SOUTHSIDE BANCSHARES INC
Form 10-Q
November 06, 2014
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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 September 30, 2014

OR

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

For the transition period from ____________ to ____________

Commission file number: 0-12247

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 No 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 (Do not check if a smaller reporting company)	Smaller reporting company o

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 November 3, 2014 was 18,917,402 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)

	September 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$49,937	$45,624
Interest earning deposits	19,284	8,807
Total cash and cash equivalents	69,221	54,431
Investment securities:		
Available for sale, at estimated fair value	321,221	337,429
Held to maturity, at carrying value (estimated fair value of $398,386 and $377,383, respectively)	389,529	391,552
Mortgage-backed securities:		
Available for sale, at estimated fair value	674,529	840,258
Held to maturity, at carrying value (estimated fair value of $260,695 and $271,836, respectively)	256,528	275,569
FHLB stock, at cost	24,435	34,065
Other investments, at cost	2,099	2,065
Loans held for sale	75,436	151
Loans:		
Loans	1,398,674	1,351,273
Less: Allowance for loan losses	(13,415)	(18,877)
Net Loans	1,385,259	1,332,396
Premises and equipment, net	53,889	52,060
Goodwill	22,034	22,034
Other intangible assets, net	100	178
Interest receivable	14,221	21,973
Deferred tax asset	12,822	18,415
Unsettled trades to sell securities	5,120	3,933
Other assets	61,588	59,154
TOTAL ASSETS	$3,368,031	$3,445,663
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$585,415	$529,897
Interest bearing	1,858,149	1,997,911
Total deposits	2,443,564	2,527,808
Short-term obligations:		
Federal funds purchased and repurchase agreements	2,116	859
FHLB advances	51,808	73,445
Total short-term obligations	53,924	74,304
Long-term obligations:		
FHLB advances	476,004	499,349
Long-term debt	60,311	60,311
Total long-term obligations	536,315	559,660

Unsettled trades to purchase securities	15,224	973
Other liabilities	27,895	23,400
TOTAL LIABILITIES	3,076,922	3,186,145
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 12)		
Shareholders' equity:		
Common stock ($1.25 par, 40,000,000 shares authorized, 21,384,554 shares issued at September 30, 2014 and 20,386,221 shares issued at December 31, 2013)	26,731	25,483
Paid-in capital	244,150	214,091
Retained earnings	65,409	78,673
Treasury stock (2,469,638 shares at cost)	(37,692)	(37,692)
Accumulated other comprehensive loss	(7,489)	(21,037)
TOTAL SHAREHOLDERS' EQUITY	291,109	259,518
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$3,368,031	$3,445,663

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

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Interest income				
Loans	$17,168	$18,625	$53,836	$54,680
Investment securities – taxable	210	139	476	672
Investment securities – tax-exempt	6,325	6,927	18,304	17,322
Mortgage-backed securities	6,070	5,069	21,309	13,685
FHLB stock and other investments	36	36	144	135
Other interest earning assets	31	15	96	93
Total interest income	29,840	30,811	94,165	86,587
Interest expense				
Deposits	1,876	2,011	5,976	6,082
Short-term obligations	226	116	353	1,755
Long-term obligations	2,018	2,043	6,368	5,778
Total interest expense	4,120	4,170	12,697	13,615
Net interest income	25,720	26,641	81,468	72,972
Provision for loan losses	4,868	3,640	11,651	6,153
Net interest income after provision for loan losses	20,852	23,001	69,817	66,819
Noninterest income				
Deposit services	3,860	4,005	11,292	11,662
Net gain (loss) on sale of securities available for sale	1,151	(142)	1,660	9,204
Total other-than-temporary impairment losses	—	—	—	(52)
Portion of loss recognized in other comprehensive income (before taxes)	—	—	—	10
Net impairment losses recognized in earnings	—	—	—	(42)
Impairment of investment in SFG Finance, LLC	(2,239)	—	(2,239)	—
Gain on sale of loans	108	130	269	690
Trust income	798	759	2,340	2,212
Bank owned life insurance income	320	327	941	845

Other	1,021	1,334	3,077	3,178
Total noninterest income	5,019	6,413	17,340	27,749
Noninterest expense				
Salaries and employee benefits	12,798	13,167	38,992	39,777
Occupancy expense	1,773	1,922	5,313	5,690
Advertising, travel & entertainment	489	599	1,637	1,896
ATM and debit card expense	327	310	946	994
Professional fees	1,132	730	3,363	1,932
Software and data processing expense	543	528	1,530	1,515
Telephone and communications	292	383	890	1,218
FDIC insurance	437	433	1,319	1,263
FHLB prepayment fees	—	—	—	988
Other	2,226	2,192	6,635	6,476
Total noninterest expense	20,017	20,264	60,625	61,749
Income before income tax expense	5,854	9,150	26,532	32,819
Income tax (benefit) expense	(243)	257	1,754	3,816
Net income	$6,097	$8,893	$24,778	$29,003
Earnings per common share – basic	$0.32	$0.47	$1.32	$1.54
Earnings per common share – diluted	$0.32	$0.47	$1.31	$1.54
Dividends paid per common share	$0.22	$0.20	$0.64	$0.60

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$6,097	$8,893	$24,778	$29,003
Other comprehensive income (loss):				
Unrealized holding gains (losses) on available for sale securities during the period	2,751	(2,686)	21,070	(46,966)
Change in net unrealized loss on securities transferred to held to maturity	282	165	836	193
Noncredit portion of other-than-temporary impairment losses on the AFS securities	—	—	—	(10)
Reclassification adjustment for net (gain) loss on sale of available for sale securities, included in net income	(1,151)	142	(1,660)	(9,204)
Reclassification of other-than-temporary impairment charges on available for sale securities, included in net income	—	—	—	42
Amortization of net actuarial loss, included in net periodic benefit cost	260	697	781	2,091
Amortization of prior service credit, included in net periodic benefit cost	(3)	(10)	(10)	(32)
Other comprehensive income (loss), before tax	2,139	(1,692)	21,017	(53,886)
Income tax (expense) benefit related to other items of comprehensive income	(862)	592	(7,469)	18,860
Other comprehensive income (loss), net of tax	1,277	(1,100)	13,548	(35,026)
Comprehensive income (loss)	$7,374	$7,793	$38,326	$(6,023)

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(in thousands, except share and per share data)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2012	$24,308	$195,602	$70,708	$(35,793)	$2,938	$257,763
Net Income			29,003			29,003
Other comprehensive loss					(35,026)	(35,026)
Issuance of common stock (43,733 shares)	54	959				1,013
Purchase of common stock (90,300 shares)				(1,899)		(1,899)
Stock compensation expense		571				571
Tax benefits related to stock awards		43				43
Net issuance of common stock under employee stock plan	24	72	(68)			28
Cash dividends paid on common stock ($0.60 per share)			(10,539)			(10,539)
Stock dividend declared	1,065	15,995	(17,060)			—
Balance at September 30, 2013	$25,451	$213,242	$72,044	$(37,692)	$(32,088)	$240,957
Balance at December 31, 2013	$25,483	$214,091	$78,673	$(37,692)	$(21,037)	$259,518
Net Income			24,778			24,778
Other comprehensive income					13,548	13,548
Issuance of common stock (26,894 shares)	34	763				797
Stock compensation expense		842				842
Tax benefits related to stock awards		249				249
Net issuance of common stock under employee stock plan	90	1,025	(112)			1,003
Cash dividends paid on common stock ($0.64 per share)			(11,865)			(11,865)
Impairment of investment in SFG Finance, LLC.		2,239				2,239
Stock dividend declared	1,124	24,941	(26,065)			—
Balance at September 30, 2014	$26,731	$244,150	$65,409	$(37,692)	$(7,489)	$291,109

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

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

	Nine Months Ended September 30,	
	2014	2013
OPERATING ACTIVITIES:		
Net income	$24,778	$29,003
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	2,429	2,756
Amortization of premium	15,620	24,029
Accretion of discount and loan fees	(2,763)	(4,462)
Provision for loan losses	11,651	6,153
Stock compensation expense	842	571
Deferred tax benefit	(2,322)	(202)
Excess tax benefits from stock-based compensation	(253)	(43)
Net gain on sale of securities available for sale	(1,660)	(9,204)
Net other-than-temporary impairment losses	—	42
Impairment of investment in SFG Finance, LLC.	2,239	—
Loss on premises and equipment	14	4
Loss (gain) on other real estate owned	65	(59)
Net change in:		
Interest receivable	7,752	2,235
Other assets	(2,185)	(6,796)
Interest payable	(69)	(447)
Other liabilities	4,943	2,661
Loans originated for sale	(533)	3,105
Net cash provided by operating activities	60,548	49,346
INVESTING ACTIVITIES:		
Securities held to maturity:		
Purchases	—	(127,479)
Maturities, calls and principal repayments	18,883	150,737
Securities available for sale:		
Purchases	(538,361)	(1,303,285)
Sales	529,054	697,458
Maturities, calls and principal repayments	214,296	287,582
Proceeds from redemption of FHLB stock	11,437	5,819
Purchases of FHLB stock and other investments	(1,841)	(10,711)
Net loans originated	(142,523)	(62,287)
Purchases of premises and equipment	(4,280)	(3,898)
Proceeds from sales of premises and equipment	8	—
Proceeds from sales of other real estate owned	275	480
Proceeds from sales of repossessed assets	5,158	3,155
Net cash provided by (used in) investing activities	92,106	(362,429)

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

	Nine Months Ended September 30,	
	2014	2013
FINANCING ACTIVITIES:		
Net (decrease) increase in demand and savings accounts	(11,761)	23,483
Net (decrease) increase in certificates of deposit	(72,566)	32,966
Net increase (decrease) in federal funds purchased and repurchase agreements	1,257	(126)
Proceeds from FHLB advances	6,485,983	13,062,172
Repayment of FHLB advances	(6,530,965)	(12,885,012)
Excess tax benefits from stock-based awards	253	43
Net issuance of common stock under employee stock plan	1,003	28
Purchase of common stock	—	(1,899)
Proceeds from the issuance of common stock	797	1,013
Cash dividends paid	(11,865)	(10,539)
Net cash (used in) provided by financing activities	(137,864)	222,129
Net increase (decrease) in cash and cash equivalents	14,790	(90,954)
Cash and cash equivalents at beginning of period	54,431	150,630
Cash and cash equivalents at end of period	$69,221	$59,676
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	$12,766	$14,062
Income taxes paid	$4,300	$2,700
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Loans transferred to other repossessed assets and real estate through foreclosure	$4,581	$3,931
Loans transferred to held for sale from held for investment	$74,752	$—
Transfer of available for sale securities to held to maturity securities	$—	$452,884
Adjustment to pension liability	$(771)	$(2,059)
5% stock dividend	$26,065	$17,060
Unsettled trades to purchase securities	$(15,224)	$(25,414)
Unsettled trades to sell securities	$5,120	$—

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

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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. "SFG" refers to SFG Finance, LLC (formerly Southside Financial Group, LLC), which is a wholly-owned subsidiary of the Bank.

In early 2013, we decided to close Southside Securities, Inc., our introducing broker-dealer. We completed the closure of Southside Securities, Inc. during the second quarter of 2013.

The consolidated balance sheet as of September 30, 2014, 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 nine-month periods ended September 30, 2014 and 2013 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.

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, 2013. For a description of our significant accounting and reporting policies, refer to Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

On March 20, 2014, our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 10, 2014, which was paid on May 1, 2014. All share data has been adjusted to give retroactive recognition to stock dividends.

Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Accounting Standard Update (ASU) 2014-08 "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" in April 2014 to change the criteria used for accounting for dispositions and enhance the requirements for reporting a discontinued operation. Dispositions which represent a strategic shift that has or will have a major effect on the entity's financial condition or operating results are required to be reported as discontinued operations. ASU 2014-08 is effective for interim and annual periods beginning after December 15, 2014 with early adoption permitted. We early adopted ASU 2014-08 in September 2014 in connection with the SFG loans transferred to held for sale, which occurred during the third quarter of 2014. The adoption of ASU 2014-08 did not have a material impact on our consolidated financial statements.

The FASB issued ASU 2014-04 "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure" in January 2014 to clarify when an entity is considered to have obtained physical possession of a residential real estate property collateralizing a consumer mortgage loan. Upon physical possession (from an in-substance possession or foreclosure) of such real property, an entity is required to reclassify the nonperforming mortgage loan to other real estate owned. The ASU is effective for our interim and annual periods beginning after January 1, 2015. Early adoption is permitted. ASU 2014-04 is not expected to have a material impact on our consolidated financial statements.

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2. Pending Acquisition

On April 28, 2014, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with OmniAmerican Bancorp, Inc., a Maryland corporation (“OmniAmerican”) and the holding company for OmniAmerican Bank, a federal savings association based in Fort Worth, Texas. As of September 30, 2014, OmniAmerican had $1.3 billion in assets. The Merger Agreement provides that, subject to the terms and conditions thereof, OmniAmerican will merge with and into the Company, with the Company as the surviving corporation. The merger is expected to close during the fourth quarter of 2014, subject to receipt of regulatory approvals and satisfaction of other customary closing conditions.

Pursuant to the Merger Agreement, each outstanding share of common stock of OmniAmerican will be converted into (a) 0.4459 of a share of common stock of the Company, subject to adjustment pursuant to the terms of the Merger Agreement and (b) $13.125 in cash.

On October 14, 2014, the shareholders of the Company approved the issuance of shares of Company common stock to the stockholders of OmniAmerican, and the stockholders of OmniAmerican approved the merger and also approved, on an advisory basis, certain compensation that will or may become payable to OmniAmerican's named executive officers in connection with the merger.

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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Basic and Diluted Earnings:				
Net income	$6,097	$8,893	$24,778	$29,003
Basic weighted-average shares outstanding	18,864	18,772	18,838	18,756
Add: Stock options	101	52	94	34
Diluted weighted-average shares outstanding	18,965	18,824	18,932	18,790
Basic Earnings Per Share:	$0.32	$0.47	$1.32	$1.54
Diluted Earnings Per Share:	$0.32	$0.47	$1.31	$1.54

For the three- and nine-month periods ended September 30, 2014, there were approximately 3,000 and 14,000 anti-dilutive shares, respectively. For the nine-month period ended September 30, 2013, there were approximately 6,000 anti-dilutive shares. For the three-month period ended September 30, 2013, there were no anti-dilutive shares.

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4. Accumulated Other Comprehensive (Loss) Income

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

	Nine Months Ended September 30, 2014				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(8,656)	$—	$(12)	$(12,369)	$(21,037)
Other comprehensive income (loss) before reclassifications	21,906	—	—	—	21,906
Reclassified to income	(1,660)	—	(10)	781	(889)
Income tax benefit (expense)	(7,016)	—	4	(457)	(7,469)
Net current-period other comprehensive income (loss), net of tax	13,230	—	(6)	324	13,548
Ending balance, net of tax	$4,574	$—	$(18)	$(12,045)	$(7,489)

	Three Months Ended September 30, 2014				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$3,281	$—	$(17)	$(12,030)	$(8,766)
Other comprehensive income (loss) before reclassifications	3,033	—	—	—	3,033
Reclassified to income	(1,151)	—	(3)	260	(894)
Income tax benefit (expense)	(589)	—	2	(275)	(862)
Net current-period other comprehensive income (loss), net of tax	1,293	—	(1)	(15)	1,277
Ending balance, net of tax	$4,574	$—	$(18)	$(12,045)	$(7,489)

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	Nine Months Ended September 30, 2013				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$30,500	$(1,140)	$248	$(26,670)	$2,938
Other comprehensive income (loss) before reclassifications	(46,960)	177	—	—	(46,783)
Reclassified to income	(9,204)	42	(32)	2,091	(7,103)
Income tax benefit (expense)	19,657	(76)	11	(732)	18,860
Net current-period other comprehensive (loss) income, net of tax	(36,507)	143	(21)	1,359	(35,026)
Ending balance, net of tax	$(6,007)	$(997)	$227	$(25,311)	$(32,088)

	Three Months Ended September 30, 2013				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(4,446)	$(1,012)	$234	$(25,764)	$(30,988)
Other comprehensive income (loss) before reclassifications	(2,544)	23	—	—	(2,521)
Reclassified to income	142	—	(10)	697	829
Income tax benefit (expense)	841	(8)	3	(244)	592
Net current-period other comprehensive (loss) income, net of tax	(1,561)	15	(7)	453	(1,100)
Ending balance, net of tax	$(6,007)	$(997)	$227	$(25,311)	$(32,088)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Unrealized gains and losses on available for sale securities:				
Realized net gain (loss) on sale of securities (1)	$1,151	$(142)	$1,660	$9,204
Impairment losses (2)	—	—	—	(42)
Total before tax	1,151	(142)	1,660	9,162
Tax (expense) benefit	(386)	50	(564)	(3,207)
Net of tax	$765	$(92)	$1,096	$5,955
Amortization of pension plan items:				
Net actuarial loss (3)	$(260)	$(697)	$(781)	$(2,091)
Prior service credit (3)	3	10	10	32
Total before tax	(257)	(687)	(771)	(2,059)
Tax benefit	82	241	262	721
Net of tax	$(175)	$(446)	$(509)	$(1,338)
Total reclassifications for the period, net of tax	$590	$(538)	$587	$4,617

(1) Listed as Net gain (loss) on sale of securities available for sale on the Statements of Income.
(2) Listed as Net impairment losses recognized in earnings on the Statements of Income.
(3) These accumulated other comprehensive income components are included in the computation of net periodic benefit cost presented in “Note 8 - Employee Benefit Plans.”

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5. Securities

The amortized cost, carrying value, and estimated fair value of investment and mortgage-backed securities as of September 30, 2014 and December 31, 2013 are reflected in the tables below (in thousands):

	September 30, 2014						
		Recognized in OCI			Not recognized 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. Treasuries	$34,814	$4	$47	$34,771			$34,771
State and Political Subdivisions	266,781	7,576	1,166	273,191			273,191
Other Stocks and Bonds	13,083	176	—	13,259			13,259
Mortgage-backed Securities: (1)							
Residential	568,822	12,919	850	580,891			580,891
Commercial	93,921	389	672	93,638			93,638
Total	$977,421	$21,064	$2,735	$995,750			$995,750
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$394,309	$5,265	$10,045	$389,529	$9,875	$1,018	$398,386
Mortgage-backed Securities: (1)							
Residential	55,256	—	75	55,181	3,131	—	58,312
Commercial	207,890	—	6,543	201,347	3,197	2,161	202,383
Total	$657,455	$5,265	$16,663	$646,057	$16,203	$3,179	$659,081

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	December 31, 2013						
		Recognized in OCI			Not recognized 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. Government Agency Debentures	$11,612	$—	$1,483	$10,129			$10,129
State and Political Subdivisions	322,412	4,537	12,875	314,074			314,074
Other Stocks and Bonds	13,074	159	7	13,226			13,226
Mortgage-backed Securities:(1)							
Residential	760,418	14,940	3,273	772,085			772,085
Commercial	71,262	220	3,309	68,173			68,173
Total	$1,178,778	$19,856	$20,947	$1,177,687			$1,177,687
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$396,549	$5,925	$10,922	$391,552	$1,207	$15,376	$377,383
Mortgage-backed Securities:(1)							
Residential	74,129	—	99	74,030	3,923	—	77,953
Commercial	208,667	—	7,128	201,539	—	7,656	193,883
Total	$679,345	$5,925	$18,149	$667,121	$5,130	$23,032	$649,219

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

During 2013, the Company transferred certain commercial mortgage-backed securities and state and political subdivision securities from available for sale (“AFS”) to held to maturity (“HTM”). We transferred these securities due to overall balance sheet strategies, and our management has the current intent and ability to hold these securities until maturity. The net unrealized 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. There were no securities transferred from AFS to HTM during the nine months ended September 30, 2014.

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The following table represents the unrealized loss on securities as of September 30, 2014 and December 31, 2013 (in thousands):

	As of September 30, 2014					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Treasuries	$29,805	$47	$—	$—	$29,805	$47
State and Political Subdivisions	27,890	53	59,584	1,113	87,474	1,166
Mortgage-backed Securities:						
Residential	67,538	272	20,651	578	88,189	850
Commercial	59,826	388	9,928	284	69,754	672
Total	$185,059	$760	$90,163	$1,975	$275,222	$2,735
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$5,925	$38	$90,535	$980	$96,460	$1,018
Mortgage-backed Securities:						
Commercial	54,471	494	58,235	1,667	112,706	2,161
Total	$60,396	$532	$148,770	$2,647	$209,166	$3,179

	As of December 31, 2013					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Government Agency Debentures	$—	$—	$10,129	$1,483	$10,129	$1,483
State and Political Subdivisions	191,117	11,757	18,408	1,118	209,525	12,875
Other Stocks and Bonds	2,992	7	—	—	2,992	7
Mortgage-backed Securities:						
Residential	126,965	3,266	1,351	7	128,316	3,273
Commercial	65,406	3,309	—	—	65,406	3,309
Total	$386,480	$18,339	$29,888	$2,608	$416,368	$20,947
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$283,667	$15,311	$1,705	$65	$285,372	$15,376
Mortgage-backed Securities:						
Commercial	193,883	7,656	—	—	193,883	7,656
Total	$477,550	$22,967	$1,705	$65	$479,255	$23,032

We review securities in an unrealized loss position to evaluate if a classification of other-than-temporarily impaired 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 to other comprehensive income for the noncredit portion.

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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. 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 are not other-than-temporarily impaired at September 30, 2014.

Prior to December 31, 2013, we held pooled trust preferred securities ("TRUPs"). The turmoil in the capital markets had a significant impact on our estimate of fair value of our TRUPs. These TRUPs were structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. Given the facts and circumstances associated with the TRUPs, we reviewed the financial condition of each of the underlying issuing banks within the TRUP collateral pool that had not deferred and defaulted and performed detailed cash flow modeling for each TRUP. During the nine months ended September 30, 2013, the additional write-down recognized in earnings was approximately $42,000.

The following table presents a roll forward of the credit losses recognized in earnings on the TRUPs (in thousands):

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Balance, beginning of period	$3,298	$3,256
Additions for credit losses recognized on debt securities that had previously incurred impairment losses	—	42
Balance, end of period	$3,298	$3,298

On December 13, 2013, management decided to sell all TRUPs as a result of new guidance effective in 2014 as listed in Section 419 of the Dodd-Frank Act (the “Volcker Rule”). The sale of the TRUPs, with a $2.7 million amortized-cost basis, resulted in a loss of approximately $959,000. Until the final rules under the Volcker Rule were issued by the agencies on December 10, 2013, management did not intend to sell the securities and it was not more likely than not that we would be required to sell the security before the anticipated recovery of its amortized cost basis.

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

	Nine Months Ended September 30,	
	2014	2013
U.S. Treasury	$191	$17
U.S. Government Agency Debentures	100	378
State and Political Subdivisions	18,333	17,447
Other Stocks and Bonds	156	152
Mortgage-backed Securities	21,309	13,685
Total interest income on securities	$40,089	$31,679
	Three Months Ended September 30,	
	2014	2013
U.S. Treasury	$150	$—
U.S. Government Agency Debentures	—	73
State and Political Subdivisions	6,332	6,940
Other Stocks and Bonds	53	53
Mortgage-backed Securities	6,070	5,069

Total interest income on securities	$12,605	$12,135

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Of the approximately $1.7 million in net securities gains from the AFS portfolio for the nine months ended September 30, 2014, there were $6.8 million in realized gains and $5.2 million in realized losses. Of the $9.2 million in net securities gains from the AFS portfolio for the nine months ended September 30, 2013, there were $13.0 million in realized gains and approximately $3.8 million in realized losses. There were no sales from the HTM portfolio during the nine months ended September 30, 2014 or 2013.

The amortized cost, carrying value and fair value of securities at September 30, 2014, 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.

	September 30, 2014	
	Amortized Cost	Fair Value
AVAILABLE FOR SALE	(in thousands)	
Investment Securities:		
Due in one year or less	$3,619	$3,652
Due after one year through five years	53,593	54,048
Due after five years through ten years	32,624	33,315
Due after ten years	224,842	230,206
	314,678	321,221
Mortgage-backed Securities:	662,743	674,529
Total	$977,421	$995,750

	September 30, 2014	
	Carrying Value	Fair Value
HELD TO MATURITY	(in thousands)	
Investment Securities:		
Due in one year or less	$—	$—
Due after one year through five years	2,917	2,915
Due after five years through ten years	33,464	33,696
Due after ten years	353,148	361,775
	389,529	398,386
Mortgage-backed Securities:	256,528	260,695
Total	$646,057	$659,081

Investment and MBS with carrying values of $918.6 million and $1.14 billion were pledged as of September 30, 2014 and December 31, 2013, 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.

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6. Loans and Allowance for Probable Loan Losses

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

	September 30, 2014	December 31, 2013
Real Estate Loans:		
Construction	$178,127	$125,219
1-4 Family Residential	394,889	390,499
Other	332,519	262,536
Commercial Loans	162,356	157,655
Municipal Loans	256,319	245,550
Loans to Individuals [(1)]	74,464	169,814
Total Loans	1,398,674	1,351,273
Less: Allowance for Loan Losses	13,415	18,877
Net Loans	$1,385,259	$1,332,396

(1) At September 30, 2014, SFG purchased loans, totaling approximately $74.8 million, were transferred to loans held for sale, and therefore, are not included in the loan tables presented in this note to the consolidated financial statements.

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. 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

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.

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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.

Loan pools purchased through SFG were subjected to a modeling system that considered credit scores and estimated collateral values to determine expected defaults in each pool. SFG purchased loan pools of approximately $6.1 million and $36.5 million, net of discount, during the three and nine months ended September 30, 2014, respectively. There have been no material loan pool purchases since August 2014 and there will be no additional loan pool purchases through SFG. For the three and nine months ended September 30, 2013, SFG purchased loan pools of approximately $16.3 million and $61.6 million, net of discount, respectively.

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 SFG holds and that we were endeavoring to complete such a sale in the fourth quarter of 2014. As a result of this decision, SFG loans totaling $74.8 million were transferred to held for sale and are therefore not included in our loan portfolio as of September 30, 2014.

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 and estimating necessary reserves 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

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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 reviews 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 $50,000 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.

For loans to individuals, the methodology associated with determining the appropriate allowance for losses on loans primarily consists of an evaluation of individual payment histories, remaining term to maturity and underlying collateral support.

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:

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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) – Special Treatment Required – These loans require some degree of special treatment, but not due to credit quality. This category 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;

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- 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 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.

Loans that are accruing and not considered troubled debt restructurings ("TDR") are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses.

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.

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

	Nine Months Ended September 30, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals [1]	Total
Balance at beginning of period	$2,142	$3,277	$2,572	$1,970	$668	$ 8,248	$18,877
Provision (reversal) for loan losses	47	206	(245)	1,525	45	10,073	11,651
Loans charged off	(14)	(22)	—	(65)	—	(18,630)	(18,731)
Recoveries of loans charged off	107	77	6	139	—	1,289	1,618
Balance at end of period	$2,282	$3,538	$2,333	$3,569	$713	$ 980	$13,415

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	Three Months Ended September 30, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals (1)	Total
Balance at beginning of period	$2,496	$3,915	$2,436	$1,757	$663	$ 7,141	$18,408
Provision (reversal) for loan losses	(262)	(422)	(105)	1,844	50	3,763	4,868
Loans charged off	—	—	—	(60)	—	(10,357)	(10,417)
Recoveries of loans charged off	48	45	2	28	—	433	556
Balance at end of period	$2,282	$3,538	$2,333	$3,569	$713	$ 980	$13,415

(1) Of the $18.6 million and $10.4 million in charge-offs recorded in the Loans to Individuals category for the nine and three months ended September 30, 2014, respectively, approximately $6.0 million of these amounts relate to the write-down of SFG loans to fair value in connection with the transfer of SFG loans to held for sale.

	Nine Months Ended September 30, 2013							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,355	$3,545	$2,290	$3,158	$633	$7,373	$1,231	$20,585
Provision (reversal) for loan losses	(214)	246	108	(628)	(21)	7,846	(1,184)	6,153
Loans charged off	—	(228)	(67)	(292)	—	(8,784)	—	(9,371)
Recoveries of loans charged off	49	85	338	190	—	1,327	—	1,989
Balance at end of period	$2,190	$3,648	$2,669	$2,428	$612	$7,762	$47	$19,356

	Three Months Ended September 30, 2013							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,100	$3,609	$2,104	$2,450	$633	$6,901	$573	$18,370
Provision (reversal) for loan losses	63	(35)	237	(8)	(21)	3,930	(526)	3,640
Loans charged off	—	—	—	(94)	—	(3,420)	—	(3,514)
Recoveries of loans charged off	27	74	328	80	—	351	—	860
Balance at end of period	$2,190	$3,648	$2,669	$2,428	$612	$7,762	$47	$19,356

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

	As of September 30, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment	$20	$100	$24	$368	$14	$92	$618
Ending balance – collectively evaluated for impairment	2,262	3,438	2,309	3,201	699	888	12,797
Balance at end of period	$2,282	$3,538	$2,333	$3,569	$713	$980	$13,415

	As of December 31, 2013						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment	$103	$161	$73	$240	$15	$173	$765
Ending balance – collectively evaluated for impairment	2,039	3,116	2,499	1,730	653	8,075	18,112
Balance at end of period	$2,142	$3,277	$2,572	$1,970	$668	$8,248	$18,877

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

	September 30, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$794	$4,394	$1,643	$1,209	$699	$304	$9,043
Loans collectively evaluated for impairment	177,333	390,495	330,876	161,147	255,620	74,160	1,389,631
Total ending loan balance	$178,127	$394,889	$332,519	$162,356	$256,319	$74,464	$1,398,674

	December 31, 2013						
	Real Estate						
	Construction	1-4 Family	Other	Commercial	Municipal	Loans to	Total

		Residential		Loans	Loans	Individuals	
Loans individually evaluated for impairment	$1,472	$2,624	$1,778	$1,369	$759	$559	$8,561
Loans collectively evaluated for impairment	123,747	387,875	260,758	156,286	244,791	169,255	1,342,712
Total ending loan balance	$125,219	$390,499	$262,536	$157,655	$245,550	$169,814	$1,351,273

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The following tables set forth loans by credit quality indicator for the periods presented (in thousands):

	September 30, 2014					
	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Total
Real Estate Loans:						
Construction	$171,892	$2,709	$1,177	$2,320	$29	$178,127
1-4 Family Residential	385,158	1,464	1,724	5,489	1,054	394,889
Other	321,834	2,499	2,593	5,593	—	332,519
Commercial Loans	141,512	797	—	19,845	202	162,356
Municipal Loans	255,370	—	—	949	—	256,319
Loans to Individuals	73,905	21	—	384	154	74,464
Total	$1,349,671	$7,490	$5,494	$34,580	$1,439	$1,398,674

	December 31, 2013					
	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Total
Real Estate Loans:						
Construction	$121,280	$—	$1,419	$2,454	$66	$125,219
1-4 Family Residential	380,741	1,626	3,025	4,901	206	390,499
Other	249,381	2,553	4,698	5,887	17	262,536
Commercial Loans	150,683	836	9	5,826	301	157,655
Municipal Loans	244,505	—	—	1,045	—	245,550
Loans to Individuals	168,764	27	2	719	302	169,814
Total	$1,315,354	$5,042	$9,153	$20,832	$892	$1,351,273

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

	At September 30, 2014	At December 31, 2013
Nonaccrual loans	$4,685	$8,088
Accruing loans past due more than 90 days	1	3
Restructured loans	4,388	3,888
Other real estate owned	383	726
Repossessed assets	407	901
Total Nonperforming Assets [1]	$9,864	$13,606

(1) At September 30, 2014, there were $2.0 million in SFG nonaccrual loans and $40,000 in SFG restructured loans that were transferred to held for sale and not included in the nonperforming assets presented above. At September 30, 2014, total nonperforming assets, including loans held for sale, were $11.9 million.

Nonaccrual 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

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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.

The following table sets forth the recorded investment in nonaccrual and accruing loans past due more than 90 days by class of loans for the periods presented (in thousands):

	September 30, 2014		December 31, 2013	
	Nonaccrual	Accruing Loans Past Due More Than 90 Days	Nonaccrual	Accruing Loans Past Due More Than 90 Days
Real Estate Loans:				
Construction	$794	$—	$1,472	$—
1-4 Family Residential	2,539	—	1,435	—
Other	510	—	599	—
Commercial Loans	581	—	1,062	—
Loans to Individuals	261	1	3,520	3
Total	$4,685	$1	$8,088	$3

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

	September 30, 2014					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total
Real Estate Loans:						
Construction	$292	$16	$794	$1,102	$177,025	$178,127
1-4 Family Residential	160	411	2,539	3,110	391,779	394,889
Other	103	1,919	510	2,532	329,987	332,519
Commercial Loans	338	37	581	956	161,400	162,356
Municipal Loans	250	—	—	250	256,069	256,319
Loans to Individuals	432	78	262	772	73,692	74,464
Total	$1,575	$2,461	$4,686	$8,722	$1,389,952	$1,398,674

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	December 31, 2013					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total
Real Estate Loans:						
Construction	$311	$—	$1,472	$1,783	$123,436	$125,219
1-4 Family Residential	4,340	781	1,435	6,556	383,943	390,499
Other	2,652	—	599	3,251	259,285	262,536
Commercial Loans	411	22	1,062	1,495	156,160	157,655
Municipal Loans	—	—	—	—	245,550	245,550
Loans to Individuals	7,241	2,590	3,523	13,354	156,460	169,814
Total	$14,955	$3,393	$8,091	$26,439	$1,324,834	$1,351,273

The following tables set 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):

	Nine Months Ended			
	September 30, 2014		September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Real Estate Loans:				
Construction	$1,354	$—	$1,801	$2
1-4 Family Residential	3,371	49	3,015	31
Other	2,339	47	2,031	50
Commercial Loans	1,353	19	2,090	12
Municipal Loans	741	31	152	16
Loans to Individuals	2,402	2	3,016	313
Total	$11,560	$148	$12,105	$424

	Three Months Ended			
	September 30, 2014		September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Real Estate Loans:				
Construction	$1,141	$—	$1,539	$—
1-4 Family residential	4,206	18	2,840	11
Other	2,604	16	1,781	17
Commercial loans	1,072	7	2,218	4
Municipal loans	714	10	379	5
Loans to individuals	1,854	—	2,950	64
Total	$11,591	$51	$11,707	$101

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

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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.

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

	September 30, 2014				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:					
Construction	$1,494	$—	$794	$794	$20
1-4 Family Residential	4,538	—	4,394	4,394	100
Other	1,654	—	1,643	1,643	24
Commercial Loans	1,358	—	1,209	1,209	368
Municipal Loans	699	—	699	699	14
Loans to Individuals	316	—	304	304	92
Total	$10,059	$—	$9,043	$9,043	$618

	December 31, 2013				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:					
Construction	$2,629	$—	$1,472	$1,472	$103
1-4 Family Residential	2,748	—	2,624	2,624	161
Other	1,800	—	1,778	1,778	73
Commercial Loans	1,606	—	1,369	1,369	240
Municipal Loans	759	—	759	759	15
Loans to Individuals	4,280	—	3,943	3,943	1,950
Total	$13,822	$—	$11,945	$11,945	$2,542

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

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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 September 30, 2014 and 2013 of loans considered to be TDRs that were restructured during the periods presented (dollars in thousands):

	Nine Months Ended September 30, 2014				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans
Real Estate Loans:					
1-4 Family Residential	$—	$282	$193	$475	2
Other	—	—	401	401	2
Commercial Loans	302	—	173	475	6
Loans to Individuals	—	12	73	85	7
Total	$302	$294	$840	$1,436	17

	Three Months Ended September 30, 2014				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans
Real Estate Loans:					
1-4 Family Residential	$—	$—	$193	$193	1
Commercial Loans	—	—	117	117	1
Loans to Individuals	—	—	27	27	3
Total	$—	$—	$337	$337	5

	Nine Months Ended September 30, 2013				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans
Real Estate Loans:					
Construction	$40	$—	$—	$40	1
1-4 Family Residential	282	—	120	402	5
Other	162	—	15	177	2
Commercial Loans	266	—	91	357	5
Municipal Loans	759	—	—	759	1
Loans to Individuals	14	278	55	347	42
Total	$1,523	$278	$281	$2,082	56

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	Three Months Ended September 30, 2013				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Loans
Real Estate Loans:					
Other	$162	$—	$—	$162	1
Commercial Loans	—	—	73	73	1
Municipal Loans	759	—	—	759	1
Loans to Individuals	—	120	8	128	16
Total	$921	$120	$81	$1,122	19

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

The majority of loans restructured as TDRs during the three and nine months ended September 30, 2014 were modified with a combination of interest rate reductions and maturity extensions. Interest continues to be charged on principal balances outstanding during the term extended. Therefore, the financial effects of the recorded investment of loans restructured as TDRs during the three and nine months ended September 30, 2014 and September 30, 2013 were insignificant. 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 nine months ended September 30, 2014, there were $117,000 TDRs in payment default. There were no material defaults for the three and nine months ended September 30, 2013. Payment defaults for TDRs did not significantly impact the determination of the allowance for loan loss.

At September 30, 2014 and December 31, 2013, there were no commitments to lend additional funds to borrowers whose terms had been modified in TDRs.

7. Long-term Obligations

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

	September 30, 2014	December 31, 2013
FHLB Advances (1)	$476,004	$499,349
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	$536,315	$559,660

(1) At September 30, 2014, the weighted average cost of these advances was 1.37%. Long-term FHLB Advances have maturities ranging from October 2015 through July 2028.

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

(3) This debt carries an adjustable rate of 3.1731% through December 30, 2014 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.

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(4) This debt carries an adjustable rate of 1.5361% through October 29, 2014 and adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.

(5) This debt carries an adjustable rate of 2.4841% through December 14, 2014 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.

(6) This debt carries an adjustable rate of 2.0349% through November 23, 2014 and adjusts quarterly 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):

	Nine Months Ended September 30,			
	Defined Benefit Pension Plan		Restoration Plan	
	2014	2013	2014	2013
Service cost	$1,273	$1,588	$206	$224
Interest cost	2,623	2,366	422	351
Expected return on assets	(4,236)	(3,596)	—	—
Net actuarial loss recognition	407	1,648	374	443
Prior service (credit) cost amortization	(14)	(31)	4	(1)
Net periodic benefit cost	$53	$1,975	$1,006	$1,017

	Three Months Ended September 30,			
	Defined Benefit Pension Plan		Restoration Plan	
	2014	2013	2014	2013
Service cost	$424	$529	$69	$75
Interest cost	875	789	141	117
Expected return on assets	(1,412)	(1,199)	—	—
Net loss recognition	135	549	125	148
Prior service (credit) cost amortization	(4)	(10)	1	—
Net periodic benefit cost	$18	$658	$336	$340

Employer Contributions. As of September 30, 2014, contributions of $180,000 have been made to our Restoration Plan. We do not anticipate contributing to our Defined Benefit Pension Plan in 2014.

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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 1,340,098 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 nine months ended September 30, 2014 and 2013, there were no grants of RSUs or NQSOs pursuant to the 2009 Incentive Plan.

As of September 30, 2014, there were 298,925 unvested awards outstanding. For the three and nine months ended September 30, 2014, there was share-based compensation expense of $266,000 and $843,000, respectively, with an associated income tax benefit for the three and nine months of $90,000 and $286,000, respectively. As of September 30, 2013, there were 241,603 unvested awards outstanding. Share-based compensation expense for the three and nine months ended September 30, 2013 was $198,000 and $571,000, respectively, with an associated income tax benefit for the three and nine months of $69,000 and $200,000, respectively.

As of September 30, 2014 and 2013, there was $2.2 million and $1.5 million of unrecognized compensation cost, respectively, related to the unvested awards outstanding. The remaining cost at September 30, 2014 is expected to be recognized over a weighted-average period of 2.54 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 nine months ended September 30, 2014 and 2013, there were 72,482 and 20,315 shares, respectively, issued in connection with stock compensation awards from available authorized shares.

The following table presents activity related to our RSUs and NQSOs as of September 30, 2014.

		Restricted Stock Units Outstanding		Stock Options Outstanding		
	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, 2014	738,764	56,823	$22.00	501,846	$20.56	$6.18
Granted	—	—	—	—	—	—
Stock options exercised	—	—	—	(59,292)	17.69	5.18

Stock awards vested	—	(13,246)	17.80	—	—	—
Forfeited	22,751	(2,901)	22.11	(19,850)	22.55	6.81
Canceled/expired	1,898	—	—	(1,898)	18.99	5.27
Balance, September 30, 2014	763,413	40,676	$23.36	420,806	$20.88	$6.30

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Other information regarding options outstanding and exercisable as of September 30, 2014 is as follows:

Range of Exercise Prices		Options Outstanding			Options Exercisable	
		Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Number of Shares	Weighted-Average Exercise Price
$16.58 -	$25.85	420,806	$20.88	8.03	162,557	$17.70
Total		420,806	$20.88	8.03	162,557	$17.70

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 $5.2 million and $2.5 million at September 30, 2014, respectively.

Cash received from stock options exercised for the nine months ended September 30, 2014 and 2013 was $1.0 million and $79,000, respectively. The total intrinsic value related to stock options exercised during the nine months ended September 30, 2014 and 2013, was approximately $885,000 and $31,000, 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.
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.

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

Quarterly, we review the prices supplied by the independent pricing service 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 service by comparison to prices obtained from, in most cases, three additional third party sources, with the exception of municipal securities in which case two additional third party source prices are obtained. 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.

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 nine months ended September 30, 2014.

Loans Held for Sale – These loans are reported at the lower of cost or fair value. Fair value is determined based on expected proceeds, which are based on sales contracts and commitments and are considered Level 2 inputs. At September 30, 2014, loans held for sale included $684,000 of 1-4 family residential loans and $74.8 million of subprime automobile loans. At September 30, 2014, the subprime automobile loans were transferred to held for sale. Based on our estimates of fair value, no valuation allowance was recognized as of September 30, 2014 or December 31, 2013.

Foreclosed Assets – Foreclosed assets are initially recorded at fair value less costs to sell. The fair value 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 initial recognition of foreclosed assets, we recognize charge-offs through the allowance for loan losses to the extent the fair value of the foreclosed asset, less costs to sell, is less than the loan amount.

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 September 30, 2014 and December 31, 2013, 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.

Level 3 assets recorded at fair value on a nonrecurring basis at September 30, 2014, 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

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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.

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):

	At or For the Nine Months Ended September 30, 2014			
		Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Investment Securities:				
U.S. Treasuries	$34,771	$34,771	$—	$—
State and Political Subdivisions	273,191	—	273,191	—
Other Stocks and Bonds	13,259	—	13,259	—
Mortgage-backed Securities: (1)				
Residential	580,891	—	580,891	—
Commercial	93,638	—	93,638	—
Total recurring fair value measurements	$995,750	$34,771	$960,979	$—
Nonrecurring fair value measurements				
Foreclosed assets	$790	$—	$—	$790
Impaired loans (2)	8,425	—	—	8,425
Loans held for sale	75,436	—	75,436	—
Total nonrecurring fair value measurements	$84,651	$—	$75,436	$9,215

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	At or For the Year Ended December 31, 2013			
		Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Investment Securities:				
U.S. Government Agency Debentures	$10,129	$—	$10,129	$—
State and Political Subdivisions	314,074	—	314,074	—
Other Stocks and Bonds	13,226	—	13,226	—
Mortgage-backed Securities: (1)				
Residential	772,085	—	772,085	—
Commercial	68,173	—	68,173	—
Total recurring fair value measurements	$1,177,687	$—	$1,177,687	$—
Nonrecurring fair value measurements				
Foreclosed assets	$1,627	$—	$—	$1,627
Impaired loans (2)	9,403	—	—	9,403
Loans held for sale	151	—	151	—
Total nonrecurring fair value measurements	$11,181	$—	$151	$11,030

(1) All mortgage-backed securities are issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.
(2) Loans represent collateral dependent impaired loans with a specific valuation allowance.

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For the periods prior to the TRUPs sale in December 2013, the following table presents additional information about the TRUPs measured at fair value on a recurring basis and for which we utilized Level 3 inputs to determine fair value (in thousands):

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
TRUPs		
Balance at Beginning of Period	$1,144	$990
Total gains or losses (realized/unrealized):		
Included in earnings	—	(42)
Included in other comprehensive income (loss)	23	219
Purchases	—	—
Issuances	—	—
Settlements	—	—
Transfers in and/or out of Level 3	—	—
Balance at End of Period	$1,167	$1,167
The amount of total gains or losses for the periods included in earnings attributable to the change in unrealized gains or losses relating to assets still held at reporting date	$—	$(42)

The significant unobservable inputs used in the fair value measurement of our TRUPs included the credit rating downgrades, the severity and duration of the mark-to-market loss, and the structural nuances of each TRUP. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Significant increases (decreases) in any of those inputs would result in a significant lower (higher) fair value.

Disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, is required for which 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 - 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 is a reasonable estimate of those assets' fair value.

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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.
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 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 fair value (in thousands):

		Estimated Fair Value			
September 30, 2014	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$69,221	$69,221	$69,221	$—	$—
Investment securities:					
Held to maturity, at carrying value	389,529	398,386	—	398,386	—
Mortgage-backed securities:					
Held to maturity, at carrying value	256,528	260,695	—	260,695	—
FHLB stock and other investments, at cost	26,534	26,534	—	26,534	—
Loans, net of allowance for loan losses	1,385,259	1,355,989	—	—	1,355,989
Loans held for sale	75,436	75,436	—	75,436	—
Financial Liabilities:					
Retail deposits	$2,443,564	$2,441,462	$—	$2,441,462	$—
Federal funds purchased and repurchase agreements	2,116	2,116	—	2,116	—
FHLB advances	527,812	517,180	—	517,180	—
Long-term debt	60,311	43,755	—	43,755	—

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December 31, 2013	Carrying Amount	Estimated Fair Value Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$54,431	$54,431	$54,431	$—	$—
Investment securities:					
Held to maturity, at carrying value	391,552	377,383	—	377,383	—
Mortgage-backed securities:					
Held to maturity, at carrying value	275,569	271,836	—	271,836	—
FHLB stock and other investments, at cost	36,130	36,130	—	36,130	—
Loans, net of allowance for loan losses	1,332,396	1,306,524	—	—	1,306,524
Loans held for sale	151	151	—	151	—
Financial Liabilities:					
Retail deposits	$2,527,808	$2,526,143	$—	$2,526,143	$—
Federal funds purchased and repurchase agreements	859	859	—	859	—
FHLB advances	572,794	559,648	—	559,648	—
Long-term debt	60,311	43,476	—	43,476	—

As discussed earlier, the fair value estimate of financial instruments for which quoted market prices are unavailable is dependent upon the 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 (benefit) included in the accompanying statements of income consist of the following (in thousands):

Three Months Ended
September 30,