SOUTHSIDE BANCSHARES INC Form 10-Q August 10, 2015 <u>Table of Contents</u>

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

FORM 10-Q (Mark One) x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended June 30, 2015 OR TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

^o OF 1934

For the transition period from ______ to _____

Commission file number: 0-12247 SOUTHSIDE BANCSHARES, INC. (Exact name of registrant as specified in its charter)

TEXAS	75-1848732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 S. Beckham Avenue, Tyler, Texas	75701
(Address of principal executive offices)	(Zip Code)
903-531-7111	_
(Registrant's telephone number, including area code)	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes $x = N_0 o$

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 x No o

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The number of shares of the issuer's common stock, par value \$1.25, outstanding as of August 7, 2015 was 25,357,855 shares.

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PART I. FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (UNAUDITED) (in thousands, except share amounts)

June 30, December 31, 2015 2014 ASSETS Cash and due from banks \$50,406 \$64.001 Interest earning deposits 20,654 26,623 Total cash and cash equivalents 77,029 84,655 Investment securities: Available for sale, at estimated fair value 371,019 306,706 Held to maturity, at carrying value (estimated fair value of \$391,191 and \$400,248, 387,212 388,823 respectively) Mortgage-backed securities: Available for sale, at estimated fair value 1,094,802 1,142,002 Held to maturity, at carrying value (estimated fair value of \$362,283 and \$261,339, 356,669 253,496 respectively) FHLB stock, at cost 37,769 39,942 Other investments 5,350 3,929 Loans held for sale 7,431 2,899 Loans: Loans 2.179.863 2,181,133 Less: Allowance for loan losses (16,822) (13,292) Net Loans 2,163,041 2,167,841 Premises and equipment, net 110,493 112,860 Goodwill 90,571 91,372 Other intangible assets, net 7.654 8,844 Interest receivable 22,666 22,436 Deferred tax asset 18,906 12,707 Unsettled trades to sell securities 57,202 Bank owned life insurance 93,673 92,384 Other assets 11,733 19,163 TOTAL ASSETS \$4,856,018 \$4,807,261 LIABILITIES AND SHAREHOLDERS' EQUITY Deposits: Noninterest bearing \$715,966 \$661,014 Interest bearing 2,752,717 2,713,403 Total deposits 3,468,683 3,374,417 Short-term obligations: Federal funds purchased and repurchase agreements 2,084 4,237 FHLB advances 282,699 297,368 Total short-term obligations 284,783 301,605 Long-term obligations: FHLB advances 572,254 600,052 Long-term debt 60,311 60,311

Total long-term obligations Unsettled trades to purchase securities Other liabilities TOTAL LIABILITIES	632,565 3,453 34,860 4,424,344		660,363 5,982 39,651 4,382,018	
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 12)				
Shareholders' equity:				
Common stock (\$1.25 par, 40,000,000 shares authorized, 27,821,074 shares issued at June 30, 2015 and 26,578,127 shares issued at December 31, 2014)	34,776		33,223	
Paid-in capital	422,392		389,886	
Retained earnings	31,871		55,396	
Treasury stock (2,469,638 shares at cost)	(37,692)	(37,692)
Accumulated other comprehensive loss	(19,673)	(15,570)
TOTAL SHAREHOLDERS' EQUITY	431,674		425,243	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$4,856,018		\$4,807,261	
The accompanying notes are an integral part of these consolidated financial stateme	nts.			

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

(in thousands, except per share data)

(In the usualus, except per share data)		Three Months Ended		Ended
	June 30,	2014	June 30,	2014
T	2015	2014	2015	2014
Interest income	¢ 22 007	¢ 10 205	¢ 47 002	¢26.660
Loans	\$23,887	\$18,305	\$47,803	\$36,668
Investment securities – taxable	459	143	696	266
Investment securities – tax-exempt	5,644	6,021	11,509	11,979
Mortgage-backed securities	7,666	7,557	16,128	15,239
FHLB stock and other investments	65	38	158	108
Other interest earning assets	29	22	63	65
Total interest income	37,750	32,086	76,357	64,325
Interest expense				
Deposits	2,493	1,984	5,022	4,100
Short-term obligations	154	56	296	127
Long-term obligations	2,198	2,190	4,343	4,350
Total interest expense	4,845	4,230	9,661	8,577
Net interest income	32,905	27,856	66,696	55,748
Provision for loan losses	268	2,650	4,116	6,783
Net interest income after provision for loan losses	32,637	25,206	62,580	48,965
Noninterest income				
Deposit services	4,920	3,794	9,909	7,432
Net gain on sale of securities available for sale	105	498	2,581	509
Gain on sale of loans	822	81	1,199	161
Trust income	820	762	1,713	1,542
Bank owned life insurance income	653	307	1,322	621
Other	1,099	1,073	2,743	2,056
Total noninterest income	8,419	6,515	19,467	12,321
Noninterest expense		,		
Salaries and employee benefits	16,869	13,092	35,068	26,194
Occupancy expense	2,593	1,786	6,052	3,540
Advertising, travel & entertainment	683	605	1,340	1,148
ATM and debit card expense	750	302	1,429	619
Professional fees	793	1,304	1,535	2,231
Software and data processing expense	1,237	486	2,268	987
Telephone and communications	603	320	1,072	598
FDIC insurance	629	434	1,267	882
Other	3,768	2,097	7,603	4,409
Total noninterest expense	27,925	20,426	57,634	40,608
Total noninterest expense	21,925	20,420	57,054	40,000
Income before income tax expense	13,131	11,295	24,413	20,678
Income tax expense	1,967	838	3,870	1,997
Net income	\$11,164	\$10,457	\$20,543	\$18,681
Earnings per common share – basic	\$11,104 \$0.44	\$10,4 <i>37</i> \$0.53	\$20,545 \$0.81	\$0.94
Earnings per common share – diluted	\$0.44 \$0.44	\$0.53 \$0.53	\$0.81 \$0.81	\$0.94 \$0.94
Lamings per common share – unucu	$\Psi 0.44$	φ0.33	φ0.01	Φ0.74

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Dividends paid per common share	\$0.23	\$0.21	\$0.46	\$0.42	
The accompanying notes are an integral part of these consolidated financial statements.					
2					

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

(in thousands)

	Three Mo June 30,	ont	hs Ended		Six Month June 30,	s E	Ended	
	2015		2014		2015		2014	
Net income	\$11,164		\$10,457		\$20,543		\$18,681	
Other comprehensive income:								
Net unrealized holding (losses) gains on available for sale securities during the period	(14,915)	8,308		(5,395)	18,319	
Change in net unrealized loss on securities transferred to held to maturity	244		278		526		554	
Reclassification adjustment for net gain on sale of available for sale securities, included in net income	or (105)	(498)	(2,581)	(509)
Amortization of net actuarial loss, included in net periodic benefit cost	614		289		1,145		521	
Amortization of prior service credit, included in net periodic benefit cost	(4)	(4)	(8)	(7)
Other comprehensive (loss) income, before tax	(14,166)	8,373		(6,313)	18,878	
Income tax benefit (expense) related to other items of comprehensive income	4,959		(2,930)	2,210		(6,607)
Other comprehensive (loss) income, net of tax Comprehensive income	(9,207 \$1,957)	5,443 \$15,900		(4,103 \$16,440)	12,271 \$30,952	

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

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

(in thousands, except share and per share data)

(in thousands, except share and per	share data)							
	Common Stock	Paid In Capital	Retained Earnings		Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholde Equity	ers'
Balance at December 31, 2013	\$25,483	\$214,091	\$78,673		\$(37,692)	\$(21,037)	\$259,518	
Net income			18,681				18,681	
Other comprehensive income						12,271	12,271	
Issuance of common stock (18,265 shares)	23	500	_		_	_	523	
Stock compensation expense		577			_		577	
Tax benefits related to stock awards	s —	38			_	_	38	
Net issuance of common stock under employee stock plans	14	158	(103)	_	_	69	
Cash dividends paid on common stock (\$0.42 per share)	_		(7,717)	_	_	(7,717)
Stock dividend declared	1,124	24,941	(26,065)	_	_		
Balance at June 30, 2014	\$26,644	\$240,305	\$63,469		(37,692)	\$(8,766)	\$283,960	
	*				+ (- - c - -)		*	
Balance at December 31, 2014	\$33,223	\$389,886	\$55,396		\$(37,692)	\$(15,570)	\$425,243	
Net income			20,543		_	<u> </u>	20,543	`
Other comprehensive loss					_	(4,103)	(4,103)
Issuance of common stock (21,499 shares)	26	587	—		—	—	613	
Stock compensation expense		567			_	_	567	
Tax benefits related to stock awards	5 —	32			_	_	32	
Net issuance of common stock under employee stock plans	15	157	(21)	_	_	151	
Cash dividends paid on common stock (\$0.46 per share)	_	_	(11,372)	_	_	(11,372)
Stock dividend declared	1,512	31,163	(32,675)	_			
Balance at June 30, 2015	\$34,776	\$422,392	\$31,871	-	\$(37,692)	\$(19,673)	\$431,674	

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

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

(in thousands)		
	Six Month	is Ended
	June 30,	
	2015	2014
OPERATING ACTIVITIES:		
Net income	\$20,543	\$18,681
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	4,052	1,615
Amortization of premium	14,286	10,750
Accretion of discount and loan fees	(4,373) (1,971)
Provision for loan losses	4,116	6,783
Stock compensation expense	567	577
Deferred tax benefit	(2,019) (1,361)
Tax benefit related to stock awards	(32) (42)
Net gain on sale of securities available for sale	(2,581) (509)
Net loss (gain) on premises and equipment	137	(7)
Net loss on other real estate owned	382	65
Net change in:		
Interest receivable	(230) 1,461
Other assets	2,070	(1,459)
Interest payable	(52) (40)
Other liabilities	(3,601) 3,356
Loans originated for sale	(4,532) (604)
Net cash provided by operating activities	28,733	37,295
INVESTING ACTIVITIES:		
Securities held to maturity:		
Purchases	(56,752) —
Maturities, calls and principal repayments	11,411	14,797
Securities available for sale:		
Purchases	(528,964) (327,668)
Sales	336,136	252,696
Maturities, calls and principal repayments	158,022	153,637
Proceeds from redemption of FHLB stock	5,692	8,938
Purchases of FHLB stock and other investments	(3,594) (384)
Net loans originated	1,235	(49,047)
Purchases of premises and equipment	(1,828) (2,878)
Proceeds from sales of premises and equipment	6	8
Proceeds from sales of other real estate owned	634	275
Proceeds from sales of repossessed assets	1,619	3,268
Net cash (used in) provided by investing activities	(76,383) 53,642

(continued)

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

	Six Months	s E	nded	
	June 30,			
	2015		2014	
FINANCING ACTIVITIES:				
Net increase in demand and savings accounts	80,540		157,322	
Net increase (decrease) in certificates of deposit	14,368		(83,711)
Net (decrease) increase in federal funds purchased and repurchase agreements	(2,153)	1,198	
Proceeds from FHLB advances	8,447,303		6,267,018	
Repayment of FHLB advances	(8,489,458)	(6,325,689)
Tax benefit related to stock awards	32		42	
Net issuance of common stock under employee stock plan	151		69	
Proceeds from the issuance of common stock	613		523	
Cash dividends paid	(11,372)	(7,717)
Net cash provided by financing activities	40,024		9,055	
Net (decrease) increase in cash and cash equivalents	(7,626)	99,992	
Cash and cash equivalents at beginning of period	84,655		54,431	
Cash and cash equivalents at end of period	\$77,029		\$154,423	
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:				
Interest paid	\$9,713		\$8,617	
Income taxes paid	\$2,000		\$3,550	
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING				
ACTIVITIES:				
	¢ 1 072		¢ 2 007	
Loans transferred to other repossessed assets and real estate through foreclosure	\$1,073 \$57,724		\$2,807	
Transfer of available for sale securities to held to maturity securities	\$57,724	`	\$— ¢ (514	`
Adjustment to pension liability	\$(1,137 \$22,675)	\$(514 \$26.065)
5% stock dividend	\$32,675	``	\$26,065	`
Unsettled trades to purchase securities	\$(3,453)	\$(10,269)
Unsettled trades to sell securities	\$—		\$19,183	

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

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

1. Basis of Presentation

In this report, the words "the Company," "we," "us," and "our" refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words "Southside" and "Southside Bancshares" refer to Southside Bancshares, Inc. The words "Southside Bank" and "the Bank" refer to Southside Bank. "OABC" and "Omni" refer to OmniAmerican Bancorp, Inc. "SFG refers to SFG Finance, LLC (formerly Southside Financial Group, LLC), which was a wholly-owned subsidiary of the Bank and was dissolved in April 2015.

The consolidated balance sheet as of June 30, 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows and notes to the financial statements for the three- and six-month periods ended June 30, 2015 and 2014 are unaudited; in the opinion of management, all adjustments necessary for a fair statement of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Certain prior period amounts have been reclassified to conform to current year presentation and had no impact on net income, equity or cash flows.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2014. For a description of our significant accounting and reporting policies, refer to "Note 1- Summary of Significant Accounting and Reporting Policies" in our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014.

On April 13, 2015, our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 27, 2015, which was paid on May 14, 2015. All share data has been adjusted to give retroactive recognition to stock dividends.

Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." This update clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of the residential real estate property collateralizing a consumer mortgage loan, upon either: (i) the creditor obtaining legal title to the property upon completion of the foreclosure; or (ii) the borrower conveying all interest in the property to the creditor to satisfy the loan through completion of a deed-in-lieu of foreclosure or through a similar legal agreement. ASU 2014-04 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance did not have a significant impact on our consolidated financial statements. In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This update states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update affects entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU 2014-09 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is not permitted. We are reviewing the potential impact the adoption of this guidance will have on our consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This update aligns the accounting for repurchase-to-maturity

transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements by accounting for these transactions as secured borrowings. This update also requires a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return of the transferred financial assets throughout the term of the transaction. ASU 2014-11 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance did not have a significant impact on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." This update affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The update requires that, upon foreclosure, a guaranteed mortgage loan be derecognized and a separate other receivable be recognized when specific criteria are met. ASU 2014-14 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance did not have a significant impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) – Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 affects the accounting for fees paid by a customer in cloud computing arrangements such as (i) software as a service, (ii) platform as a service (iii) infrastructure as a service and (iv) other similar hosting arrangements. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this guidance is not expected to have a significant impact on our consolidated financial statements.

In May 2015, the FASB issued ASU 2015-07, "Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share." ASU 2015-07 eliminates the current requirement to categorize within the fair value hierarchy investments whose fair values are measured at net asset value ("NAV"). Instead, entities will be required to disclose the fair values of such investments so that financial statement users can reconcile amounts reported in the fair value hierarchy table and the amounts reported on the balance sheet. ASU 2015-07 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this guidance is not expected to have a significant impact on our consolidated financial statements.

2. Acquisition

On December 17, 2014, we acquired 100% of the outstanding stock of OmniAmerican Bancorp, Inc. and its wholly-owned subsidiary OmniAmerican Bank (collectively, "Omni") headquartered in Fort Worth, Texas. Omni operated 14 banking offices in Fort Worth, Texas and surrounding areas. We acquired Omni to further expand our presence in the growing Fort Worth market. The operations of Omni were merged into ours as of the date of the acquisition.

The Omni acquisition was accounted for using the purchase method of accounting and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The purchase price allocation remains preliminary and is subject to final determination and valuation of the fair value of assets acquired and liabilities assumed. Subsequent to filing our Annual Report on Form 10-K for the year ended December 31, 2014, we continued to evaluate the assets and liabilities assumed. This evaluation resulted in adjustments to goodwill, consisting primarily of a \$1.4 million adjustment to the fair value of Visa Class B stock included in other investments on the consolidated balance sheets, not previously recorded. The impact of the adjustments to goodwill, net of deferred tax, is reflected below. For more information concerning the fair value of the assets acquired and liabilities assumed in relation to the acquisition of Omni, see "Note 2 - Acquisition" in our Annual Report on Form 10-K for the year ended December 31, 2014.

The following table reflects the changes in the carrying amount of our goodwill for the six months ended June 30, 2015 (in thousands):

	Goodwill	
Balance as of December 31, 2014	\$91,372	
Less: measurement period adjustments	(801)
Balance as of June 30, 2015	\$90,571	

In connection with the integration of our policies and operations, certain loans acquired have been reclassified as of December 31, 2014 to be consistent with our current classification methodology, see "Note 6 - Loans and Allowance for Probable Loan Losses" and "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Composition of Loans" in this Quarterly Report on Form 10-Q.

3. Earnings Per Share

Earnings per share on a basic and diluted basis have been adjusted to give retroactive recognition to stock dividends and is calculated as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Basic and Diluted Earnings:				
Net income	\$11,164	\$10,457	\$20,543	\$18,681
Basic weighted-average shares outstanding	25,337	19,776	25,330	19,769
Add: Stock awards	88	97	84	93
Diluted weighted-average shares outstanding	25,425	19,873	25,414	19,862
Basic Earnings Per Share:	\$0.44	\$0.53	\$0.81	\$0.94
Diluted Earnings Per Share:	\$0.44	\$0.53	\$0.81	\$0.94

For both the three- and six-month periods ended June 30, 2015, there were approximately 12,000 anti-dilutive shares. For the three- and six-month periods ended June 30, 2014, there were approximately 18,000 and 22,000 anti-dilutive shares, respectively.

4. Accumulated Other Comprehensive (Loss) Income

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

	Three Months Ended June 30, 2015 Unrealized Gains (Losses) on Securities				
	Other	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total	
Beginning balance, net of tax	\$11,000	\$4	\$(21,470) \$(10,466)
Other comprehensive loss before reclassifications	(14,671) —		(14,671)
Reclassified to income	(105) (4) 614	505	
Income tax benefit (expense)	5,172	2	(215) 4,959	
Net current-period other comprehensive (loss) income, net of tax	(9,604) (2) 399	(9,207)
Ending balance, net of tax	\$1,396	\$2	\$(21,071) \$(19,673)
	Six Mont Unrealize Gains (Losses) o Securities	Pension I on	Plans		
	Unrealize Gains (Losses) o	ed Pension I	Plans	Total	
Beginning balance, net of tax	Unrealize Gains (Losses) o Securities	ed Pension I Net Prior Service (Cost)	Plans Net Gain (Loss)	Total) \$(15,570)
Beginning balance, net of tax Other comprehensive loss before reclassifications	Unrealize Gains (Losses) of Securities Other	ed Pension I Net Prior Service (Cost) Credit	Plans Net Gain (Loss)))
	Unrealize Gains (Losses) of Securities Other \$6,238	ed Pension I Net Prior Service (Cost) Credit \$7	Plans Net Gain (Loss)) \$(15,570 (4,869)))
Other comprehensive loss before reclassifications	Unrealize Gains (Losses) of Securities Other \$6,238 (4,869	ed Pension I Net Prior Service (Cost) Credit \$7) —	Plans Net Gain (Loss) \$(21,815 —) \$(15,570 (4,869)
Other comprehensive loss before reclassifications Reclassified to income	Unrealize Gains (Losses) of Securities Other \$6,238 (4,869 (2,581	ed Pension F Net Prior Service (Cost) Credit \$7) —) (8	Plans Net Gain (Loss) \$(21,815) 1,145) \$(15,570 (4,869 (1,444)

	Unrealize Gains (Losses) o	Pension I		Ļ	
	Securities				
		Net Prior			
	Other	Service (Cost) Credit	Net Gain (Loss)	Total	
Beginning balance, net of tax	\$(1,977) \$(14) \$(12.218) \$(14,209)
	\$(1,977 8,586) \$(14) \$(12,218	8,586)
Other comprehensive income before reclassifications Reclassified to income) 289	-)
	(498) (4	/	(213	
Income tax (expense) benefit	(2,830) 1	(101) (2,930)
Net current-period other comprehensive income (loss), net of tax	5,258	(3) 188	5,443	`
Ending balance, net of tax	\$3,281	\$(17) \$(12,030) \$(8,766)
	Six Mont Unrealize Gains (Losses) o Securities	Pension I			
	Unrealize Gains (Losses) o	ed Pension I	Plans	Total	
Beginning balance, net of tax	Unrealize Gains (Losses) o Securities	ed Pension I S Net Prior Service (Cost)	Plans Net Gain (Loss)	Total) \$(21,037)
	Unrealize Gains (Losses) of Securities Other	ed Pension I Net Prior Service (Cost) Credit	Plans Net Gain (Loss))
Beginning balance, net of tax Other comprehensive income before reclassifications Reclassified to income	Unrealize Gains (Losses) of Securities Other \$(8,656	ed Pension I Net Prior Service (Cost) Credit	Plans Net Gain (Loss)) \$(21,037)
Other comprehensive income before reclassifications	Unrealize Gains (Losses) of Securities Other \$(8,656 18,873	ed Pension I Net Prior Service (Cost) Credit) \$(12 —	Plans Net Gain (Loss)) \$(12,369 —) \$(21,037 18,873)
Other comprehensive income before reclassifications Reclassified to income Income tax (expense) benefit	Unrealize Gains (Losses) of Securities Other \$(8,656 18,873 (509 (6,427	ed Pension I Net Prior Service (Cost) Credit) \$(12) (7) 2	Plans Net Gain (Loss)) \$(12,369) 521) \$(21,037 18,873 5) (6,607	
Other comprehensive income before reclassifications Reclassified to income	Unrealize Gains (Losses) of Securities Other \$(8,656 18,873 (509	ed Pension I Net Prior Service (Cost) Credit) \$(12 —) (7	Plans Net Gain (Loss)) \$(12,369) 521 (182) \$(21,037 18,873 5) (6,607 12,271	

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

	June 30,		Six Months Ended June 30			e 30,		
	2015		2014		2015		2014	
Unrealized gains and losses on available for sale securities:								
Realized net gain on sale of securities ⁽¹⁾	\$105		\$498		\$2,581		\$509	
Tax expense	(36)	(174)	(903)	(178)
Net of tax	69		324		1,678		331	
Amortization of pension plan:								
Net actuarial loss ⁽²⁾	\$(614)	\$(289)	\$(1,145)	\$(521)
Prior service credit ⁽²⁾	4		4		8		7	
Total before tax	(610)	(285)	(1,137)	(514)
Tax benefit	213		100		398		180	
Net of tax	(397)	(185)	(739)	(334)
Total reclassifications for the period, net of tax	\$(328)	\$139		\$939		\$(3)

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

(2) These accumulated other comprehensive income components are included in the computation of net periodic pension cost presented in "Note 8 - Employee Benefit Plans."

5. Securities

The amortized cost, carrying value, and estimated fair value of investment and mortgage-backed securities as of June 30, 2015 and December 31, 2014 are reflected in the tables below (in thousands):

	June 30, 2015						
		Recognized	in OCI		Not recogni		
	Amortized	Gross Unrealized	Gross Unrealized	Carrying	Gross Unrealized	Gross Unrealized	Estimated
AVAILABLE FOR SALE Investment Securities:	Cost	Gains	Losses	Value	Gains	Losses	Fair Value
U.S. Treasury	\$101,239	\$198	\$914	\$100,523	\$—	\$—	\$100,523
U.S. Government Agency Debentures	4,845	1	_	4,846	_	_	4,846
State and Political Subdivisions	243,446	5,156	2,182	246,420	_		246,420
Other Stocks and Bonds	13,092	111		13,203		_	13,203
Other Equity Securities Mortgage-backed Securities: ⁽¹⁾	6,058	—	31	6,027	—	—	6,027
Residential	713,576	13,622	872	726,326		_	726,326
Commercial	372,155	874	4,553	368,476			368,476
Total	\$1,454,411	\$19,962	\$8,552	\$1,465,821	\$—	\$—	\$1,465,821
HELD TO MATURITY Investment Securities: State and Political Subdivisions Mortgage-backed Securities: ⁽¹⁾	\$391,784	\$5,193	\$9,765	\$387,212	\$6,613	\$2,634	\$391,191
Residential	41,215	— 1 015	61	41,154	2,602		43,756
Commercial Total	320,144 \$753,143	1,315 \$6,508	5,944 \$15,770	315,515 \$743,881	4,989 \$14,204	1,977 \$4,611	318,527 \$753,474

	December 3	1, 2014					
		Recognized	in OCI		Not recogni	zed in OCI	
	Amortized	Gross Unrealized	Gross Unrealized	Carrying	Gross Unrealized	Gross Unrealized	Estimated
AVAILABLE FOR SALE	Cost	Gains	Losses	Value	Gains	Losses	Fair Value
Investment Securities: U.S. Treasury	\$14,883	\$30	\$7	\$14,906	\$—	\$—	\$14,906
U.S. Government Agency Debentures	4,835		7	4,828	_	_	4,828
State and Political Subdivisions	260,535	8,055	906	267,684	_	_	267,684
Other Stocks and Bonds	13,086	153	_	13,239			13,239
Other Equity Securities Mortgage-backed Securities: ⁽¹⁾	6,061	_	12	6,049	_	_	6,049
Residential	952,481	12,624	807	964,298			964,298
Commercial	176,112	1,743	151	177,704	—		177,704
Total	\$1,427,993	\$22,605	\$1,890	\$1,448,708	\$—	\$—	\$1,448,708
HELD TO MATURITY Investment Securities: State and Political Subdivisions Mortgage-backed	\$393,525	\$5,168	\$9,870	\$388,823	\$12,181	\$756	\$400,248
Securities: ⁽¹⁾ Residential Commercial Total	52,287 207,624 \$653,436	 \$5,168	70 6,345 \$16,285	52,217 201,279 \$642,319	2,871 5,461 \$20,513	 489 \$1,245	55,088 206,251 \$661,587

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

From time to time, the Company may transfer securities from available for sale ("AFS") to held to maturity ("HTM") due to overall balance sheet strategies. Our management has the current intent and ability to hold the transferred securities until maturity. Any net unrealized gain or loss on the transferred securities included in accumulated other comprehensive income at the time of transfer will be amortized over the remaining life of the underlying security as an adjustment of the yield on those securities. AFS securities transferred with losses included in accumulated other comprehensive income continue to be included in management's assessment for other-than-temporary impairment for each individual security.

During the second quarter of 2015, the Company transferred commercial mortgage-backed securities with a fair value of \$57.7 million from AFS to HTM. The unrealized gain on the securities transferred from AFS to HTM was \$1.3 million (\$864,000, net of tax) at the date of transfer based on the fair value of the securities on the transfer date.

The following table represents the unrealized loss on securities as of June 30, 2015 and December 31, 2014 (in thousands):

	As of June 3 Less Than 12	2 Months	More Than 1		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE		2000		2000		2000
Investment Securities:						
U.S. Treasury	\$71,085	\$914	\$—	\$—	\$71,085	\$914
State and Political Subdivisions	93,099	1,178	26,796	1,004	119,895	2,182
Other Equity Securities	6,027	31			6,027	31
Mortgage-backed Securities:						
Residential	139,161	849	8,329	23	147,490	872
Commercial	265,182	4,553			265,182	4,553
Total	\$574,554	\$7,525	\$35,125	\$1,027	\$609,679	\$8,552
HELD TO MATURITY						
Investment Securities:	¢110.415	\$ 000	ф. с. с. 1 .	¢1.640	ф 175 (CO	\$2.624
State and Political Subdivisions	\$119,415	\$986	\$56,247	\$1,648	\$175,662	\$2,634
Mortgage-backed Securities:	127 5(0	1 005	(= 1 (02	144.005	1 077
Commercial Total	137,569 \$256,984	1,885	6,516 \$62,762	92 \$ 1.740	144,085 \$ 210 747	1,977 \$4,611
Total	\$230,984	\$2,871	\$62,763	\$1,740	\$319,747	\$4,611
	As of Decem	ber 31, 2014				
	Less Than 12		More Than 1	2 Months	Total	
					TOTAL	
		Unrealized		Unrealized		Unrealized
	Fair Value		Fair Value		Fair Value	Unrealized Loss
AVAILABLE FOR SALE		Unrealized		Unrealized		
AVAILABLE FOR SALE Investment Securities:		Unrealized		Unrealized		
		Unrealized		Unrealized		
Investment Securities:	Fair Value \$4,968	Unrealized Loss \$7	Fair Value	Unrealized Loss	Fair Value \$4,968	Loss \$7
Investment Securities: U.S. Treasury U.S. Government Agency Debentures	Fair Value \$4,968 4,828	Unrealized Loss \$7 7	Fair Value \$—	Unrealized Loss \$—	Fair Value \$4,968 4,828	Loss \$7 7
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions	Fair Value \$4,968 4,828 28,155	Unrealized Loss \$7 7 90	Fair Value	Unrealized Loss	Fair Value \$4,968 4,828 72,424	Loss \$7 7 906
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities	Fair Value \$4,968 4,828	Unrealized Loss \$7 7	Fair Value \$—	Unrealized Loss \$—	Fair Value \$4,968 4,828	Loss \$7 7
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities:	Fair Value \$4,968 4,828 28,155 6,049	Unrealized Loss \$7 7 90 12	Fair Value \$ 44,269 	Unrealized Loss \$ 816 	Fair Value \$4,968 4,828 72,424 6,049	Loss \$7 7 906 12
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential	Fair Value \$4,968 4,828 28,155 6,049 347,777	Unrealized Loss \$7 7 90 12 573	Fair Value \$	Unrealized Loss \$ 816 234	Fair Value \$4,968 4,828 72,424 6,049 375,409	Loss \$7 7 906 12 807
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103	Unrealized Loss \$7 7 90 12 573 54	Fair Value \$	Unrealized Loss \$ 816 234 97	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219	Loss \$7 7 906 12 807 151
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total	Fair Value \$4,968 4,828 28,155 6,049 347,777	Unrealized Loss \$7 7 90 12 573	Fair Value \$	Unrealized Loss \$ 816 234	Fair Value \$4,968 4,828 72,424 6,049 375,409	Loss \$7 7 906 12 807
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103	Unrealized Loss \$7 7 90 12 573 54	Fair Value \$	Unrealized Loss \$ 816 234 97	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219	Loss \$7 7 906 12 807 151
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY Investment Securities:	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103 \$412,880	Unrealized Loss \$7 7 90 12 573 54 \$743	Fair Value \$	Unrealized Loss \$ 816 234 97 \$1,147	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219 \$494,897	Loss \$7 7 906 12 807 151 \$1,890
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY Investment Securities: State and Political Subdivisions	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103	Unrealized Loss \$7 7 90 12 573 54	Fair Value \$	Unrealized Loss \$ 816 234 97	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219	Loss \$7 7 906 12 807 151
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY Investment Securities: State and Political Subdivisions Mortgage-backed Securities:	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103 \$412,880	Unrealized Loss \$7 7 90 12 573 54 \$743	Fair Value \$ 44,269 27,632 10,116 \$82,017 \$64,946	Unrealized Loss \$ 816 234 97 \$1,147 \$725	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219 \$494,897 \$72,789	Loss \$7 7 906 12 807 151 \$1,890 \$756
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY Investment Securities: State and Political Subdivisions Mortgage-backed Securities: Commercial	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103 \$412,880 \$7,843 	Unrealized Loss \$7 7 90 12 573 54 \$743 \$31 	Fair Value \$	Unrealized Loss \$ 816 234 97 \$1,147 \$725 489	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219 \$494,897 \$72,789 44,144	Loss \$7 7 906 12 807 151 \$1,890 \$756 489
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Equity Securities Mortgage-backed Securities: Residential Commercial Total HELD TO MATURITY Investment Securities: State and Political Subdivisions Mortgage-backed Securities:	Fair Value \$4,968 4,828 28,155 6,049 347,777 21,103 \$412,880	Unrealized Loss \$7 7 90 12 573 54 \$743	Fair Value \$ 44,269 27,632 10,116 \$82,017 \$64,946	Unrealized Loss \$ 816 234 97 \$1,147 \$725	Fair Value \$4,968 4,828 72,424 6,049 375,409 31,219 \$494,897 \$72,789	Loss \$7 7 906 12 807 151 \$1,890 \$756

We review those securities in an unrealized loss position for significant differences between fair value and the cost basis to evaluate if a classification of other-than-temporary impairment is warranted. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. The Company considers an other-than-temporary impairment to have occurred when there is an adverse change in expected cash flows. When it is determined that a decline in fair value of HTM and AFS securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and the noncredit portion to other comprehensive income. Based upon the length of time and the extent to which fair value is less than cost, we believe the securities with an unrealized loss do not have other-than-temporary impairment at June 30, 2015.

The majority of the unrealized loss positions are comprised of highly rated municipal securities and U.S. Agency mortgage- backed securities ("MBS") where the unrealized loss is a direct result of the change in interest rates and spreads. For those securities in an unrealized loss position, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the security before the anticipated recovery of its amortized cost basis. To the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and MBS portfolio with an other-than-temporary impairment at June 30, 2015.

Interest income recognized on securities for the periods presented (in thousands):

	Three Months	Ended June 30,
	2015	2014
U.S. Treasury	\$345	\$41
U.S. Government Agency Debentures	32	41
State and Political Subdivisions	5,645	6,031
Other Stocks and Bonds	52	51
Other Equity Securities	29	
Mortgage-backed Securities	7,666	7,557
Total interest income on securities	\$13,769	\$13,721
	Six Months Er	nded June 30,
	2015	2014
U.S. Treasury	\$461	\$41
U.S. Government Agency Debentures	64	100
State and Political Subdivisions	11,515	12,001
Other Stocks and Bonds	104	103
Other Equity Securities	61	
Mortgage-backed Securities	16,128	15,239
Total interest income on securities	\$28,333	\$27,484

Of the approximately \$2.6 million in net securities gains from the AFS portfolio for the six months ended June 30, 2015, there were \$2.7 million in realized gains and \$120,000 in realized losses. Of the \$509,000 in net securities gains from the AFS portfolio for the six months ended June 30, 2014, there were \$4.6 million in realized gains and \$4.1 million in realized losses. There were no sales from the HTM portfolio during the six months ended June 30, 2015 or 2014. We calculate realized gains and losses on sales of securities under the specific identification method.

The amortized cost, carrying value and fair value of securities at June 30, 2015, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. MBS are presented in total by category due to the fact that MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the security holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	June 30, 2015	
	Amortized Cost	Fair Value
AVAILABLE FOR SALE	(in thousands)	
Investment Securities:		
Due in one year or less	\$10,479	\$10,533
Due after one year through five years	26,347	26,786
Due after five years through ten years	150,749	150,286
Due after ten years	175,047	177,387
	362,622	364,992
Mortgage-backed Securities and Other Equity Securities:	1,091,789	1,100,829
Total	\$1,454,411	\$1,465,821
	June 30, 2015	
	June 30, 2015 Carrying Value	Fair Value
HELD TO MATURITY	·	Fair Value
HELD TO MATURITY Investment Securities:	Carrying Value	Fair Value
	Carrying Value	Fair Value \$1,068
Investment Securities:	Carrying Value (in thousands)	
Investment Securities: Due in one year or less	Carrying Value (in thousands) \$1,067	\$1,068
Investment Securities: Due in one year or less Due after one year through five years	Carrying Value (in thousands) \$1,067 11,205	\$1,068 11,481
Investment Securities: Due in one year or less Due after one year through five years Due after five years through ten years	Carrying Value (in thousands) \$1,067 11,205 42,863	\$1,068 11,481 42,969
Investment Securities: Due in one year or less Due after one year through five years Due after five years through ten years	Carrying Value (in thousands) \$1,067 11,205 42,863 332,077	\$1,068 11,481 42,969 335,673
Investment Securities: Due in one year or less Due after one year through five years Due after five years through ten years Due after ten years	Carrying Value (in thousands) \$1,067 11,205 42,863 332,077 387,212	\$1,068 11,481 42,969 335,673 391,191

Investment securities and MBS with carrying values of \$1.10 billion and \$1.12 billion were pledged as of June 30, 2015 and December 31, 2014, respectively, to collateralize Federal Home Loan Bank ("FHLB") advances, repurchase agreements, and public funds or for other purposes as required by law.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates their fair value and are assessed for other-than-temporary impairment. These securities have no maturity date.

6. Loans and Allowance for Probable Loan Losses

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

	June 30, 2015	December 31, 2014
Real Estate Loans:		
Construction	\$295,633	\$267,830
1-4 Family Residential	683,944	690,895
Other	500,906	468,171
Commercial Loans	228,789	226,460
Municipal Loans	256,492	257,492
Loans to Individuals	214,099	270,285
Total Loans ⁽¹⁾	2,179,863	2,181,133
Less: Allowance for Loan Losses	16,822	13,292
Net Loans	\$2,163,041	\$2,167,841

(1) Includes approximately \$679.7 million and \$763.3 million of loans acquired with the Omni acquisition as of June 30, 2015 and December 31, 2014, respectively. These loans were measured at fair value at the acquisition date with no carryover of allowance for loan loss. The allowance for loan loss recorded on acquired loans for the six months ended June 30, 2015 was not significant.

Real Estate Construction Loans

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

Real Estate 1-4 Family Residential Loans

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

residences. Substantially all of our 1-4 family residential loan originations are secured by properties located in or near our market areas.

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

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

Other Real Estate Loans

Other Real Estate loans primarily include loans collateralized by commercial office buildings, retail, medical facilities and offices, warehouse facilities, hotels and churches. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Other real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

Commercial Loans

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type, other than the medical industry. Loans to borrowers in the medical industry include all loan types listed above for commercial loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations.

In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

Municipal Loans

We have a specific lending department that makes loans to municipalities and school districts throughout the state of Texas. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service.

Loans to Individuals

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

On October 3, 2014, we announced that we intended to sell all of our subprime automobile loans purchased through SFG, as well as the repossessed assets held by SFG. During the fourth quarter of 2014, the sale of the subprime automobile loans and repossessed assets held by SFG was completed. As a result, the carrying amount of SFG loans totaling \$70.3 million were sold and were therefore not included in our loan portfolio as of December 31, 2014. There have been no subsequent loan pool purchases through SFG since December 2014 and there will be no additional loan pool purchases through SFG. For the six months ended June 30, 2014, SFG purchased loan pools of approximately \$30.4 million, net of discount.

Allowance for Loan Losses

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

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

We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are updated based on actual charge-off experience quarterly and adjusted for qualitative factors. Our pools of similar loans include consumer loans and loans secured by 1-4 residential family loans.

Prior to September 30, 2014, SFG loans included in loans to individuals that experienced past due status or extension of maturity characteristics were reserved for at higher levels based on the circumstances associated with each specific loan. In general, the reserves for SFG were calculated based on the past due status of the loan. For reserve purposes, the portfolio was segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that paid late took longer to repay than the original contract. Additionally, some loans may have been granted extensions for extenuating payment circumstances and evaluated for troubled debt classification. The remaining term extensions increased the risk of collateral deterioration and, accordingly, reserves were increased to recognize this risk.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, and geographic and industry loan concentration.

Credit Quality Indicators

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

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

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

A lack of, or abnormally extended payment program;

A heavy degree of concentration of collateral without sufficient margin;

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

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

Special Mention (Rating 6) – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment

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prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

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

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

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

Changes in lending policies or procedures, including underwriting, collection, charge-off, and recovery procedures; Changes in local, regional and national economic and business conditions, including entry into new markets; Changes in the volume or type of credit extended;

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

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

Changes in charge-off trends;

Changes in loan review or Board oversight;

- Changes in the level of concentrations of
- credit; and

Changes in external factors, such as competition and legal and regulatory requirements.

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

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

		s Ended June 3	0, 2015				
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	\$2,774	\$3,400	\$3,360	\$5,316	\$824	\$1,252	\$16,926
Provision (reversal) for loan losses	86	93	162	(308) 9	226	268
Loans charged off	_	(40)	_	(50) —	(803)	(893)
Recoveries of loans charged off	49	15	7	55		395	521
Balance at end of period	\$2,909	\$3,468	\$3,529	\$5,013	\$833	\$1,070	\$16,822

	Six Months Ended June 30, 2015 Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total	
Balance at beginning of period ⁽¹⁾	\$2,456	\$2,822	\$3,025	\$3,279	\$716	\$994	\$13,292	
Provision (reversal) for loan losses	361	666	431	1,757	117	784	4,116	
Loans charged off		(46)	—	(107)		(1,826)	(1,979)	
Recoveries of loans charged off	92	26	73	84		1,118	1,393	
Balance at end of period	\$2,909	\$3,468	\$3,529	\$5,013	\$833	\$1,070	\$16,822	

(1) Loans acquired with the Omni acquisition were measured at fair value on December 17, 2014 with no carryover of allowance for loan loss.

	Three Months Ended June 30, 2014 Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	l Municipal Loans	Loans to Individuals	Total	
Balance at beginning of period		\$3,797	\$2,411	\$2,031	\$777	\$7,641	\$18,787	
Provision (reversal) for loan losses	^r 319	92	24	(322)	(114)	2,651	2,650	
Loans charged off	—			(5)	—	(3,541)	(3,546)
Recoveries of loans charged off	47	26	1	53	_	390	517	
Balance at end of period	\$2,496	\$3,915	\$2,436	\$1,757	\$663	\$7,141	\$18,408	
	Six Months Ended June 30, 2014 Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total	
Balance at beginning of period	\$2,142	\$3,277	\$2,572	\$1,970	\$668	\$8,248	\$18,877	
Provision (reversal) for loan losses	309	628	(140)	(319)	(5)	6,310	6,783	
Loans charged off	(14)	(22)	—	(5)		(8,273)	(8,314)
Recoveries of loans charged off	59	32	4	111	_	856	1,062	
Balance at end of								

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

	As of June 30, 2015 Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total	
Ending balance –								
individually evaluated	\$45	\$28	\$121	\$3,274	\$201	\$46	\$3,715	
for impairment Ending balance –								
collectively evaluated	2.864	3,440	3,408	1,739	632	1,024	13,107	
for impairment	_,	0,110	0,100	1,707	002	1,021	10,107	
Balance at end of period	\$2,909	\$3,468	\$3,529	\$5,013	\$833	\$1,070	\$16,822	

	As of December 31, 2014 Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total	
Ending balance –								
individually evaluated for impairment	\$43	\$102	\$26	\$242	\$14	\$103	\$530	
Ending balance –								
collectively evaluated	2,413	2,720	2,999	3,037	702	891	12,762	
for impairment								
Balance at end of period	\$2,456	\$2,822	\$3,025	\$3,279	\$716	\$994	\$13,292	

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

	June 30, 2015 Real Estate								
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total		
Loans individually evaluated for impairment	\$2,342	\$1,793	\$4,099	\$14,987	\$949	\$179	\$24,349		
Loans collectively evaluated for impairment	293,061	675,039	493,344	204,826	255,543	213,410	2,135,223		
Purchased credit impaired	¹ 230	7,112	3,463	8,976		510	20,291		
Total ending loan balance	\$295,633	\$683,944	\$500,906	\$228,789	\$256,492	\$214,099	\$2,179,863		
	December 31, 2014 Real Estate								
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total		
Loans individually evaluated for impairment	\$2,461	\$2,936	\$1,605	\$1,011	\$699	\$310	\$9,022		
Loans collectively evaluated for impairment (1)		680,658	463,564	216,272	256,793	268,894	2,150,765		
Purchased credit impaired loans ⁽²⁾	¹ 785	7,301	3,002	9,177	_	1,081	21,346		
Total ending loan balance	\$267,830	\$690,895	\$468,171	\$226,460	\$257,492	\$270,285	\$2,181,133		

(1) Includes purchased non impaired loans which were measured at fair value at acquisition and did not have an associated allowance for loan loss as of December 31, 2014.

(2) PCI loans were measured at fair value at acquisition and did not have an associated allowance for loan loss as of December 31, 2014.

The following table sets forth loans by credit quality indicator for the periods presented (in thousands): June 30, 2015

	Pass	Pass Watch	Special Mention ⁽¹⁾	Substandard (1)	Doubtful ⁽¹⁾	Total
Real Estate Loans:						
Construction	\$290,038	\$29	\$1,366	\$4,174	\$26	\$295,633
1-4 Family Residential	670,852	1,428	1,664	6,305	3,695	683,944
Other	489,166		83	11,657		500,906
Commercial Loans	200,583	751	962	17,910	8,583	228,789
Municipal Loans	255,543			699	250	256,492
Loans to Individuals	212,757	11		469	862	214,099
Total	\$2,118,939	\$2,219	\$4,075	\$41,214	\$13,416	\$2,179,863

(1) Includes \$0.1 million special mention, \$4.4 million substandard, and \$10.4 million doubtful of PCI loans as of June 30, 2015.

	December 31, 2014								
	Pass Pass Watch Special Mention (1		Special Mention ⁽¹⁾	Substandard ⁽¹⁾	Doubtful	Total			
Real Estate Loans:									
Construction	\$260,183	\$862	\$1,394	\$5,363	\$28	\$267,830			
1-4 Family Residential	677,559	1,453	1,706	9,167	1,010	690,895			
Other	455,394	2,416	2,569	7,792		468,171			
Commercial Loans	199,306	781	1,044	25,102	227	226,460			
Municipal Loans	256,543			949		257,492			
Loans to Individuals	269,204	16		871	194	270,285			
Total	\$2,118,189	\$5,528	\$6,713	\$49,244	\$1,459	\$2,181,133			

(1) Includes \$0.7 million special mention and \$17.8 million substandard of PCI loans as of December 31, 2014.

Nonperforming Assets and Past Due Loans

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

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

PCI loans are recorded at fair value at acquisition date. Although the PCI loans may be contractually delinquent, we do not classify these loans as past due or nonperforming as the loans were written down to fair value at the acquisition date and the accretable yield is recognized in interest income over the remaining life of the loan. Subsequent to acquisition, we re-assess PCI loans for additional impairment.

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

	At	At
	June 30,	December 31,
	2015	2014
Nonaccrual loans ⁽¹⁾	\$21,223	\$4,096
Accruing loans past due more than 90 days ⁽¹⁾	30	4
Restructured loans ⁽¹⁾	5,667	5,874
Other real estate owned	787	1,738
Repossessed assets	87	565
Total Nonperforming Assets	\$27,794	\$12,277

(1) Excludes PCI loans measured at fair value at acquisition.

Foreclosed assets include other real estate owned and repossessed assets. For 1-4 family residential real estate properties, a loan is recognized as a foreclosed property once legal title to the real estate property has been received upon completion of foreclosure or the borrower has conveyed all interest in the residential property through a deed in lieu of foreclosure. Loans secured by 1-4 family residential properties for which formal foreclosure proceedings were in process as of June 30, 2015 were \$170,000.

The following table sets forth the recorded investment in nonaccrual loans by class of loans for the periods presented (in thousands):

	Nonaccrual Loans	s (1)
	June 30, 2015	December 31, 2014
Real Estate Loans:		
Construction	\$597	\$716
1-4 Family Residential	1,972	2,017
Other	3,204	675
Commercial Loans	14,249	416
Municipal Loans	249	
Loans to Individuals	952	272
Total	\$21,223	\$4,096

(1) Excludes PCI loans measured at fair value at acquisition.

Accruing loans past due more than 90 days were not significant.

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

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

	June 30, 2015		
	Unpaid	Recorded	Related
	Contractual	Investment With	Allowance for
	Principal Balance	Allowance	Loan Losses
Real Estate Loans:			
Construction	\$3,093	\$2,342	\$45
1-4 Family Residential	1,877	1,793	28
Other	4,587	4,532	121
Commercial Loans	16,597	14,987	3,274
Municipal Loans	949	949	201
Loans to Individuals	199	179	46
Total ⁽¹⁾	\$27,302	\$24,782	\$3,715
	December 31, 201	4	
	December 31, 201	.4	
	Unpaid	Recorded	Palatad
			Related
	Unpaid	Recorded	Allowance for
	Unpaid Contractual	Recorded Investment	
Real Estate Loans:	Unpaid Contractual Principal	Recorded Investment With	Allowance for
Real Estate Loans: Construction	Unpaid Contractual Principal	Recorded Investment With	Allowance for
	Unpaid Contractual Principal Balance	Recorded Investment With Allowance	Allowance for Loan Losses
Construction	Unpaid Contractual Principal Balance \$3,183	Recorded Investment With Allowance \$2,461	Allowance for Loan Losses \$43
Construction 1-4 Family Residential	Unpaid Contractual Principal Balance \$3,183 4,023	Recorded Investment With Allowance \$2,461 3,854	Allowance for Loan Losses \$43 108
Construction 1-4 Family Residential Other	Unpaid Contractual Principal Balance \$3,183 4,023 1,622	Recorded Investment With Allowance \$2,461 3,854 1,605	Allowance for Loan Losses \$43 108 26
Construction 1-4 Family Residential Other Commercial Loans	Unpaid Contractual Principal Balance \$3,183 4,023 1,622 1,162	Recorded Investment With Allowance \$2,461 3,854 1,605 1,011	Allowance for Loan Losses \$43 108 26 242

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

(1) PCI loans are excluded from this table as there was no evidence of further deterioration in credit quality subsequent to the acquisition date that would indicate it is probable that our recorded investment in these loans would not be recoverable.

There were no impaired loans recorded without an allowance as of June 30, 2015 or December 31, 2014.

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

	June 30, 2015							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current ⁽¹⁾	Total		
Real Estate Loans:								
Construction	\$561	\$55	\$550	\$1,166	\$294,467	\$295,633		
1-4 Family Residential	458	1,541	455	2,454	681,490	683,944		
Other	53	218	1,346	1,617	499,289	500,906		
Commercial Loans	408	924	122	1,454	227,335	228,789		
Municipal Loans			250	250	256,242	256,492		
Loans to Individuals	2,952	760	299	4,011	210,088	214,099		
Total	\$4,432	\$3,498	\$3,022	\$10,952	\$2,168,911	\$2,179,863		

	December 31, 2014							
	30-59 Days Past Due	² 90 Davs		Total Past Due Current ⁽¹⁾		Total		
Real Estate Loans:								
Construction	\$376	\$42	\$716	\$1,134	\$266,696	\$267,830		
1-4 Family Residential	3,511	509	2,017	6,037	684,858	690,895		
Other	1,203		675	1,878	466,293	468,171		
Commercial Loans	397	3	416	816	225,644	226,460		
Municipal Loans					257,492	257,492		
Loans to Individuals	362	66	276	704	269,581	270,285		
Total	\$5,849	\$620	\$4,100	\$10,569	\$2,170,564	\$2,181,133		

(1) Includes PCI loans measured at fair value at acquisition.

The following table sets forth interest income recognized on impaired loans by class of loans for the periods presented. Average recorded investment of impaired loans is reported on a year-to-date basis (in thousands): Three Months Ended

Three Months Ended						
	June 30, 2015		June 30, 2014			
	Average Recorded	Interest Income	Average Recorded	Interest Income		
	Investment (1)	Recognized (1)	Investment	Recognized		
Real Estate Loans:		-		-		
Construction	\$2,361	\$23	\$1,643	\$9		
1-4 Family residential	3,692	14	3,418	21		
Other	3,586	13	2,838	22		
Commercial loans	15,163	9	1,444	12		
Municipal loans	949	10	759	21		
Loans to individuals	881	1	2,144	23		
Total	\$26,632	\$70	\$12,246	\$108		
	Six Months Ended					
	Six Months Ended June 30, 2015		June 30, 2014			
		Interest Income	June 30, 2014 Average Recorded	Interest Income		
	June 30, 2015	Interest Income Recognized ⁽¹⁾		Interest Income Recognized		
Real Estate Loans:	June 30, 2015 Average Recorded		Average Recorded			
Real Estate Loans: Construction	June 30, 2015 Average Recorded		Average Recorded			
	June 30, 2015 Average Recorded Investment ⁽¹⁾	Recognized (1)	Average Recorded Investment	Recognized		
Construction	June 30, 2015 Average Recorded Investment ⁽¹⁾ \$2,382	Recognized ⁽¹⁾ \$46	Average Recorded Investment \$1,578	Recognized		
Construction 1-4 Family Residential	June 30, 2015 Average Recorded Investment ⁽¹⁾ \$2,382 3,855	Recognized ⁽¹⁾ \$46 29	Average Recorded Investment \$1,578 2,982	Recognized \$11 65		
Construction 1-4 Family Residential Other	June 30, 2015 Average Recorded Investment ⁽¹⁾ \$2,382 3,855 2,731	Recognized ⁽¹⁾ \$46 29 25	Average Recorded Investment \$1,578 2,982 2,362	Recognized \$11 65 75		
Construction 1-4 Family Residential Other Commercial Loans	June 30, 2015 Average Recorded Investment ⁽¹⁾ \$2,382 3,855 2,731 9,070	Recognized ⁽¹⁾ \$46 29 25 18	Average Recorded Investment \$1,578 2,982 2,362 1,446	Recognized \$11 65 75 19		
Construction 1-4 Family Residential Other Commercial Loans Municipal Loans	June 30, 2015 Average Recorded Investment ⁽¹⁾ \$2,382 3,855 2,731 9,070 842	Recognized ⁽¹⁾ \$46 29 25 18 19	Average Recorded Investment \$1,578 2,982 2,362 1,446 759	Recognized \$11 65 75 19 21		

(1) Excludes PCI loans measured at fair value at acquisition.

Troubled Debt Restructurings

The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, restructuring amortization schedules and other actions intended to minimize potential losses.

The following tables set forth the recorded balance at June 30, 2015 and 2014 of loans considered to be TDRs that were restructured during the periods presented (dollars in thousands):

Three Months Ended June 30, 2015						
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans	
Real Estate Loans:						
Commercial Loans	\$300	\$—	\$—	\$300	1	
Loans to Individuals	4		58	62	7	
Total	\$304	\$—	\$58	\$362	8	
	Six Months En	15				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans	
Real Estate Loans:						
1-4 Family Residential	\$—	\$—	\$262	\$262	2	
Other	30		—	30	1	
Commercial Loans	300		762	1,062	2	
Loans to Individuals	4		84	88	9	
Total	\$334	\$—	\$1,108	\$1,442	14	
	Three Months I	Ended June 30, 1	2014			
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans	
Real Estate Loans:						
Other	\$—	\$—	\$388	\$388	1	
Commercial Loans	60		—	60	2	
Total	\$60	\$—	\$388	\$448	3	
	Six Months En	ded June 30, 20	14			
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans	
Real Estate Loans:						
1-4 Family Residential	\$—	\$284	\$—	\$284	1	
Other	_		413	413	2	
Commercial Loans	313		56	369	5	
Loans to Individuals	_	15	45	60	4	
Total	\$313	\$299	\$514	\$1,126	12	

(1) These modifications include an extension of the amortization period and interest rate reduction.

The majority of loans restructured as TDRs during the six months ended June 30, 2015 were modified with a combination of interest rate reductions and maturity extensions. Interest continues to be charged on principal balances outstanding during the extended term. Therefore, the financial effects of the recorded investment of loans restructured as TDRs during the three and six months ended June 30, 2015 and June 30, 2014 were not significant. Generally, the loans identified as TDRs were previously reported as impaired loans prior to restructuring and therefore the modification did not impact our determination of the allowance for loan losses.

On an ongoing basis, the performance of the TDRs is monitored for subsequent payment default. Payment default for TDRs is recognized when the borrower is 90 days or more past due. For the three and six months ended June 30, 2015 and 2014, there were no material defaults. Payment defaults for TDRs did not significantly impact the determination of the allowance for loan loss in either period presented.

At June 30, 2015 and 2014, there were no commitments to lend additional funds to borrowers whose terms had been modified in TDRs.

Purchased Credit Impaired Loans

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

	June 30, 2015	December 31, 2014
Outstanding principal balance	\$30,215	\$32,572
Carrying amount	\$20,291	\$21,346

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

	Three Months	Six Months
	Ended	Ended
	June 30, 2015	
Balance at beginning of period	\$1,296	\$1,820
Additions		
Additions due to acquisition		_
Accretion	(618) (1,142)
Balance at end of period	\$678	\$678

7. Long-term Obligations

Long-term obligations are summarized as follows (in thousands):

	June 30, 2015	December 31, 2014
FHLB Advances ⁽¹⁾	\$572,254	\$600,052
Long-term Debt ⁽²⁾		
Southside Statutory Trust III Due 2033 ⁽³⁾	20,619	20,619
Southside Statutory Trust IV Due 2037 ⁽⁴⁾	23,196	23,196
Southside Statutory Trust V Due 2037 ⁽⁵⁾	12,887	12,887
Magnolia Trust Company I Due 2035 ⁽⁶⁾	3,609	3,609
Total Long-term Debt	60,311	60,311
Total Long-term Obligations	\$632,565	\$660,363

(1) At June 30, 2015, the weighted average cost of these advances was 1.31%. Long-term FHLB Advances have maturities ranging from July 2016 through July 2028.

This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier (2) 1 capital, subject to certain limitations.

(3) This debt carries an adjustable rate of 3.22175% through September 29, 2015 and adjusts quarterly thereafter at a rate equal to three-month LIBOR plus 294 basis points.

(4) This debt carries an adjustable rate of 1.57815% through July 29, 2015 and adjusts quarterly thereafter at a rate equal to three-month LIBOR plus 130 basis points.

(5) This debt carries an adjustable rate of 2.53585% through September 14, 2015 and adjusts quarterly thereafter at a rate equal to three-month LIBOR plus 225 basis points.

(6) This debt carries an adjustable rate of 2.082% through August 23, 2015 and adjusts quarterly thereafter at a rate equal to three-month LIBOR plus 180 basis points.

8. Employee Benefit Plans

The components of net periodic benefit cost are as follows (in thousands):

	Three Months Ended June 30,								
	Defined Benefit				Defined Benefit Pension			Restoration	
	Pension Plan				Plan Acquired			Plan	
	2015	2	2014		2015		2014	2015	2014
Service cost	\$443	\$	\$401		\$—		\$—	\$118	\$68
Interest cost	848	8	876		60			171	145
Expected return on assets	(1,420) (1,412)	(74)			
Net actuarial loss recognition	369	1	141		—			245	148
Prior service (credit) cost amortization	(5) (6)	—			1	2
Net periodic benefit cost	\$235	\$	\$ —		\$(14)	\$—	\$535	\$363

	Six Months Ended June 30,					
	Defined	Benefit	Defined	Benefit Pension	Restoration	
	Pension Plan		Plan Acquired		Plan	
	2015	2014	2015	2014	2015	2014
Service cost	\$919	\$849	\$—	\$—	\$191	\$137
Interest cost	1,705	1,748	119		306	281
Expected return on assets	(2,842) (2,824) (147) —		
Net actuarial loss recognition	752	272	—		393	249
Prior service (credit) cost amortization	(11) (10) —	—	3	3
Net periodic benefit cost	\$523	\$35	\$(28) \$—	\$893	\$670

9. Share-based Incentive Plans

2009 Incentive Plan

On April 16, 2009, our shareholders approved the Southside Bancshares, Inc. 2009 Incentive Plan (the "2009 Incentive Plan"), which is a stock-based incentive compensation plan. A total of 1,407,103 shares of our common stock were reserved and available for issuance pursuant to awards granted under the 2009 Incentive Plan. Under the 2009 Incentive Plan, we were authorized to grant nonqualified stock options ("NQSOs"), restricted stock units ("RSUs"), or any combination thereof to certain officers. During the six months ended June 30, 2015, we granted RSUs and NQSOs pursuant to the 2009 Incentive Plan. During the six months ended June 30, 2014, there were no grants of RSUs or NQSOs pursuant to the 2009 Incentive Plan.

As of June 30, 2015, there were 622,484 unvested awards outstanding. For the three and six months ended June 30, 2015, there was share-based compensation expense of \$294,000 and \$567,000, respectively, with an associated income tax benefit for the three and six months of \$103,000 and \$198,000, respectively. As of June 30, 2014, there were 374,227 unvested awards outstanding. Share-based compensation expense for the three and six months ended June 30, 2014 was \$291,000 and \$577,000, respectively, with an associated income tax benefit for the three and six months ended June 30, 2014 was \$291,000 and \$577,000, respectively, with an associated income tax benefit for the three and six months of \$102,000 and \$202,000, respectively.

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As of June 30, 2015 and 2014, there was \$4.9 million and \$2.5 million of unrecognized compensation cost, respectively, related to the unvested awards outstanding. The remaining cost at June 30, 2015 is expected to be recognized over a weighted-average period of 3.3 years.

The NQSOs have contractual terms of 10 years and vest in equal annual installments over three- and four-year periods.

The fair value of each RSU is the closing stock price on the date of grant. The RSUs vest in equal annual installments over three- and four-year periods.

Each award is evidenced by an award agreement that specifies the exercise price, if applicable, the duration of the award, the number of shares to which the award pertains, and such other provisions as the Board determines. Shares issued in connection with stock compensation awards are issued from authorized shares and not from treasury shares. During the six months ended June 30, 2015 and 2014, there were 12,336 and 12,404 shares, respectively, issued in connection with stock compensation awards from available authorized shares.

The estimated weighted-average grant-date fair value per option and the underlying Black-Scholes option-pricing model assumptions for stock options granted during the six months ended June 30, 2015 are summarized in the following table:

Weighted-average grant date fair value per option	Six Months Ended June 30, 2015 \$6.29
Weighted-average assumptions:	
Risk-free interest rates	2.01%
Expected dividend yield	3.24%
Expected volatility factors of the market price of Southside Bancshares common stock	30.91%
Expected option life (in years)	6.3

The following table presents activity related to our RSUs and NQSOs for the six months ended June 30, 2015.

		Restricted St Outstanding		Stock Option Outstanding	IS	
	Shares Available for Grant	Number of Shares	Weighted- Average Grant-Date Fair Value	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Grant-Date Fair Value
Balance, January 1, 2015	821,604	31,753	\$21.75	419,334	\$19.88	\$6.00
Granted	(425,437)	55,332	27.69	370,105	28.08	6.29
Stock options exercised				(9,351)	18.04	5.39
Stock awards vested		(3,132)	15.79			
Forfeited	20,669	(2,821)	25.24	(17,848)	22.87	6.75
Canceled/expired	451			(451)	24.62	7.78
Balance, June 30, 2015	417,287	81,132	\$25.91	761,789	\$23.81	\$6.13

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life in Years	Number of Shares	Weighted- Average Exercise Price	
\$15.79 - \$28.51 Total	761,789 761,789	\$23.81 \$23.81	8.54 8.54	220,437 220,437	\$18.14 \$18.14	

Other information regarding options outstanding and exercisable as of June 30, 2015 is as follows:

The total intrinsic value (i.e., the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option) of outstanding stock options and exercisable stock options was \$4.1 million and \$2.4 million at June 30, 2015, respectively.

Cash received from stock options exercised for the six months ended June 30, 2015 and 2014 was \$169,000 and \$86,000, respectively. The total intrinsic value related to stock options exercised during the six months ended June 30, 2015 and 2014, was approximately \$88,000 and \$50,000, respectively.

10. Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Valuation techniques including the market approach, the income approach and/or the cost approach are utilized to determine fair value. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Valuation policies and procedures are determined by our investment department and reported to our Asset/Liability Committee ("ALCO") for review. An entity must consider all aspects of nonperforming risk, including the entity's own credit standing, when measuring fair value of a liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. A fair value hierarchy for valuation inputs 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.

Level 3 assets recorded at fair value on a nonrecurring basis at June 30, 2015, included loans for which a specific allowance was established based on the fair value of collateral and other real estate for which fair value of the properties was less than the cost basis. For both asset classes, the unobservable inputs were the additional adjustments applied by management to the appraised values to reflect such factors as non-current appraisals and revisions to estimated time to sell. These adjustments are determined based on qualitative judgments made by management on a case-by-case basis and are not quantifiable inputs, although they are used in the determination of fair value.

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

Certain financial assets are measured at fair value in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of fair value accounting or write-downs of individual assets. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with our monthly and/or quarterly valuation process. There were no transfers between Level 1 and Level 2 during the six months ended June 30, 2015.

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

We review the prices supplied by the independent pricing services for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In addition, we obtain an understanding of their underlying pricing methodologies and their Statement on Standards for Attestation Engagements-Reporting on Controls of a Service Organization ("SSAE 16"). We validate prices supplied by the independent pricing services by comparison to prices obtained from, in most cases, three additional third party sources. For securities where prices are outside a reasonable range, we further review those securities to determine what a reasonable price estimate is for that security, given available data.

Foreclosed Assets – Foreclosed assets are initially recorded at fair value less costs to sell. The fair value measurements of foreclosed assets can include Level 2 measurement inputs such as real estate appraisals and comparable real estate sales information, in conjunction with Level 3 measurement inputs such as cash flow projections, qualitative adjustments, sales cost estimates, etc. As a result, the categorization of foreclosed assets is Level 3 of the fair value hierarchy. In connection with the measurement and initial recognition of certain foreclosed assets, we may recognize charge-offs through the allowance for loan losses.

Impaired Loans – Certain impaired loans may be reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria or appraisals. At June 30, 2015 and December 31, 2014, the impact of loans with specific reserves based on the fair value of the collateral was reflected in our allowance for loan losses.

Certain nonfinancial assets and nonfinancial liabilities measured at fair value on a recurring basis include reporting units measured at fair value and tested for goodwill impairment.

The following tables summarize assets measured at fair value on a recurring and nonrecurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

	As of June 30,), 2015 Fair Value Measurements at the End of the Reporting Period Using			
	Carrying Amount	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Recurring fair value measurements					
Investment Securities:	¢ 100 500	¢ 100 500	¢	¢	
U.S. Treasury	\$100,523	\$100,523	\$ <u> </u>	\$—	
U.S. Government Agency Debentures State and Political Subdivisions	4,846 246,420	_	4,846 246,420	_	
Other Stocks and Bonds	13,203		13,203		
Other Equity Securities	6,027	 6,027	15,205 —		
Mortgage-backed Securities: ⁽¹⁾	0,027	0,027			
Residential	726,326	_	726,326		
Commercial	368,476	_	368,476		
Total recurring fair value measurements	\$1,465,821	\$106,550	\$1,359,271	\$—	
Nonrecurring fair value measurements					
Foreclosed assets	\$874	\$ <u> </u>	\$—	\$874	
Impaired loans ⁽²⁾	21,067	ф —	ф 	21,067	
Total nonrecurring fair value measurements	\$21,941	\$—	\$—	\$21,941	
	As of Decemb	er 31, 2014			
		Fair Value Measu	rements at the En	d of the	
		Fair Value Measu Reporting Period		d of the	
	Carrying	Reporting Period Quoted Prices in Active Markets	Using Significant Other	Significant	
	Carrying Amount	Reporting Period Quoted Prices in Active Markets for Identical	Using Significant Other Observable	Significant Unobservable	
	Carrying Amount	Reporting Period Quoted Prices in Active Markets for Identical Assets	Using Significant Other Observable Inputs	Significant Unobservable Inputs	
Dequiring fair value magnification	• •	Reporting Period Quoted Prices in Active Markets for Identical	Using Significant Other Observable	Significant Unobservable	
Recurring fair value measurements	• •	Reporting Period Quoted Prices in Active Markets for Identical Assets	Using Significant Other Observable Inputs	Significant Unobservable Inputs	
Investment Securities:	Amount	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury	Amount \$14,906	Reporting Period Quoted Prices in Active Markets for Identical Assets	Using Significant Other Observable Inputs (Level 2) \$—	Significant Unobservable Inputs	
Investment Securities:	Amount \$14,906 4,828	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2) \$— 4,828	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures	Amount \$14,906	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2) \$—	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions	Amount \$14,906 4,828 267,684	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2) \$— 4,828 267,684	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾	Amount \$ 14,906 4,828 267,684 13,239	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 	Using Significant Other Observable Inputs (Level 2) \$— 4,828 267,684	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾ Residential	Amount \$14,906 4,828 267,684 13,239 6,049 964,298	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 	Using Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾ Residential Commercial	Amount \$ 14,906 4,828 267,684 13,239 6,049 964,298 177,704	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 6,049 	Using Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾ Residential	Amount \$14,906 4,828 267,684 13,239 6,049 964,298	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 	Using Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾ Residential Commercial	Amount \$ 14,906 4,828 267,684 13,239 6,049 964,298 177,704	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 6,049 	Using Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3)	
Investment Securities: U.S. Treasury U.S. Government Agency Debentures State and Political Subdivisions Other Stocks and Bonds Other Equity Securities Mortgage-backed Securities: ⁽¹⁾ Residential Commercial Total recurring fair value measurements	Amount \$ 14,906 4,828 267,684 13,239 6,049 964,298 177,704	Reporting Period Quoted Prices in Active Markets for Identical Assets (Level 1) \$ 14,906 6,049 	Using Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3)	

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Total nonrecurring fair value measurements	\$11,707	\$—	\$—	\$11,707			

All mortgage-backed securities are issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.
Loans represent collateral dependent impaired loans with a specific valuation allowance. Losses on these loans represent charge-offs which are netted against the allowance for loan losses.

Disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet is required when it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Such techniques and assumptions, as they apply to individual categories of our financial instruments, are as follows:

Cash and cash equivalents - The carrying amount for cash and cash equivalents is a reasonable estimate of those assets' fair value.

Investment and mortgage-backed securities held to maturity - Fair values for these securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services.

FHLB stock and other investments - The carrying amount of FHLB stock and other investments is a reasonable estimate of those assets' fair value.

Loans receivable - For adjustable rate loans that reprice frequently and with no significant change in credit risk, the carrying amounts are a reasonable estimate of those assets' fair value. The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Nonperforming loans are estimated using discounted cash flow analyses or the underlying value of the collateral where applicable.

Loans held for sale – The fair value of loans held for sale is determined based on expected proceeds, which are based on sales contracts and commitments.

Deposit liabilities - The fair value of demand deposits, savings accounts, and certain money market deposits is the amount on demand at the reporting date, that is, the carrying value. Fair values for fixed rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities.

Federal funds purchased and repurchase agreements - Federal funds purchased generally have original terms to maturity of one day and repurchase agreements generally have terms of less than one year, and therefore both, are considered short-term borrowings. Consequently, their carrying value is a reasonable estimate of fair value.

FHLB advances - The fair value of these advances is estimated by discounting the future cash flows using rates at which advances would be made to borrowers with similar credit ratings and for the same remaining maturities.

Long-term debt - The carrying amount for the long-term debt is estimated by discounting future cash flows using estimated rates at which long-term debt would be made to borrowers with similar credit ratings and for the remaining maturities.

The following tables present our financial assets, financial liabilities, and unrecognized financial instruments measured on a nonrecurring basis at both their respective carrying amounts and estimated fair value (in thousands):

		Estimated Fai	ir Value		
June 30, 2015	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents Investment securities:	\$77,029	\$77,029	\$77,029	\$—	\$—
Held to maturity, at carrying value	387,212	391,191		391,191	
Mortgage-backed securities:	567,212	571,171		571,171	
Held to maturity, at carrying value	356,669	362,283		362,283	—
FHLB stock and other investments, at cost	43,119	43,119		43,119	
Loans, net of allowance for loan losses Loans held for sale	2,163,041 7,431	2,130,397 7,431		— 7,431	2,130,397
Financial Liabilities:	7,431	7,431		7,431	
Retail deposits	\$3,468,683	\$3,465,818	\$—	\$3,465,818	\$—
Federal funds purchased and repurchase	2,084	2,084		2,084	
agreements FHLB advances					
Long-term debt	854,953 60,311	847,565 44,230	_	847,565 44,230	_
	00,011	1,200		11,200	
		Estimated F	Fair Value		
December 31, 2014	Carrying Amount	Estimated F Total	Fair Value Level 1	Level 2	Level 3
Financial Assets:	Amount	Total	Level 1		
Financial Assets: Cash and cash equivalents				Level 2 \$—	Level 3 \$—
Financial Assets:	Amount	Total	Level 1		
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities:	Amount \$84,655 388,823	Total \$84,655 400,248	Level 1	\$— 400,248	
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value	Amount \$84,655 388,823 253,496	Total \$84,655 400,248 261,339	Level 1	\$— 400,248 261,339	
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost	Amount \$84,655 388,823 253,496 43,871	Total \$84,655 400,248 261,339 43,871	Level 1	\$— 400,248	\$— — —
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost Loans, net of allowance for loan losses	Amount \$84,655 388,823 253,496 43,871 2,167,841	Total \$84,655 400,248 261,339 43,871 2,140,088	Level 1	\$— 400,248 261,339 43,871 —	
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost	Amount \$84,655 388,823 253,496 43,871	Total \$84,655 400,248 261,339 43,871	Level 1	\$— 400,248 261,339	\$— — —
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost Loans, net of allowance for loan losses Loans held for sale Financial Liabilities: Retail deposits	Amount \$84,655 388,823 253,496 43,871 2,167,841	Total \$84,655 400,248 261,339 43,871 2,140,088 2,899	Level 1 \$84,655 	\$— 400,248 261,339 43,871 —	\$— — —
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost Loans, net of allowance for loan losses Loans held for sale Financial Liabilities: Retail deposits Federal funds purchased and repurchase agreements	Amount \$84,655 388,823 253,496 43,871 2,167,841 2,899	Total \$84,655 400,248 261,339 43,871 2,140,088 2,899 \$3,369,784 4,237	Level 1 \$84,655 	\$— 400,248 261,339 43,871 — 2,899	\$ 2,140,088
Financial Assets: Cash and cash equivalents Investment securities: Held to maturity, at carrying value Mortgage-backed securities: Held to maturity, at carrying value FHLB stock and other investments, at cost Loans, net of allowance for loan losses Loans held for sale Financial Liabilities: Retail deposits Federal funds purchased and repurchase	Amount \$84,655 388,823 253,496 43,871 2,167,841 2,899 \$3,374,417	Total \$84,655 400,248 261,339 43,871 2,140,088 2,899 \$3,369,784	Level 1 \$84,655 	\$— 400,248 261,339 43,871 <u>-</u> 2,899 \$3,369,784	\$ 2,140,088

As discussed earlier, the fair value estimate of financial instruments for which quoted market prices are unavailable is dependent upon assumptions used. Consequently, those estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented in the above fair value table do not necessarily represent their underlying value.

11. Income Taxes

The income tax expense included in the accompanying statements of income consists of the following (in thousands):

	Three Months Ended	Six Months Ended
	June 30,	June 30,
	2015 2014	2015 2014
Current income tax expense	\$2,451 \$1,342	\$5,889 \$3,358
Deferred income tax (benefit) expense	(484) (504) (2,019) (1,361)
Income tax expense	\$1,967 \$838	\$3,870 \$1,997

Net deferred tax assets totaled \$18.9 million at June 30, 2015 and \$12.7 million at December 31, 2014. No valuation allowance for deferred tax assets was recorded at June 30, 2015 or December 31, 2014, as management believes it is more likely than not that all of the deferred tax assets will be realized in future years. Unrecognized tax benefits were not material at June 30, 2015.

We recognized income tax expense of \$2.0 million and \$3.9 million, for an effective tax rate of 15.0% and 15.9%, for the three and six months ended June 30, 2015, respectively, compared to income tax expense of \$838,000 and \$2.0 million, for an effective tax rate of 7.4% and 9.7%, for the three and six months ended June 30, 2014. The higher effective tax rate for the three and six months ended June 30, 2015 was due to a decrease in tax-exempt income as a percentage of pre-tax income as compared to the same period in 2014. We file income tax returns in the U.S. federal jurisdiction and in certain states. We are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2011.

12. Off-Balance-Sheet Arrangements, Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we are a party to certain financial instruments, with off-balance-sheet risk, to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss that we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

Financial instruments with off-balance-sheet risk were as follows (in thousands):

	At	At
	June 30,	December 31,
	2015	2014
Unused commitments:		
Commitments to extend credit	\$431,380	\$373,255
Standby letters of credit	6,950	6,222

Total	\$438,330	\$379,477

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

Lease Commitments. We lease certain branch facilities and office equipment under operating leases. It is expected that certain leases will be renewed, or equipment replaced with new leased equipment, as these leases expire.

Securities. In the normal course of business we buy and sell securities. There were \$3.5 million and \$6.0 million of unsettled trades to purchase securities at June 30, 2015 and December 31, 2014, respectively. There were no unsettled trades to sell securities as of June 30, 2015. As of December 31, 2014, there were \$57.2 million unsettled trades to sell securities.

Deposits. There were no unsettled issuances of brokered CDs at June 30, 2015 or December 31, 2014.

Litigation. We are involved with various litigation in the normal course of business. Management, after consulting with our legal counsel, believes that any liability resulting from litigation will not have a material effect on our financial position, results of operations or liquidity.

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

The following is a discussion of the consolidated financial condition, changes in financial condition, and results of our operations, and should be read and reviewed in conjunction with the financial statements, and the notes thereto, in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2014. We reported an increase in net income for the three and six months ended June 30, 2015 compared to the same periods in 2014. Net income for the three and six months ended June 30, 2015 was \$11.2 million and \$20.5 million, respectively, compared to \$10.5 million and \$18.7 million, respectively, for the same periods in 2014. Forward-Looking Statements

Certain statements of other than historical fact that are contained in this report may be considered to be "forward-looking statements" within the meaning of and subject to the protections of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date. These statements may include words such as "expect," "estimate," "project," "anticipate," "appear," "believe," "could," "should," "may," "will," "would," "seek," "inten "goal," "objective," "plans," "potential," and similar expressions. Forward-looking statements are statements with respect to our beliefs, plans, expectations, objectives, goals, anticipations, assumptions, estimates, intentions and future performance, and are subject to significant known and unknown risks and uncertainties, which could cause our actual results to differ materially from the results discussed in the forward-looking statements. For example, discussions of the effect of our expansion, trends in asset quality and earnings from growth, and certain market risk disclosures are based upon information presently available to management and are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. Accordingly, our results could materially differ from those that have been estimated. Other factors that could cause actual results to differ materially from those indicated by forward-looking statements include, but are not limited to, the following: general economic conditions, either globally, nationally, in the State of Texas, or in the specific markets in which we operate, including, without limitation, the deterioration of the commercial real estate, residential real estate, construction and development, credit and liquidity markets, which could cause an adverse change in our net interest margin, or a decline in the value of our assets, which could result in realized losses;

current or future legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which we are engaged, including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Federal Reserve's actions with respect to interest rates, the capital requirements promulgated by the Basel Committee on Banking Supervision ("Basel Committee") and other regulatory responses to economic conditions;

adverse changes in the status or financial condition of the Government-Sponsored Enterprises (the "GSEs") impacting the GSEs' guarantees or ability to pay or issue debt;

adverse changes in the credit portfolio of other U.S. financial institutions relative to the performance of certain of our investment securities;

economic or other disruptions caused by acts of terrorism in the United States, Europe or other areas;

changes in the interest rate yield curve such as flat, inverted or steep yield curves, or changes in the interest rate environment that impact interest margins and may impact prepayments on the mortgage-backed securities ("MBS") portfolio;

increases in our nonperforming assets;

our ability to maintain adequate liquidity to fund operations and growth;

the failure of our assumptions underlying allowance for loan losses and other estimates;

unexpected outcomes of, and the costs associated with, existing or new litigation involving us;

changes impacting our balance sheet and leverage strategy;

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risks related to actual U.S. Agency MBS prepayments exceeding projected prepayment levels; risks related to U.S. Agency MBS prepayments increasing due to U.S. Government programs designed to assist homeowners to refinance their mortgage that might not otherwise have qualified;

our ability to monitor interest rate risk;

significant increases in competition in the banking and financial services industry;

changes in consumer spending, borrowing and saving habits;

technological changes;

our ability to increase market share and control expenses;

the effect of changes in federal or state tax laws;

the effect of compliance with legislation or regulatory changes;

the effect of changes in accounting policies and practices;

credit risks of borrowers, including any increase in those risks due to changing economic conditions;

risks related to loans secured by real estate, including the risk that the value and marketability of collateral could decline; and

other risks and uncertainties discussed in Part I - "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014.

All written or oral forward-looking statements made by us or attributable to us are expressly qualified by this cautionary notice. We disclaim any obligation to update any factors or to announce publicly the result of revisions to any of the forward-looking statements included herein to reflect future events or developments, unless otherwise required by law.

Critical Accounting Estimates

Our accounting and reporting estimates conform with U.S. generally accepted accounting principles ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. We consider our critical accounting policies to include the following:

Allowance for Losses on Loans. The allowance for losses on loans represents our best estimate of probable losses inherent in the existing loan portfolio. The allowance for losses on loans is increased by the provision for losses on loans charged to expense and reduced by loans charged-off, net of recoveries. The provision for losses on loans is determined based on our assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experience, the level of classified and nonperforming loans and the results of regulatory examinations.

The loan loss allowance is based on the most current review of the loan portfolio and is validated by multiple processes. The servicing officer has the primary responsibility for updating significant changes in a customer's financial position. Each officer prepares status updates on any credit deemed to be experiencing repayment difficulties which, in the officer's opinion, would place the collection of principal or interest in doubt. Our internal loan review department is responsible for an ongoing review of our loan portfolio with specific goals set for the loans to be reviewed on an annual basis.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of \$150,000 or more is updated on a quarterly basis in order to

properly determine the necessary allowance and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The measurement of loss on impaired loans is generally based on the fair value of the collateral if repayment is expected solely from the collateral or the present value of the expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions, such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation.

Changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the conditions of the various markets in which collateral may be sold all may affect the required level of the allowance for losses on loans and the associated provision for loan losses.

As of June 30, 2015, our review of the loan portfolio indicated that a loan loss allowance of \$16.8 million was appropriate to cover probable losses in the portfolio.

Refer to "Part II - Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations -Loan Loss Experience and Allowance for Loan Losses" and "Note 6– Loans and Allowance for Probable Loan Losses" in our Annual Report on Form 10-K for the year ended December 31, 2014 for a detailed description of our estimation process and methodology related to the allowance for loan losses.

Estimation of Fair Value. The estimation of fair value is significant to a number of our assets and liabilities. In addition, GAAP requires disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values for securities are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves. Fair values for most investment and MBS are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or estimates from independent pricing services. Where there are price variances outside certain ranges from different pricing services for specific securities, those pricing variances are reviewed with other market data to determine which of the price estimates is appropriate for that period.

Impairment of Investment Securities and Mortgage-backed Securities. Investment and MBS classified as available for sale ("AFS") are carried at fair value and the impact of changes in fair value are recorded on our consolidated balance sheet as an unrealized gain or loss in "Accumulated other comprehensive (loss) income," a separate component of shareholders' equity. Securities classified as AFS or held to maturity ("HTM") are subject to our review to identify when a decline in value is other-than-temporary. When it is determined that a decline in value, with a corresponding charge to earnings for the credit portion and to other comprehensive income for the noncredit portion. Factors considered in determining whether a decline in value is other-than-temporary include: (1) whether the decline is substantial, the duration of the decline and the reasons for the decline in value; (2) whether the decline is related to a credit event, a change in interest rate or a change in the market discount rate; (3) the financial condition and near-term prospects of the issuer; and (4) whether we have a current intent to sell the security and whether it is not more likely than not that we will be required to sell the security before the anticipated recovery of its amortized cost basis. For certain assets, we consider expected cash flows of the investment in determining if impairment exists.

Defined Benefit Pension Plan. The plan obligations and related assets of our defined benefit pension plan (the "Plan") are presented in "Note 11 – Employee Benefits" in our Annual Report on Form 10-K for the year ended December 31, 2014. Entry into the Plan by new employees was frozen effective December 31, 2005. Plan assets, which consist primarily of marketable equity and debt instruments, are valued using observable market quotations. Plan obligations and the annual pension expense are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. Key assumptions in measuring the plan obligations include the discount rate, the rate of salary increases and the estimated future return on plan assets. In determining the discount

rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for our defined benefit pension and

restoration plans. In developing the cash flow matching analysis, we constructed a portfolio of high quality noncallable bonds (rated AA- or better) to match as close as possible the timing of future benefit payments of the plans at December 31, 2014. Based on this cash flow matching analysis, we were able to determine an appropriate discount rate.

Salary increase assumptions are based upon historical experience and our anticipated future actions. The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation on the assets invested to provide for the Plan's liabilities. We considered broad equity and bond indices, long-term return projections, and actual long-term historical Plan performance when evaluating the expected long-term rate of return assumption. At June 30, 2015, the weighted-average actuarial assumptions of the Plan were: a discount rate of 4.14%; a long-term rate of return on Plan assets of 7.25%; and assumed salary increases of 3.50%. Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of Plan participants, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the Plan and other factors.

Off-Balance-Sheet Arrangements, Commitments and Contingencies

Details of our off-balance-sheet arrangements, commitments and contingencies as of June 30, 2015 and December 31, 2014 are included in "Note 12 – Off-Balance-Sheet Arrangements, Commitments and Contingencies" in our consolidated financial statements included in this Quarterly Report on Form 10-Q.

Balance Sheet Strategy

We utilize wholesale funding and securities to enhance our profitability and balance sheet composition by determining acceptable levels of credit, interest rate and liquidity risk consistent with prudent capital management. This balance sheet strategy consists of borrowing a combination of long- and short-term funds from the FHLB, and when determined appropriate, issuing brokered CDs. These funds are invested primarily in U.S. Agency MBS, and to a lesser extent, long-term municipal securities. Although U.S. Agency MBS often carry lower yields than traditional mortgage loans and other types of loans we make, these securities generally (i) increase the overall quality of our assets because of either the implicit or explicit guarantees of the U.S. Government, (ii) are more liquid than individual loans and (iii) may be used to collateralize our borrowings or other obligations. While the strategy of investing a substantial portion of our assets in U.S. Agency MBS and municipal securities has historically resulted in lower interest rate spreads and margins, we believe that the lower operating expenses and reduced credit risk, combined with the managed interest rate risk of this strategy, have enhanced our overall profitability over the last several years. At this time, we utilize this balance sheet strategy with the goal of enhancing overall profitability by maximizing the use of our capital.

Risks associated with the asset structure we maintain include a lower net interest rate spread and margin when compared to our peers, changes in the slope of the yield curve, which can reduce our net interest rate spread and margin, increased interest rate risk, the length of interest rate cycles, changes in volatility spreads associated with the MBS and municipal securities, the unpredictable nature of MBS prepayments and credit risks associated with the municipal securities. See "Part I - Item 1A. Risk Factors – Risks Related to Our Business" in our Annual Report on Form 10-K for the year ended December 31, 2014, for a discussion of risks related to interest rates. Our asset structure, net interest spread and net interest margin require us to closely monitor our interest rates. Significant increases in interest rates, especially long-term interest rates, could adversely impact the fair value of the AFS securities portfolio as a result of changes in interest rates. Significant increases in interest rate cycles, and the slope of the interest rate yield curve, net interest income could fluctuate more than simulated under the scenarios modeled by our ALCO and described under "Item 3. Quantitative and Qualitative Disclosures about Market Risk" in this Quarterly Report on Form 10-Q.

Determining the appropriate size of the balance sheet is one of the critical decisions any bank makes. Our balance sheet is not merely the result of a series of micro-decisions, but rather the size is controlled based on the economics of assets compared to the economics of funding. The current low interest rate environment and investment and economic landscape make it unlikely that we will experience significant asset growth driven by an increase in the securities portfolio until one or more of these conditions change.

The management of our securities portfolio as a percentage of earning assets is guided by the current economics associated with increasing the securities portfolio, changes in our overall loan and deposit levels, and changes in our wholesale funding levels. If adequate quality loan growth is not available to achieve our goal of enhancing profitability by maximizing the use of capital, as described above, then we may purchase additional securities, if appropriate, which may cause securities as a percentage of earning assets to increase. Should we determine that increasing the securities portfolio or replacing the current securities maturities and principal payments is not an efficient use of capital, we may decrease the level of securities through proceeds from maturities, principal payments on MBS or sales. Our balance sheet strategy is designed such that our securities portfolio should help mitigate financial performance associated with slower loan growth and higher credit costs.

During the quarter ended June 30, 2015, we primarily sold U.S. Agency MBS and collateralized mortgage obligations ("CMO") that resulted in an overall gain on the sale of AFS securities of \$105,000. This was a continuation of our first quarter strategy to sell U.S. Agency low coupon MBS with longer payment windows from the Omni acquired securities portfolio. During the quarter ended June 30, 2015, we primarily purchased premium CMOs with favorable expected returns in relation to risk, commercial mortgage-backed securities ("CMBS") and U.S. Treasury notes. Our total portfolio, comprised of investment and MBS, increased from \$2.09 billion at December 31, 2014 to \$2.21 billion at June 30, 2015. The total unamortized premium for our MBS increased to \$40.5 million at June 30, 2015 compared to \$23.5 million at June 30, 2014.

At June 30, 2015, securities increased as a percentage of assets to 45.5% as compared to 43.5% at December 31, 2014 due to a 5.7% increase in the securities portfolio and a slight decrease in the loan portfolio. Our balance sheet management strategy is dynamic and will be continually reevaluated as market conditions warrant. As interest rates, yield curves, MBS prepayments, funding costs, security spreads and loan and deposit portfolios change, our determination of the proper types, amount and maturities of securities to own and funding needs and funding sources will continue to be reevaluated. Should the economics of purchasing securities decrease, we may allow this part of the balance sheet to shrink through run-off or security sales. However, should the economics become more attractive, we may continue to strategically increase the securities portfolio and the balance sheet.

With respect to liabilities, we continue to utilize a combination of FHLB advances and deposits to achieve our strategy of minimizing cost while achieving overall interest rate risk objectives as well as the liability management objectives of the ALCO. FHLB funding is the primary wholesale funding source we are currently utilizing. Our FHLB borrowings decreased 4.7%, or \$42.5 million, to \$855.0 million at June 30, 2015 from \$897.4 million at December 31, 2014, due primarily to the increase in deposits. During the six months ended June 30, 2015, our long-term FHLB advances decreased \$27.8 million, to \$572.3 million from \$600.1 million at December 31, 2014. We will continue to purchase long-term FHLB advances as a hedge against future potential high interest rates. Our brokered CDs increased from \$23.4 million at December 31, 2014 to \$28.9 million at June 30, 2015. All of the brokered CDs, except for one \$5.0 million CD, are long-term with short-term calls that we control. We utilized long-term callable brokered CDs because the brokered CDs at the time of issuance better matched overall ALCO objectives by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. We are actively evaluating the callable brokered CDs and may exercise the call option if there is an economic benefit. Our wholesale funding policy currently allows maximum brokered CDs of \$180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest expense and lack of customer loyalty are risks associated with the use of brokered CDs. When considering trends in deposits excluding brokered CDs, the overall growth in deposits resulted in a decrease in our total wholesale funding as a percentage of deposits, to 25.7% at June 30, 2015 from 27.5% at December 31, 2014 and an increase in FHLB advances resulted in an increase compared to 20.7% at June 30, 2014.

Net Interest Income

Net interest income is one of the principal sources of a financial institution's earnings stream and represents the difference or spread between interest and fee income generated from interest earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates or interest rate yield curves, as well as repricing characteristics and volume, and changes in the mix of interest earning assets and interest bearing liabilities, materially impact net interest income. The increase in average loans, MBS, deposits, interest bearing deposits and FHLB advances during the three and six months ended June 30, 2015 when compared to the same period in 2014 is attributable to the acquisition of Omni.

Net interest income for the six months ended June 30, 2015 was \$66.7 million, an increase of \$10.9 million, or 19.6%, compared to the same period in 2014 primarily due to increases in interest income on loans and mortgage-backed securities income. This is a result of our average interest earning assets increasing \$1.12 billion, or 34.3%, during the six months ended June 30, 2015, when compared to the same period in 2014, which was partially offset by a decrease in our net interest spread and net interest margin to 3.36% and 3.44%, respectively, for the six months ended June 30, 2015 from 3.79% and 3.93%, respectively, for the same period in 2014.

During the six months ended June 30, 2015, total interest income increased \$12.0 million, or 18.7%, to \$76.4 million compared to \$64.3 million for the same period in 2014. The increase in total interest income was the result of the increase in average interest earning assets of \$1.12 billion, or 34.3%, from \$3.27 billion for the six months ended June 30, 2014 to \$4.39 billion for the same period in 2015, while partially offset by a decrease in the average yield on earning assets from 4.46% for the six months ended June 30, 2014 to 3.89% for the six months ended June 30, 2015. Total interest expense increased \$1.1 million, or 12.6%, to \$9.7 million, during the six months ended June 30, 2015, as compared to \$8.6 million during the same period in 2014. The increase was attributable to an increase in average interest bearing liabilities of \$1.08 billion, or 41.4%, from \$2.60 billion for the six months ended June 30, 2014, to \$3.68 billion for the same period in 2015, while partially offset by a decrease in the average yield on interest bearing liabilities for the six months ended June 30, 2015, to 0.53% from 0.67% for the same period in 2014. Net interest income increased during the three months ended June 30, 2015, when compared to the same period in 2014 primarily as a result of an increases on loans and mortgage-backed securities income. Our average interest earning assets during this period increased \$1.14 billion, or 35.2%, during the three months ended June 30, 2015, when compared to the same period in 2014. For the three months ended June 30, 2015, our net interest spread and net interest margin decreased to 3.30% and 3.39%, respectively, from 3.79% and 3.94%, respectively, for the same period in 2014.

During the six months ended June 30, 2015, average loans increased \$820.9 million, or 60.0%, to \$2.19 billion, when compared to \$1.37 billion for the same period in 2014. The increase in loans was primarily a result of the acquisition of Omni. The average yield on loans decreased from 5.70% for the six months ended June 30, 2014, to 4.59% for the six months ended June 30, 2015, due to overall lower interest rates and the higher yield SFG purchased automobile loans included in the portfolio during the six months ended June 30, 2014. Interest income on loans increased \$11.1 million, or 30.4%, to \$47.8 million for the six months ended June 30, 2015, when compared to \$36.7 million for the same period in 2014 as a result of the increase in the average balance which was partially offset by a decrease in the average yield. For the three months ended June 30, 2015, average loans increased \$817.3 million, or 59.6%, to \$2.19 billion, when compared to \$1.37 billion for the same period in 2014. The average yield on loans decreased from 5.64% for the three months ended June 30, 2014 to 4.56% for the three months ended June 30, 2015. Due to the competitive loan pricing environment, we anticipate that we may be required to continue to offer lower interest rate loans that compete with those offered by other financial institutions in order to retain quality loan relationships. Offering lower interest rate loans could impact the overall yield on loans and, therefore, profitability. Average investment and MBS increased \$285.8 million, or 15.7%, from \$1.82 billion to \$2.10 billion, for the six months ended June 30, 2015 when compared to the same period in 2014. At June 30, 2015, substantially all of our MBS were fixed rate securities. The overall yield on average investment and MBS decreased to 3.30% during the six months ended June 30, 2015, from 3.71% during the same period in 2014. Interest income on investment and MBS increased \$849,000 during the six months ended June 30, 2015, or 3.1%, compared to the same period in 2014 due to

an increase in the average balance which was partially offset by a decrease in the average yield. For the three months ended June 30, 2015, average investment and MBS increased \$302.2 million, or 16.7%, to \$2.11 billion, when compared

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to \$1.81 billion for the same period in 2014. The overall yield on average investment and MBS decreased to 3.20% during the three months ended June 30, 2015, from 3.70% during the same period in 2014 primarily as a result of an increase in MBS. Interest income from investment and MBS increased \$48,000, or 0.3%, to \$13.8 million for the three months ended June 30, 2015, compared to \$13.7 million for the same period in 2014. The increase in interest income for the three months is due to an increase in the average balance while partially offset by a decrease in the average yield. The decrease in the overall yield on average investment and MBS for the three and six months ended June 30, 2015 primarily reflects an overall higher interest rate environment during 2014, the purchase of lower yielding securities when compared to those securities paying off, maturing or sold and the addition of Omni's securities portfolio at fair value in a low interest rate environment.

Average FHLB stock and other investments increased \$13.5 million, or 45.1%, to \$43.3 million, for the six months ended June 30, 2015, when compared to \$29.9 million for the same period in 2014 due to an increase in average FHLB advances during 2015 and the corresponding requirement to hold stock associated with those advances. Interest income from our FHLB stock and other investments increased \$50,000, or 46.3%, during the six months ended June 30, 2015, when compared to the same period in 2014 due to an increase in the average balance and average yield from 0.73% for the six months ended June 30, 2014, compared to 0.74% for the same period in 2015. For the three months ended June 30, 2015, average FHLB stock and other investments increased \$14.6 million, or 52.1%, to \$42.7 million, when compared to \$28.1 million for the same period in 2014. Interest income from FHLB stock and other investments increased \$14.6 million, or 52.1%, to \$38,000 for the same period in 2014 as a result of the increase in the average balance and average yield from 0.54% in 2014 to 0.61% in 2015. The FHLB stock is a variable instrument with the rate typically tied to the federal funds rate. We are required as a member of the FHLB to own a specific amount of stock that changes as the level of our FHLB advances and asset size change.

During the six months ended June 30, 2015, our average loans and average securities increased when compared to the same period in 2014. Average loans increased to 50.0% of average total interest earning assets for the six months ended June 30, 2015 as compared to 41.9% for the same period in 2014. Average total securities as a percentage of average total interest earning assets was 48.9% and 56.5% for the six months ended June 30, 2015, and 2014, respectively. The other interest earning asset categories averaged 1.1% and 1.6% for the six months ended June 30, 2015 and 2014, respectively.

Total interest expense increased \$1.1 million, or 12.6%, to \$9.7 million during the six months ended June 30, 2015, as compared to \$8.6 million during the same period in 2014. The increase was primarily attributable to the increase in average interest bearing liabilities of \$1.08 billion, or 41.4%, for the six months ended June 30, 2015 compared to the same period in 2014 which was partially offset by the decrease from the average rate paid of 0.67% for the six months ended June 30, 2014, to 0.53% for the six months ended June 30, 2015. This increase in average interest bearing liabilities was primarily the result of the acquisition of Omni and included increases in interest bearing deposits of \$816.5 million, or 41.4%, short-term interest bearing liabilities of \$191.3 million, or 313.9% and long-term FHLB advances of \$68.1 million, or 13.5%. For the three months ended June 30, 2015, total interest expense increased \$615,000, or 14.5%, to \$4.8 million, compared to \$4.2 million for the same period in 2014, as a result of an increase in the average balance which more than offset a decrease in the average rate paid. Average interest bearing liabilities increased \$1.11 billion, or 43.4%, while the average rate paid decreased from 0.67% for the three months ended June 30, 2014, to 0.53% for the three months ended June 30, 2015.

Our average total deposits increased \$907.1 million, or 35.7%, from \$2.54 billion for the six months ended June 30, 2014 to \$3.45 billion for the six months ended June 30, 2015. Average interest bearing deposits increased \$816.5 million, or 41.4%, from \$1.97 billion for the six months ended June 30, 2014 to \$2.79 billion for the same period in 2015, while the average rate paid decreased from 0.42% for the six months ended June 30, 2014, to 0.36% for the six months ended June 30, 2015. Average time deposits increased \$237.8 million, or 38.3%, from \$620.6 million for the six months ended June 30, 2014 to \$858.4 million for the same period in 2015, while the average rate paid decreased to 0.63% for the six months ended June 30, 2015, as compared to 0.73% for the same period in 2014. Average interest bearing demand deposits increased \$460.8 million, or 37.2%, for the six months ended June 30, 2015 when

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compared to the same period in 2014, while the average rate paid decreased to 0.27% for the six months ended June 30, 2015, as compared to 0.29% for the same period in 2014. Average savings deposits increased \$118.0 million, or 103.4%, for the six months ended June 30, 2015 when compared to the same period in 2014, while the average rate paid decreased

to 0.10% for the six months ended June 30, 2015, as compared to 0.12% for the same period in 2014. Interest expense for interest bearing deposits for the six months ended June 30, 2015, increased \$922,000, or 22.5%, when compared to the same period in 2014, due to an increase in the average balance which more than offset the decrease in the average rate paid. Average noninterest bearing demand deposits increased \$90.6 million, or 16.0%, during the six months ended June 30, 2015 compared to the same period in 2014. The latter three categories, interest bearing demand deposits, savings deposits and noninterest bearing demand deposits, are considered the lowest cost deposits and comprised 75.1% and 75.6% of total average deposits during the six months ended June 30, 2015 and 2014, respectively.

At June 30, 2015, we had \$28.9 million in brokered CDs as compared to \$23.4 million at December 31, 2014. Brokered CDs represented 0.8% of deposits at June 30, 2015 as compared to 0.7% at December 31, 2014, all with maturities of less than five years.

For the three and six months ended June 30, 2015, average short-term interest bearing liabilities, consisting primarily of FHLB advances, federal funds purchased and repurchase agreements, were \$232.5 million and \$252.3 million, respectively, and reflected increases of \$199.7 million, or 609.3%, and \$191.3 million, or 313.9%, respectively, when compared to the same periods in 2014. Average short-term interest bearing liabilities increased due to the acquisition of Omni in the fourth quarter of 2014. Interest expense associated with short-term interest bearing liabilities increased \$98,000, or 175.0%, and \$169,000, or 133.1%, for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, while the average rate paid decreased to 0.27% and 0.24% for the three and six months ended June 30, 2015, compared to 0.69% and 0.42% for the same periods in 2014. The increase in the interest expense was due to an increase in the average balance while partially offset by a decrease in the average rate paid. For the three and six months ended June 30, 2015, average long-term interest bearing liabilities consisting of FHLB advances were \$569.3 million and \$572.7 million, respectively, and reflected increases of \$61.2 million, or 12.0%, and \$68.1 million, or 13.5%, respectively when compared to the same periods in 2014. Interest expense associated with long-term FHLB advances changed slightly for the three and six months ended June 30, 2015 compared to the same periods in 2014 due to the decrease in the average rates paid. The average rate paid decreased to 1.28% for the six months ended June 30, 2015, when compared to 1.46% for the same period in 2014 and for the three months ended June 30, 2015, the average rate paid decreased to 1.29%, when compared to 1.45% for the same period in 2014. Average long-term debt, consisting of our junior subordinated debentures, was \$60.3 million for the three and six months ended June 30, 2015 and 2014, respectively. Interest expense associated with long-term debt increased slightly for the three and six months ended June 30, 2015 compared to the same periods in 2014, as a result of a slight increase in the average yield during the three and six months ended June 30, 2015. The interest rate on the \$20.6 million of long-term debentures issued to Southside Statutory Trust III adjusts guarterly at a rate equal to three-month LIBOR plus 294 basis points. The interest rate on the \$23.2 million of long-term debentures issued to Southside Statutory Trust IV adjusts guarterly at a rate equal to three-month LIBOR plus 130 basis points. The interest rate on the \$12.9 million of long-term debentures issued to Southside Statutory Trust V adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points. The interest rate on the \$3.6 million of long-term debentures issued to Magnolia Trust Company I, adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

RESULTS OF OPERATIONS

The analysis below shows average interest earning assets and interest bearing liabilities together with the average yield on the interest earning assets and the average cost of the interest bearing liabilities.

	AVERAGE BALANCES AND YIELDS					
	(dollars in thousands)					
			(unaudite	ed)		
			Three M	onths Ended		
	June 30, 2015			June 30, 2014		
	AVG		AVG	AVG		AVG
	BALANCE	INTERES	TYIELD	BALANCE	INTEREST	YIELD
ASSETS						
INTEREST EARNING ASSETS:						
Loans ^{(1) (2)}	\$2,188,886	\$24,889	4.56 %	\$1,371,609	\$ 19,302	5.64 %
Loans Held For Sale	3,675	45				