

C & F FINANCIAL CORP
Form 10-Q
November 07, 2018
Table of Contents

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 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 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia 54-1680165
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

802 Main Street West Point, VA 23181
(Address of principal executive offices) (Zip Code)

(804) 843-2360

(Registrant's telephone number, including area code)

N/A

(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 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 the 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 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

At November 5, 2018, the latest practicable date for determination, 3,501,741 shares of common stock, \$1.00 par value, of the registrant were outstanding.

Table of Contents

TABLE OF CONTENTS

<u>PART I - Financial Information</u>		Page
<u>Item 1.</u>	Financial Statements	3
	Consolidated Balance Sheets – September 30, 2018 (unaudited) and December 31, 2017	3
	Consolidated Statements of Income (unaudited) – Three and nine months ended September 30, 2018 and 2017	4
	Consolidated Statements of Comprehensive Income (unaudited) – Three and nine months ended September 30, 2018 and 2017	5
	Consolidated Statements of Shareholders' Equity (unaudited) – Nine months ended September 30, 2018 and 2017	6
	Consolidated Statements of Cash Flows (unaudited) – Nine months ended September 30, 2018 and 2017	7
	Notes to Consolidated Financial Statements (unaudited)	8
<u>Item 2.</u>	Management's Discussion and Analysis of Financial Condition and Results of Operations	33
<u>Item 3.</u>	Quantitative and Qualitative Disclosures About Market Risk	59
<u>Item 4.</u>	Controls and Procedures	59
<u>PART II - Other Information</u>		
<u>Item 1A.</u>	Risk Factors	59
<u>Item 2.</u>	Unregistered Sales of Equity Securities and Use of Proceeds	59
<u>Item 6.</u>	Exhibits	60
	Signatures	61

Table of Contents

Part I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except for per share amounts)

	September 30, 2018 (unaudited)	December 31, 2017 *
Assets		
Cash and due from banks	\$ 12,440	\$ 14,070
Interest-bearing deposits in other banks	96,709	105,353
Total cash and cash equivalents	109,149	119,423
Securities—available for sale at fair value, amortized cost of \$220,753 and \$218,168, respectively	217,114	218,976
Loans held for sale, at fair value	45,979	55,384
Loans, net of allowance for loan losses of \$34,959 and \$35,726, respectively	1,002,423	992,062
Restricted stock, at cost	3,247	3,298
Corporate premises and equipment, net	37,053	36,969
Other real estate owned, net of valuation allowance of \$57 and \$57, respectively	188	168
Accrued interest receivable	7,354	7,589
Goodwill	14,425	14,425
Core deposit and other amortizable intangible assets, net	1,234	1,594
Bank-owned life insurance	15,869	15,589
Net deferred tax asset	12,953	12,093
Other assets	32,616	31,486
Total assets	\$ 1,499,604	\$ 1,509,056
Liabilities		
Deposits		
Noninterest-bearing demand deposits	\$ 276,298	\$ 247,669
Savings and interest-bearing demand deposits	535,915	575,807
Time deposits	346,242	347,953
Total deposits	1,158,455	1,171,429
Short-term borrowings	15,030	20,621
Long-term borrowings	119,529	122,029
Trust preferred capital notes	25,237	25,210
Accrued interest payable	916	838

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Other liabilities	30,778	27,227
Total liabilities	1,349,945	1,367,354

Commitments and contingent liabilities (Note 9)

Shareholders' Equity

Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,503,399 and 3,495,845 shares issued and outstanding, respectively, includes 132,905 and 137,880 of unvested shares, respectively)	3,370	3,358
Additional paid-in capital	13,619	12,800
Retained earnings	137,851	127,431
Accumulated other comprehensive loss, net	(5,181)	(1,887)
Total shareholders' equity	149,659	141,702
Total liabilities and shareholders' equity	\$ 1,499,604	\$ 1,509,056

* Derived from audited consolidated financial statements.

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except for per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest income				
Interest and fees on loans	\$ 21,673	\$ 20,971	\$ 63,116	\$ 62,036
Interest on interest-bearing deposits and federal funds sold	527	314	1,544	801
Interest and dividends on securities				
U.S. government agencies and corporations	90	89	265	253
Mortgage-backed securities	528	380	1,516	1,088
Tax-exempt obligations of states and political subdivisions	675	773	2,086	2,453
Taxable obligations of states and political subdivisions	84	64	229	176
Corporate bonds and other	114	112	330	340
Total interest income	23,691	22,703	69,086	67,147
Interest expense				
Savings and interest-bearing deposits	411	292	1,123	860
Time deposits	1,020	907	2,957	2,634
Borrowings	1,081	992	3,102	2,750
Trust preferred capital notes	291	300	861	862
Total interest expense	2,803	2,491	8,043	7,106
Net interest income	20,888	20,212	61,043	60,041
Provision for loan losses	2,400	4,435	7,700	11,935
Net interest income after provision for loan losses	18,488	15,777	53,343	48,106
Noninterest income				
Gains on sales of loans	1,752	2,156	6,399	6,718
Service charges on deposit accounts	1,031	1,178	3,121	3,356
Other service charges and fees	1,296	1,327	3,900	3,951
Net gains on calls of available for sale securities	5	2	9	10
Wealth management services income, net	441	382	1,325	1,132
Interchange income	981	850	2,868	2,559
Other	1,121	947	2,692	2,805
Total noninterest income	6,627	6,842	20,314	20,531
Noninterest expenses				

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Salaries and employee benefits	10,967	10,854	32,773	32,838
Occupancy	2,207	1,908	6,262	5,756
Other	5,500	5,609	16,939	16,156
Total noninterest expenses	18,674	18,371	55,974	54,750
Income before income taxes	6,441	4,248	17,683	13,887
Income tax expense	1,340	1,231	3,620	4,000
Net income	\$ 5,101	\$ 3,017	\$ 14,063	\$ 9,887
Net income per share - basic	\$ 1.46	\$ 0.87	\$ 4.02	\$ 2.84
Net income per share - assuming dilution	\$ 1.46	\$ 0.87	\$ 4.02	\$ 2.84
Weighted average number of shares outstanding - basic	3,503,371	3,487,170	3,502,550	3,485,725
Weighted average number of shares outstanding - assuming dilution	3,503,371	3,487,170	3,502,550	3,485,830

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$ 5,101	\$ 3,017	\$ 14,063	\$ 9,887
Other comprehensive (loss) income:				
Defined benefit plan:				
Reclassification of recognized net actuarial losses into net income ¹	32	41	93	115
Related income tax effects	(7)	(16)	(20)	(41)
Amortization of prior service credit into net income ¹	(16)	(15)	(46)	(45)
Related income tax effects	4	5	10	16
Defined benefit plan, net of tax	13	15	37	45
Cash flow hedges:				
Unrealized holding (losses) gains arising during the period	(5)	57	245	54
Related income tax effects	1	(23)	(63)	(22)
Cash flow hedges, net of tax	(4)	34	182	32
Securities available for sale:				
Unrealized holding (losses) gains arising during the period	(1,252)	(263)	(4,438)	308
Related income tax effects	263	92	932	(108)
Reclassification of net realized gains into net income ²	(5)	(2)	(9)	(10)
Related income tax effects	1	1	2	4
Securities available for sale, net of tax	(993)	(172)	(3,513)	194
Other comprehensive (loss) income, net of tax	(984)	(123)	(3,294)	271
Comprehensive income	\$ 4,117	\$ 2,894	\$ 10,769	\$ 10,158

¹ These items are included in the computation of net periodic benefit cost and are included in “Noninterest income-Other” on the Consolidated Statements of Income. See “Note 6: Employee Benefit Plans,” for additional information.

² These items are included in “Net gains on calls of available for sale securities” on the Consolidated Statements of Income.

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except for per share amounts)

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance December 31, 2017	\$ 3,358	\$ 12,800	\$ 127,431	\$ (1,887)	\$ 141,702
Comprehensive income:					
Net income	—	—	14,063	—	14,063
Other comprehensive loss	—	—	—	(3,294)	(3,294)
Share-based compensation	—	956	—	—	956
Restricted stock vested	15	(15)	—	—	—
Common stock issued	1	106	—	—	107
Common stock purchased	(4)	(228)	—	—	(232)
Cash dividends declared – common stock (\$1.04 per share)	—	—	(3,643)	—	(3,643)
Balance September 30, 2018	\$ 3,370	\$ 13,619	\$ 137,851	\$ (5,181)	\$ 149,659

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance December 31, 2016	\$ 3,331	\$ 11,705	\$ 125,162	\$ (984)	\$ 139,214
Comprehensive income:					
Net income	—	—	9,887	—	9,887
Other comprehensive income	—	—	—	271	271
Stock options exercised	2	81	—	—	83
Share-based compensation	—	1,075	—	—	1,075
Restricted stock vested	17	(17)	—	—	—
Common stock issued	3	109	—	—	112
Common stock purchased	(4)	(181)	—	—	(185)
	—	—	(3,451)	—	(3,451)

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Cash dividends declared – common stock
(\$0.99 per share)

Balance September 30, 2017	\$ 3,349	\$ 12,772	\$ 131,598	\$ (713)	\$ 147,006
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See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net income	\$ 14,063	\$ 9,887
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,345	2,034
Provision for loan losses	7,700	11,935
Provision for indemnifications	53	140
Share-based compensation	956	1,075
Pension expense	315	470
Pension contribution	(3,000)	(1,500)
Net accretion of certain acquisition-related discounts	(2,329)	(1,319)
Accretion of discounts and amortization of premiums on securities, net	1,349	1,236
Amortization of intangible assets	360	527
Net realized gains on calls of securities available for sale	(9)	(10)
Net realized gains on sales of other real estate owned	—	(10)
Net realized gains on sale of corporate premises and equipment	(205)	(16)
Income from bank-owned life insurance	(248)	(253)
Origination of loans held for sale	(538,704)	(556,829)
Proceeds from sales of loans held for sale	554,508	566,197
Gains on sales of loans held for sale	(6,399)	(6,718)
Change in other assets and liabilities:		
Accrued interest receivable	235	156
Other assets	2,501	(434)
Accrued interest payable	78	103
Other liabilities	2,644	(1,002)
Net cash provided by operating activities	36,213	25,669
Investing activities:		
Proceeds from maturities and calls of securities available for sale and payments on mortgage-backed securities	35,267	33,960
Purchases of securities available for sale	(39,192)	(33,855)
Net proceeds from sales (purchases) of restricted stock	51	(40)
Purchases of loans held for investment by non-bank affiliates	(103,759)	(91,267)
Repayments on loans held for investment by non-bank affiliates	87,644	88,907
Net decrease (increase) in retail banking loans held for investment	471	(34,737)
Proceeds from sales of other real estate owned	—	245
Purchases of corporate premises and equipment	(2,447)	(2,404)
Proceeds from sales of corporate premises and equipment	223	53
Net cash used in investing activities	(21,742)	(39,138)

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Financing activities:

Net (decrease) increase in demand, interest-bearing demand and savings deposits	(11,263)	23,372
Net decrease in time deposits	(1,711)	(672)
Net (decrease) increase in short-term borrowings	(5,591)	1,293
Repayments of long-term borrowings	(2,500)	—
Issuance of common stock	107	112
Proceeds from exercise of stock options	—	83
Cash dividends paid	(3,643)	(3,451)
Other financing activities	(144)	—
Net cash (used in) provided by financing activities	(24,745)	20,737
Net (decrease) increase in cash and cash equivalents	(10,274)	7,268
Cash and cash equivalents at beginning of period	119,423	103,201
Cash and cash equivalents at end of period	\$ 109,149	\$ 110,469
Supplemental disclosure		
Interest paid	\$ 7,938	\$ 6,976
Income taxes paid	190	4,616
Supplemental disclosure of noncash investing and financing activities		
Unrealized (losses) gains on securities available for sale	\$ (4,447)	\$ 298
Transfers from loans to other real estate owned	20	208
Value of shares withheld at vesting for employee taxes	232	185
Unrealized gains on cash flow hedging instruments	245	54

See notes to consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

Principles of Consolidation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2017.

The unaudited consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation) and its wholly-owned subsidiary, Citizens and Farmers Bank (the Bank or C&F Bank). All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, the Corporation owns C&F Financial Statutory Trust I, C&F Financial Statutory Trust II and Central Virginia Bankshares Statutory Trust I, all of which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as liabilities of the Corporation. The accounting and reporting policies of C&F Financial Corporation and Subsidiary conform to U.S. GAAP and to predominant practices within the banking industry.

Nature of Operations: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia.

C&F Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (C&F Wealth Management), C&F Insurance Services, Inc. and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Finance, acquired on September 1, 2002, is a finance company purchasing automobile, boat and recreational vehicle (RV) loans through indirect lending programs. C&F Wealth Management, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through third-party service providers. C&F Insurance Services, Inc. was organized in July 1999 for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity interest in a full service title and

settlement agency. Business segment data is presented in Note 8.

Basis of Presentation: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the allowance for indemnifications, impairment of loans, impairment of securities, the valuation of other real estate owned (OREO), the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made.

Reclassification: Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation. None of these reclassifications are considered material.

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. The Corporation's derivative financial instruments include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be sold in the secondary market on a best efforts basis and the related forward commitments to sell mortgage loans, (2) interest rate swaps with certain qualifying

Table of Contents

commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify and are designated as cash flow hedges on the Corporation's trust preferred capital notes. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in the fair value of these instruments are reported as noninterest income or noninterest expense, as applicable. The gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings. The Corporation's derivative financial instruments are described more fully in Note 10.

Share-Based Compensation: Shared-based compensation expense, net of forfeitures, for the third quarter of 2018 and the first nine months of 2018 was \$316,000 (\$235,000 after tax) and \$956,000 (\$710,000 after tax), respectively, for restricted stock granted during 2013 through 2018. As of September 30, 2018, there was \$2.65 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

A summary of activity for restricted stock awards during the first nine months of 2018 and 2017 is presented below:

	2018	
	Shares	Weighted-Average Grant Date Fair Value
Unvested, December 31, 2017	137,880	\$ 43.52
Granted	11,610	58.30
Vested	(14,625)	40.47
Forfeited	(1,960)	43.26
Unvested, September 30, 2018	132,905	45.14

	2017	
	Shares	Weighted-Average Grant Date Fair Value
Unvested, December 31, 2016	141,755	\$ 39.77
Granted	15,725	45.46
Vested	(17,260)	35.40

Forfeited	(1,690)	43.16
Unvested, September 30, 2017	138,530	40.91

Recently Adopted Accounting Pronouncements:

On January 1, 2018, the Corporation adopted Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)," and all amendments thereto (collectively, ASU 2014-09), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain/loss from the transfer of nonfinancial assets, such as OREO. The Corporation adopted ASU 2014-09 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-09, while prior period amounts continue to be reported in accordance with pronouncements in effect prior to January 1, 2018. The adoption of ASU 2014-09 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effect adjustment was recorded.

Table of Contents

Most revenue associated with the Corporation's financial instruments, including interest income and gains/losses on investment securities, derivatives and sales of financial instruments are outside the scope of ASU 2014-09. The Corporation's services that fall within the scope of ASU 2014-09 are presented within noninterest income and are recognized as revenue as the Corporation satisfies its obligation to the customer. A description of the Corporation's primary revenue streams accounted for under ASU 2014-09 follows:

Service Charges on Deposit Accounts. The Corporation earns fees from its deposit customers for overdraft and account maintenance services. Overdraft fees are recognized when the overdraft occurs. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation.

Other Service Charges and Fees. The Corporation earns fees from its customers for transaction-based services. Such services include safe deposit box, ATM, stop payment and wire transfer fees at the retail banking segment and on-line payment processing and statement request fees at the consumer finance segment. In each case, these service charges and fees are recognized in income at the time or within the same period that the Corporation's performance obligation is satisfied.

Interchange Income. The Corporation earns interchange fees from debit and affinity credit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services.

Wealth Management Services Income. The Corporation earns wealth management services income by providing investment brokerage services and health and life insurance products to its customers through third-party service providers. Fees that are transaction-based (e.g., execution of trades) are recognized on a monthly basis. Other fees, or commissions, are earned over time as the contracted monthly or quarterly services are provided and are generally assessed based on either account activity or the market value of assets under management at month or quarter end.

Gains/Losses on Sales of OREO. The Corporation records a gain/loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform the obligations under the contract and whether collectability of the transaction price is probable. In determining the gain/loss on the sale, the Corporation adjusts the transaction price and the related gain/loss on sale if a significant financing component is present.

On January 1, 2018, the Corporation adopted ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 makes targeted improvements to several areas of U.S. GAAP including the disclosure of the fair value of financial instruments that are not measured at fair value on a recurring basis. The new guidance, among other things, (i) eliminates the requirements to disclose the methods and significant assumptions used to estimate the fair value and the description of the changes therein, if any, during the period, (ii) requires the use of the exit price notion in calculating the fair values of financial instruments not measured at fair value on a recurring basis and (iii) eliminates the guidance that allowed the use of the entry price notion to calculate the fair value of certain financial instruments, such as loans and long-term debt. Accordingly, the Corporation began disclosing the fair value of these financial instruments using an exit price notion rather than an entry price notion in the first quarter of 2018 (see “Note 7: Fair Value of Assets and Liabilities”).

On January 1, 2018, the Corporation adopted ASU 2017-07, “Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” ASU 2017-07 requires that the service cost component of the net periodic benefit cost be presented with other employee compensation costs and that the remaining components be presented in the aggregate with noninterest income or noninterest expense, as appropriate. This guidance is required to be applied on a retrospective basis. Accordingly, income of \$116,000 and \$370,000 was reclassified from “Salaries and employee benefits” to “Noninterest income – Other” on the Consolidated Statements of Income for the three and nine months ended September 30, 2017, respectively.

Table of Contents

In the third quarter of 2018, the Corporation adopted ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” ASU 2017-12 improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements by expanding the types of risk management activities to which hedge accounting can be applied and by simplifying its application. As a result of the adoption of ASU 2017-12, any ineffectiveness in qualifying and designated cash flow hedging relationships will be recorded in other comprehensive income rather than in earnings. The adoption of ASU 2017-12 did not have a significant effect on the financial statements, and most of its provisions are effective for the Corporation on a prospective basis.

In the third quarter of 2018, the Corporation adopted ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” which requires all entities that hold investments in callable debt securities at a premium to amortize the premium to the earliest call date. The amendments in ASU 2017-08 were applied on a modified retrospective basis as of January 1, 2018 and did not have a significant effect on the financial statements.

Recent Significant Accounting Pronouncements:

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, “Leases (Topic 842).” Subsequently, this ASU was amended when the FASB issued other updates, including ASU 2018-10, “Codification Improvements to Topic 842, Leases” and ASU 2018-11, “Leases (Topic 842)” (collectively, ASC 842). Among other things in the amendments in ASC 842, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) 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. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in ASC 842 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach by either applying the new guidance as of the beginning of the earliest comparative period presented in the financial statements or by electing an optional transition method that will apply the new guidance as of the beginning of the period of adoption. Under the optional transition method, prior periods will continue to be reported under current guidance. The modified retrospective approach would not require any transition accounting for leases that expired before application date under either method. Lessees and lessors may not apply a full retrospective transition approach.

The Corporation has completed an inventory of its leases, which comprise primarily leases of real estate and office equipment in which the Corporation is the lessee, and all of which are accounted for as operating leases under current guidance. The Corporation will adopt ASC 842 effective January 1, 2019 using the optional transition method. Under

a practical expedient available for transition, the classification of leases will remain the same upon adoption of ASC 842. Upon transition, the Corporation will record a lease liability of approximately \$3 million for its remaining payment obligations as of January 1, 2019 for leases in effect at that time and a corresponding right of use asset. This estimate of the required lease liability is based on leases in effect as of September 30, 2018. The measurement of the lease liability will continue to be refined as the implementation process is completed. The Corporation expects to finalize its controls and procedures for accounting for leases under ASC 842 in the fourth quarter of 2018. Adoption of ASC 842 is not expected to change the pattern of recognition of expense for the Corporation's leases in effect as of September 30, 2018.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," as part of its project on financial instruments. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. For public business entities that are SEC filers, the new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The amendments will be applied on a modified retrospective basis, with the cumulative effect of

Table of Contents

adopting the new standard being recorded as an adjustment to opening retained earnings in the period of adoption. The Corporation has established a working group that is in the process of gathering historical data and evaluating appropriate portfolio segmentation and modeling methods. The Corporation has not yet determined an estimate of the effect that ASU 2016-13 will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, 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 and 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 is effective for public business entities that are SEC filers for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-04 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.” These amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-13 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, “Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans.” These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Certain disclosure requirements have been deleted while the following disclosure requirements have been added: the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments also clarify the disclosure requirements regarding the projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets and the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets. The amendments are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-14 to have a material effect on its consolidated financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not currently expected to have a material effect on the Corporation's financial position, results of operations or cash flows.

NOTE 2: Securities

The Corporation's debt securities, all of which are classified as available for sale, are summarized as follows:

	September 30, 2018			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)				
U.S. government agencies and corporations	\$ 17,011	\$ —	\$ (822)	\$ 16,189
Mortgage-backed securities	106,940	29	(3,239)	103,730
Obligations of states and political subdivisions	96,802	831	(438)	97,195
	\$ 220,753	\$ 860	\$ (4,499)	\$ 217,114

Table of Contents

(Dollars in thousands)	December 31, 2017			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. government agencies and corporations	\$ 16,514	\$ —	\$ (341)	\$ 16,173
Mortgage-backed securities	97,677	142	(761)	97,058
Obligations of states and political subdivisions	103,977	2,022	(254)	105,745
	\$ 218,168	\$ 2,164	\$ (1,356)	\$ 218,976

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

(Dollars in thousands)	September 30, 2018	
	Amortized Cost	Fair Value
Due in one year or less	\$ 53,133	\$ 52,987
Due after one year through five years	150,514	147,076
Due after five years through ten years	11,769	11,711
Due after ten years	5,337	5,340
	\$ 220,753	\$ 217,114

The following table presents the gross realized gains and losses on and the proceeds from maturities, calls and paydowns of securities. There were no sales of securities during the periods presented.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Realized gains and losses from calls of securities:				
Gross realized gains	\$ 5	\$ 2	\$ 10	\$ 14
Gross realized losses	—	—	(1)	(4)
Net realized gains	\$ 5	\$ 2	\$ 9	\$ 10
Proceeds from maturities, calls and paydowns of securities	\$ 12,865	\$ 12,472	\$ 35,267	\$ 33,960

The Corporation pledges securities primarily to secure public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$93.24 million and aggregate fair value of \$91.90 million were pledged at September 30, 2018. Securities with an aggregate amortized cost of \$118.70 million and an aggregate fair value of \$119.26 million were pledged at December 31, 2017.

Table of Contents

Securities in an unrealized loss position at September 30, 2018, by duration of the period of the unrealized loss, are shown below.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	\$ 749	\$ 1	\$ 15,440	\$ 821	\$ 16,189	\$ 822
Mortgage-backed securities	53,707	1,290	44,876	1,949	98,583	3,239
Obligations of states and political subdivisions	27,814	182	12,944	256	40,758	438
Total temporarily impaired securities	\$ 82,270	\$ 1,473	\$ 73,260	\$ 3,026	\$ 155,530	\$ 4,499

There were 270 debt securities totaling \$155.53 million considered temporarily impaired at September 30, 2018. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. Interest rates have increased consistently across the United States Treasury security yield curve during 2018, thereby increasing unrealized losses on the Corporation's debt securities. The Corporation's mortgage-backed securities are entirely issued by either U.S. government agencies or U.S. government-sponsored enterprises. Collectively, these entities provide a guarantee, which is either explicitly or implicitly supported by the full faith and credit of the U.S. government, that investors in such mortgage-backed securities will receive timely principal and interest payments. At September 30, 2018, approximately 97 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated "A" or better by Standard & Poor's (S&P) or Moody's Investors Service (Moody's). Of those in a net unrealized loss position, approximately 99 percent were rated "A" or better by S&P or Moody's, as measured by market value, at September 30, 2018. For the approximately one percent not rated "A" or better, as measured by market value at September 30, 2018, the Corporation considers these to meet regulatory credit quality standards, meaning that the securities have low risk of default by the obligor and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more-likely-than-not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at September 30, 2018 and no other-than-temporary impairment loss has been recognized in net income.

Securities in an unrealized loss position at December 31, 2017, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized

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(Dollars in thousands)	Value	Loss	Value	Loss	Value	Loss
U.S. government agencies and corporations	\$ 2,972	\$ 31	\$ 13,201	\$ 310	\$ 16,173	\$ 341
Mortgage-backed securities	57,116	341	22,545	420	79,661	761
Obligations of states and political subdivisions	18,644	117	9,363	137	28,007	254
Total temporarily impaired securities	\$ 78,732	\$ 489	\$ 45,109	\$ 867	\$ 123,841	\$ 1,356

The Corporation's investment in restricted stock totaled \$3.25 million at September 30, 2018 and consisted of Federal Home Loan Bank (FHLB) stock. Restricted stock is generally viewed as a long-term investment, which is carried at cost because there is no market for the stock other than the FHLBs. Therefore, when evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing any temporary decline in value. The Corporation does not consider its investment in restricted stock to be other-than-temporarily impaired at September 30, 2018 and no impairment has been recognized.

Table of Contents

NOTE 3: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	September 30, 2018	December 31, 2017
Real estate – residential mortgage	\$ 184,362	\$ 184,863
Real estate – construction 1	55,650	44,782
Commercial, financial and agricultural 2	426,310	437,884
Equity lines	55,655	55,237
Consumer	15,464	13,018
Consumer finance	299,941	292,004
	1,037,382	1,027,788
Less allowance for loan losses	(34,959)	(35,726)
Loans, net	\$ 1,002,423	\$ 992,062

¹ Includes the Corporation's real estate construction lending and consumer real estate lot lending.

² Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Consumer loans included \$216,000 and \$290,000 of demand deposit overdrafts at September 30, 2018 and December 31, 2017, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of Central Virginia Bank (CVB) on October 1, 2013 (or acquired loans) that were recorded at fair value at the acquisition date and are included in the Consolidated Balance Sheets are as follows:

(Dollars in thousands)	September 30, 2018			December 31, 2017		
	Acquired Loans - Purchased	Acquired Loans - Performing	Acquired Loans - Total	Acquired Loans - Purchased	Acquired Loans - Performing	Acquired Loans - Total
	\$ 10,253	\$ 40,140	\$ 50,393	\$ 12,856	\$ 45,083	\$ 57,939

Outstanding principal balance						
Carrying amount						
Real estate – residential mortgage	\$ 439	\$ 9,166	\$ 9,605	\$ 492	\$ 10,855	\$ 11,347
Commercial, financial and agricultural ¹	1,593	19,778	21,371	2,472	22,305	24,777
Equity lines	116	9,216	9,332	139	9,621	9,760
Consumer	—	6	6	—	12	12
Total acquired loans	\$ 2,148	\$ 38,166	\$ 40,314	\$ 3,103	\$ 42,793	\$ 45,896

¹ Includes acquired loans classified by the Corporation as commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Table of Contents

Loans on nonaccrual status were as follows:

(Dollars in thousands)	September 30, 2018	December 31, 2017
Real estate – residential mortgage	\$ 611	\$ 830
Commercial, financial and agricultural:		
Commercial real estate lending	1,206	3,796
Commercial business lending	24	34
Equity lines	912	651
Consumer	—	—
Consumer finance	1,025	764
Total loans on nonaccrual status	\$ 3,778	\$ 6,075

The past due status of loans as of September 30, 2018 was as follows:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing ²
Real estate – residential mortgage	\$ 405	\$ —	\$ 294	\$ 699	\$ 439	\$ 183,224	\$ 184,362	\$ 194
Real estate – construction:								
Construction lending	—	—	—	—	—	44,756	44,756	—
Consumer lot lending	—	—	—	—	—	10,894	10,894	—
Commercial, financial and agricultural:								
Commercial real estate lending	65	1,397	315	1,777	1,593	302,413	305,783	315
Land acquisition and development lending	—	—	—	—	—	34,035	34,035	—
Builder line lending	247	—	—	247	—	27,593	27,840	—
Commercial business lending	—	—	24	24	—	58,628	58,652	—
Equity lines	250	186	72	508	116	55,031	55,655	72
Consumer	154	—	—	154	—	15,310	15,464	—
Consumer finance	9,892	1,974	1,025	12,891	—	287,050	299,941	—
Total	\$ 11,013	\$ 3,557	\$ 1,730	\$ 16,300	\$ 2,148	\$ 1,018,934	\$ 1,037,382	\$ 581

¹ For the purposes of the table above, "Current" includes loans that are 1-29 days past due.

² Includes purchased credit impaired (PCI) loans of \$78,000.

The table above includes the following:

- nonaccrual loans that are current of \$942,000, 30-59 days past due of \$218,000, 60-89 days past due of \$1.39 million and 90+ days past due of \$1.23 million.
- performing loans purchased in the acquisition of CVB that are current of \$37.97 million, 30-59 days past due of \$120,000 and 90+ days past due of \$72,000.

16

Table of Contents

The past due status of loans as of December 31, 2017 was as follows:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing ²
Real estate – residential mortgage	\$ 1,905	\$ 14	\$ 245	\$ 2,164	\$ 492	\$ 182,207	\$ 184,863	\$ 90
Real estate – construction:								
Construction lending	—	—	—	—	—	41,449	41,449	—
Consumer lot lending	—	—	—	—	—	3,333	3,333	—
Commercial, financial and agricultural:								
Commercial real estate lending	241	—	3,874	4,115	2,472	297,903	304,490	78
Land acquisition and development lending	—	—	—	—	—	39,844	39,844	—
Builder line lending	685	—	—	685	—	28,911	29,596	—
Commercial business lending	—	—	2	2	—	63,952	63,954	2
Equity lines	550	—	136	686	139	54,412	55,237	136
Consumer	9	—	—	9	—	13,009	13,018	—
Consumer finance	12,273	2,061	764	15,098	—	276,906	292,004	—
Total	\$ 15,663	\$ 2,075	\$ 5,021	\$ 22,759	\$ 3,103	\$ 1,001,926	\$ 1,027,788	\$ 306

¹ For the purposes of the table above, “Current” includes loans that are 1-29 days past due.

² Includes PCI loans of \$90,000.

The table above includes the following:

- nonaccrual loans that are current of \$890,000, 30-59 days past due of \$458,000, 60 - 89 days past due of \$14,000 and 90+ days past due of \$4.71 million.
- performing loans purchased in the acquisition of CVB that are current of \$42.53 million, 30-59 days past due of \$137,000, 60-89 days past due of \$14,000 and 90+ days past due of \$115,000.

Loan modifications that were classified as troubled debt restructurings (TDRs) were as follows:

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(Dollars in thousands)	Three Months Ended September 30, 2018		2017		Pre- Modification Recorded Investment	Post- Modification Recorded Investment
	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Number of Loans		
Real estate – residential mortgage – interest rate concession	—	\$ —	\$ —	2	\$ 365	\$ 365
Consumer – interest rate concession	1	5	5	—	—	—
Total	1	\$ 5	\$ 5	2	\$ 365	\$ 365

(Dollars in thousands)	Nine Months Ended September 30, 2018		2017		Pre- Modification Recorded Investment	Post- Modification Recorded Investment
	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Number of Loans		
Real estate – residential mortgage – interest reduction	—	\$ —	\$ —	2	\$ 365	\$ 365
Commercial, financial and agricultural: Commercial real estate lending – interest rate and term concession	—	—	—	3	4,646	4,646
Commercial real estate lending – interest rate concession	—	—	—	4	2,154	2,154
Consumer – interest rate concession	1	5	5	—	—	—
Total	1	\$ 5	\$ 5	9	\$ 7,165	\$ 7,165

A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. All TDRs are considered impaired loans and are individually evaluated in the determination of the allowance for loan losses. The specific reserve associated with a TDR is reevaluated

Table of Contents

when a TDR payment default occurs. There were no TDR payment defaults during the three and nine months ended September 30, 2018. During the three and nine months ended September 30, 2017, TDR payment defaults occurred on three loans totaling \$4.65 million that were part of a single commercial relationship and were more than 90 days past due.

Impaired loans, which included TDRs of \$6.96 million, and the related allowance at September 30, 2018 were as follows:

	Unpaid Principal	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
(Dollars in thousands)	Balance					
Real estate – residential mortgage	\$ 3,020	\$ 1,153	\$ 1,768	\$ 99	\$ 3,010	\$ 109
Commercial, financial and agricultural:						
Commercial real estate lending	4,245	1,639	2,335	674	4,845	108
Commercial business lending	33	25	—	—	26	—
Equity lines	365	31	327	326	360	1
Consumer	5	—	5	5	5	—
Total	\$ 7,668	\$ 2,848	\$ 4,435	\$ 1,104	\$ 8,246	\$ 218

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2017 were as follows:

	Unpaid Principal	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
(Dollars in thousands)	Balance					
Real estate – residential mortgage	\$ 3,745	\$ 1,603	\$ 2,033	\$ 214	\$ 3,743	\$ 184
Commercial, financial and agricultural:						
Commercial real estate lending	6,981	2,841	4,031	615	7,818	168
Commercial business lending	41	35	—	—	45	—
Equity lines	32	31	—	—	32	2
Consumer	321	322	—	—	321	13

Total	\$ 11,120	\$ 4,832	\$ 6,064	\$ 829	\$ 11,959	\$ 367
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PCI loans had an unpaid principal balance of \$10.25 million and a carrying value of \$2.15 million at September 30, 2018. Determining the fair value of PCI loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the effect of estimated credit losses and is called the nonaccretable difference, and is not recorded. In accordance with U.S. GAAP, there was no carry-over of the previously established allowance for loan losses for acquired loans.

The following table presents a summary of the change in the accretable yield of the PCI loan portfolio:

(Dollars in thousands)	Nine Months Ended	
	September 30, 2018	September 30, 2017
Accretable yield, balance at beginning of period	\$ 7,304	\$ 8,637
Accretion	(2,892)	(2,176)
Reclassification of nonaccretable difference due to improvement in expected cash flows	1,410	1,022
Other changes, net	(324)	306
Accretable yield, balance at end of period	\$ 5,498	\$ 7,789

Table of Contents

NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2018:

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at							
December 31, 2017	\$ 2,371	\$ 605	\$ 7,478	\$ 688	\$ 231	\$ 24,353	\$ 35,726
Provision charged (credited) to operations	(122)	174	(625)	450	123	7,700	7,700
Loans charged off	—	—	(2)	—	(248)	(11,743)	(11,993)
Recoveries of loans previously charged off	52	—	46	—	174	3,254	3,526
Balance at September 30, 2018	\$ 2,301	\$ 779	\$ 6,897	\$ 1,138	\$ 280	\$ 23,564	\$ 34,959

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2017: