Independent Bank Group, Inc.
Form 10-Q
July 27, 2016

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

FORM 10-Q
(Mark One)
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended June 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 001-35854

Independent Bank Group, Inc.
(Exact name of registrant as specified in its charter)

Texas	13-4219346
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1600 Redbud Boulevard, Suite 400 McKinney, Texas	75069-3257
(Address of principal executive offices)	(Zip Code)

(972) 562-9004
(Registrant's telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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 such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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. Check One:

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Applicable Only to Corporate Issuers
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.
Common Stock, Par Value $0.01 Per Share – 18,475,978 shares as of July 26, 2016.

INDEPENDENT BANK GROUP, INC. AND SUBSIDIARIES
Form 10-Q
June 30, 2016

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Balance Sheets
June 30, 2016 (unaudited) and December 31, 2015
(Dollars in thousands, except share information)

Assets	June 30, 2016	December 31, 2015
Cash and due from banks	$153,975	$129,096
Interest-bearing deposits in other banks	282,630	164,183
Cash and cash equivalents	436,605	293,279
Certificates of deposit held in other banks	12,886	61,746
Securities available for sale (amortized cost of $282,616 and $270,711, respectively)	287,976	273,463
Loans held for sale	13,942	12,299
Loans, net of allowance for loan losses of $30,916 and $27,043, respectively	4,218,549	3,960,809
Premises and equipment, net	93,151	93,015
Other real estate owned	1,567	2,168
Federal Home Loan Bank (FHLB) of Dallas stock and other restricted stock	26,379	14,256
Bank-owned life insurance (BOLI)	56,396	40,861
Deferred tax asset	5,192	5,892
Goodwill	258,319	258,643
Core deposit intangible, net	15,161	16,357
Other assets	20,674	22,212
Total assets	$5,446,797	$5,055,000
Liabilities, Temporary Equity and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$1,107,620	$1,071,656
Interest-bearing	3,100,785	2,956,623
Total deposits	4,208,405	4,028,279
FHLB advances	470,784	288,325
Repurchase agreements	—	12,160
Other borrowings	107,335	68,295
Other borrowings, related parties	50	2,503
Junior subordinated debentures	18,147	18,147
Other liabilities	12,448	9,982
Total liabilities	4,817,169	4,427,691
Commitments and contingencies		
Temporary equity: Series A preferred stock (0 and 23,938.35 shares issued and outstanding, respectively)	—	23,938
Stockholders' equity:		
Common stock (18,475,978 and 18,399,194 shares outstanding, respectively)	185	184
Additional paid-in capital	533,369	530,107
Retained earnings	91,997	70,698

Accumulated other comprehensive income	4,077	2,382
Total stockholders' equity	629,628	603,371
Total liabilities, temporary equity and stockholders' equity	$5,446,797	$5,055,000

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Income
Three and Six Months Ended June 30, 2016 and 2015 (unaudited)
(Dollars in thousands, except per share information)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest income:				
Interest and fees on loans	$50,418	$41,625	$100,328	$81,205
Interest on taxable securities	764	551	1,494	1,160
Interest on nontaxable securities	444	449	895	863
Interest on interest-bearing deposits and other	315	122	688	255
Total interest income	51,941	42,747	103,405	83,483
Interest expense:				
Interest on deposits	3,923	3,018	7,574	5,727
Interest on FHLB advances	998	718	1,999	1,470
Interest on repurchase agreements and other borrowings	987	1,096	1,990	2,165
Interest on junior subordinated debentures	150	135	299	263
Total interest expense	6,058	4,967	11,862	9,625
Net interest income	45,883	37,780	91,543	73,858
Provision for loan losses	2,123	1,659	5,120	3,329
Net interest income after provision for loan losses	43,760	36,121	86,423	70,529
Noninterest income:				
Service charges on deposit accounts	1,752	1,679	3,447	3,264
Mortgage fee income	2,021	1,429	3,397	2,729
Gain on sale of other real estate	10	49	53	179
Gain on sale of securities available for sale	4	90	4	90
Gain on sale of premises and equipment	3	—	41	—
Increase in cash surrender value of BOLI	270	268	535	538
Other	869	594	1,922	1,275
Total noninterest income	4,929	4,109	9,399	8,075
Noninterest expense:				
Salaries and employee benefits	19,567	14,650	36,341	29,074
Occupancy	4,041	4,027	8,081	7,937
Data processing	1,203	666	2,385	1,354
FDIC assessment	869	493	1,595	1,012
Advertising and public relations	251	253	546	599
Communications	550	554	1,085	1,093
Net other real estate owned expenses (including taxes)	2	37	35	96
Other real estate impairment	—	25	55	25
Core deposit intangible amortization	492	367	980	739
Professional fees	977	677	1,637	1,167
Acquisition expense, including legal	90	28	729	500
Other	2,981	2,678	6,073	5,245
Total noninterest expense	31,023	24,455	59,542	48,841
Income before taxes	17,666	15,775	36,280	29,763
Income tax expense	5,857	5,204	12,019	9,740

Net income	$11,809	$10,571	$24,261	$20,023
Basic earnings per share	$0.64	$0.61	$1.31	$1.16
Diluted earnings per share	$0.64	$0.61	$1.31	$1.16

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
Three and Six Months Ended June 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$11,809	$10,571	$24,261	$20,023
Other comprehensive income (loss) before tax:				
Change in net unrealized gains (losses) on available for sale securities during the year	1,407	(2,087)	2,612	(706)
Reclassification adjustment for gain on sale of securities available for sale included in net income	(4)	(90)	(4)	(90)
Other comprehensive income (loss) before tax	1,403	(2,177)	2,608	(796)
Income tax expense (benefit)	491	(821)	913	(338)
Other comprehensive income (loss), net of tax	912	(1,356)	1,695	(458)
Comprehensive income	$12,721	$9,215	$25,956	$19,565

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
Six Months Ended June 30, 2016 and 2015 (unaudited)
(Dollars in thousands, except for par value, share and per share information)

	Series A Preferred Stock $.01 Par Value 10 million shares authorized	Common Stock $.01 Par Value 100 million shares authorized		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
		Shares	Amount				
Balance, December 31, 2015	$ —	18,399,194	$ 184	$ 530,107	$ 70,698	$ 2,382	$ 603,371
Net income	—	—	—	—	24,261	—	24,261
Other comprehensive income, net of tax	—	—	—	—	—	1,695	1,695
Restricted stock forfeited	—	(6,036)	—	—	—	—	—
Restricted stock granted	—	82,820	1	(1)	—	—	—
Stock based compensation expense	—	—	—	3,641	—	—	3,641
Income tax deficiency on restricted stock vested	—	—	—	(378)	—	—	(378)
Preferred stock dividends	—	—	—	—	(8)	—	(8)
Cash dividends ($0.16 per share)	—	—	—	—	(2,954)	—	(2,954)
Balance, June 30, 2016	$ —	18,475,978	$ 185	$ 533,369	$ 91,997	$ 4,077	$ 629,628
Balance, December 31, 2014	$ 23,938	17,032,669	$ 170	$ 476,609	$ 37,731	$ 2,403	$ 540,851
Net income	—	—	—	—	20,023	—	20,023
Other comprehensive loss, net of tax	—	—	—	—	—	(458)	(458)
Offering costs related to acquired bank	—	—	—	(144)	—	—	(144)
Restricted stock forfeited	—	(11,399)	—	—	—	—	—
Restricted stock granted	—	87,124	1	(1)	—	—	—
Income tax deficiency on restricted stock vested	—	—	—	(66)	—	—	(66)
Stock based compensation expense	—	—	—	2,099	—	—	2,099
Preferred stock dividends	—	—	—	—	(120)	—	(120)
Cash dividends ($0.16 per share)	—	—	—	—	(2,738)	—	(2,738)
Balance, June 30, 2015	$ 23,938	17,108,394	$ 171	$ 478,497	$ 54,896	$ 1,945	$ 559,447

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
Six Months Ended June 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2016			2015		
Cash flows from operating activities:						
Net income	$	24,261		$	20,023	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation expense	3,306			3,074		
Accretion of income recognized on acquired loans	(3,362		)	(1,211		)
Amortization of core deposit intangibles	980			739		
Amortization of premium on securities, net	812			772		
Amortization of discount and origination costs on other borrowings	64			75		
Stock based compensation expense	3,641			2,099		
FHLB stock dividends	(103		)	(22		)
Gain on sale of securities available for sale	(4		)	(90		)
Gain on sale of premises and equipment	(41		)	—		
Gain recognized on other real estate transactions	(53		)	(179		)
Impairment of other real estate	55			25		
Deferred tax (benefit) expense	(388		)	194		
Provision for loan losses	5,120			3,329		
	(535		)	(538		)

Increase in cash surrender value of life insurance				
Loans originated for sale	(133,684	)	(113,721	)
Proceeds from sale of loans	132,041		110,937	
Net change in other assets	446		6,243	
Net change in other liabilities	2,068		36,111	
Net cash provided by operating activities	34,624		67,860	
Cash flows from investing activities:				
Proceeds from maturities, calls and pay downs of securities available for sale	399,799		171,680	
Proceeds from sale of securities available for sale	5,399		12,128	
Purchases of securities available for sale	(417,911	)	(156,599	)
Proceeds from maturities of certificates held in other banks	48,860		—	
Purchase of bank owned life insurance contracts	(15,000	)	—	
Net (purchases) redemptions of FHLB stock	(12,020	)	402	
Net loans originated	(259,286	)	(172,760	)
Additions to premises and equipment	(3,564	)	(4,290	)
Proceeds from sale of premises and equipment	163		—	
Proceeds from sale of other real estate owned	1,122		1,437	
Capitalized additions to other real estate owned	—		(10	)
Net cash used in investing activities	(252,438	)	(148,012	)

Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	213,324	175,533
Net (decrease) increase in time deposits	(53,886)	42,353
Proceeds from FHLB advances	525,000	105,000
Repayments of FHLB advances	(342,541)	(140,039)
Net change in repurchase agreements	8,528	1,362
Repayments of other borrowings	(5,798)	(966)
Proceeds from other borrowings	43,413	—
Redemption of preferred stock	(23,938)	—
Offering costs paid in connection with acquired banks	—	(144)
Dividends paid	(2,962)	(2,798)
Net cash provided by financing activities	361,140	180,301
Net change in cash and cash equivalents	143,326	100,149
Cash and cash equivalents at beginning of year	293,279	324,047
Cash and cash equivalents at end of period	$ 436,605	$ 424,196

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)
(Dollars in thousands, except for share and per share information)

Note 1. Summary of Significant Accounting Policies
Nature of Operations: Independent Bank Group, Inc. (IBG) through its subsidiary, Independent Bank, a Texas state banking corporation (Bank) (collectively known as the Company), provides a full range of banking services to individual and corporate customers in the North Texas, Central Texas and Houston areas through its various branch locations in those areas. The Company is engaged in traditional community banking activities, which include commercial and retail lending, deposit gathering, investment and liquidity management activities. The Company’s primary deposit products are demand deposits, money market accounts and certificates of deposit, and its primary lending products are commercial business and real estate, real estate mortgage and consumer loans.
Basis of Presentation: The accompanying consolidated financial statements include the accounts of IBG, its wholly-owned subsidiaries, the Bank and IBG Adriatica Holdings, Inc. (Adriatica) and the Bank’s wholly-owned subsidiaries, IBG Real Estate Holdings, Inc., IBG Aircraft Company III, Preston Grand, Inc, and McKinney Avenue Holdings, Inc. and its wholly owned subsidiary, McKinney Avenue SPE 1, Inc. McKinney Avenue Holdings, Inc. and its subsidiary were formed during the first quarter 2016 for the purpose of possible future asset holdings. Adriatica became inactive in 2014. All material intercompany transactions and balances have been eliminated in consolidation. In addition, the Company wholly-owns IB Trust I (Trust I), IB Trust II (Trust II), IB Trust III (Trust III), IB Centex Trust I (Centex Trust I) and Community Group Statutory Trust I (CGI Trust I). The Trusts were formed to issue trust preferred securities and do not meet the criteria for consolidation.
The consolidated interim financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. These financial statements should be read in conjunction with the financial statements and the notes thereto in the Company's Annual Report of Form10-K for the year ended December 31, 2015. The consolidated statement of condition at December 31, 2015 had been derived from the audited financial statements as of that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.
Segment Reporting: The Company has one reportable segment. The Company’s chief operating decision-maker uses consolidated results to make operating and strategic decisions.
Reclassifications: Certain prior period financial statement amounts have been reclassified to conform to current period presentation. The reclassifications have no effect on net income or stockholders' equity as previously reported.

Redemption of Small Business Lending Fund Series A Preferred Stock: On January 14, 2016, the Company redeemed all outstanding shares of its Senior Non-Cumulative Perpetual Small Business Lending Fund Series A Preferred Stock held by the Treasury and related accrued dividends.

Subsequent events: Companies are required to evaluate events and transactions that occur after the balance sheet date but before the date the financial statements are issued. They must recognize in the financial statements the effect of all events or transactions that provide additional evidence of conditions that existed at the balance sheet date, including the estimates inherent in the financial statement preparation process. Entities shall not recognize the impact of events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. The Company has evaluated subsequent events through the date of filing these financial statements with the Securities and Exchange Commission (SEC) and noted no subsequent events requiring financial statement recognition or disclosure, except as disclosed in Note 12.
Earnings per share: Basic earnings per common share are net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. The unvested share-based payment awards that contain rights to non forfeitable dividends are considered participating securities for this calculation.

Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock warrants. The participating nonvested common stock was not included in dilutive shares as it was anti-dilutive. Proceeds from the assumed exercise of dilutive stock warrants are assumed to be used to repurchase common stock at the average market price.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic earnings per share:				
Net income	$ 11,809	$ 10,571	$ 24,261	$ 20,023
Less: Preferred stock dividends	—	(60)	(8)	(120)
Net income after preferred stock dividends	11,809	10,511	24,253	19,903
Less:				
Undistributed earnings allocated to participating securities	174	183	385	362
Dividends paid on participating securities	25	27	53	58
Net income available to common shareholders	$ 11,610	$ 10,301	$ 23,815	$ 19,483
Weighted-average basic shares outstanding	18,157,372	16,769,194	18,123,585	16,740,881
Basic earnings per share	$ 0.64	$ 0.61	$ 1.31	$ 1.16
Diluted earnings per share:				
Net income available to common shareholders	$ 11,610	$ 10,301	$ 23,815	$ 19,483
Total weighted-average basic shares outstanding	18,157,372	16,769,194	18,123,585	16,740,881
Add dilutive stock warrants	77,892	87,023	70,721	82,852
Total weighted-average diluted shares outstanding	18,235,264	16,856,217	18,194,306	16,823,733
Diluted earnings per share	$ 0.64	$ 0.61	$ 1.31	$ 1.16
Anti-dilutive participating securities	35,504	24,379	38,533	43,661

Note 2. Statement of Cash Flows

As allowed by the accounting standards, the Company has chosen to report on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, and loans made to customers and principal collections on those loans. The Company uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information is presented below:

	Six Months Ended June 30,	
	2016	2015
Cash transactions:		
Interest expense paid	$10,855	$9,805
Income taxes paid	$12,010	$12,900
Noncash transactions:		
Accrued preferred stock dividends	$—	$60
Transfers of loans to other real estate owned	$523	$—
Loans to facilitate the sale of other real estate owned	$—	$159
Securities purchased, not yet settled	$—	$3,000
Excess tax deficiency on restricted stock vested	$(378)	$(66)
Transfer of repurchase agreements to deposits	$20,688	$—

The supplemental schedule of noncash investing activities from Company acquisition activity includes the following measurement-period adjustments made during the period:

	Six Months Ended June 30,	
	2016	2015
Assets acquired:		
Loans	$735	$—
Goodwill	(324)	361
Other real estate owned	—	(373)
Core deposit intangibles	(216)	—
Deferred tax asset	(175)	193
Total assets	$20	$181
Liabilities assumed:		
Other liabilities	20	181
Total liabilities	$20	$181

Note 3. Securities Available for Sale

Securities available for sale have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at June 30, 2016 and December 31, 2015, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
June 30, 2016				
U.S. treasuries	$ 1,000	$ 1	$ —	$ 1,001
Government agency securities	137,766	653	(5)	138,414
Obligations of state and municipal subdivisions	80,781	3,014	(87)	83,708
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	63,069	1,799	(15)	64,853
	$ 282,616	$ 5,467	$ (107)	$ 287,976
December 31, 2015				
U.S. treasuries	$ 999	$ 3	$ —	$ 1,002
Government agency securities	135,630	237	(567)	135,300
Obligations of state and municipal subdivisions	83,442	2,222	(248)	85,416
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	50,640	1,202	(97)	51,745
	$ 270,711	$ 3,664	$ (912)	$ 273,463

Securities with a carrying amount of approximately $197,429 and $195,479 at June 30, 2016 and December 31, 2015, respectively, were pledged to secure public fund deposits and repurchase agreements.

Proceeds from sale of securities available for sale and gross gains and gross losses for the three months and six months ended June 30, 2016 and 2015 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Proceeds from sale	5,399	$ 12,128	$ 5,399	$ 12,128
Gross gains	4	90	4	90
Gross losses	—	—	—	—

The amortized cost and estimated fair value of securities available for sale at June 30, 2016, by contractual maturity, are shown below. Maturities of pass-through certificates will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2016 Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 28,438	$ 28,449
Due from one year to five years	129,613	130,355
Due from five to ten years	22,947	23,676
Thereafter	38,549	40,643
	219,547	223,123
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	63,069	64,853
	$ 282,616	$ 287,976

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The number of securities, unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2016 and December 31, 2015, are summarized as follows:

	Less Than 12 Months			Greater Than 12 Months			Total	
Description of Securities	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Securities Available for Sale								
June 30, 2016								
Government agency securities	1	$1,176	$ (5)	1	$1,000	$ —	$2,176	$ (5)
Obligations of state and municipal subdivisions	12	5,509	(16)	8	4,295	(71)	9,804	(87)
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	3	7,701	(15)	—	—	—	7,701	(15)
	16	$14,386	$ (36)	9	$5,295	$ (71)	$19,681	$ (107)
December 31, 2015								
Government agency securities	25	$84,798	$ (531)	4	$4,964	$ (36)	$89,762	$ (567)
Obligations of state and municipal subdivisions	32	16,202	(88)	19	8,662	(160)	24,864	(248)
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	6	10,765	(97)	—	—	—	10,765	(97)
	63	$111,765	$ (716)	23	$13,626	$ (196)	$125,391	$ (912)

Unrealized losses are generally due to changes in interest rates. The Company has the intent to hold these securities until maturity or a forecasted recovery, and it is more likely than not that the Company will not have to sell the securities before the recovery of their cost basis. As such, the losses are deemed to be temporary.

Note 4. Loans, Net and Allowance for Loan Losses

Loans, net at June 30, 2016 and December 31, 2015, consisted of the following:

	June 30, 2016	December 31, 2015
Commercial	$636,557	$731,818
Real estate:		
Commercial	2,229,913	1,949,734
Commercial construction, land and land development	444,738	419,611
Residential	626,245	607,990
Single family interim construction	232,658	187,984
Agricultural	48,976	50,178
Consumer	32,233	41,966
Other	137	124
	4,251,457	3,989,405
Deferred loan fees	(1,992)	(1,553)
Allowance for loan losses	(30,916)	(27,043)
	$4,218,549	$3,960,809

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans.

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. The Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. These cash flows, however, may not be as expected and the value of collateral securing the loans may fluctuate. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short term loans may be made on an unsecured basis. Additionally, our commercial loan portfolio includes loans made to customers in the energy industry, which is a complex, technical and cyclical industry. Experienced bankers with specialized energy lending experience originate our energy loans. Companies in this industry produce, extract, develop, exploit and explore for oil and natural gas. Loans are primarily collateralized with proven producing oil and gas reserves based on a technical evaluation of these reserves. At June 30, 2016 and December 31, 2015, there were approximately $108.9 million and $182.5 million of exploration and production (E&P) energy loans outstanding, respectively.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors the diversification of the portfolio on a quarterly basis by type and geographic location. Management also tracks the level of owner occupied property versus non owner occupied property.

Land and commercial land development loans are underwritten using feasibility studies, independent appraisal reviews and financial analysis of the developers or property owners. Generally, borrowers must have a proven track record of success. Commercial construction loans are generally based upon estimates of cost and value of the completed project. These estimates may not be accurate. Commercial construction loans often involve the disbursement of substantial funds with the repayment dependent on the success of the ultimate project. Sources of repayment for these loans may be pre-committed permanent financing or sale of the developed property. The loans in this portfolio are geographically diverse and due to the increased risk are monitored closely by management and the board of directors on a quarterly basis.

Residential real estate and single family interim construction loans are underwritten primarily based on borrowers' credit scores, documented income and minimum collateral values. Relatively small loan amounts are spread across many individual borrowers, which minimizes risk in the residential portfolio. In addition, management evaluates trends in past dues and current economic factors on a regular basis.

Agricultural loans are collateralized by real estate and/or agricultural-related assets. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Loan-to-value ratios on loans secured by farmland generally do not exceed 80% and have amortization periods limited to twenty years. Agricultural non-real estate loans are generally comprised of term loans to fund the purchase of equipment, livestock and seasonal operating lines to grain farmers to plant and harvest corn and soybeans. Specific underwriting standards have been established for agricultural-related loans, including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop and other farm assets as considered necessary.

Agricultural loans carry significant credit risks as they involve larger balances concentrated with single borrowers or groups of related borrowers. In addition, repayment of such loans depends on the successful operation or management of the farm property securing the loan or for which an operating loan is utilized. Farming operations may be affected by adverse weather conditions such as drought, hail or floods that can severely limit crop yields.

Consumer loans represent less than 1% of the outstanding total loan portfolio. Collateral consists primarily of automobiles and other personal assets. Credit score analysis is used to supplement the underwriting process.

Most of the Company's lending activity occurs within the State of Texas, primarily in the north, central and southeast Texas regions. A large percentage of the Company's portfolio consists of commercial and residential real estate loans. As of June 30, 2016 and December 31, 2015, there were no concentrations of loans related to a single industry in excess of 10% of total loans.

The allowance for loan losses is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance is derived from the following two components: 1) allowances established on individual impaired loans, which are based on a review of the individual characteristics of each loan, including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates, and 2) allowances based on actual historical loss experience for the last three years for similar types of loans in the Company's loan portfolio adjusted for primarily changes in the lending policies and procedures; collection, charge-off and recovery practices; nature and volume of the loan portfolio; change in value of underlying collateral; volume and severity of nonperforming loans; existence and effect of any concentrations of credit and the level of such concentrations and current, national and local economic and business conditions. This second component also includes an unallocated allowance to cover uncertainties that could affect management's estimate of probable losses. The unallocated allowance reflects the imprecision inherent in the underlying assumptions used in the methodologies for estimating this component.

The Company's management continually evaluates the allowance for loan losses determined from the allowances established on individual loans and the amounts determined from historical loss percentages adjusted for the qualitative factors above. Should any of the factors considered by management change, the Company's estimate of loan losses could also change and would affect the level of future provision expense. While the calculation of the allowance for loan losses utilizes management's best judgment and all the information available, the adequacy of the allowance for loan losses is dependent on a variety of factors beyond the Company's control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses, and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Loans requiring an allocated loan loss provision are generally identified at the servicing officer level based on review of weekly past due reports and/or the loan officer's communication with borrowers. In addition, past due loans are discussed at weekly officer loan committee meetings to determine if classification is warranted. The Company's credit department has implemented an internal risk based loan review process to identity potential internally classified loans that supplements the annual independent external loan review. The external review generally covers all loans greater than $2.9 million annually. These reviews include analysis of borrower's financial condition, payment histories and collateral values to determine if a loan should be internally classified. Generally, once classified, an impaired loan analysis is completed by the credit department to determine if the loan is impaired and the amount of allocated allowance required.

The Texas economy, specifically the Company's lending area of north, central and southeast Texas, has generally performed better than certain other parts of the country. However, the ongoing volatility in oil prices has the potential to have a negative impact on the Texas economy, specifically in Houston. The risk of loss associated with all segments of the portfolio could increase due to this impact. The Company increased its allowance for loan losses during the first quarter 2016 in consideration of this risk to the energy portfolio. Due to the stabilization of commodity prices and reductions to the energy portfolio during the second quarter 2016, no additional allocations were warranted. The economy and other risk factors are minimized by the Company's underwriting standards, which include the following principles: 1) financial strength of the borrower including strong earnings, high net worth, significant liquidity and acceptable debt to worth ratio, 2) managerial business competence, 3) ability to repay, 4) loan to value, 5) projected cash flow and 6) guarantor financial statements as applicable. The following is a summary of the activity in the allowance for loan losses by loan class for the three and six months ended June 30, 2016 and 2015:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
Three months ended June 30, 2016									
Balance at the beginning of period	$ 12,173	$ 14,001	$ 2,473	$ 989	$ 187	$ 162	$ 16	$ (17)	$ 29,984
Provision for loan losses	374	1,491	52	132	(12)	7	23	56	2,123
Charge-offs	(1,191)	—	—	—	—	(1)	(22)	—	(1,214)
Recoveries	1	—	8	—	—	3	11	—	23
Balance at end of period	$ 11,357	$ 15,492	$ 2,533	$ 1,121	$ 175	$ 171	$ 28	$ 39	$ 30,916
Six months ended June 30, 2016									
Balance at the beginning of period	$ 10,573	$ 13,007	$ 2,339	$ 769	$ 215	$ 164	$ —	$ (24)	$ 27,043
Provision for loan losses	1,966	2,537	185	352	(40)	4	53	63	5,120
Charge-offs	(1,191)	(54)	—	—	—	(2)	(45)	—	(1,292)
Recoveries	9	2	9	—	—	5	20	—	45
Balance at end of period	$ 11,357	$ 15,492	$ 2,533	$ 1,121	$ 175	$ 171	$ 28	$ 39	$ 30,916
Three months ended June 30, 2015									
Balance at the beginning of period	$ 6,078	$ 10,654	$ 2,194	$ 734	$ 238	$ 156	$ —	$ 173	$ 20,227
Provision for loan losses	658	1,054	122	4	(4)	57	—	(232)	1,659
Charge-offs	(106)	—	—	—	—	(41)	—	—	(147)
Recoveries	2	12	2	—	—	9	—	—	25
Balance at end of period	$ 6,632	$ 11,720	$ 2,318	$ 738	$ 234	$ 181	$ —	$ (59)	$ 21,764

Six months ended June 30, 2015									
Balance at the beginning of period	$ 5,051	$ 10,110	$ 2,205	$ 669	$ 246	$ 146	$ —	$ 125	$ 18,552
Provision for loan losses	1,681	1,580	109	69	(12)	86	—	(184)	3,329
Charge-offs	(106)	—	—	—	—	(77)	—	—	(183)
Recoveries	6	30	4	—	—	26	—	—	66
Balance at end of period	$ 6,632	$ 11,720	$ 2,318	$ 738	$ 234	$ 181	$ —	$ (59)	$ 21,764

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The following table details the amount of the allowance for loan losses and recorded investment in loans by class as of June 30, 2016 and December 31, 2015:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
June 30, 2016									
Allowance for losses:									
Individually evaluated for impairment	$ 3,587	$ 4	$ —	$ —	$ —	$ —	$ —	$ —	$ 3,591
Collectively evaluated for impairment	7,770	15,488	2,533	1,121	175	171	28	39	27,325
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	$ 11,357	$ 15,492	$ 2,533	$ 1,121	$ 175	$ 171	$ 28	$ 39	$ 30,916
Loans:									
Individually evaluated for impairment	$ 11,959	$ 1,392	$ 3,703	$ —	$ —	$ 64	$ —	$ —	$ 17,118
Collectively evaluated for impairment	621,716	2,641,515	620,529	232,658	48,976	32,152	137	—	4,197,683
Acquired with deteriorated credit quality	2,882	31,744	2,013	—	—	17	—	—	36,656
Ending balance	$ 636,557	$ 2,674,651	$ 626,245	$ 232,658	$ 48,976	$ 32,233	$ 137	$ —	$ 4,251,457
December 31, 2015									
Allowance for losses:									
Individually evaluated for impairment	$ 3,085	$ 116	$ —	$ —	$ —	$ 2	$ —	$ —	$ 3,203
Collectively evaluated for impairment	7,488	12,891	2,339	769	215	162	—	(24)	23,840
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	$ 10,573	$ 13,007	$ 2,339	$ 769	$ 215	$ 164	$ —	$ (24)	$ 27,043
Loans:									
Individually evaluated for impairment	$ 7,382	$ 4,671	$ 3,136	$ —	$ 170	$ 111	$ —	$ —	$ 15,470
Collectively evaluated for impairment	720,732	2,321,209	602,206	187,984	50,008	41,835	124	—	3,924,098
Acquired with deteriorated credit quality	3,704	43,465	2,648	—	—	20	—	—	49,837
Ending balance	$ 731,818	$ 2,369,345	$ 607,990	$ 187,984	$ 50,178	$ 41,966	$ 124	$ —	$ 3,989,405

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Nonperforming loans by loan class at June 30, 2016 and December 31, 2015, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
June 30, 2016								
Nonaccrual loans	$ 11,950	$ 56	$ 1,141	$ —	$ —	$ 82	$ —	$ 13,229
Loans past due 90 days and still accruing	7	—	—	—	—	—	—	7
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	9	1,336	2,597	—	—	—	—	3,942
	$ 11,966	$ 1,392	$ 3,738	$ —	$ —	$ 82	$ —	$ 17,178
December 31, 2015								
Nonaccrual loans	$ 7,366	$ 591	$ 552	$ —	$ 170	$ 111	$ —	$ 8,790
Loans past due 90 days and still accruing	—	—	—	—	—	—	—	—
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	16	3,480	2,574	—	—	—	—	6,070
	$ 7,382	$ 4,071	$ 3,126	$ —	$ 170	$ 111	$ —	$ 14,860

The accrual of interest is discontinued on a loan when management believes after considering collection efforts and other factors that the borrower's financial condition is such that collection of interest is doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged-off is reversed against interest income. Cash collections on nonaccrual loans are generally credited to the loan receivable balance, and no interest income is recognized on those loans until the principal balance has been collected. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Impaired loans are those loans where it is probable that all amounts due will not be collected according to contractual terms of the loan agreement. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on 1) the present value of expected future cash flows discounted at the loans effective interest rate; 2) the loan's observable market price; or 3) the fair value of collateral if the loan is collateral dependent. Substantially all of the Company’s impaired loans are measured at the fair value of the collateral. In limited cases, the Company may use the other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

All commercial, real estate, agricultural loans and troubled debt restructurings are considered for individual impairment analysis. Smaller balance consumer loans are collectively evaluated for impairment.

Impaired loans by loan class at June 30, 2016 and December 31, 2015, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
June 30, 2016								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	$ 6,777	$ 78	$ —	$ —	$ —	$ —	$ —	$ 6,855
Impaired loans with no allowance for loan losses	5,182	1,314	3,703	—	—	64	—	10,263
Total	$ 11,959	$ 1,392	$ 3,703	$ —	$ —	$ 64	$ —	$ 17,118
Unpaid principal balance of impaired loans	$ 13,488	$ 1,436	$ 3,723	$ —	$ —	$ 80	$ —	$ 18,727
Allowance for loan losses on impaired loans	$ 3,587	$ 4	$ —	$ —	$ —	$ —	$ —	$ 3,591
December 31, 2015								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	$ 7,221	$ 1,930	$ —	$ —	$ —	$ 5	$ —	$ 9,156
Impaired loans with no allowance for loan losses	161	2,741	3,136	—	170	106	—	6,314
Total	$ 7,382	$ 4,671	$ 3,136	$ —	$ 170	$ 111	$ —	$ 15,470
Unpaid principal balance of impaired loans	$ 7,520	$ 4,936	$ 3,204	$ —	$ 172	$ 133	$ —	$ 15,965
Allowance for loan losses on impaired loans	$ 3,085	$ 116	$ —	$ —	$ —	$ 2	$ —	$ 3,203
For the three months ended June 30, 2016								
Average recorded investment in impaired loans	$ 17,966	$ 1,789	$ 3,441	$ —	$ —	$ 70	$ —	$ 23,266
Interest income recognized on impaired loans	$ —	$ 13	$ 32	$ —	$ —	$ —	$ —	$ 45
For the six months ended June 30, 2016								
Average recorded investment in impaired loans	$ 14,438	$ 2,750	$ 3,339	$ —	$ 57	$ 84	$ —	$ 20,668
Interest income recognized on impaired loans	$ —	$ 38	$ 72	$ —	$ —	$ —	$ —	$ 110
For the three months ended June 30, 2015								
Average recorded investment in impaired loans	$ 5,788	$ 6,389	$ 3,248	$ —	$ —	$ 79	$ —	$ 15,504
	$ 22	$ 97	$ 63	$ —	$ —	$ —	$ —	$ 182

Interest income recognized on impaired loans								
For the six months ended June 30, 2015								
Average recorded investment in impaired loans	$ 4,352	$ 6,515	$ 3,294	$ —	$ —	$ 78	$ —	$ 14,239
Interest income recognized on impaired loans	$ 43	$ 192	$ 93	$ —	$ —	$ 1	$ —	$ 329

Certain impaired loans have adequate collateral and do not require a related allowance for loan loss.

The Company will charge off that portion of any loan which management considers a loss. Commercial and real estate loans are generally considered for charge-off when exposure beyond collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower’s financial condition.

The restructuring of a loan is considered a “troubled debt restructuring” if both 1) the borrower is experiencing financial difficulties and 2) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, extending amortization and other actions intended to minimize potential losses.

A "troubled debt restructured" loan is identified as impaired and measured for credit impairment as of each reporting period in accordance with the guidance in Accounting Standards Codification (ASC) 310-10-35. Modifications primarily relate to extending the amortization periods of the loans and interest rate concessions. The majority of these loans were identified as impaired prior to restructuring; therefore, the modifications did not materially impact the Company's determination of the allowance for loan losses. The recorded investment in troubled debt restructurings, including those on nonaccrual, was $4,052 and $6,691 as of June 30, 2016 and December 31, 2015.
Following is a summary of loans modified under troubled debt restructurings during the three and six months ended June 30, 2016 and 2015:
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	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
Troubled debt restructurings during the three months ended June 30, 2016								
Number of contracts	1	—	—	—	—	—	—	1
Pre-restructuring outstanding recorded investment	$ 24	$ —	$ —	$ —	$ —	$ —	$ —	$ 24
Post-restructuring outstanding recorded investment	$ 24	$ —	$ —	$ —	$ —	$ —	$ —	$ 24
Troubled debt restructurings during the six months ended June 30, 2016								
Number of contracts	1	—	—	—	—	—	—	1
Pre-restructuring outstanding recorded investment	$ 24	$ —	$ —	$ —	$ —	$ —	$ —	$ 24
Post-restructuring outstanding recorded investment	$ 24	$ —	$ —	$ —	$ —	$ —	$ —	$ 24
Troubled debt restructurings during the three months ended June 30, 2015								
Number of contracts	—	—	—	—	—	—	—	—
Pre-restructuring outstanding recorded investment	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Post-restructuring outstanding recorded investment	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Troubled debt restructurings during the six months ended June 30, 2015								
Number of contracts	—	—	—	—	—	—	—	—
Pre-restructuring outstanding recorded investment	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Post-restructuring outstanding recorded investment	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —

At June 30, 2016 and 2015, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the three and six months ended June 30, 2016 and 2015, respectively. At June 30, 2016 and 2015, the Company had no commitments to lend additional funds to any borrowers with loans whose terms have been modified under troubled debt restructurings.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following table presents information regarding the aging of past due loans by loan class as of June 30, 2016 and December 31, 2015:

	Loans 30-89 Days Past Due	Loans 90 or More Past Due	Total Past Due Loans	Current Loans	Total Loans
June 30, 2016					
Commercial	$183	$8,949	$9,132	$627,425	$636,557
Commercial real estate, land and land development	531	41	572	2,674,079	2,674,651
Residential real estate	1,986	328	2,314	623,931	626,245
Single-family interim construction	1,243	—	1,243	231,415	232,658
Agricultural	252	—	252	48,724	48,976
Consumer	88	47	135	32,098	32,233
Other	—	—	—	137	137
	$4,283	$9,365	$13,648	$4,237,809	$4,251,457
December 31, 2015					
Commercial	$2,740	$7,220	$9,960	$721,858	$731,818
Commercial real estate, land and land development	2,059	—	2,059	2,367,286	2,369,345
Residential real estate	1,456	330	1,786	606,204	607,990
Single-family interim construction	503	—	503	187,481	187,984
Agricultural	89	170	259	49,919	50,178
Consumer	290	26	316	41,650	41,966
Other	—	—	—	124	124
	$7,137	$7,746	$14,883	$3,974,522	$3,989,405

The Company’s internal classified report is segregated into the following categories: 1) Pass/Watch, 2) Special Mention, 3) Substandard and 4) Doubtful. The loans placed in the Pass/Watch category reflect the Company’s opinion that the loans reflect potential weakness that requires monitoring on a more frequent basis. The loans in the Special Mention category reflect the Company’s opinion that the credit contains weaknesses which represent a greater degree of risk and warrant extra attention. These loans are reviewed monthly by officers and senior management to determine if a change in category is warranted. The loans placed in the Substandard category are considered to be potentially inadequately protected by the current debt service capacity of the borrower and/or the pledged collateral. These credits, even if apparently protected by collateral value, have shown weakness related to adverse financial, managerial, economic, market or political conditions, which may jeopardize repayment of principal and interest. There is possibility that some future loss could be sustained by the Company if such weakness is not corrected. The Doubtful category includes loans that are in default or principal exposure is probable. Substandard and Doubtful loans are individually evaluated to determine if they should be classified as impaired and an allowance is allocated if deemed necessary under ASC 310-10.

The loans that are not impaired are included with the remaining “pass” credits in determining the portion of the allowance for loan loss based on historical loss experience and other qualitative factors. The portfolio is segmented into categories including: commercial loans, consumer loans, commercial real estate loans, residential real estate loans and agricultural loans. The adjusted historical loss percentage is applied to each category. Each category is then added together to determine the allowance allocated under ASC 450-20.

A summary of loans by credit quality indicator by class as of June 30, 2016 and December 31, 2015, is as follows:

	Pass	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
June 30, 2016						
Commercial	$561,126	$35,057	$7,590	$ 32,784	$ —	$636,557
Commercial real estate, construction, land and land development	2,659,724	10,024	3,499	1,404	—	2,674,651
Residential real estate	619,256	1,688	376	4,925	—	626,245
Single-family interim construction	232,658	—	—	—	—	232,658
Agricultural	48,925	51	—	—	—	48,976
Consumer	32,085	26	19	103	—	32,233
Other	137	—	—	—	—	137
	$4,153,911	$46,846	$11,484	$ 39,216	$ —	$4,251,457
December 31, 2015						
Commercial	$616,149	$46,607	$44,469	$ 24,593	$ —	$731,818
Commercial real estate, construction, land and land development	2,343,883	18,463	3,341	3,658	—	2,369,345
Residential real estate	599,937	2,150	982	4,921	—	607,990
Single-family interim construction	187,984	—	—	—	—	187,984
Agricultural	48,185	66	1,757	170	—	50,178
Consumer	41,601	57	32	276	—	41,966
Other	124	—	—	—	—	124
	$3,837,863	$67,343	$50,581	$ 33,618	$ —	$3,989,405

The Company has acquired certain loans which experienced credit deterioration since origination (purchased credit impaired (PCI) loans). Accretion on PCI loans is based on estimated future cash flows, regardless of contractual maturity. No additional PCI loans were acquired during the six months ended June 30, 2016.

The following table summarizes the outstanding balance and related carrying amount of purchased credit impaired loans as of the respective acquisition date for the acquisition occurring in 2015:

	Acquisition Date November 1, 2015 Grand Bank
Outstanding balance	$ 3,548
Nonaccretable difference	(593)
Accretable yield	—
Carrying amount	$ 2,955

The carrying amount of all acquired PCI loans included in the consolidated balance sheet and the related outstanding balance at June 30, 2016 and December 31, 2015, were as follows:

	June 30, 2016	December 31, 2015
Outstanding balance	$41,799	$ 57,178
Carrying amount	36,656	49,837

There was no allocation established in the allowance for loan losses relating to PCI loans at June 30, 2016 or December 31, 2015.

The changes in accretable yield during the six months ended June 30, 2016 and 2015 in regard to loans transferred at acquisition for which it was probable that all contractually required payments would not be collected are presented in the table below.

	For the Six Months Ended June 30,	
	2016	2015
Balance at January 1,	$2,380	$2,546
Additions	—	—
Accretion	(653)	(460)
Transfers from nonaccretable	—	748
Balance at June 30,	$1,727	$2,834

Note 5. Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Company’s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of this instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At June 30, 2016 and December 31, 2015, the approximate amounts of these financial instruments were as follows:

	June 30,	December 31,
	2016	2015
Commitments to extend credit	$871,230	$838,341
Standby letters of credit	10,192	10,361
	$881,422	$848,702

Commitments to extend credit are agreements to lend to a customer as 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. The Company evaluates each customer’s credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management’s credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, farm crops, property, plant and equipment and income-producing commercial properties.

Letters of credit are written conditional commitments used by the Company to guarantee the performance of a customer to a third party. The Company’s policies generally require that letter of credit arrangements contain security and debt covenants similar to those contained in loan arrangements. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table above. If the commitment is funded, the Company would be entitled to seek recovery from the customer. As of June 30, 2016 and December 31, 2015, no amounts have been recorded as liabilities for the Company’s potential obligations under these guarantees.

Litigation

The Company is involved in certain legal actions arising from normal business activities. Management believes that the outcome of such proceedings will not materially affect the financial position, results of operations or cash flows of the Company.

Independent Bank is a party to a legal proceeding inherited by Independent Bank in connection with its acquisition of BOH Holdings, Inc. and its subsidiary, Bank of Houston. Please see Part II, Item 1. for more details on this lawsuit.

Lease Commitments
The Company leases certain branch facilities and other facilities. Rent expense related to these leases amounted to $638 and $1,313 for the three and six months ended June 30, 2016, respectively, and $501 and $984 for the three and six months ended June 30, 2015, respectively.

Note 6. Repurchase Agreements and Other Borrowings

At June 30, 2016 and December 31, 2015, repurchase agreements totaled $0 and $12,160, respectively. During the six months ended June 30, 2016, repurchase agreements were transferred to deposit accounts.

Other borrowings, including those borrowings due to related parties totaled $107,385 and $70,798 at June 30, 2016 and December 31, 2015, respectively. The balance of borrowings at June 30, 2016 is net of discount and origination costs totaling $2,615.

In June 2016, the Company issued an additional $45,000 in aggregate principal of it's 5.875% subordinated notes (notes) due August 1, 2024. The notes were sold at an original discount of $787.5, which will be amortized into interest expense over the life of the notes. Interest on the notes is payable semiannually. The notes may not be redeemed prior to maturity and meet the criteria to be recognized as Tier 2 capital for regulatory purposes.

In January 2016, the Company redeemed two debenture issuances in full with principal payments totaling $5,798 plus all interest accrued at time of redemption.

Note 7. Income Taxes

Income tax expense for the three and six months ended June 30, 2016 and 2015 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Income tax expense for the period	$5,857	$5,204	$12,019	$9,740
Effective tax rate	33.2 %	33.0 %	33.1 %	32.7 %

The effective tax rates differ from the statutory federal tax rate of 35% largely due to tax exempt interest income earned on certain investment securities and loans and the nontaxable earnings on bank owned life insurance.

Note 8. 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, Fair Value Measurements and Disclosures, 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.

The following table represents assets reported on the consolidated balance sheets at their fair value on a recurring basis as of June 30, 2016 and December 31, 2015 by level within the ASC Topic 820 fair value measurement hierarchy:

	Assets/ Liabilities Measured at Fair Value	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016				
Measured on a recurring basis:				
Assets:				
Investment securities available for sale:				
U.S. treasuries	$ 1,001	$ —	$ 1,001	$ —
Government agency securities	138,414	—	138,414	—
Obligations of state and municipal subdivisions	83,708	—	83,708	—
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	64,853	—	64,853	—
December 31, 2015				
Measured on a recurring basis:				
Assets:				
Investment securities available for sale:				
U.S. treasuries	$ 1,002	$ —	$ 1,002	$ —
Government agency securities	135,300	—	135,300	—
Obligations of state and municipal subdivisions	85,416	—	85,416	—
Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC	51,745	—	51,745	—

There were no transfers between level categorizations and no changes in valuation methodologies for the periods presented.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

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 and other yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security’s terms and conditions, among other things.

In accordance with ASC Topic 820, certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at June 30, 2016 and December 31, 2015, for which a nonrecurring change in fair value has been recorded:

		Fair Value Measurements at Reporting Date Using			
	Assets Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Period Ended Total Losses
June 30, 2016					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	$ 6,155	$ —	$ —	$ 6,155	$ 504
Other real estate	—	—	—	—	—
December 31, 2015					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	$ 4,827	$ —	$ —	$ 4,827	$ 3,029
Other real estate	577	—	—		