

NBT BANCORP INC
Form 10-Q
May 10, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018.

OR

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

For the transition period from _____ to _____.

COMMISSION FILE NUMBER 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE 16-1268674
(State of Incorporation) (I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth Company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of April 30, 2018, there were 43,632,377 shares outstanding of the Registrant's common stock, \$0.01 par value per share.

NBT BANCORP INC.
FORM 10-Q-Quarter Ended March 31, 2018

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Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

	March 31, 2018	December 31, 2017
(In thousands, except share and per share data)		
Assets		
Cash and due from banks	\$ 157,498	\$ 156,852
Short-term interest bearing accounts	2,081	2,812
Equity securities, at fair value	21,992	-
Securities available for sale, at fair value	1,265,912	1,255,925
Securities held to maturity (fair value \$477,409 and \$481,871, respectively)	487,126	484,073
Trading securities	-	11,467
Federal Reserve Bank and Federal Home Loan Bank stock	43,778	46,706
Loans	6,647,124	6,584,773
Less allowance for loan losses	70,200	69,500
Net loans	\$6,576,924	\$6,515,273
Premises and equipment, net	80,073	81,305
Goodwill	268,043	268,043
Intangible assets, net	12,506	13,420
Bank owned life insurance	173,735	172,388
Other assets	141,166	128,548
Total assets	\$9,230,834	\$9,136,812
Liabilities		
Demand (noninterest bearing)	\$2,323,456	\$2,286,892
Savings, NOW and money market	4,230,047	4,076,978
Time	840,425	806,766
Total deposits	\$7,393,928	\$7,170,636
Short-term borrowings	586,012	719,123
Long-term debt	88,824	88,869
Junior subordinated debt	101,196	101,196
Other liabilities	108,144	98,811
Total liabilities	\$8,278,104	\$8,178,635
Stockholders' equity		
Preferred stock, \$0.01 par value. Authorized 2,500,000 shares at March 31, 2018 and December 31, 2017	\$-	\$-
Common stock, \$0.01 par value. Authorized 100,000,000 shares at March 31, 2018 and December 31, 2017; issued 49,651,493 at March 31, 2018 and December 31, 2017	497	497
Additional paid-in-capital	574,626	574,209
Retained earnings	555,783	543,713
Accumulated other comprehensive loss	(40,991)	(22,077)
Common stock in treasury, at cost, 6,035,840 and 6,108,684 shares at March 31, 2018 and December 31, 2017, respectively	(137,185)	(138,165)
Total stockholders' equity	\$952,730	\$958,177
Total liabilities and stockholders' equity	\$9,230,834	\$9,136,812

See accompanying notes to unaudited interim consolidated financial statements.

Table of ContentsNBT Bancorp Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	Three Months Ended March 31,	
	2018	2017
(In thousands, except per share data)		
Interest, fee and dividend income		
Interest and fees on loans	\$70,443	\$64,027
Securities available for sale	6,926	7,009
Securities held to maturity	2,625	2,781
Other	766	619
Total interest, fee and dividend income	\$80,760	\$74,436
Interest expense		
Deposits	\$3,931	\$3,474
Short-term borrowings	1,966	1,139
Long-term debt	476	606
Junior subordinated debt	901	726
Total interest expense	\$7,274	\$5,945
Net interest income	\$73,486	\$68,491
Provision for loan losses	7,496	7,379
Net interest income after provision for loan losses	\$65,990	\$61,112
Noninterest income		
Insurance and other financial services revenue	\$6,504	\$6,770
Service charges on deposit accounts	3,972	3,977
ATM and debit card fees	5,273	4,950
Retirement plan administration fees	5,339	4,172
Trust	4,878	4,532
Bank owned life insurance	1,347	1,411
Net securities gains	72	-
Other	3,892	2,938
Total noninterest income	\$31,277	\$28,750
Noninterest expense		
Salaries and employee benefits	\$36,567	\$33,587
Occupancy	6,119	6,170
Data processing and communications	4,279	4,198
Professional fees and outside services	3,492	3,032
Equipment	4,038	3,698
Office supplies and postage	1,573	1,608
FDIC expenses	1,201	1,178
Advertising	337	390
Amortization of intangible assets	914	967
Loan collection and other real estate owned, net	1,337	1,279
Other	4,415	5,175
Total noninterest expense	\$64,272	\$61,282
Income before income tax expense	\$32,995	\$28,580
Income tax expense	7,009	8,301
Net income	\$25,986	\$20,279
Earnings per share		

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Basic	\$0.60	\$0.47
Diluted	\$0.59	\$0.46

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (unaudited)

	Three Months Ended March 31,	
	2018	2017
(In thousands)		
Net income	\$25,986	\$20,279
Other comprehensive (loss) income, net of tax:		
Unrealized net holding (losses) gains arising during the period (pre-tax amounts of \$(15,454) and \$836)	(11,590)	497
Reclassification adjustment for an impairment write-down of equity security (pre-tax amounts of \$- and \$1,312)	-	811
Unrealized gains on derivatives (cash flow hedges) (pre-tax amounts of \$1,048 and \$249)	786	154
Reclassification of net unrealized (gains) losses on cash flow hedges to interest expense (pre-tax amounts of \$(359) and \$82)	(269)	50
Amortization of unrealized net gains and losses related to the reclassification of available for sale investment securities to held to maturity (pre-tax amounts of \$188 and \$238)	141	147
Pension and other benefits:		
Amortization of prior service cost and actuarial gains (pre-tax amounts of \$295 and \$435)	221	269
Total other comprehensive (loss) income	\$(10,711)	\$1,928
Comprehensive income	\$15,275	\$22,207

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity (unaudited)

	Common Stock	Additional Paid-in- Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Common Stock in Treasury	Total
(In thousands, except share and per share data)						
Balance at December 31, 2016	\$ 497	\$575,078	\$501,761	\$ (21,520)	\$(142,500)	\$913,316
Net income	-	-	20,279	-	-	20,279
Cash dividends - \$0.23 per share	-	-	(10,020)	-	-	(10,020)
Net issuance of 184,651 shares to employee and other stock plans	-	(3,712)	-	-	2,882	(830)
Stock-based compensation	-	2,261	(95)	-	-	2,166
Other comprehensive income	-	-	-	1,928	-	1,928
Balance at March 31, 2017	\$ 497	\$573,627	\$511,925	\$ (19,592)	\$(139,618)	\$926,839
Balance at December 31, 2017	\$ 497	\$574,209	\$543,713	\$ (22,077)	\$(138,165)	\$958,177
Net income	-	-	25,986	-	-	25,986
Cumulative effect adjustment for ASU 2016-01 implementation	-	-	1,475	(2,628)	-	(1,153)
Cumulative effect adjustment for ASU 2018-02 implementation	-	-	5,575	(5,575)	-	-
Cash dividends - \$0.48 per share	-	-	(20,966)	-	-	(20,966)
Net issuance of 72,844 shares to employee and other stock plans	-	(2,037)	-	-	980	(1,057)
Stock-based compensation	-	2,454	-	-	-	2,454
Other comprehensive loss	-	-	-	(10,711)	-	(10,711)
Balance at March 31, 2018	\$ 497	\$574,626	\$555,783	\$ (40,991)	\$(137,185)	\$952,730

See accompanying notes to unaudited interim consolidated financial statements.

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Consolidated Statements of Cash Flows (unaudited)

	Three Months Ended March 31,	
	2018	2017
(In thousands)		
Operating activities		
Net income	\$25,986	\$20,279
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	7,496	7,379
Depreciation and amortization of premises and equipment	2,327	2,249
Net amortization on securities	1,081	1,267
Amortization of intangible assets	914	967
Excess tax (benefit) on stock-based compensation	(407)	(1,472)
Stock-based compensation expense	2,454	2,166
Bank owned life insurance income	(1,347)	(1,411)
Trading security purchases	-	(1,277)
Net unrealized losses in trading securities	-	491
Proceeds from sales of loans held for sale	23,977	24,896
Originations and purchases of loans held for sale	(24,188)	(27,622)
Net gains on sales of loans held for sale	(57)	(46)
Net security (gains)	(72)	-
Net (gain) loss on sales and write-down of other real estate owned	(174)	157
Impairment write-down of equity security	-	1,312
Net (increase) decrease in other assets	(7,272)	3,539
Net increase (decrease) in other liabilities	9,333	(5,145)
Net cash provided by operating activities	\$40,051	\$27,729
Investing activities		
Securities available for sale:		
Proceeds from maturities, calls and principal paydowns	\$51,122	\$78,038
Proceeds from sales	-	1,000
Purchases	(91,520)	(110,330)
Securities held to maturity:		
Proceeds from maturities, calls and principal paydowns	18,242	19,914
Purchases	(21,333)	(5,943)
Equity securities:		
Proceeds from sales	2,623	-
Other:		
Net increase in loans	(69,659)	(82,299)
Proceeds from Federal Home Loan Bank stock redemption	71,081	56,521
Purchases of Federal Reserve Bank and Federal Home Loan Bank stock	(68,153)	(52,065)
Purchases of premises and equipment, net	(1,186)	(1,269)
Proceeds from the sales of other real estate owned	534	2,430
Net cash (used in) investing activities	\$(108,249)	\$(94,003)
Financing activities		
Net increase in deposits	\$223,292	\$211,363
Net (decrease) in short-term borrowings	(133,111)	(141,460)
Proceeds from issuance of long-term debt	25,000	-
Repayments of long-term debt	(25,045)	(64)

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Proceeds from the issuance of shares to employee benefit plans and other stock plans	672	1,983
Cash paid by employer for tax-withholding on stock issuance	(1,729)	(2,813)
Cash dividends	(20,966)	(10,020)
Net cash provided by financing activities	\$68,113	\$58,989
Net (decrease) in cash and cash equivalents	\$(85)	\$(7,285)
Cash and cash equivalents at beginning of period	159,664	149,181
Cash and cash equivalents at end of period	\$159,579	\$141,896

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	Three Months Ended March 31, 2018		2017
Supplemental disclosure of cash flow information			
Cash paid during the period for:			
Interest expense	\$7,677	\$6,363	
Income taxes paid, net of refund	3,199	1,019	
Noncash investing activities:			
Loans transferred to other real estate owned	\$780	\$3,946	

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries
Notes to Unaudited Interim Consolidated Financial Statements
March 31, 2018

1. Description of Business

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), NBT Holdings, Inc. ("NBT Holdings"), Hathaway Agency, Inc. and CNBF Capital Trust I, NBT Statutory Trust I, NBT Statutory Trust II, Alliance Financial Capital Trust I and Alliance Financial Capital Trust II (collectively, the "Trusts"). The Company's principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.

The Company's business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking, retail banking and wealth management services primarily to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts, Vermont and the southern coastal Maine area. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company's business philosophy is to operate as a community bank with local decision-making providing a broad array of banking and financial services to retail, commercial and municipal customers.

2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly-owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." The interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles in the United States of America ("GAAP"). These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2017 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

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3. Securities

The amortized cost, estimated fair value and unrealized gains (losses) of available for sale ("AFS") securities are as follows:

(In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
As of March 31, 2018				
Federal agency	\$ 139,775	\$ -	\$ 1,316	\$ 138,459
State & municipal	39,700	31	345	39,386
Mortgage-backed:				
Government-sponsored enterprises	524,468	523	11,155	513,836
U.S. government agency securities	30,473	267	545	30,195
Collateralized mortgage obligations:				
Government-sponsored enterprises	511,727	243	15,541	496,429
U.S. government agency securities	48,944	151	1,488	47,607
Total AFS securities	\$ 1,295,087	\$ 1,215	\$ 30,390	\$ 1,265,912
As of December 31, 2017				
Federal agency	\$ 109,862	\$ -	\$ 963	\$ 108,899
State & municipal	42,171	62	277	41,956
Mortgage-backed:				
Government-sponsored enterprises	530,392	1,406	3,345	528,453
U.S. government agency securities	26,363	334	223	26,474
Collateralized mortgage obligations:				
Government-sponsored enterprises	496,033	254	10,114	486,173
U.S. government agency securities	50,721	165	1,065	49,821
Equity securities	10,623	3,672	146	14,149
Total AFS securities	\$ 1,266,165	\$ 5,893	\$ 16,133	\$ 1,255,925

The amortized cost, estimated fair value and unrealized gains (losses) of securities held to maturity ("HTM") are as follows:

(In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
As of March 31, 2018				
Mortgage-backed:				
Government-sponsored enterprises	\$ 93,769	\$ -	\$ 2,749	\$ 91,020
U.S. government agency securities	389	47	-	436
Collateralized mortgage obligations:				
Government-sponsored enterprises	188,260	-	5,004	183,256
State & municipal	204,708	292	2,303	202,697
Total HTM securities	\$ 487,126	\$ 339	\$ 10,056	\$ 477,409
As of December 31, 2017				
Mortgage-backed:				
Government-sponsored enterprises	\$ 96,357	\$ 85	\$ 810	\$ 95,632
U.S. government agency securities	418	57	-	475
Collateralized mortgage obligations:				
Government-sponsored enterprises	186,327	224	2,577	183,974
State & municipal	200,971	1,439	620	201,790

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Total HTM securities	\$484,073	\$ 1,805	\$ 4,007	\$481,871
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Available for sale and held to maturity securities with amortized costs totaling \$1.6 billion at March 31, 2018 and \$1.5 billion at December 31, 2017 were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at March 31, 2018 and December 31, 2017, available for sale and held to maturity securities with an amortized cost of \$218.3 million and \$231.3 million, respectively, were pledged as collateral for securities sold under the repurchase agreements.

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The following table sets forth information with regard to investment securities with unrealized losses segregated according to the length of time the securities had been in a continuous unrealized loss position:

(In thousands)	Less than 12 months			12 months or longer			Total		
	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions
As of March 31, 2018									
AFS securities:									
Federal agency	\$74,268	\$(459)	6	\$64,191	\$(857)	6	\$138,459	\$(1,316)	12
State & municipal	25,927	(271)	44	4,979	(74)	7	30,906	(345)	51
Mortgage-backed	440,714	(9,582)	90	55,185	(2,118)	25	495,899	(11,700)	115
Collateralized mortgage obligations	249,512	(5,330)	38	259,488	(11,699)	43	509,000	(17,029)	81
Total securities with unrealized losses	\$790,421	\$(15,642)	178	\$383,843	\$(14,748)	81	\$1,174,264	\$(30,390)	259
HTM securities:									
Mortgaged-backed	\$59,070	\$(1,344)	4	\$31,950	\$(1,405)	2	\$91,020	\$(2,749)	6
Collateralized mortgage obligations	147,877	(2,864)	23	35,379	(2,140)	6	183,256	(5,004)	29
State & municipal	74,241	(1,299)	118	15,177	(1,004)	24	89,418	(2,303)	142
Total securities with unrealized losses	\$281,188	\$(5,507)	145	\$82,506	\$(4,549)	32	\$363,694	\$(10,056)	177
As of December 31, 2017									
AFS securities:									
Federal agency	\$64,653	\$(242)	5	\$44,246	\$(721)	4	\$108,899	\$(963)	9
State & municipal	23,566	(200)	39	5,994	(77)	8	29,560	(277)	47
Mortgage-backed	317,630	(2,381)	55	58,316	(1,187)	24	375,946	(3,568)	79
Collateralized mortgage obligations	227,917	(2,658)	35	275,303	(8,521)	42	503,220	(11,179)	77
Equity securities	-	-	-	2,959	(146)	1	2,959	(146)	1
Total securities with unrealized losses	\$633,766	\$(5,481)	134	\$386,818	\$(10,652)	79	\$1,020,584	\$(16,133)	213
HTM securities:									
Mortgage -backed	\$15,477	\$(140)	2	\$33,703	\$(670)	2	\$49,180	\$(810)	4
Collateralized mortgage obligations	118,476	(1,064)	17	37,614	(1,513)	6	156,090	(2,577)	23
State & municipal	22,387	(132)	40	15,720	(488)	24	38,107	(620)	64
Total securities with unrealized losses	\$156,340	\$(1,336)	59	\$87,037	\$(2,671)	32	\$243,377	\$(4,007)	91

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Declines in the fair value of HTM securities below their amortized cost, less any current period credit loss, that are deemed to be other-than-temporary are reflected in earnings as realized losses or in other comprehensive income. This classification is dependent upon whether the Company intends to sell the security, or whether it is more likely than not it will be required to sell the security before recovery. The other-than-temporary impairment ("OTTI") shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total OTTI related to the credit loss shall be recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in other comprehensive income net of applicable taxes.

In estimating OTTI losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the historical and implied volatility of the fair value of the security.

Management has the intent to hold the securities classified as HTM until they mature, at which time it is believed the Company will receive full value for the securities. The unrealized losses on HTM debt securities are due to increases in market interest rates over yields at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or if market yields for such investments decline.

Management also has the intent to hold and will not be required to sell, the debt securities classified as AFS for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses on AFS debt securities are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. For AFS debt securities, OTTI losses are recognized in earnings if the Company intends to sell the security. In other cases the Company considers the relevant factors noted above, as well as the Company's intent and ability to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value and whether evidence exists to support a realizable value equal to or greater than the cost basis. Any impairment loss on an equity security is equal to the full difference between the cost basis and the fair value of the security.

As of March 31, 2018 and December 31, 2017, management believes the impairments detailed in the table above are temporary. There were no OTTI losses realized in the Company's consolidated statement of income for the quarter ended March 31, 2018. For the quarter ended March 31, 2017, a \$1.3 million impairment loss on an equity investment was realized in the Company's consolidated statements of income.

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The following tables set forth information with regard to gains and losses on equity securities for the quarter ended March 31, 2018:

(In thousands)

Net gains and losses recognized on equity securities	\$	72
Less: Net gains and losses recognized during the period on equity securities sold during the period		44
Unrealized gains and losses recognized on equity securities still held at March 31, 2018	\$	28

As of March 31, 2018, the carrying value of equity securities without readily determinable fair values was \$5.0 million. The Company performed a qualitative assessment to determine whether the investments were impaired and identified no areas of concern as of March 31, 2018. There were no impairments, downward or upward adjustments recognized for equity securities without readily determinable fair values during the quarter ended March 31, 2018.

The following tables set forth information with regard to contractual maturities of debt securities at March 31, 2018:

(In thousands)	Amortized Cost	Estimated Fair Value
AFS debt securities:		
Within one year	\$99,647	\$99,288
From one to five years	82,353	81,136
From five to ten years	175,040	172,862
After ten years	938,047	912,626
Total AFS debt securities	\$1,295,087	\$1,265,912
HTM debt securities:		
Within one year	\$37,885	\$37,885
From one to five years	43,089	43,159
From five to ten years	208,715	204,710
After ten years	197,437	191,655
Total HTM debt securities	\$487,126	\$477,409

Maturities of mortgage-backed, collateralized mortgage obligations and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at March 31, 2018 and December 31, 2017.

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4. Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

The allowance for loan losses is maintained at a level estimated by management to provide adequately for probable incurred losses inherent in the current loan portfolio. The appropriateness of the allowance for loan losses is continuously monitored. It is assessed for appropriateness using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three segments, each with different risk characteristics and methodologies for assessing risk. Those segments are further segregated between our loans accounted for under the amortized cost method (referred to as "originated" loans) and loans acquired in a business combination (referred to as "acquired" loans). Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class segment.

As of March 31, 2018, the Company made adjustments to the class segments within the portfolios to better align risk characteristics and reflect the monitoring and assessment of risks as the portfolios continue to evolve. Agricultural Non-Real Estate and Agricultural Real Estate were consolidated with Commercial and Commercial Real Estate, respectively. Agricultural loans are a type of commercial loan with certain specific underwriting guidelines; however, the portfolio has decreased to less than 3% of the Commercial portfolio and separate classification was no longer warranted. The Indirect Lending class segment was further separated into Dealer Finance and Specialty Lending class segments. The growth in our Specialty Lending portfolio to 21% of Consumer Loans warranted evaluation of this class separately due to different risk characteristics from Dealer Finance class segment. The Direct and Home Equity class segments were consolidated into Direct to reflect common management, similar underwriting and in-market focus. The change to the class segments in the allowance methodology did not have a significant impact on the allowance for loan losses. The following table illustrates the portfolio and class segments for the loan portfolio in 2018 compared to 2017:

Portfolio	Class - 2018	Class - 2017
Commercial Loans	Commercial and Industrial	Commercial
	Commercial Real Estate	Commercial Real Estate
	Business Banking	Agricultural Agricultural Real Estate Business Banking
Consumer Loans	Dealer Finance	Indirect
	Specialty Lending	Home Equity
	Direct	Direct
Residential Real Estate Mortgages		

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Commercial Loans

The Company offers a variety of commercial loan products including commercial (non-real estate), commercial real estate, agricultural, agricultural real estate and business banking loans. The Company's underwriting analysis for commercial loans typically includes credit verification, independent appraisals, a review of the borrower's financial condition and a detailed analysis of the borrower's underlying cash flows.

Commercial and Industrial ("C&I") – The Company offers a variety of loan options to meet the specific needs of our C&I customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion, equipment purchases, livestock purchases and finance seasonal crop expenses. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans typically carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment, accounts receivable and perishable agricultural products, which are generally less liquid than real estate and exposed to industry price volatility. To reduce these risks, management also attempts to obtain personal guarantees of the borrowers or obtain government loan guarantees to provide further support. In 2018 the Commercial and Agricultural class segments were combined to create the C&I class segment.

Commercial Real Estate ("CRE") – The Company offers CRE loans to finance real estate purchases, refinancings, expansions and improvements to commercial and agricultural properties. CRE loans are made to finance the purchases and improvements of real property, which generally consists of real estate with completed structures. These CRE loans are secured by liens on the real estate, which may include both owner occupied and non-owner-occupied properties, such as apartments, commercial structures, health care facilities and other facilities. These loans are typically less risky than commercial loans, since they are secured by real estate. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition and a detailed analysis of the borrower's underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the commercial property and no more than 75% of the appraised value of the agricultural property. Government loan guarantees may be obtained to provide further support for agricultural property. In 2018 the Commercial Real Estate and Agricultural Real Estate class segments were combined to create the CRE class segment.

Business Banking - The Company offers a variety of loan options to meet the specific needs of our Business Banking customers including term loans, Business Banking mortgages and lines of credit. Such loans are generally less than \$750 thousand and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases and agricultural needs. Generally, a collateral lien is placed on assets owned by the borrower and can include real estate, equipment, inventory, receivables or other business assets. These loans carry a higher risk than C&I and CRE loans due to the smaller size of the borrower and lower levels of capital. To reduce the risk, the Company obtains personal guarantees of the owners for a majority of the loans.

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Consumer Loans

The Company offers a variety of consumer loan products including Dealer Finance, Specialty Lending and Direct loans.

Dealer Finance – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the Company primarily finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 70% of the Dealer Finance relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of Dealer Finance consumer loans are underwritten on a secured basis using the underlying collateral being financed. In 2018 the Indirect class segment was further separated into Dealer Finance and Specialty Lending class segments (see above and below).

Specialty Lending – The Company offers unsecured consumer loans across a national footprint originated through our relationship with national technology-driven consumer lending companies. Advances of credit through this specialty lending business line are subject to the Company's underwriting standards including criteria such as FICO score and debt to income thresholds. In 2018 the Indirect class segment has been further separated into Dealer Finance (see above) and Specialty Lending class segments. The Company offers unsecured consumer loans across a national footprint originated through relationships with national technology-driven consumer lending companies to finance such things as dental and medical procedures, K-12 tuition, solar energy installations and other consumer purpose loans.

Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. In addition to installment loans, the Company also offers personal lines of credit, overdraft protection, home equity lines of credit and second mortgage loans (loans secured by a lien position on one-to-four family residential real estate) to finance home improvements, debt consolidation, education and other uses. Most of the consumer installment loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. For home equity loans, consumers are able to borrow up to 85% of the equity in their homes. These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Consumer installment loans are often secured with collateral consisting of a perfected lien on the asset being purchased or a perfected lien on a consumer's deposit account. A minimal amount of consumer installment loans are unsecured, which carry a higher risk of loss. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate. In 2018 the Home Equity segment was consolidated into the Direct class segment.

Residential Real Estate Mortgages

Residential real estate loans consist primarily of loans secured by a first or second mortgage on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. When market conditions are favorable, for longer term, fixed-rate residential real estate mortgages without escrow, the Company retains the servicing, but sells the right to receive principal and interest to Freddie Mac. This practice allows the Company to manage interest rate risk, liquidity risk and credit risk. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower) or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

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Allowance for Loan Loss Calculation

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually impaired loans, these include estimates of impairment, if any, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectability. These factors include: past loss experience, size, trend, composition and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges are necessary to maintain the allowance at a level which management believes is reflective of overall level of incurred loss in the portfolio. While management uses available information to recognize losses on loans, additions and reductions of the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content or changes in management's assessment of any or all of the determining factors discussed above.

The following tables illustrate the changes in the allowance for loan losses by our portfolio segments:

(In thousands)	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Total
Balance as of December 31, 2017	\$ 27,606	\$ 36,830	\$ 5,064	\$69,500
Charge-offs	(805)	(7,687)	(182)	(8,674)
Recoveries	187	1,644	47	1,878
Provision	1,202	6,186	108	7,496
Ending Balance as of March 31, 2018	\$ 28,190	\$ 36,973	\$ 5,037	\$70,200
Balance as of December 31, 2016	\$ 25,444	\$ 33,375	\$ 6,381	\$65,200
Charge-offs	(1,294)	(6,502)	(598)	(8,394)
Recoveries	447	1,035	33	1,515
Provision	130	6,861	388	7,379
Ending Balance as of March 31, 2017	\$ 24,727	\$ 34,769	\$ 6,204	\$65,700

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For acquired loans, to the extent that we experience deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to acquisition of the loans, an allowance for loan losses would be established based on our estimate of incurred losses at the balance sheet date. There was no allowance for loan losses for the acquired loan portfolio as of March 31, 2018 and December 31, 2017. Net charge-offs related to acquired loans totaled approximately \$0.1 million and \$0.4 million during the three months ended March 31, 2018 and March 31, 2017, respectively, and are included in the table above.

The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segments:

(In thousands)	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Total
As of March 31, 2018				
Allowance for loan losses	\$28,190	\$36,973	\$5,037	\$70,200
Allowance for loans individually evaluated for impairment	42	-	-	42
Allowance for loans collectively evaluated for impairment	28,148	36,973	5,037	70,158
Ending balance of loans	3,048,003	2,266,054	1,333,067	6,647,124
Ending balance of originated loans individually evaluated for impairment	6,006	8,305	6,771	21,082
Ending balance of acquired loans collectively evaluated for impairment	172,920	40,666	164,123	377,709
Ending balance of originated loans collectively evaluated for impairment	\$2,869,077	\$2,217,083	\$1,162,173	\$6,248,333
As of December 31, 2017				
Allowance for loan losses	\$27,606	\$36,830	\$5,064	\$69,500
Allowance for loans individually evaluated for impairment	57	-	-	57
Allowance for loans collectively evaluated for impairment	27,549	36,830	5,064	69,443
Ending balance of loans	3,028,269	2,234,809	1,321,695	6,584,773
Ending balance of originated loans individually evaluated for impairment	5,876	8,432	6,830	21,138
Ending balance of acquired loans collectively evaluated for impairment	187,313	43,906	170,472	401,691
Ending balance of originated loans collectively evaluated for impairment	\$2,835,080	\$2,182,471	\$1,144,393	\$6,161,944

Credit Quality of Loans

For all loan classes within the Company's loan portfolio, loans are placed on nonaccrual status when timely collection of principal and/or interest in accordance with contractual terms is in doubt. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well-secured and in the process of collection, or sooner when management concludes circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses.

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If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. For all loan classes within the Company's loan portfolio, nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full or in part is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

The following tables set forth information with regard to past due and nonperforming loans by loan class:

	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due			Recorded Total Loans
(In thousands)	Accruing	Accruing	Accruing	Accruing	NonAccrual	Current	
As of March 31, 2018							
<u>Originated</u>							
Commercial Loans:							
C&I	\$ 639	\$ 1,268	\$ -	\$ 1,907	\$ 1,196	\$ 784,845	\$ 787,948
CRE	28	-	-	28	5,232	1,600,096	1,605,356
Business Banking	2,116	797	-	2,913	6,194	472,672	481,779
Total Commercial Loans	\$ 2,783	\$ 2,065	\$ -	\$ 4,848	\$ 12,622	\$ 2,857,613	\$ 2,875,083
Consumer Loans:							
Dealer Finance	\$ 10,850	\$ 1,920	\$ 987	\$ 13,757	\$ 2,201	\$ 1,224,238	\$ 1,240,196
Specialty Lending	3,843	1,627	1,292	6,762	-	464,912	471,674
Direct	2,334	982	401	3,717	2,470	507,331	513,518
Total Consumer Loans	\$ 17,027	\$ 4,529	\$ 2,680	\$ 24,236	\$ 4,671	\$ 2,196,481	\$ 2,225,388
Residential Real Estate							
Mortgages	\$ 2,389	\$ 1,635	\$ 203	\$ 4,227	\$ 5,487	\$ 1,159,230	\$ 1,168,944
Total Originated Loans	\$ 22,199	\$ 8,229	\$ 2,883	\$ 33,311	\$ 22,780	\$ 6,213,324	\$ 6,269,415
<u>Acquired</u>							
Commercial Loans:							
C&I	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 33,484	\$ 33,484
CRE	-	-	-	-	2	97,463	97,465
Business Banking	539	9	-	548	673	40,750	41,971
Total Commercial Loans	\$ 539	\$ 9	\$ -	\$ 548	\$ 675	\$ 171,697	\$ 172,920
Consumer Loans:							
Dealer Finance	\$ 7	\$ 3	\$ -	\$ 10	\$ 15	\$ 577	\$ 602
Direct	368	-	51	419	281	39,364	40,064
Total Consumer Loans	\$ 375	\$ 3	\$ 51	\$ 429	\$ 296	\$ 39,941	\$ 40,666
Residential Real Estate							
Mortgages	\$ 565	\$ 102	\$ -	\$ 667	\$ 1,675	\$ 161,781	\$ 164,123
Total Acquired Loans	\$ 1,479	\$ 114	\$ 51	\$ 1,644	\$ 2,646	\$ 373,419	\$ 377,709
Total Loans	\$ 23,678	\$ 8,343	\$ 2,934	\$ 34,955	\$ 25,426	\$ 6,586,743	\$ 6,647,124

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	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Non-Accrual	Current	Recorded Total Loans
(In thousands)							
As of December 31, 2017							
<u>Originated</u>							
Commercial Loans:							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 202	\$753,577	\$753,779
Commercial Real Estate	161	138	-	299	3,178	1,533,065	1,536,542
Agricultural	117	-	-	117	1,043	34,386	35,546
Agricultural Real Estate	493	-	-	493	2,736	30,905	34,134
Business Banking	1,907	597	-	2,504	5,304	473,147	480,955
Total Commercial Loans	\$ 2,678	\$ 735	\$ -	\$ 3,413	\$ 12,463	\$2,825,080	\$2,840,956
Consumer Loans:							
Indirect	\$ 18,747	\$ 4,033	\$ 3,492	\$ 26,272	\$ 2,115	\$1,642,664	\$1,671,051
Home Equity	2,887	854	341	4,082	2,736	448,081	454,899
Direct	341	108	70	519	35	64,399	64,953
Total Consumer Loans	\$ 21,975	\$ 4,995	\$ 3,903	\$ 30,873	\$ 4,886	\$2,155,144	\$2,190,903
Residential Real Estate							
Mortgages	\$ 3,730	\$ 667	\$ 1,262	\$ 5,659	\$ 5,987	\$1,139,577	\$1,151,223
Total Originated Loans	\$ 28,383	\$ 6,397	\$ 5,165	\$ 39,945	\$ 23,336	\$6,119,801	\$6,183,082
<u>Acquired</u>							
Commercial Loans:							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$39,575	\$39,575
Commercial Real Estate	-	-	-	-	2	106,632	106,634
Business Banking	354	-	-	354	669	40,081	41,104
Total Commercial Loans	\$ 354	\$ -	\$ -	\$ 354	\$ 671	\$186,288	\$187,313
Consumer Loans:							
Indirect	\$ 38	\$ -	\$ 1	\$ 39	\$ 22	\$1,157	\$1,218
Home Equity	254	34	103	391	225	39,256	39,872
Direct	6	1	1	8	23	2,785	2,816
Total Consumer Loans	\$ 298	\$ 35	\$ 105	\$ 438	\$ 270	\$43,198	\$43,906
Residential Real Estate							
Mortgages	\$ 627	\$ 226	\$ 140	\$ 993	\$ 1,431	\$168,048	\$170,472
Total Acquired Loans	\$ 1,279	\$ 261	\$ 245	\$ 1,785	\$ 2,372	\$397,534	\$401,691
Total Loans	\$ 29,662	\$ 6,658	\$ 5,410	\$ 41,730	\$ 25,708	\$6,517,335	\$6,584,773

There were no material commitments to extend further credit to borrowers with nonperforming loans as of March 31, 2018 and December 31, 2017.

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Impaired Loans

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified loans, including all troubled debt restructured loans (“TDRs”) and nonaccrual commercial loans that are graded Substandard, Doubtful or Loss, with outstanding balances of \$750 thousand or more are evaluated for impairment through the Company’s quarterly status review process. The Company considers commercial loans less than \$750 thousand to be homogeneous loans. In determining that we will be unable to collect all principal and/or interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are identified as impaired, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows or 3) the loan’s observable market price. These impaired loans are reviewed on a quarterly basis for changes in the measurement of impairment. Impaired amounts are charged off immediately if such amounts are determined by management to be uncollectable. Any change to the previously recognized amount of impairment loss is recognized as a component of the provision for loan losses.

The following table provides information on impaired loans specifically evaluated for impairment:

	March 31, 2018			December 31, 2017		
	Recorded	Unpaid		Recorded	Unpaid	
	Investmen	Principal	Related	Investmen	Principal	Related
(In thousands)	Balance	Balance	Allowance	Balance	Balance	Allowance
	(Book)	(Legal)		(Book)	(Legal)	
<u>Originated</u>						
With no related allowance recorded:						
Commercial Loans:						
C&I	\$430	\$696		\$-	\$-	
CRE	4,397	6,362		-	-	
Commercial	-	-		-	251	
Commercial Real Estate	-	-		2,211	3,979	
Agricultural	-	-		452	465	
Agricultural Real Estate	-	-		2,250	2,423	
Business Banking	1,078	2,135		860	1,730	
Total Commercial Loans	\$5,905	\$9,193		\$5,773	\$8,848	
Consumer Loans:						
Dealer Finance	\$198	\$216		\$-	\$-	
Direct	8,107	10,077		-	-	
Indirect	-	-		131	143	
Home Equity	-	-		8,027	9,966	
Direct	-	-		274	274	
Total Consumer Loans	\$8,305	\$10,293		\$8,432	\$10,383	
Residential Real Estate Mortgages	\$6,771	\$9,097		\$6,830	\$8,780	
Total	\$20,981	\$28,583		\$21,035	\$28,011	
With an allowance recorded:						
Commercial Loans:						
C&I	\$27	\$26	\$ 27	\$-	\$-	\$ -
CRE	74	81	15	-	-	-
Commercial Real Estate	-	-	-	76	82	30
Agricultural	-	-	-	27	27	27

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Total Commercial Loans	\$101	\$107	\$ 42	\$103	\$109	\$ 57
Total:	\$21,082	\$28,690	\$ 42	\$21,138	\$28,120	\$ 57

There were no acquired impaired loans specifically evaluated for impairment as of March 31, 2018 or December 31, 2017.

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The following tables summarize the average recorded investments on loans specifically evaluated for impairment and the interest income recognized:

(In thousands)	For the three months ended			
	March 31, 2018		March 31, 2017	
	Interest		Interest	
	Average Recorded Investments	Average Income Recognized Accrual	Average Recorded Investments	Average Income Recognized Accrual
<u>Originated</u>				
Commercial Loans:				
C&I	\$467	\$ -	\$-	\$ -
CRE	4,506	32	-	-
Commercial	-	-	2,926	-
Commercial Real Estate	-	-	5,995	44
Agricultural	-	-	173	-
Agricultural Real Estate	-	-	1,580	11
Business Banking	954	5	650	2
Total Commercial Loans	\$5,927	\$ 37	\$11,324	\$ 57
Consumer Loans:				
Dealer Finance	\$184	\$ 3	\$-	\$ -
Direct	8,190	109	-	-
Indirect	-	-	5	-
Home Equity	-	-	8,431	110
Total Consumer Loans	\$8,374	\$ 112	\$8,436	\$ 110
Residential Real Estate Mortgages	\$6,881	\$ 73	\$5,611	\$ 39
Total Originated	\$21,182	\$ 222	\$25,371	\$ 206
<u>Acquired</u>				
Commercial Loans:				
Commercial Real Estate	\$-	\$ -	\$301	\$ -
Total Commercial Loans	\$-	\$ -	\$301	\$ -
Total Acquired	\$-	\$ -	\$301	\$ -
Total Loans	\$21,182	\$ 222	\$25,672	\$ 206

Credit Quality Indicators

The Company has developed an internal loan grading system to evaluate and quantify the Company's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of borrower's management, primary and secondary sources of repayment, payment history, nature of the business and outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a consistent basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.

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Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment and management. Commercial loans are graded Doubtful, Substandard, Special Mention and Pass.

Doubtful

A Doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as a loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Nonaccrual treatment is required for Doubtful assets because of the higher probability of loss.

Substandard

Substandard loans have a high probability of payment default or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some Substandard loans, the likelihood of full collection of interest and principal may be in doubt and those loans should be placed on nonaccrual. Although Substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated Substandard.

Special Mention

Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a Substandard classification. Borrowers may be experiencing adverse operating trends (i.e., declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (i.e., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a Special Mention rating. Although a Special Mention loan has a higher probability of default than a pass asset, its default is not imminent.

Pass

Loans graded as Pass encompass all loans not graded as Doubtful, Substandard or Special Mention. Pass loans are in compliance with loan covenants and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

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Business Banking Grading System

Business banking loans are graded as either Classified or Non-classified:

Classified

Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness or weaknesses, that jeopardize the liquidation of the debt or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt, Classified loans are considered to have a nonaccrual status. In some cases, Classified loans are considered uncollectable and of such little value that their continuance as assets is not warranted.

Non-classified

Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants and payments are generally made as agreed.

Consumer and Residential Real Estate Mortgage Grading System

Consumer and Residential Real Estate Mortgage loans are graded as either Nonperforming or Performing.

Nonperforming

Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing or 2) on nonaccrual status.

Performing

All loans not meeting any of these criteria are considered Performing.

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The following tables illustrate the Company's credit quality by loan class:

(In thousands)

March 31, 2018

Originated

Commercial Credit Exposure

By Internally Assigned Grade:

	C&I	CRE	Total
Pass	\$731,934	\$1,550,184	\$2,282,118
Special Mention	37,543	15,868	53,411
Substandard	18,471	39,304	57,775
Total	\$787,948	\$1,605,356	\$2,393,304

Business Banking Credit Exposure

By Internally Assigned Grade:

	Business Banking	Total
Non-classified	\$468,842	\$468,842
Classified	12,937	12,937
Total	\$481,779	\$481,779

Consumer Credit Exposure

	Dealer Finance	Specialty Lending	Direct	Total
By Payment Activity:				
Performing	\$1,237,008	\$470,382	\$510,647	\$