization, earnings and projected growth of the Bank, and are limited by various regulatory restrictions. See the section entitled Regulatory Considerations in this Item 1 and Note 15 in the Notes to Consolidated Financial Statements for additional restrictions. We had a total of 959 (full-time equivalent) associates at March 1, 2012. Page 33 contains other financial and statistical information about us.

Subsidiaries of CCBG

CCBG's principal asset is the capital stock of the Bank. CCB, our banking subsidiary, accounted for approximately 100% of consolidated assets at December 31, 2011, and approximately 100% of consolidated net income for the year ended December 31, 2011. In addition to our banking subsidiary, we have three primary indirect subsidiaries, Capital City Trust Company, Capital City Banc Investments, Inc., and Capital City Services Company, all of which are wholly-owned subsidiaries of CCB. We also have two direct wholly-owned subsidiaries of CCBG, CCBG Capital Trust I and CCBG Capital Trust II, which were formed in connection with two issuances of trust preferred securities. The nature of our primary indirect subsidiaries is provided below.

Operating Segment

We have one reportable segment with four principal services: Banking Services (CCB), Data Processing Services (Capital City Services Co.), Trust and Asset Management Services (Capital City Trust Co.), and Brokerage Services (Capital City Banc Investments). Revenues from each of these principal services for the year ended 2011 totaled approximately 93.1%, 2.0%, 2.8%, and 2.1% of our total revenue, respectively. In 2010 and 2009, Banking Services (CCB) revenue was approximately 93.1% and 93.6% of our total revenue, respectively.

Capital City Bank

CCB is a Florida-chartered full-service bank engaged in the commercial and retail banking business. Significant services offered by the Bank include:

- § **Business Banking** The Bank provides banking services to corporations and other business clients. Credit products are available for a wide variety of general business purposes, including financing for commercial business properties, equipment, inventories and accounts receivable, as well as commercial leasing and letters of credit. We also provide treasury management services, and, through a marketing alliance with Elavon, Inc., merchant credit card transaction processing services.
- § **Commercial Real Estate Lending** The Bank provides a wide range of products to meet the financing needs of commercial developers and investors, residential builders and developers, and community development. Credit products are available to

facilitate the purchase of land and/or build structures for business use and for investors who are developing residential or commercial property.

- § *Residential Real Estate Lending* The Bank provides products to help meet the home financing needs of consumers, including conventional permanent and construction/permanent (fixed, adjustable, or variable rate) financing arrangements, and FHA/VA loan products. The bank offers both fixed-rate and adjustable rate residential mortgage (ARM) loans. A portion of our loans originated are sold into the secondary market. The Bank offers these products through its existing network of banking offices. We do not originate subprime residential real estate loans.
- § *Retail Credit* The Bank provides a full range of loan products to meet the needs of consumers, including personal loans, automobile loans, boat/RV loans, home equity loans, and through a marketing alliance with ELAN we offer credit card programs.
- § *Institutional Banking* The Bank provides banking services to meet the needs of state and local governments, public schools and colleges, charities, membership and not-for-profit associations including customized checking and savings accounts, cash management systems, tax-exempt loans, lines of credit, and term loans.
- § *Retail Banking* The Bank provides a full range of consumer banking services, including checking accounts, savings programs, automated teller machines (ATMs), debit/credit cards, night deposit services, safe deposit facilities, PC/Internet banking, and mobile banking. Clients can use Capital City Bank Direct which offers a live call center between the hours of 8 a.m. to 6 p.m. Monday through Friday and from 9 a.m. to 12 noon on Saturday. The call center can also be accessed via live chat through the internet. Bank Direct also offers an automated phone system offering 24-hour access to client deposit and loan account information and transfer of funds between linked accounts. The Bank is a member of the Star ATM Network that permits banking clients to access cash at ATMs or point-of-sale merchants.

Capital City Trust Company

Capital City Trust Company (the Trust Company) is the investment management arm of CCB. The Trust Company provides asset management for individuals through agency, personal trust, IRAs, and personal investment management accounts. Administration of pension, profit sharing, and 401(k) plans is a significant product line. Associations, endowments, and other nonprofit entities hire the Trust Company to manage their investment portfolios. Additionally, a staff of well-trained professionals serves individuals requiring the services of a trustee, personal representative, or a guardian. The market value of trust assets under discretionary management exceeded \$660.6 million as of December 31, 2011, with total assets under administration exceeding \$733.1 million.

Capital City Banc Investments, Inc.

Capital City Banc Investments, Inc. offers access to retail investment products through INVEST Financial Corporation, a member of FINRA and SIPC. Non-deposit investment and insurance products are: (i) not FDIC insured; (ii) not deposits, obligations, or guaranteed by any bank; and (iii) subject to investment risk, including the possible loss of principal amount invested. Capital City Banc Investments, Inc. offers a full line of retail securities products, including U.S. Government bonds, tax-free municipal bonds, stocks, mutual funds, unit investment trusts, annuities, life insurance and long-term health care. We are not an affiliate of INVEST Financial Corporation.

Capital City Services Company

Capital City Services Company (the Services Company) provides data processing services to financial institutions (including CCB), government agencies, and commercial clients located in North Florida and South Georgia. As of March 1, 2012, the Services Company is providing data processing services to five correspondent banks, which have relationships with CCB.

Regulatory Matter

Capital City Bank

As previously disclosed, the Board of Governors of the Federal Reserve System (the Federal Reserve) recently conducted a regular safety and soundness examination of CCB. In accordance with their findings, the Federal Reserve requested that the CCB Board of Directors approve a board resolution addressing matters described below (the 2012 Bank Resolution). Because we have fully complied with the obligations of the board resolution adopted by the CCB Board of Directors in February 2010 (the Existing Bank Resolution), the 2012 Bank Resolution supersedes and replaces the Existing Bank Resolution. From a regulatory perspective and the same as the Existing Bank Resolution, the 2012 Bank Resolution is an informal, nonpublic agreement, which is the mildest form of supervisory action used by the Federal Reserve to correct problems or to request periodic reports addressing certain aspects of a member bank's operations. No capital directive is included in the 2012 Bank Resolution and, as was previously disclosed, CCB is not required to adjust its allowance for loan losses as a result of the recent examination.

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The 2012 Bank Resolution requires CCB to (i) obtain prior approval from the Federal Reserve and OFR before declaring or paying dividends to CCBG; and (ii) validate its allowance for loan and lease losses (ALLL) methodology, including revising its ALLL policy to clearly define roles and responsibilities and ensure that the validation process is independent of the estimation process.

We expect to execute the 2012 Bank Resolution by the end of the first quarter of 2012, and fully comply within the prescribed time frames.

Capital City Bank Group, Inc.

In February 2010, the Board of Directors of CCBG approved a board resolution requested by the Federal Reserve (the 2010 Holding Company Resolution), and together with the 2012 Bank Resolution, the Federal Reserve Resolutions), which remains in effect. Under the 2010 Holding Company Resolution, without the prior approval of the Federal Reserve, CCBG agreed to not (i) incur any new debt or refinance existing debt; (ii) declare any dividends on any class of stock or make any payments on its trust preferred securities; (iii) reduce its capital position by redeeming shares of stock; or (iv) make any payment that would reduce capital outside of normal and routine operating expenses.

Status of Resolutions

While both CCB and CCBG continue to remain well capitalized, we do not expect the Federal Reserve Resolutions to be rescinded until asset quality and the level of credit risk exposure improve.

Dividends and Trust Preferred Payments

On December 14, 2011, we announced the suspension of our quarterly dividend on our common stock. We believe that, given our inability to earn our dividend since 2008, it was, and continues to be, prudent to preserve our capital at least until the economic conditions in Florida and Georgia improve. In addition, in consultation with the Federal Reserve, we have agreed to defer the payment of interest on the Company's trust preferred securities and to maintain the suspension of our quarterly dividend on our common stock until asset quality and the level of credit risk exposure improve. We will, however, continue the accrual of interest on the trust preferred securities in accordance with our contractual obligations. Furthermore, due to our contractual obligations with the holders of the trust preferred securities, we may not make dividend payments to our shareowners in the future until all accrued and unpaid interest owed to trust preferred securities holders is paid. Therefore, we cannot pay dividends to our shareowners until we (i) obtain approval from our regulators to pay interest on our trust preferred securities, (ii) pay all accrued and unpaid interest owed to holders of our trust preferred securities, and (iii) obtain approval from our regulators to pay dividends to our shareowners. We remain committed to resuming dividend payments to our shareowners and interest on our trust preferred securities as soon as conditions warrant, and subject to approval from our regulators, which approval may not be granted until such time as CCB's asset quality and the level of credit risk exposure improve.

Underwriting Standards

A core goal of CCB is to support the communities in which it operates. The Bank seeks loans from within its primary trade area, which is defined as the counties in which the Bank's offices are located. The Bank will originate loans within its secondary trade area, defined as adjacent counties to those in which the Bank has offices. There may also be occasions when the Bank will have opportunities to make loans that are out of both the primary and secondary trade areas. These loans will only be approved if the applicant is known to the Bank and applicant's primary business is within our primary or secondary trade area. Approval of all loans is subject to the Bank's policies and standards described in more detail below.

The Bank has adopted comprehensive lending policies, underwriting standards and loan review procedures. Management and the Board of Directors reviews and approves these policies and procedures on a regular basis (at least annually). No material changes have been made to these policies and procedures in the past five years.

Management has also implemented reporting systems to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans. Bank 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 portfolio are monitored and reported to the Board on a quarterly basis (i.e., commercial real estate) and have strategic plans in place to supplement Board approved credit policies governing exposure limits and underwriting standards. The Bank recognizes that exceptions to the below listed policy guidelines may occasionally occur and has established procedures for approving exceptions to these policy guidelines.

Residential Real Estate Loans

The Bank originates 1-4 family, owner-occupied residential real estate loans in its Residential Real Estate line of business. The Bank's policy is to underwrite these loans in accordance with secondary market guidelines in effect at the time of origination, including loan-to-value (LTV) and documentation requirements. The Bank originates fixed-rate, adjustable-rate and variable rate residential real estate loans. Over the past two years, the vast majority of residential loan originations have been fixed-rate loans which are sold in the secondary market on a non-recourse basis with related servicing rights (i.e., the Bank does not service sold loans). These loans require private mortgage insurance (PMI) if the LTV exceeds 80%. Some of the adjustable-rate residential real estate product is retained in the Bank's loan portfolio and loans with LTV's in excess of 85% require PMI. ARM loans with an initial fixed interest rate period greater than three years are sold in the secondary market on a non-recourse basis. The Bank verifies applicants' income, obtains credit reports and independent real estate appraisals in the underwriting process to ensure adequate collateral coverage and that loans are extended to individuals with good credit and income sufficient to repay the loan. Underwriting documentation is maintained in accordance with secondary market guidelines. The Bank has approved and funded two option ARM loans in the past, but no longer offers an option ARM product. The Bank has never offered subprime loans. Since 2008, the Bank has not offered initial teaser rates on ARM products maintained in the Bank's portfolio. Prior to 2008, the Bank offered slightly discounted (1%) initial fixed interest rates on ARM loans maintained in the Bank's loan portfolio.

The Bank also originates 1-4 family, owner-occupied residential real estate loans throughout its banking office network. These loans are generally not eligible for sale into the secondary market due to not meeting a specific secondary market underwriting requirement. The product offering is a variable rate 3/1 ARM with a maximum term of 30 years and maximum LTV of 80%. The Bank verifies applicants' income, obtains credit reports and independent real estate appraisals in the underwriting process to ensure adequate collateral coverage and that loans are extended to individuals with good credit and income sufficient to repay the loan.

Residential real estate loans also include home equity lines of credit and home equity loans (HELOCs). The Bank's home equity portfolio includes revolving open-ended equity loans with interest-only or minimal monthly principal payments and closed-end amortizing loans. As of December 31, 2011, approximately 78% of the residential home equity loan portfolio consisted of the revolving open-ended product. Both equity loan products are available for both first mortgage and junior liens. Approximately 60% of the Bank's \$244.3 million residential home equity loan portfolio consisted of first lien mortgages at December 31, 2011. Policy guidelines include the following:

- § a maximum LTV of 80%, including the first mortgage amount; maximum total debt to income ratio of 40%; minimum Beacon score of 630; not subject to PMI;
- § a maximum LTV of 90%, including the first mortgage amount; maximum total debt to income ratio of 30%; minimum Beacon score of 700; not subject to PMI; and
- § a maximum LTV of 100%, including the first mortgage amount; maximum total debt to income ratio of 40%; minimum Beacon score of 630; PMI required for full loan amount.

Interest rates may be fixed or adjustable. Adjustable-rate loans are tied to the Prime Rate with a typical margin of 1.0% or more. Adjustable-rate loans are typically underwritten based upon an assumed rate of no lower than 8.0%, being higher if the fully indexed rate is higher. Appraisals are normally required for all residential real estate loans, both those sold to the secondary market and those maintained in the Bank's loan portfolio. These appraisals are required to comply with regulatory guidance concerning loans secured by primary residences and underwriting standards established for secondary market loan sales. For HELOCs, a drive-by appraisal may be used in instances where the loan exposure is less than \$250,000. In certain cases, and when the senior and junior mortgages represent a cumulative loan exposure of \$600,000 or more, a full appraisal is required.

Commercial Loans

The Bank's policy sets forth guidelines for debt service coverage ratios, LTVs and documentation standards. Commercial loans are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral and personal or other guarantees. The Bank's 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 the Bank's commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory. Many of the loans in the commercial portfolio have variable interest rates tied to the Prime Rate or U.S. Treasury indices.

Commercial Real Estate Loans

The Bank's policy sets forth guidelines for debt service coverage ratios, LTVs and documentation standards. Commercial real estate loans are primarily made based on identified cash flows of the borrower with consideration given to underlying real estate collateral and personal guarantees. The Bank's policy establishes a maximum LTV specific to property type (ranging from 65% for raw land up to 80% for improved properties) and minimum 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. Commercial real estate loans may be fixed or variable-rate loans with interest rates tied to the Prime Rate or U.S. Treasury indices.

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Bank policy requires appraisals for loans in excess of \$250,000 that are secured by real property. Appraisals are required to be prepared by a state-licensed or state-certified appraiser (in accordance with the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and other applicable regulatory guidelines).

Consumer Loans

The Bank's consumer 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. The majority of the Bank's consumer loans are short-term and have fixed rates of interest that are set giving consideration to current market interest rates and the financial strength of the borrower. The Bank's policy establishes maximum debt to income ratios, minimum credit scores, and includes guidelines for verification of applicants' income and receipt of credit reports.

Lending Limits and Extensions of Additional Credit

The Bank has established an internal lending limit of \$10.0 million for the total aggregate amount of credit that will be extended to a client and any related entities within its Board approved policies. In practice, the Bank seeks to maintain an internal lending limit of \$7.5 million in order to maintain a well-diversified loan portfolio. As of December 31, 2011, there were only seven client relationships (including parties affiliated with borrowers) above the \$7.5 million level with a cumulative loan exposure (both outstanding and available) of approximately \$56.1 million, one of which was a substandard credit relationship.

In the normal course of business, the Bank does not extend additional credit to a client who has had a loan charged-off or is classified as substandard. However, as part of the modification process with a troubled client, we may make an additional loan to a borrower (or an advance under an existing loan agreement) as part of the workout process. This is not a normal practice and is typically only undertaken when the client provides a credit enhancement as part of the agreement (i.e., additional collateral, new guarantor, etc.) that provides a material improvement to the loan structure. These types of modifications are reviewed on a case-by-case basis due to their unique nature.

In addition, CCB limits the authority of its loan officers to originate, monitor, and collect on loans based on a number of factors, including without limitation, the ability, attitudes, experience, market knowledge, and character of loan officers. All of these factors are considered in assigning individual loan authorities, as well as determining the officer's responsibilities. Each CCB loan officer has been assigned a loan authority limit. Loans in excess of the officer's authority are submitted to the Bank's centralized Credit Administration Department for underwriting and approval if the loan is within the department's approval limits or to the Bank's Credit Committee if the loan exceeds the department's approval limits. These limits have been established in order to better manage credit risk and are based on aggregate debt with the client and related party interests, as described above.

Loan Modification and Restructuring

In the normal course of business, CCB receives requests from its clients to renew, extend, refinance, or otherwise modify their current loan obligations. In most cases, this may be the result of a balloon maturity that is typical in most commercial loan agreements, a request to refinance to obtain current market rates of interest, competitive reasons, or the conversion of a construction loan to a permanent financing structure at the completion or stabilization of the property. In these cases, the request is held to the normal underwriting standards and pricing strategies as any other loan request, whether new or renewal.

In some cases, the modification may be due to a reduction in debt service capacity experienced by the client (i.e., potentially troubled loan whereby the client may be experiencing financial difficulties). To maximize the collection of loan balances, we evaluate troubled loans on a case-by-case basis to determine if a loan modification would be appropriate. We pursue loan modifications when there is a reasonable chance that an appropriate modification would allow our client to continue servicing the debt.

For loans secured by residential real estate, if the client demonstrates a loss of income such that the client cannot reasonably support even a modified loan, we may pursue short sales or deed-in-lieu arrangements. For loans secured by income producing commercial properties, we perform a rigorous and ongoing review that is systematic in nature. We review a number of factors, including cash flow, loan structure, collateral value, and guarantees, to identify loans within our income producing commercial loan portfolio that are most likely to experience distress. Based on our review of these factors and our assessment of overall risk, we evaluate the benefits of proactively initiating discussions with our clients to improve a loan's risk profile.

In some cases, we may renegotiate terms of their loans so that they have a higher likelihood of continuing to perform. To date, we have restructured loans in a variety of ways to help our clients service their debt and to mitigate the potential for additional losses. The primary restructuring methods being offered to our residential clients are reductions in interest rates and extensions in terms. For commercial loans, the primary restructuring method is the extensions of terms.

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Accruing loans with modifications deemed to be economic concessions resulting from borrower difficulties are reported as Troubled Debt Restructurings (TDR s). Nonaccruing loans that are modified and demonstrate a history of repayment performance and a probability of future performance in accordance with their modified terms are reclassified to accruing status, typically after a designated period of time.

Loans that are past due in principal or interest for more than 90 days are placed on nonaccrual status, unless the loan is well-secured and in the process of collection. Bank policy dictates that all loans, whether current or delinquent, to such a past due borrower or related entity be classified. CCB s historic and current policy prohibits making additional loans to a borrower or any related interest of a borrower who is on nonaccrual status or who is past due in principal or interest more than 90 days, except under certain workout plans when the client provides a credit enhancement as part of the plan (i.e., additional collateral, new guarantor, etc.) and if such extension of credit aids with loss mitigation. These types of modifications are reviewed on a case-by-case basis due to their unique nature.

In some cases, when it is determined that the client does not have the capacity and/or desire to work with the Bank in order to arrive at an amicable arrangement we will pursue foreclosure and/or other litigation. These proceedings are subject to the laws of the states in which we operate, primarily Florida and Georgia. The majority of our legal proceedings are in Florida.

State law in Florida requires us to foreclose through a court proceeding. As part of our efforts to maximize our recovery, we may temporarily delay foreclosure and seek judgments via lawsuit. This proceeding is typically undertaken in cases where we have found commercial loan clients to be strategically working against the Bank or as a means for us to obtain the original collateral and additional liens in an accelerated manner (i.e., may allow for a faster process than normal foreclosure proceedings). There have been very few delays in foreclosure due to documentation weaknesses and they are immaterial to the overall process.

Additionally, under certain circumstances, we may convert construction loans to commercial loans. The Bank s policy regarding residential construction loans (one-to-four family homes financed for home builders) is to only make such construction loans to experienced local builders who have a successful track record with the Bank, and then only when the construction will be in our market, as defined by policy. Each loan is typically made for a period of one year to allow for construction and marketing. After such period, if the property has not been sold, the loan may be extended for an additional six months. If after such extension the property has not been sold, the loan is typically put on an amortizing basis of no more than 20 years. Exceptions to this policy are made when warranted and only after approval from the Bank s central Credit Committee.

The Bank s policy regarding commercial construction loans (i.e., owner-occupied buildings, project-financing, or income-producing properties) provides for a detailed underwriting and approval process, requires the use of Bank-approved contractors, and delegates administration of the process to the Bank s central Construction Loan Administration department. These loans normally include an interest-only period (during the construction and stabilization period) and subsequent conversion to a set amortization period depending on property type and policy limits following the construction and stabilization period.

Expansion of Business

Our philosophy is to grow and prosper, building long-term client relationships based on quality service, high ethical standards, and safe and sound banking practices. We maintain a locally oriented, community-based focus, which is augmented by experienced, centralized support in select specialized areas. Our local market orientation is reflected in our network of banking office locations, experienced community executives with a dedicated president for each market, and community boards that support our focus on responding to local banking needs. We strive to offer a broad array of sophisticated products and to provide quality service by empowering associates to make decisions in their local markets.

We have sought to build a franchise in small-to medium-sized, less competitive markets, located on the outskirts of the larger metropolitan markets where we are positioned as a market leader. Many of our markets are on the outskirts of these larger markets in close proximity to major interstate thoroughfares such as Interstates I-10 in Florida and I-75 in Florida and Georgia. Our three largest markets are Tallahassee (Leon-Florida), Gainesville (Alachua-Florida), and Macon (Bibb-Georgia). As of June 30, 2011, in 13 of 20 counties where we have banking offices in Florida and 3 of 5 counties where we have banking offices in Georgia, we rank within the top 4 banks in terms of market share. Furthermore, in the counties in which we operate, we collectively maintain an 8.82% market share in the Florida counties and 6.26% in the Georgia counties, suggesting that there is significant opportunity to grow market share within these geographic areas. The larger employers in many of our markets are state and local governments, healthcare providers, education institutions, and small businesses. While we realize that the markets in our footprint do not provide for a level of potential growth that the larger metropolitan markets may provide, our markets do provide good growth dynamics and have historically grown in excess of the national average. We strive to provide value added services to our clients by being their banker, not just a bank. This element of our strategy enables us to distinguish Capital City Bank from its competitors and was memorialized during 2009 and 2010 in our More Than Your Bank, Your Banker advertising campaign.

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Over the last five years, our growth has slowed significantly. Since 2007, our number of offices has increased by one. Average loans have declined from \$1.935 billion in 2007 to \$1.687 billion in 2011. Average deposits have grown from \$1.990 billion in 2007 to \$2.082 billion in 2011. Similarly, total average assets have increased from \$2.507 billion in 2007 to \$2.583 billion in 2011. Nonperforming loan inflow has stabilized since 2009, but total nonperforming assets remain elevated at 5.21% of total assets at December 31, 2011. The elevated nonperforming assets combined with lower net interest margins have led to significantly lower earnings for the past four years compared to earnings in 2006 and 2007.

While our growth has slowed, our long-term vision remains to profitably expand our franchise through a combination of organic growth in existing markets and acquisitions. We have long understood that our core deposit funding base is a predominant driver in our profitability and overall franchise value and have focused extensively on this component of our organic growth efforts in recent years. While we have not been an active acquirer of banks since 2005, acquisitions remain a part of our strategy. During the period 2005 to 2008, unreasonable pricing expectations prevented us from consummating an acquisition. Since 2008, economic conditions and lack of visibility into credit quality of potential targets have kept us out of the acquisition market. Furthermore, we would need to seek approval from the Federal Reserve to acquire any financial institution, which approval will receive greater scrutiny until such time as CCB's asset quality and credit risk exposure improve.

As conditions improve, potential acquisition growth will continue to be focused on Florida, Georgia, and Alabama with a particular focus on financial institutions located on the outskirts of major metropolitan areas within a geographic circle, which borders on, but does not include the cities of Tampa, Orlando, Jacksonville, Atlanta, and Mobile. Five markets have been identified, four in Florida and one in Georgia, in which management will proactively pursue expansion opportunities. These markets include Alachua, Marion, Hernando/Pasco counties in Florida, the western panhandle of Florida, and Bibb and surrounding counties in central Georgia. Our focus on some of these markets may change as we continue to evaluate our strategy and the impact the current economic cycle is having on any individual market. We will also continue to evaluate de novo expansion opportunities in attractive new markets in the event that acquisition opportunities are not feasible. Other expansion opportunities that will be evaluated include asset management and mortgage banking. Embedded in our acquisition strategy is our desire to partner with institutions that are culturally similar, have experienced management and possess either established market presence or have potential for improved profitability through growth, economies of scale, or expanded services. Generally, these target institutions will range in asset size from \$100 million to \$400 million. As discussed above, our ability to expand in the short-term may be restricted by our elevated levels of nonperforming assets and the Federal Reserve Resolutions (See *Item 1. Business About Us Regulatory Matter*).

Competition

We operate in a highly competitive environment, especially with respect to services and pricing. In addition, the banking business is experiencing enormous changes. In 2009, 140 financial institutions failed in the U.S., including 25 in Georgia and 14 in Florida. In 2010, 157 financial institutions failed in the U.S., including 21 in Georgia and 29 in Florida. In 2011, 92 financial institutions failed in the U.S., including 23 in Georgia and 13 in Florida. Nearly all of the failed banks were community banks. The assets and deposits of many of these failed community banks were acquired mostly by larger financial institutions, and we expect significant consolidation to continue during 2012. We believe that the larger financial institutions acquiring failed banks in our market areas are less familiar with the markets in which we operate and typically target a different client base. We believe clients who bank at community banks tend to prefer the relationship style service of community banks compared to larger banks. As a result, we believe the reduction of the number of community banks could further enhance our competitive position and opportunities in many of our markets. Larger financial institutions, however, can benefit from economies of scale. Therefore, these larger institutions may be able to offer banking products and services at more competitive prices than us. Additionally, these larger financial institutions may offer financial products that we do not offer.

Our primary market area consists of 20 counties in Florida, five counties in Georgia, and one county in Alabama. In these markets, the Bank competes against a wide range of banking and nonbanking institutions including savings and loan associations, credit unions, money market funds, mutual fund advisory companies, mortgage banking companies, investment banking companies, finance companies and other types of financial institutions. All of Florida's major banking concerns have a presence in Leon County. CCB's Leon County deposits totaled \$817.8 million, or 37.6% of our consolidated deposits at December 31, 2011.

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The following table depicts our market share percentage within each respective county, based on total commercial bank deposits within the county.

	Market Share as of June 30, ⁽¹⁾		
	2011	2010	2009
Florida			
Alachua County	4.2%	4.8%	3.9%
Bradford County	52.2%	50.3%	51.3%
Citrus County	3.0%	2.9%	2.7%
Clay County	1.8%	1.8%	1.7%
Dixie County	18.8%	21.3%	23.4%
Gadsden County	60.4%	59.1%	55.1%
Gilchrist County	34.4%	39.2%	39.5%
Gulf County	11.3%	8.3%	7.7%
Hernando County	1.8%	2.0%	1.6%
Jefferson County	21.3%	19.5%	18.3%
Leon County	15.7%	16.9%	15.9%
Levy County	28.5%	28.6%	27.9%
Madison County	10.0%	10.2%	10.1%
Pasco County	0.2%	0.3%	0.2%
Putnam County	18.6%	14.9%	14.0%
St. Johns County	1.0%	0.9%	0.8%
Suwannee County	6.5%	6.7%	6.6%
Taylor County	32.0%	30.7%	30.7%
Wakulla County	10.9%	5.3%	3.8%
Washington County	13.0%	13.8%	14.2%
Georgia			
Bibb County	3.5%	3.3%	2.6%
Burke County	8.3%	6.9%	7.7%
Grady County	15.8%	16.1%	16.2%
Laurens County	10.6%	10.9%	12.7%
Troup County	6.1%	7.2%	5.9%
Alabama			
Chambers County	6.8%	5.7%	6.6%

⁽¹⁾ Obtained from the June 30, 2011 FDIC Summary of Deposits Report.

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The following table sets forth the number of commercial banks and offices, including our offices and our competitors' offices, within each of the respective counties.

County	Number of Commercial Banks	Number of Commercial Bank Offices
Florida		
Alachua	17	65
Bradford	3	3
Citrus	14	49
Clay	15	33
Dixie	4	5
Gadsden	4	6
Gilchrist	4	8
Gulf	4	7
Hernando	14	42
Jefferson	2	2
Leon	18	92
Levy	4	13
Madison	6	6
Pasco	25	116
Putnam	6	15
St. Johns	21	61
Suwannee	5	8
Taylor	3	4