Allegiance Bancshares, Inc.
Form 10-Q
November 01, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 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: 001-37585

Allegiance Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Texas	26-3564100
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8847 West Sam Houston Parkway, N., Suite 200

Houston, Texas 77040

(Address of principal executive offices, including zip code)

(281) 894-3200

(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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

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 October 30, 2018, there were 21,827,053 outstanding shares of the registrant's Common Stock, par value $1.00 per share.

ALLEGIANCE BANCSHARES, INC.

INDEX TO FORM 10-Q

SEPTEMBER 30, 2018

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PART I—FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2018	December 31, 2017
	(Dollars in thousands, except share data)	
ASSETS		
Cash and due from banks	$145,192	$133,124
Interest-bearing deposits at other financial institutions	46,276	48,979
Total cash and cash equivalents	191,468	182,103
Available for sale securities, at fair value	300,115	309,615
Loans held for investment	2,440,926	2,270,876
Less: allowance for loan losses	(23,586)	(23,649)
Loans, net	2,417,340	2,247,227
Accrued interest receivable	11,609	12,194
Premises and equipment, net	18,970	18,477
Other real estate owned	1,801	365
Federal Home Loan Bank stock	11,851	12,862
Bank owned life insurance	22,838	22,422
Goodwill	39,389	39,389
Core deposit intangibles, net	2,688	3,274
Other assets	17,470	12,303
TOTAL ASSETS	$3,035,539	$2,860,231
LIABILITIES AND SHAREHOLDERS’ EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$789,705	$683,110
Interest-bearing		
Demand	197,032	215,499
Money market and savings	542,679	554,051
Certificates and other time	904,375	761,314
Total interest-bearing deposits	1,644,086	1,530,864
Total deposits	2,433,791	2,213,974
Accrued interest payable	2,106	610
Borrowed funds	211,569	282,569
Subordinated debt	48,839	48,659

Other liabilities	11,103	7,554
Total liabilities	2,707,408	2,553,366
COMMITMENTS AND CONTINGENCIES (See Note 11)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $1 par value; 1,000,000 shares authorized; there were no shares issued or outstanding	—	—
Common stock, $1 par value; 40,000,000 shares authorized; 13,396,703 shares issued and outstanding at September 30, 2018 and 13,226,826 shares issued and outstanding at December 31, 2017	13,397	13,227
Capital surplus	221,762	218,408
Retained earnings	98,968	74,894
Accumulated other comprehensive (loss) income	(5,996)	336
Total shareholders' equity	328,131	306,865
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,035,539	$2,860,231

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands, except per share data)			
INTEREST INCOME:				
Loans, including fees	$32,988	$28,588	$94,951	$80,584
Securities:				
Taxable	636	547	1,881	1,548
Tax-exempt	1,447	1,574	4,357	4,789
Deposits in other financial institutions	265	192	731	479
Total interest income	35,336	30,901	101,920	87,400
INTEREST EXPENSE:				
Demand, money market and savings deposits	1,248	811	3,111	2,167
Certificates and other time deposits	4,051	2,299	10,120	6,539
Borrowed funds	1,272	654	3,780	2,068
Subordinated debt	729	140	2,168	394
Total interest expense	7,300	3,904	19,179	11,168
NET INTEREST INCOME	28,036	26,997	82,741	76,232
Provision for loan losses	—	6,908	1,284	11,258
Net interest income after provision for loan losses	28,036	20,089	81,457	64,974
NONINTEREST INCOME:				
Nonsufficient funds fees	175	144	565	527
Service charges on deposit accounts	177	204	506	604
Loss on sale of securities	—	(12)	—	(12)
Gain on sale of other real estate	—	—	1	—
Bank owned life insurance income	137	146	416	440
Rebate from correspondent bank	613	370	1,621	939
Other	826	608	2,270	1,780
Total noninterest income	1,928	1,460	5,379	4,278
NONINTEREST EXPENSE:				
Salaries and employee benefits	12,965	11,580	38,537	32,557
Net occupancy and equipment	1,281	1,325	3,886	4,054
Depreciation	490	427	1,330	1,225
Data processing and software amortization	1,226	783	3,635	2,197
Professional fees	303	822	1,339	2,704
Regulatory assessments and FDIC insurance	505	582	1,533	1,740

Core deposit intangibles amortization	195	195	586	586
Communications	262	251	769	731
Advertising	351	302	1,021	853
Acquisition and merger-related expenses	196	—	821	—
Other	1,390	1,409	4,284	4,039
Total noninterest expense	19,164	17,676	57,741	50,686
INCOME BEFORE INCOME TAXES	10,800	3,873	29,095	18,566
Provision for income taxes	1,921	887	4,949	4,138
NET INCOME	$8,879	$2,986	$24,146	$14,428
EARNINGS PER SHARE:				
Basic	$0.66	$0.23	$1.81	$1.10
Diluted	$0.65	$0.22	$1.77	$1.07

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Net income	$8,879	$2,986	$ 24,146	$ 14,428
Other comprehensive (loss) income, before tax:				
Unrealized (loss) gain on securities:				
Change in unrealized holding (loss) gain on available for sale securities during the period	(2,265)	735	(8,106)	6,115
Reclassification of amount realized through the sale of securities	—	12	—	12
Total other comprehensive (loss) income	(2,265)	747	(8,106)	6,127
Deferred tax benefit (expense) related to other comprehensive income	476	(268)	1,774	(2,152)
Other comprehensive (loss) income, net of tax	(1,789)	479	(6,332)	3,975
Comprehensive income	$7,090	$3,465	$ 17,814	$ 18,403

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
	(in thousands, except share data)						
BALANCE AT JANUARY 1, 2017	12,958,341	$12,958	$212,649	$57,262	$ (3,052)	$ —	$ 279,817
Net income				14,428			14,428
Other comprehensive income					3,975		3,975
Common stock issued in connection with the exercise of stock options and restricted stock awards	212,388	213	3,000				3,213
Stock based compensation expense			1,294				1,294
BALANCE AT SEPTEMBER 30, 2017	13,170,729	$13,171	$216,943	$71,690	$ 923	$ —	$ 302,727
BALANCE AT JANUARY 1, 2018	13,226,826	$13,227	$218,408	$74,894	$ 336	$ —	306,865
Net income				24,146			24,146
Other comprehensive loss					(6,332)		(6,332)
Reclassification of amounts within AOCI to retained earnings due to tax reform (See Note 1)				(72)			(72)
Common stock issued in connection with the exercise of stock options and restricted stock awards	169,877	170	2,139				2,309

Stock based compensation expense			1,215				1,215
BALANCE AT SEPTEMBER 30, 2018	13,396,703	$13,397	$221,762	$98,968	$ (5,996)	$ —	$ 328,131

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$24,146	$14,428
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	1,916	1,811
Provision for loan losses	1,284	11,258
Loss on the sale of securities	—	12
Net amortization of premium on investments	2,413	2,550
Excess tax benefit related to the exercise of stock options	(420)	(989)
Bank owned life insurance	(416)	(440)
Net amortization of discount on loans	(207)	(536)
Net amortization of discount on subordinated debentures	82	81
Net amortization of discount on certificates of deposit	(3)	(3)
Net gain on the sale or write down of premises, equipment and other real estate	(1)	—
Federal Home Loan Bank stock dividends	(268)	(201)
Stock based compensation expense	1,215	1,294
Increase in accrued interest receivable and other assets	(2,846)	(4,103)
Increase in accrued interest payable and other liabilities	5,563	2,052
Net cash provided by operating activities	32,458	27,214
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of available for sale securities	2,014,951	2,007,007
Proceeds from sales of available for sale securities	—	9,000
Purchase of available for sale securities	(2,015,970)	(2,019,843)
Net change in total loans	(172,625)	(314,816)
Purchase of bank premises and equipment	(1,857)	(1,517)
Proceeds from sale of bank premises, equipment and other real estate	—	1,050
Net redemptions of Federal Home Loan Bank stock	1,279	586
Net cash used in investing activities	(174,222)	(318,533)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in noninterest-bearing deposits	106,595	119,200
Net increase in interest-bearing deposits	113,225	297,235
Proceeds from borrowed funds	—	25,000
Paydowns on borrowed funds	(71,000)	(103,000)
Proceeds from the issuance of common stock, stock option exercises, restricted stock awards and the ESPP	2,309	3,213

Net cash provided by financing activities	151,129	341,648
NET CHANGE IN CASH AND CASH EQUIVALENTS	9,365	50,329
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	182,103	142,098
CASH AND CASH EQUIVALENTS, END OF PERIOD	$191,468	$192,427
SUPPLEMENTAL INFORMATION:		
Income taxes paid	$4,700	$6,000
Interest paid	17,682	10,929

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.

CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018

(Unaudited)

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations-Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank, (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. The Company derives substantially all of its revenues and income from the operation of the Bank. The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small to medium-sized businesses, professionals and individuals. The Company operated 16 offices and one loan production office in Houston, Texas and the surrounding region as of September 30, 2018. The Bank provides its customers with a variety of banking services including checking accounts, savings accounts and certificates of deposit, and its primary lending products are commercial, personal, automobile, mortgage and home improvement loans. The Bank also offers safe deposit boxes, automated teller machines, drive-through services and 24-hour depository facilities.

Basis of Presentation-The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions with Allegiance have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

Significant Accounting and Reporting Policies

The Company’s significant accounting and reporting policies can be found in Note 1 of the Company’s annual financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

New Accounting Standards

Adoption of New Accounting Standards

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, “Revenue from Contracts with Customers” (“Topic 606”). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods. The Company’s primary sources of revenue are derived from interest and dividends earned on loans, investment securities and other financial instruments that are not within the scope of ASU 2014-09. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed, charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The new standard was effective for the Company on January 1, 2018 and did not have a significant impact on its consolidated financial statements and related disclosures.

ALLEGIANCE BANCSHARES, INC.

CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

ASU No. 2016-01, "”Financial Instruments - Overall (Subtopic 825-10): Recognition of Financial Assets and Financial Liabilities." ASU 2016-01 makes targeted amendments to fair value measurement and disclosure guidance. ASU 2016-01 requires equity investments (other than equity method investments) to be measured at fair value with changes in fair value recognized in net income. This change is only applied if a readily determinable fair value can be obtained. The update also requires the use of exit prices to measure fair value for disclosure purposes as well as other enhanced disclosure requirements. ASU 2016-01 was effective for the Company on January 1, 2018 and did not have a significant impact on its financial statements and related disclosures. See Note 5 – Fair Value Disclosures for further information.

ASU 2016-15, “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. Among other things, the update clarifies the appropriate classification for proceeds from settlement of bank owned life insurance (BOLI) policies. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted with retrospective application. ASU 2016-15 was effective for the Company on January 1, 2018 and did not have a significant impact on its financial statements and related disclosures.

ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 amends ASC 220, Income Statement - Reporting Comprehensive Income, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the “Tax Act”), resulting in significant modifications to existing law. Authoritative guidance and interpretation by regulatory bodies is ongoing, and as such, the accounting for the effects of the Tax Act is not final and the full impact of the new regulation is still being evaluated. ASU 2018-02 is effective on January 1, 2019, with early adoption permitted. The Company early adopted and recognized a decrease to retained earnings of $72 thousand due to a reclassification on January 1, 2018.

Newly Issued But Not Yet Effective Accounting Standards

ASU 2016-02, “Leases (Topic 842)." ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 will be effective for the Company on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Early application of this ASU is permitted for all entities. Adoption of ASU 2016-02 is not expected to have a material impact on the Company’s financial statements. The Company leases certain properties and equipment under operating leases that will result in the recognition of lease assets and lease liabilities on the Company’s balance sheet under the ASU. While the Company is currently evaluating the impact of adopting ASU 2016-02, it is aware that the adoption will result in an increase in right-of-use assets and lease liabilities recorded on its balance sheet.

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” Among other things, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better form their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on available for sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for the Company on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. While the Company is currently unable to reasonably estimate the impact of adopting ASU 2016-13, the Company expects that the impact of adoption will be significantly influenced by the composition, characteristics and quality of its loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date. The Company has formed a cross functional team and with the assistance of a third-party provider is assessing the Company's data and system needs to evaluate the impact that adoption of this standard will have on the financial condition and results of operations of the Company.

ALLEGIANCE BANCSHARES, INC.

CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for the Company on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on the Company's financial statements.

ASU 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities.” ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for the Company on January 1, 2019, with early adoption permitted. The Company is currently evaluating the potential impact of ASU 2017-08 on its financial statements.

2. GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS

Changes in the carrying amount of the Company’s goodwill and core deposit intangible assets were as follows:

	Goodwill	Core Deposit Intangibles
	(Dollars in thousands)	
Balance as of January 1, 2017	$39,389	$ 4,055
Amortization	—	(781)
Balance as of December 31, 2017	$39,389	$ 3,274
Amortization	—	(586)
Balance as of September 30, 2018	$39,389	$ 2,688

Goodwill is recorded on the acquisition date of an entity. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangible assets has occurred. If any such impairment is determined, a write-down is recorded. As of September 30, 2018, there were no impairments recorded on goodwill and other intangible assets.

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of September 30, 2018 is as follows (dollars in thousands):

Remaining 2018	$195
2019	781
2020	744
2021	484
2022	484
Thereafter	—
Total	$2,688

ALLEGIANCE BANCSHARES, INC.

CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

3. SECURITIES

The amortized cost and fair value of investment securities were as follows:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$6,118	$ 58	$ (73)	$6,103
Municipal securities	219,231	546	(5,901)	213,876
Agency mortgage-backed pass-through securities	44,034	36	(1,576)	42,494
Corporate bonds and other	38,321	—	(679)	37,642
Total	$307,704	$ 640	$ (8,229)	$300,115

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,507	$ 232	$ (24)	$8,715
Municipal securities	222,330	2,470	(1,842)	222,958
Agency mortgage-backed pass-through securities	32,014	159	(361)	31,812
Corporate bonds and other	46,247	62	(179)	46,130
Total	$309,098	$ 2,923	$ (2,406)	$309,615

As of September 30, 2018, the Company’s management did not expect to sell any securities classified as available for sale with material unrealized losses, and the Company believes it is more likely than not it will not be required to sell any of these securities before their anticipated recovery, at which time the Company will receive full value for the securities. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2018, management believed the unrealized losses in the previous table are temporary and no other than temporary impairment loss has been realized in the Company’s consolidated statements of income.

The amortized cost and fair value of investment securities at September 30, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$8,760	$8,730
Due after one year through five years	72,298	70,975
Due after five years through ten years	87,210	85,394
Due after ten years	95,402	92,522
Subtotal	263,670	257,621
Agency mortgage-backed pass through securities	44,034	42,494
Total	$307,704	$300,115

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ALLEGIANCE BANCSHARES, INC.

CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

	September 30, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$1,159	$ (22)	$940	$ (51)	$2,099	$ (73)
Municipal securities	86,425	(1,882)	87,398	(4,019)	173,823	(5,901)
Agency mortgage-backed pass-through securities	23,873	(620)	16,660	(956)	40,533	(1,576)
Corporate bonds and other	19,706	(174)	16,936	(505)	36,642	(679)
Total	$131,163	$ (2,698)	$121,934	$ (5,531)	$253,097	$ (8,229)

	December 31, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$3,110	$ (9)	$595	$ (15)	$3,705	$ (24)
Municipal securities	42,249	(517)	56,483	(1,325)	98,732	(1,842)
Agency mortgage-backed pass-through securities	13,238	(105)	8,921	(256)	22,159	(361)
Corporate bonds and other	30,203	(179)	—	—	30,203	(179)
Total	$88,800	$ (810)	$65,999	$ (1,596)	$154,799	$ (2,406)

There were no securities sold during the three and nine months ended September 30, 2018. During the three and nine months ended September 30, 2017, the Company sold $9.0 million of corporate bonds with a minimal loss recognized. At September 30, 2018 and December 31, 2017, the Company did not own securities of any one issuer, other than the U.S government and its agencies, in an amount greater than 10% of consolidated shareholders' equity at such respective dates.

The carrying value of pledged securities was $3.0 million at September 30, 2018 and $5.0 million at December 31, 2017, respectively. The securities are pledged to further collateralize letters of credit issued by the Bank, but confirmed by another financial institution.

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio balances, net of unearned income and fees, consist of various types of loans primarily made to borrowers located within Texas and are classified by major type as follows:

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Commercial and industrial	$458,434	$457,129
Mortgage warehouse	48,876	69,456
Real estate:		
Commercial real estate (including multi-family residential)	1,161,992	1,080,247
Commercial real estate construction and land development	298,916	243,389
1-4 family residential (including home equity)	344,342	301,219
Residential construction	117,740	109,116
Consumer and other	10,626	10,320
Total loans	2,440,926	2,270,876
Allowance for loan losses	(23,586)	(23,649)
Loans, net	$2,417,340	$2,247,227

Nonaccrual and Past Due Loans

An aging analysis of the recorded investment in past due loans, segregated by class of loans, is as follows:

	September 30, 2018					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$4,055	$ —	$ 4,055	$ 6,258	$448,121	$458,434

Mortgage warehouse	—	—	—	—	48,876	48,876
Real estate:						
Commercial real estate (including multi-family residential)	4,717	—	4,717	5,006	1,152,269	1,161,992
Commercial real estate construction and land development	3,206	—	3,206	694	295,016	298,916
1-4 family residential (including home equity)	1,064	—	1,064	2,985	340,293	344,342
Residential construction	1,169	—	1,169	—	116,571	117,740
Consumer and other	71	—	71	—	10,555	10,626
Total loans	$14,282	$ —	$ 14,282	$ 14,943	$2,411,701	$2,440,926

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	December 31, 2017					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$1,069	$ —	$ 1,069	$ 6,437	$449,623	$457,129
Mortgage warehouse	—	—	—	—	69,456	69,456
Real estate:						
Commercial real estate (including multi-family residential)	4,932	—	4,932	6,110	1,069,205	1,080,247
Commercial real estate construction and land development	5,274	—	5,274	—	238,115	243,389
1-4 family residential (including home equity)	924	—	924	781	299,514	301,219
Residential construction	674	—	674	—	108,442	109,116
Consumer and other	74	—	74	—	10,246	10,320
Total loans	$12,947	$ —	$ 12,947	$ 13,328	$2,244,601	$2,270,876

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Impaired Loans

Impaired loans by class of loans are set forth in the following tables.

	As of September 30, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$5,173	$5,786	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	17,142	17,142	—
Commercial real estate construction and land development	694	694	—
1-4 family residential (including home equity)	1,628	1,628	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	24,637	25,250	—
With an allowance recorded:			
Commercial and industrial	7,646	8,041	3,455
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	992	992	125
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	1,356	1,356	21
Residential construction	—	—	—

Consumer and other	—	—	—
Total	9,994	10,389	3,601
Total:			
Commercial and industrial	12,819	13,827	3,455
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	18,134	18,134	125
Commercial real estate construction and land development	694	694	—
1-4 family residential (including home equity)	2,984	2,984	21
Residential construction	—	—	—
Consumer and other	—	—	—
	$34,631	$35,639	$ 3,601

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	Year Ended December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$5,792	$6,666	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	12,155	12,155	—
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	19,104	19,978	—
With an allowance recorded:			
Commercial and industrial	5,600	5,652	1,640
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	8,009	8,194	716
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	13,609	13,846	2,356
Total:			
Commercial and industrial	11,392	12,318	1,640

Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	20,164	20,349	716
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
	$32,713	$33,824	$ 2,356

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The following table presents average impaired loans and interest recognized on impaired loans for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$ 12,979	$ 119	$ 13,848	$ 98
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	18,242	181	16,568	147
Commercial real estate construction and land development	695	5	209	3
1-4 family residential (including home equity)	2,993	4	1,342	3
Residential construction	—	—	—	—
Consumer and other	—	—	51	—
Total	$ 34,909	$ 309	$ 32,018	$ 251

	Nine Months Ended September 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$ 13,370	$ 316	$ 14,343	$ 332
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family	18,409	497	16,737	327

residential)				
Commercial real estate construction and land development	600	8	314	7
1-4 family residential (including home equity)	3,033	9	1,352	4
Residential construction	—	—	—	—
Consumer and other	—	—	58	1
Total	$35,412	$ 830	$32,804	$ 671

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including factors such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. The Company analyzes loans individually by classifying the loans by credit risk. As part of the ongoing monitoring of the credit quality of the Company’s loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks risk ratings to be used as credit quality indicators.

The following is a general description of the risk ratings used:

Pass—Loans classified as pass are loans with low to average risk and not otherwise classified as watch, special mention, substandard or doubtful.   In addition, the guaranteed portion of SBA loans are considered pass risk rated loans.

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Watch—Loans classified as watch loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.

Special Mention—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These classified loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful—Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values highly questionable and improbable.

Based on the most recent analysis performed, the risk category of loans by class of loan at September 30, 2018 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$430,376	$9,511	$4,287	$ 14,260	$ —	$458,434
Mortgage warehouse	48,876	—	—	—	—	48,876
Real estate:						
Commercial real estate (including multi-family residential)	1,093,942	30,376	5,553	32,121	—	1,161,992
Commercial real estate construction and land development	291,082	2,585	1,356	3,893	—	298,916
1-4 family residential (including	336,903	2,402	912	4,125	—	344,342

home equity)						
Residential construction	116,854	—	—	886	—	117,740
Consumer and other	10,525	32	—	69	—	10,626
Total loans	$2,328,558	$44,906	$12,108	$ 55,354	$ —	$2,440,926

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The following table presents the risk category of loans by class of loan at December 31, 2017:

	Pass