CENTRAL PACIFIC FINANCIAL CORP
Form 10-Q
August 02, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from to

Commission file number 001-31567

CENTRAL PACIFIC FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Hawaii	99-0212597
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

220 South King Street, Honolulu, Hawaii 96813
(Address of principal executive offices) (Zip Code)

(808) 544-0500
(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 ý No o

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

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 company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.:

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

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 7(a)(2)(B) of the Securities Act . o

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

The number of shares outstanding of registrant's common stock, no par value, on July 27, 2017 was 30,439,187 shares.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
Form 10-Q

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PART I. FINANCIAL INFORMATION

Forward-Looking Statements

This document may contain forward-looking statements concerning projections of revenues, income/loss, earnings/loss per share, capital expenditures, dividends, capital structure, net interest margin or other financial items, concerning plans and objectives of management for future operations, concerning future economic performance, or concerning any of the assumptions underlying or relating to any of the foregoing. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts, and may include the words "believes," "plans," "intends," "expects," "anticipates," "forecasts," "hopes," "should," "estimates" or words of similar meaning. While we believe that our forward-looking statements and the assumptions underlying them are reasonably based, such statements and assumptions are by their nature subject to risks and uncertainties, and thus could later prove to be inaccurate or incorrect. Accordingly, actual results could materially differ from projections for a variety of reasons, to include, but not be limited to: adverse changes in the financial performance and/or condition of our borrowers and, as a result, increased loan delinquency rates, deterioration in asset quality, and losses in our loan portfolio; the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis, storms and earthquakes) on the Company's business and operations and on tourism, the military, and other major industries operating within the Hawaii market and any other markets in which the Company does business; deterioration or malaise in domestic economic conditions, including any further destabilization in the financial industry and deterioration of the real estate market, as well as the impact of declining levels of consumer and business confidence in the state of the economy in general and in financial institutions in particular; changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, changes in capital standards, other regulatory reform, including but not limited to regulations promulgated by the Consumer Financial Protection Bureau, government-sponsored enterprise reform, and any related rules and regulations on our business operations and competitiveness; the costs and effects of legal and regulatory developments, including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; ability to successfully implement our initiatives to lower our efficiency ratio; the ability to address any material weakness in our internal controls over financial reporting or disclosure controls and procedures; the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, securities market and monetary fluctuations; negative trends in our market capitalization and adverse changes in the price of the Company's common stock; political instability; acts of war or terrorism; changes in consumer spending, borrowings and savings habits; failure to maintain effective internal control over financial reporting or disclosure controls and procedures; technological changes; changes in the competitive environment among financial holding companies and other financial service providers; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; our ability to attract and retain key personnel; changes in our organization, compensation and benefit plans; and our success at managing the risks involved in the foregoing items. For further information on factors that could cause actual results to materially differ from projections, please see the Company's publicly available Securities and Exchange Commission filings, including the Company's Form 10-K for the last fiscal year and, in particular, the discussion of "Risk Factors" set forth therein. The Company does not update any of its forward-looking statements except as required by law.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)

(dollars in thousands)	June 30, 2017	December 31, 2016
Assets		
Cash and due from banks	$85,975	$75,272
Interest-bearing deposits in other banks	54,576	9,069
Investment securities:		
Available-for-sale, at fair value	1,315,895	1,243,847
Held-to-maturity, at amortized cost; fair value of: $203,334 at June 30, 2017 and $214,366 at December 31, 2016	204,588	217,668
Total investment securities	1,520,483	1,461,515
Loans held for sale	13,288	31,881
Loans and leases	3,591,735	3,524,890
Allowance for loan and lease losses	(52,828)	(56,631)
Net loans and leases	3,538,907	3,468,259
Premises and equipment, net	49,252	48,258
Accrued interest receivable	15,636	15,675
Investment in unconsolidated subsidiaries	6,189	6,889
Other real estate owned	1,008	791
Mortgage servicing rights	15,932	15,779
Core deposit premium	3,343	4,680
Bank-owned life insurance	156,053	155,593
Federal Home Loan Bank stock	6,492	11,572
Other assets	66,001	79,003
Total Assets	$5,533,135	$5,384,236
Liabilities		
Deposits:		
Noninterest-bearing demand	$1,383,754	$1,265,246
Interest-bearing demand	917,956	862,991
Savings and money market	1,453,108	1,390,600
Time	1,131,564	1,089,364
Total deposits	4,886,382	4,608,201
Short-term borrowings	—	135,000
Long-term debt	92,785	92,785
Other liabilities	41,013	43,575
Total Liabilities	5,020,180	4,879,561
Equity		
Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding: none at June 30, 2017 and December 31, 2016	—	—
Common stock, no par value, authorized 185,000,000 shares; issued and outstanding: 30,514,799 at June 30, 2017 and 30,796,243 at December 31, 2016	519,383	530,932

Surplus	84,592	84,180
Accumulated deficit	(94,269)	(108,941)
Accumulated other comprehensive income	3,224	(1,521)
Total Shareholders' Equity	512,930	504,650
Non-controlling interest	25	25
Total Equity	512,955	504,675
Total Liabilities and Equity	$5,533,135	$5,384,236

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands, except per share data)	2017	2016	2017	2016
Interest income:				
Interest and fees on loans and leases	$35,531	$ 32,878	$70,488	$ 64,671
Interest and dividends on investment securities:				
Taxable interest	8,481	7,953	16,616	16,349
Tax-exempt interest	974	995	1,953	1,991
Dividends	12	10	24	20
Interest on deposits in other banks	61	11	135	28
Dividends on Federal Home Loan Bank stock	21	23	77	60
Total interest income	45,080	41,870	89,293	83,119
Interest expense:				
Interest on deposits:				
Demand	154	123	294	234
Savings and money market	259	269	516	532
Time	2,136	957	3,853	1,855
Interest on short-term borrowings	46	177	77	227
Interest on long-term debt	856	735	1,669	1,451
Total interest expense	3,451	2,261	6,409	4,299
Net interest income	41,629	39,609	82,884	78,820
Provision (credit) for loan and lease losses	(2,282)	(1,382)	(2,362)	(2,129)
Net interest income after credit for loan and lease losses	43,911	40,991	85,246	80,949
Other operating income:				
Mortgage banking income	1,957	1,423	3,900	2,663
Service charges on deposit accounts	2,120	1,908	4,156	3,872
Other service charges and fees	3,053	3,028	5,801	5,795
Income from fiduciary activities	964	857	1,828	1,697
Equity in earnings of unconsolidated subsidiaries	151	184	212	274
Fees on foreign exchange	130	126	293	274
Investment securities gains (losses)	(1,640)	—	(1,640)	—
Income from bank-owned life insurance	583	1,232	1,700	1,857
Loan placement fees	146	133	280	179
Net gain on sales of foreclosed assets	84	241	186	549
Other	322	805	1,168	1,433
Total other operating income	7,870	9,937	17,884	18,593
Other operating expense:				
Salaries and employee benefits	17,983	17,850	35,370	34,787
Net occupancy	3,335	3,557	6,749	6,871
Equipment	967	769	1,809	1,580
Amortization of core deposit premium	669	668	1,337	1,337
Communication expense	891	919	1,791	1,878
Legal and professional services	1,987	1,723	3,779	3,336
Computer software expense	2,190	2,222	4,442	4,926
Advertising expense	390	433	782	1,067
Foreclosed asset expense	63	49	99	64
Other	3,860	4,270	7,637	7,980

Total other operating expense	32,335	32,460	63,795	63,826
Income before income taxes	19,446	18,468	39,335	35,716
Income tax expense	7,421	6,331	14,231	12,398
Net income	$12,025	$ 12,137	$25,104	$ 23,318
Per common share data:				
Basic earnings per common share	$0.39	$ 0.39	$0.82	$ 0.75
Diluted earnings per common share	$0.39	$ 0.39	$0.81	$ 0.74
Cash dividends declared	$0.18	$ 0.14	$0.34	$ 0.28
Shares used in computation:				
Basic shares	30,568,247	31,060,593	30,641,165	31,162,013
Diluted shares	30,803,725	31,262,525	30,879,923	31,359,568

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands)	2017	2016	2017	2016
Net income	$12,025	$12,137	$25,104	$23,318
Other comprehensive income, net of tax:				
Net change in unrealized gain on investment securities	2,795	5,866	4,919	17,719
Minimum pension liability adjustment	190	249	(174)	499
Total other comprehensive income, net of tax	2,985	6,115	4,745	18,218
Comprehensive income	$15,010	$18,252	$29,849	$41,536

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

	Common Shares Outstanding	Preferred Stock	Common Stock	Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income	Non-Controlling Interest	Total
	(dollars in thousands, except per share data)							
Balance at December 31, 2016	30,796,243	$ —	$530,932	$84,180	$(108,941)	$(1,521)	$ 25	$504,675
Net income	—	—	—	—	25,104	—	—	25,104
Other comprehensive income	—	—	—	—	—	4,745	—	4,745
Cash dividends ($0.34 per share)	—	—	—	—	(10,432)	—	—	(10,432)
10,620 net shares of common stock purchased by directors' deferred compensation plan	—	—	(341)	—	—	—	—	(341)
362,371 shares of common stock repurchased and other related costs	(362,371)	—	(11,208)	—	—	—	—	(11,208)
Share-based compensation	80,927	—	—	412	—	—	—	412
Non-controlling interest	—	—	—	—	—	—	—	—
Balance at June 30, 2017	30,514,799	$ —	$519,383	$84,592	$(94,269)	$ 3,224	$ 25	$512,955
Balance at December 31, 2015	31,361,452	$ —	$548,878	$82,847	$(137,314)	$ 203	$ 25	$494,639
Net income	—	—	—	—	23,318	—	—	23,318
Other comprehensive income	—	—	—	—	—	18,218	—	18,218
Cash dividends ($0.28 per share)	—	—	—	—	(8,734)	—	—	(8,734)
5,000 net shares of common stock purchased by directors' deferred compensation plan	—	—	(99)	—	—	—	—	(99)
492,922 shares of common stock repurchased and other related costs	(492,922)	—	(10,544)	—	—	—	—	(10,544)
Share-based compensation	168,365	—	199	635	—	—	—	834
Non-controlling interest	—	—	—	—	—	—	(16)	(16)
Balance at June 30, 2016	31,036,895	$ —	$538,434	$83,482	$(122,730)	$ 18,421	$ 9	$517,616

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30,	
(dollars in thousands)	2017	2016
Cash flows from operating activities:		
Net income	$25,104	$23,318
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan and lease losses	(2,362)	(2,129)
Depreciation and amortization	3,150	2,974
Write down of other real estate, net of gain on sale	(165)	(222)
Amortization of core deposit premium and mortgage servicing rights	2,404	4,601
Net amortization of investment securities	5,826	5,801
Share-based compensation	412	635
Net loss on investment securities	1,640	—
Net gain on sales of residential loans	(2,396)	(3,311)
Proceeds from sales of loans held for sale	168,624	193,848
Originations of loans held for sale	(147,635)	(186,349)
Equity in earnings of unconsolidated subsidiaries	(212)	(274)
Net increase in cash surrender value of bank-owned life insurance	(2,170)	(1,994)
Deferred income taxes	13,648	12,398
Net tax benefits from share-based compensation	583	—
Net change in other assets and liabilities	(8,279)	1,373
Net cash provided by operating activities	58,172	50,669
Cash flows from investing activities:		
Proceeds from maturities of and calls on investment securities available for sale	86,372	81,894
Proceeds from sales of investment securities available for sale	96,019	—
Purchases of investment securities available for sale	(253,372)	(46,215)
Proceeds from maturities of and calls on investment securities held to maturity	12,715	13,289
Net loan proceeds (originations)	(17,715)	(115,771)
Purchases of loan portfolios	(50,725)	(77,702)
Proceeds from sale of other real estate	102	1,789
Proceeds from bank-owned life insurance	1,710	1,283
Purchases of premises and equipment	(4,144)	(2,183)
Net return of capital from unconsolidated subsidiaries	455	412
Contributions to unconsolidated subsidiaries	—	(5)
Net (purchases) proceeds from redemption of FHLB stock	5,080	(6,612)
Net cash used in investing activities	(123,503)	(149,821)
Cash flows from financing activities:		
Net increase (decrease) in deposits	278,181	(28,297)
Net (decrease) increase in short-term borrowings	(135,000)	157,000
Cash dividends paid on common stock	(10,432)	(8,734)
Repurchases of common stock and other related costs	(11,208)	(10,544)
Net proceeds from issuance of common stock and stock option exercises	—	199
Net cash provided by financing activities	121,541	109,624
Net increase in cash and cash equivalents	56,210	10,472
Cash and cash equivalents at beginning of period	84,341	80,194
Cash and cash equivalents at end of period	$140,551	$90,666

Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$5,461	$3,986
Income taxes	4,000	—
Cash received during the period for:		
Income taxes	—	1,605
Supplemental disclosure of non-cash investing and financing activities:		
Net change in common stock held by directors’ deferred compensation plan	341	99
Net reclassification of loans to other real estate	154	637

See accompanying notes to consolidated financial statements.

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CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of Central Pacific Financial Corp. and Subsidiaries (herein referred to as the "Company," "we," "us" or "our") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

These interim condensed consolidated financial statements and notes should be read in conjunction with the Company's consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended December 31, 2016. In the opinion of management, all adjustments necessary for a fair presentation have been made and include all normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

In December 2015, we acquired a 50% ownership interest in a mortgage loan origination and brokerage company, One Hawaii HomeLoans, LLC. The bank concluded that the investment meets the consolidation requirements under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, "Consolidation." The bank concluded that the entity meets the definition of a variable interest entity and that we are the primary beneficiary of the variable interest entity. Accordingly, the investment has been consolidated into our financial statements.

We have 50% ownership interests in four other mortgage loan origination and brokerage companies which are accounted for using the equity method and are included in investment in unconsolidated subsidiaries: Pacific Access Mortgage, LLC, Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC.

We also have non-controlling equity investments in affiliates that are accounted for under the cost method and are included in investment in unconsolidated subsidiaries.

Our investments in unconsolidated subsidiaries accounted for under the equity and cost methods were $0.4 million and $5.8 million, respectively, at June 30, 2017 and $0.7 million and $6.2 million, respectively, at December 31, 2016. Our policy for determining impairment of these investments includes an evaluation of whether a loss in value of an investment is other than temporary. Evidence of a loss in value includes absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. We perform impairment tests whenever indicators of impairment are present. If the value of an investment declines and it is considered other than temporary, the investment is written down to its respective fair value in the period in which this determination is made.

The Company sponsors the Central Pacific Bank Foundation, which is not consolidated in the Company's financial statements.

Consolidated Statements of Income Reclassification

On December 31, 2016, the Company elected to reclassify loan servicing fees, amortization of mortgage servicing rights, net gain on sale of residential mortgage loans, and unrealized gain (loss) on interest rate locks into a single line item called "mortgage banking income" in the Company's consolidated statements of income. Loan servicing fees and net gain on sale of residential mortgage loans were previously recorded in its own line in the other operating income section of the consolidated statements of income, while unrealized gain (loss) on interest rate locks was included as a component of other operating income - other. The amortization of mortgage servicing rights was previously recorded as a component of amortization and impairment of other intangible assets in the other operating expense section of the Company's consolidated statements of income. The components of mortgage banking income are disclosed in Note 12 - Mortgage Banking Income to the consolidated financial statements. The Company believes the reclassification provides a better presentation of revenues and costs of our mortgage banking activities. Prior year comparative financial statements have been adjusted retrospectively.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2016, the FASB issued ASU 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies the accounting for share-based payments. Specifically, the amendments: 1) require entities to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement; 2) change the classification of excess tax benefits to an operating activity in the statement of cash flows; 3) allows entities to elect an accounting policy to either estimate the number of forfeitures or account for forfeitures when they occur; and 4) allows entities to withhold up to the maximum individual statutory tax rate without classifying the awards as a liability. We adopted ASU 2016-09 effective January 1, 2017 and elected to recognize forfeitures as they occur. The Company's adoption was prospective, therefore, prior periods have not been adjusted. The adoption of ASU 2016-09 could result in greater volatility to reported income tax expense related to excess tax benefits and tax deficiencies for employee share-based payments. The volatility results from changes in the share price and timing of exercise of share options and vesting of share awards. For the six months ended June 30, 2017, the adoption of ASU 2016-09 resulted in a decrease to the provision for income taxes due to the tax benefit from the vesting of restricted stock units.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 was initially effective for the Company's reporting period beginning on January 1, 2017. However, in August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" which defers the effective date by one year. For financial reporting purposes, the standard allows for either a full retrospective or modified retrospective adoption. The FASB has also issued additional updates to provide further clarification to specific implementation issues associated with ASU 2014-09. These updates include ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations," ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," and ASU 2016-20 "Technical Corrections and Improvements to Topic 606." Our revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of of ASU 2014-09, and other operating income. We expect that ASU 2014-09 may require us to change how we recognize certain recurring revenue streams; however, we do not expect these changes to have a material impact on our financial statements. We continue to evaluate the impact of ASU 2014-09 on components of other operating income. This includes reviewing the contracts potentially impacted by the ASU in revenue streams such as trust and asset management fees, deposit related fees, and commissions income. Additionally, we continue to follow implementation issues relevant to the banking industry, and consider the disclosure requirements upon implementation. We expect to adopt the standard beginning January 1, 2018 under the modified retrospective approach with a cumulative effect adjustment to opening retained earnings, if such adjustment is deemed to be significant.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 changes the income statement impact of equity investments, and the recognition of changes in fair value of financial liabilities when the fair value option is selected. ASU 2016-01 is effective for the Company's reporting period beginning January 1, 2018. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term of longer than 12 months. ASU 2016-02 is effective for the Company's reporting period beginning January 1, 2019 and must be applied using the modified retrospective approach. Based on preliminary evaluation, the new pronouncement will not have a material impact on our consolidated financial statements as the projected minimum lease payments under existing leases subject to the new pronouncement are less than one percent of our current total assets as of December 31, 2016.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The ASU requires an organization to measure 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 use forward-looking information to better inform 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. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This update will be effective for the Company's reporting period beginning January 1, 2020. We are currently evaluating the potential impact the update will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides guidance on eight statement of cash flow classification issues and is intended to reduce the current and future diversity in practice described in the amendments. Current GAAP is either unclear or does not include specific guidance on the eight statement of cash flow classification issues included in ASU 2016-15. ASU 2016-15 is effective for the Company's reporting period beginning January 1, 2018. Early adoption is permitted, provided that all of the amendments are adopted in the same period. We do not plan to early adopt ASU 2016-15. The amendments in ASU 2016-15 should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. Among other things, the update clarifies the appropriate classification for proceeds from settlement of bank owned life insurance ("BOLI") policies. Based on preliminary evaluation, our current practice is consistent with the update and we thus do not expect the update to have a reclassification impact. Additionally, we do not expect other changes in classification resulting from this update to be significant.

3. INVESTMENT SECURITIES

A summary of held-to-maturity and available-for-sale investment securities are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2017				
Held-to-Maturity:				
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities	$112,053	$ 110	$ (1,839)	$110,324
Commercial - U.S. Government-sponsored entities	92,535	475	—	93,010
Total	$204,588	$ 585	$ (1,839)	$203,334
Available-for-Sale:				
Debt securities:				
States and political subdivisions	$182,853	$ 3,350	$ (521)	$185,682
Corporate securities	92,827	1,325	(80)	94,072
U.S. Treasury obligations and direct obligations of U.S Government agencies	26,395	114	(3)	26,506
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities	791,720	3,526	(6,908)	788,338
Commercial - U.S. Government agencies and sponsored entities	32,659	73	(184)	32,548
Residential - Non-government agencies	48,420	773	(239)	48,954
Commercial - Non-government agencies	135,153	3,945	(112)	138,986
Other	694	115	—	809
Total	$1,310,721	$ 13,221	$ (8,047)	$1,315,895

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2016				
Held-to-Maturity:				
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities	$124,082	$ 92	$(2,474)	$121,700
Commercial - U.S. Government-sponsored entities	93,586	—	(920)	92,666
Total	$217,668	$ 92	$(3,394)	$214,366
Available-for-Sale:				
Debt securities:				
States and political subdivisions	$184,836	$ 2,002	$(1,797)	$185,041
Corporate securities	98,596	974	(181)	99,389
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities	775,803	3,698	(9,515)	769,986
Residential - Non-government agencies	51,681	627	(761)	51,547
Commercial - Non-government agencies	135,248	2,387	(411)	137,224
Other	564	96	—	660
Total	$1,246,728	$ 9,784	$(12,665)	$1,243,847

The amortized cost and estimated fair value of investment securities at June 30, 2017 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2017	
(dollars in thousands)	Amortized Cost	Fair Value
Held-to-Maturity:		
Mortgage-backed securities:		
Residential - U.S. Government-sponsored entities	$112,053	$110,324
Commercial - U.S. Government-sponsored entities	92,535	93,010
Total	$204,588	$203,334
Available-for-Sale:		
Due in one year or less	$8,807	$8,866
Due after one year through five years	144,860	146,731
Due after five years through ten years	53,401	54,410
Due after ten years	95,007	96,253
Mortgage-backed securities:		
Residential - U.S. Government-sponsored entities	791,720	788,338
Commercial - U.S. Government agencies and sponsored entities	32,659	32,548
Residential - Non-government agencies	48,420	48,954
Commercial - Non-government agencies	135,153	138,986
Other	694	809
Total	$1,310,721	$1,315,895

In the second quarter of 2017, we completed an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. In connection with the repositioning, we sold $97.7 million in lower-yielding available-for-sale securities, and purchased $97.4 million in higher yielding, longer duration investment securities. The investment securities sold had a duration of 3.3 and an average yield of 1.91%. Gross proceeds of the sale of $96.0 million were immediately reinvested back into investment securities with a duration of 4.6 and an average yield of 2.57%. The new securities were classified in the available-for-sale portfolio. There were no gross realized gains on the sale of the investment securities. Gross realized losses on the sale of the investment securities were $1.6 million. The specific identification method was used as the basis for determining the cost of all securities sold. We did not sell any available-for-sale securities during the three months ended March 31, 2017. We also did not sell any available-for-sale securities during the six months ended June 30, 2016.

Investment securities of $1.02 billion and $1.05 billion at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public funds on deposit and other long-term debt and short-term borrowings.

Provided below is a summary of the 138 and 242 investment securities which were in an unrealized loss position at June 30, 2017 and December 31, 2016, respectively, segregated by continuous length of impairment.

(dollars in thousands)	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017						
Debt securities:						
States and political subdivisions	$ 38,303	$ (497)	$ 1,126	$ (24)	$ 39,429	$ (521)
Corporate securities	—	—	5,353	(80)	5,353	(80)
U.S. Treasury obligations and direct obligations of U.S Government agencies	3,380	(3)	—	—	3,380	(3)
Mortgage-backed securities:						
Residential - U.S. Government-sponsored entities	547,203	(8,383)	10,747	(364)	557,950	(8,747)
Residential - Non-government agencies	10,506	(239)	—	—	10,506	(239)
Commercial - U.S. Government agencies and sponsored entities	11,548	(184)	—	—	11,548	(184)
Commercial - Non-government agencies	9,498	(112)	—	—	9,498	(112)
Total temporarily impaired securities	$ 620,438	$ (9,418)	$ 17,226	$ (468)	$ 637,664	$ (9,886)

(dollars in thousands)	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016						
Debt securities:						
States and political subdivisions	$ 85,288	$ (1,797)	$ —	$ —	$ 85,288	$ (1,797)
Corporate securities	20,357	(181)	—	—	20,357	(181)
Mortgage-backed securities:						
Residential - U.S. Government-sponsored entities	648,923	(11,766)	3,978	(223)	652,901	(11,989)
Residential - Non-government agencies	30,596	(761)	—	—	30,596	(761)
Commercial - U.S. Government-sponsored entities	92,666	(920)	—	—	92,666	(920)
Commercial - Non-government agencies	52,880	(411)	—	—	52,880	(411)
Total temporarily impaired securities	$ 930,710	$ (15,836)	$ 3,978	$ (223)	$ 934,688	$ (16,059)

Other-Than-Temporary Impairment ("OTTI")

Unrealized losses for all investment securities are reviewed to determine whether the losses are deemed "other-than-temporary." Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. In conducting this assessment, we evaluate a number of factors including, but not limited to:

- The length of time and the extent to which fair value has been less than the amortized cost basis;

- Adverse conditions specifically related to the security, an industry, or a geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating changes by a rating agency; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for anticipated credit losses.

Because we have no intent to sell securities in an unrealized loss position and it is not more likely than not that we will be required to sell such securities before recovery of its amortized cost basis, we do not consider our investments to be other-than-temporarily impaired.

4. LOANS AND LEASES

Loans and leases, excluding loans held for sale, consisted of the following:

(dollars in thousands)	June 30, 2017	December 31, 2016
Commercial, financial and agricultural	$499,693	$ 509,987
Real estate:		
Construction	94,324	101,729
Residential mortgage	1,246,159	1,213,983
Home equity	394,721	361,210
Commercial mortgage	896,221	886,615
Consumer:		
Automobiles	256,858	212,926
Other consumer	201,392	235,684
Leases	523	677
Gross loans and leases	3,589,891	3,522,811
Net deferred costs	1,844	2,079
Total loans and leases, net of deferred costs	$3,591,735	$ 3,524,890

During the six months ended June 30, 2017, we foreclosed on one loan totaling $0.1 million. We did not transfer any loans to the held-for-sale category. In addition, we did not sell any portfolio loans during the six months ended June 30, 2017.

During the six months ended June 30, 2016, we foreclosed on one portfolio loan totaling $0.5 million. We did not transfer any loans to the held-for-sale category. In addition, we did not sell any portfolio loans during the six months ended June 30, 2016.

In May 2017, we purchased an indirect auto loan portfolio totaling $26.6 million which included a $0.9 million premium over the $25.7 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 77 months and a weighted average yield, net of the premium paid and servicing costs, of 2.67%.

In March 2017, we purchased a direct auto loan portfolio totaling $24.1 million which included a $0.4 million premium over the $23.8 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 55 months and a weighted average yield, net of the premium paid and servicing costs, of 2.60%.

In May 2016, we purchased an indirect auto loan portfolio totaling $18.0 million which included a $0.5 million premium over the $17.5 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 75 months and a weighted average yield, net of the premium paid and servicing costs, of 2.50%. During the second quarter of 2016, we also purchased unsecured consumer loans totaling $6.9 million, which represented the outstanding balance at the time of purchases. At the time of purchases, the unsecured consumer loans had a weighted average remaining term of 37 months and a weighted average yield net of servicing costs of 5.57%.

In March 2016, we purchased a direct auto loan portfolio totaling $23.2 million which included a $0.3 million premium over the $22.9 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 56 months and a weighted average yield, net of the premium paid and servicing costs, of 2.63%. During the first quarter of 2016, we also purchased unsecured consumer loans totaling $28.8 million, which represented the outstanding balance at the time of purchases. At the time of purchases, the unsecured consumer loans had a weighted average remaining term of 38 months and a weighted average yield net of servicing costs of 5.55%.

Impaired Loans

The following tables present by class, the balance in the allowance for loan and lease losses (the "Allowance") and the recorded investment in loans and leases based on the Company's impairment measurement method as of June 30, 2017 and December 31, 2016:

Real Estate