CITY HOLDING CO
Form 10-Q
May 03, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended March 31, 2018
OR
[ ] TRANSITION REPORT PURSANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Transition Period From ____________To_____________.

Commission File Number 0-11733
CITY HOLDING COMPANY
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| West Virginia | 55-0619957 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|---|---|
| 25 Gatewater Road | |
| Charleston, West Virginia | 25313 |
| (Address of principal executive offices) | (Zip Code) |

(304) 769-1100
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer [X] Accelerated filer [ ]

Non-accelerated filer [ ] Smaller reporting company [ ]

Emerging growth company [ ]

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.
Common stock, $2.50 Par Value – 15,434,993 shares as of April 30, 2018.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management’s Discussion and Analysis of Financial Condition and Results of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing materially from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to, (1) the Company may incur additional loan loss provision due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company could have adverse legal actions of a material nature; (4) the Company may face competitive loss of customers; (5) the Company may be unable to manage its expense levels; (6) the Company may have difficulty retaining key employees; (7) changes in the interest rate environment may have results on the Company’s operations materially different from those anticipated by the Company’s market risk management functions; (8) changes in general economic conditions and increased competition could adversely affect the Company’s operating results; (9) changes in regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company’s operating results; (10) the Company may experience difficulties growing loan and deposit balances; (11) deterioration in the financial condition of the U.S. banking system may impact the valuations of investments the Company has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; (12) the effects of the Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the regulations promulgated and to be promulgated thereunder, which may subject the Company and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses; (13) the impact of new minimum capital thresholds established as a part of the implementation of Basel III; and (14) other risk factors relating to the banking industry or the Company as detailed from time to time in the Company’s reports filed with the Securities and Exchange Commission, including those risk factors included in the disclosures under the heading “Item 1A Risk Factors” of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.  Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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City Holding Company and Subsidiaries

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Part I - FINANCIAL INFORMATION

Item 1 - Financial Statements

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Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands)

| | (Unaudited) March 31, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $97,495 | $54,450 |
| Interest-bearing deposits in depository institutions | 26,283 | 28,058 |
| Cash and Cash Equivalents | 123,778 | 82,508 |
| | | |
| Investment securities available for sale, at fair value | 545,628 | 550,389 |
| Investment securities held-to-maturity, at amortized cost (approximate fair value at March 31, 2018 and December 31, 2017 - $62,146 and $65,646, respectively) | 62,277 | 64,449 |
| Other securities | 22,165 | 14,147 |
| Total Investment Securities | 630,070 | 628,985 |
| | | |
| Gross loans | 3,137,681 | 3,127,410 |
| Allowance for loan losses | (18,381) | (18,836) |
| Net Loans | 3,119,300 | 3,108,574 |
| | | |
| Bank owned life insurance | 104,052 | 103,440 |
| Premises and equipment, net | 72,920 | 72,682 |
| Accrued interest receivable | 9,528 | 9,223 |
| Net deferred tax asset | 14,467 | 11,913 |
| Goodwill and other intangible assets, net | 78,468 | 78,595 |
| Other assets | 47,432 | 36,361 |
| Total Assets | $4,200,015 | $4,132,281 |
| | | |
| Liabilities | | |
| Deposits: | | |
| Noninterest-bearing | $703,209 | $666,639 |
| Interest-bearing: | | |
| Demand deposits | 816,976 | 769,245 |
| Savings deposits | 816,245 | 796,275 |
| Time deposits | 1,110,532 | 1,083,475 |
| Total Deposits | 3,446,962 | 3,315,634 |
| | | |
| Short term borrowings: | | |
| Federal funds purchased | — | 54,000 |
| Customer repurchase agreements | 195,375 | 198,219 |
| Long-term debt | 16,495 | 16,495 |
| Other liabilities | 49,306 | 45,426 |
| Total Liabilities | 3,708,138 | 3,629,774 |
| Shareholders’ Equity | | |
| Preferred stock, par value $25 per share: 500,000 shares authorized; none issued | — | — |
| Common stock, par value $2.50 per share: 50,000,000 shares authorized; 19,047,548 shares issued at March 31, 2018 and December 31, 2017, less 3,608,051 and 3,429,519 shares in treasury, respectively | 47,619 | 47,619 |

| | | |
|---|---|---|
| Capital surplus | 140,547 | 140,960 |
| Retained earnings | 457,650 | 444,481 |
| Cost of common stock in treasury | (137,420) | (124,909) |
| Accumulated other comprehensive income (loss): | | |
| Unrealized (loss) on securities available-for-sale | (11,486) | (611) |
| Underfunded pension liability | (5,033) | (5,033) |
| Total Accumulated Other Comprehensive Income (Loss) | (16,519) | (5,644) |
| Total Shareholders' Equity | 491,877 | 502,507 |
| Total Liabilities and Shareholders' Equity | $4,200,015 | $4,132,281 |

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands, except earnings per share data)

| Interest Income | Three months ended March 31, 2018 | 2017 |
|---|---|---|
| Interest and fees on loans | $32,918 | $30,104 |
| Interest and dividends on investment securities: | | |
| Taxable | 3,981 | 3,444 |
| Tax-exempt | 703 | 663 |
| Interest on deposits in depository institutions | 42 | 3 |
| Total Interest Income | 37,644 | 34,214 |
| | | |
| Interest Expense | | |
| Interest on deposits | 4,326 | 3,429 |
| Interest on short-term borrowings | 460 | 157 |
| Interest on long-term debt | 211 | 181 |
| Total Interest Expense | 4,997 | 3,767 |
| Net Interest Income | 32,647 | 30,447 |
| Provision for loan losses | 181 | 681 |
| Net Interest Income After Provision for Loan Losses | 32,466 | 29,766 |
| | | |
| Non-Interest Income | | |
| Net gains on sale of investment securities | — | 4,276 |
| Service charges | 6,862 | 6,730 |
| Bankcard revenue | 4,334 | 4,140 |
| Trust and investment management fee income | 1,568 | 1,386 |
| Bank owned life insurance | 821 | 1,229 |
| Other income | 907 | 746 |
| Total Non-Interest Income | 14,492 | 18,507 |
| | | |
| Non-Interest Expense | | |
| Salaries and employee benefits | 13,151 | 12,948 |
| Occupancy related expense | 2,404 | 2,473 |
| Equipment and software related expense | 1,831 | 1,890 |
| FDIC insurance expense | 315 | 375 |
| Advertising | 787 | 733 |
| Bankcard expenses | 1,076 | 943 |
| Postage, delivery, and statement mailings | 578 | 555 |
| Office supplies | 313 | 361 |
| Legal and professional fees | 450 | 449 |
| Telecommunications | 500 | 484 |
| Repossessed asset losses, net of expenses | 370 | 336 |
| Other expenses | 3,162 | 3,053 |
| Total Non-Interest Expense | 24,937 | 24,600 |
| Income Before Income Taxes | 22,021 | 23,673 |
| Income tax expense | 4,405 | 7,647 |
| Net Income Available to Common Shareholders | $17,616 | $16,026 |

| | | |
|---|---|---|
| Total Comprehensive Income | $9,398 | $16,899 |

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| | | |
|---|---|---|
| Average shares outstanding, basic | 15,414 | 15,252 |
| Effect of dilutive securities | 22 | 25 |
| Average shares outstanding, diluted | 15,436 | 15,277 |
| | | |
| Basic earnings per common share | $ 1.13 | $ 1.04 |
| Diluted earnings per common share | $ 1.13 | $ 1.04 |
| Dividends declared per common share | $ 0.46 | $ 0.44 |

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Net income | $17,616 | $16,026 |
| Unrealized (losses) gains on available-for-sale securities arising during the period | (10,712) | 5,660 |
| Reclassification adjustment for gains | — | (4,276) |
| Other comprehensive (loss) income before income taxes | (10,712) | 1,384 |
| Tax effect | 2,494 | (511) |
| Other comprehensive income (loss), net of tax | (8,218) | 873 |
| Comprehensive Income, Net of Tax | $9,398 | $16,899 |

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Three Months Ended March 31, 2018 and 2017
(in thousands)

| | Common Stock | Capital Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2016 | $46,518 | $112,873 | $417,017 | $(126,958) | $ (7,012) | $ 442,438 |
| Net income | — | — | 16,026 | — | — | 16,026 |
| Other comprehensive income | — | — | — | — | 873 | 873 |
| Cash dividends declared ($0.44 per share) | — | — | (6,917) | — | — | (6,917) |
| Stock-based compensation expense | — | 780 | — | — | — | 780 |
| Restricted awards granted | — | (638) | — | 638 | — | — |
| Issuance of 440,604 shares of common stock | 1,101 | 27,307 | — | — | — | 28,408 |
| Exercise of 1,250 stock options | — | (17) | — | 55 | — | 38 |
| Balance at March 31, 2017 | $47,619 | $140,305 | $426,126 | $(126,265) | $ (6,139) | $ 481,646 |

| | Common Stock | Capital Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2017 | $47,619 | $140,960 | $444,481 | $(124,909) | $ (5,644) | $ 502,507 |
| Net income | — | — | 17,616 | — | — | 17,616 |
| Other comprehensive income | — | — | — | — | (8,218) | (8,218) |
| Adoption of new accounting pronouncement (see Note B) | | | 2,657 | | (2,657) | — |
| Cash dividends declared ($0.46 per share) | — | — | (7,104) | — | — | (7,104) |
| Stock-based compensation expense | — | 793 | — | — | — | 793 |
| Restricted awards granted | — | (1,135) | — | 1,135 | — | — |
| Exercise of 7,388 stock options | — | (71) | — | 351 | — | 280 |
| Purchase of 204,327 treasury shares | — | — | — | (13,997) | — | (13,997) |
| Balance at March 31, 2018 | $47,619 | $140,547 | $457,650 | $(137,420) | $ (16,519) | $ 491,877 |

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

| | Three months ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Net income | $17,616 | $16,026 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Accretion and amortization | 410 | 361 |
| Provision for loan losses | 181 | 681 |
| Depreciation of premises and equipment | 1,270 | 1,525 |
| Deferred income tax expense | 287 | 2,931 |
| Net periodic employee benefit cost | 111 | 114 |
| Realized investment securities gains | — | (4,276) |
| Stock-compensation expense | 793 | 780 |
| Excess tax benefit from stock-compensation expense | (155) | (189) |
| Proceeds from life insurance | 210 | 1,137 |
| Increase in value of bank-owned life insurance | (612) | (749) |
| Loans originated for sale | (2,606) | (3,951) |
| Proceeds from the sale of loans originated for sale | 2,874 | 6,118 |
| Gain on sale of loans | (79) | (167) |
| Change in accrued interest receivable | (305) | (236) |
| Change in other assets | (11,128) | (131) |
| Change in other liabilities | 3,504 | 383 |
| Net Cash Provided by Operating Activities | 12,371 | 20,357 |
| | | |
| Proceeds from sales of securities available-for-sale | — | 5,576 |
| Proceeds from maturities and calls of securities available-for-sale | 21,230 | 23,390 |
| Proceeds from maturities and calls of securities held-to-maturity | 2,142 | 2,823 |
| Purchases of securities available-for-sale | (35,721) | (39,747) |
| Net increase in loans | (10,827) | (30,826) |
| Purchases of premises and equipment | (1,561) | (2,111) |
| Disposals of premises and equipment | 55 | 1,781 |
| Net Cash (Used in) Investing Activities | (24,682) | (39,114) |
| | | |
| Net increase in non-interest-bearing deposits | 36,570 | 42,505 |
| Net increase in interest-bearing deposits | 94,758 | 118,616 |
| Net (decrease) in short-term borrowings | (56,844) | (61,619) |
| Proceeds from issuance of common stock | — | 28,408 |
| Purchases of treasury stock | (13,997) | — |
| Proceeds from exercise of stock options | 280 | 38 |
| Dividends paid | (7,186) | (6,518) |
| Net Cash Provided by Financing Activities | 53,581 | 121,430 |
| Increase in Cash and Cash Equivalents | 41,270 | 102,673 |
| Cash and cash equivalents at beginning of period | 82,508 | 88,139 |
| Cash and Cash Equivalents at End of Period | $123,778 | $190,812 |

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)
March 31, 2018

Note A –Background and Basis of Presentation

City Holding Company ("City Holding"), a West Virginia corporation headquartered in Charleston, West Virginia, is a registered financial holding company under the Bank Holding Company Act and conducts its principal activities through its wholly-owned subsidiary, City National Bank of West Virginia ("City National"). City National is a retail and consumer-oriented community bank with 86 banking offices in West Virginia (57), Virginia (14), Kentucky (12) and southeastern Ohio (3). City National provides credit, deposit, and trust and investment management services to its customers in a broad geographical area that includes many rural and small community markets in addition to larger cities including Charleston (WV), Huntington (WV), Martinsburg (WV), Winchester (VA), Staunton (VA), Virginia Beach (VA), Ashland (KY) and Lexington (KY). In addition to its branch network, City National's delivery channels include automated-teller-machines ("ATMs"), interactive-teller machines ("ITMs"), mobile banking, debit cards, interactive voice response systems, and Internet technology. The Company’s business activities are currently limited to one reportable business segment, which is community banking.

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company and its wholly-owned subsidiaries (collectively, the "Company"). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2018. The Company’s accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management’s estimates.

The consolidated balance sheet as of December 31, 2017 has been derived from audited financial statements included in the Company’s 2017 Annual Report to Shareholders.  Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted.  These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2017 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified.  Such reclassifications had no impact on shareholders’ equity or net income for any period.

Note B - Recent Accounting Pronouncements

Recently Adopted:

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)."  This standard clarifies the principles for recognizing revenue and developed a common revenue standard. The core principle of the standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. To achieve that core principle, an entity should apply the following steps: (i) identifying the contract or contracts with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The FASB also issued several amendments to the standard, including clarifications relating to performance obligations and licensing implementation guidance and reporting gross versus net revenue. The Company adopted the standard effective January 1, 2018 using the modified retrospective approach, but did not record a cumulative effect adjustment to opening retained earnings given the immaterial impact. As part of the adoption, the Company evaluated the terms of the contracts that supported each of the revenue streams that were within the scope of ASU 2014-09 and determined that the adoption did not significantly change the way the Company recognizes revenue from each stream.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This standard makes several modifications to Subtopic 825-10 including the elimination of the available-for-sale classification of equity investments, and requires equity investments with readily determinable fair values to be measured at fair value with changes in fair value recognized in net income. This ASU became effective for the Company for interim and annual periods on January 1, 2018. The adoption of ASU No. 2016-01 did not have a material impact on the Company's financial statements. During the three months ended March 31, 2018, a $0.2 million gain was recognized in other income in the consolidated statements of income as a result of the change in the fair value of equity and perpetual preferred securities due to the adoption of ASU 2016-01.  Additionally, $2.7 million, net of deferred taxes, was reclassified from other comprehensive income to retained earnings on the consolidated balance sheets to recognize the prior period unrealized gain position of these securities (see Note C Investments and Note J Accumulated Other Comprehensive Loss).

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." This amendment clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-01 did not have a material impact on the Company's financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." This amendment requires that an employer disaggregate the service cost component from the other components of net benefit cost and also provides explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-07 did not have a material impact on the Company's financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting."  This amendment provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASU No. 2016-09. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-09 did not have a material impact on the Company’s financial statements.

In September 2017, the FASB issued ASU No. 2017-13, "Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842)." This amendment provides modifications to previously issued ASUs 2014-09 and 2016-02. The adoption of ASU No. 2017-13 did not have a material impact on the Company's financial statements.

In November 2017, the FASB issued ASU No. 2017-14, "Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606)." This amendment supersedes various SEC paragraphs and amends an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin No. 116. The adoption of ASU No. 2017-14 did not have a material impact on the Company's financial statements.

Pending Adoption:

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” This standard requires organizations to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing requirements for leases that were historically classified as operating leases under previous generally accepted accounting principals. This ASU will become effective for the Company for interim and annual periods on January 1, 2019. The Company's preliminary evaluation indicates that the adoption of ASU 2016-02 will have an immaterial impact on the Company's consolidated balance sheet. However, the Company continues to evaluate the extent of the potential impact the new guidance will have on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This standard replaces the incurred loss impairment methodology in current

GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new current expected credit losses model (CECL) will apply to the allowance for loan losses, available-for-sale and held to maturity debt securities, purchased financial assets with credit deterioration and certain off-balance sheet credit exposures. This ASU will become effective for the Company for interim and annual periods on January 1, 2020. Management is currently evaluating the potential impact of ASU No. 2016-13 on the Company's financial statements.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." This amendment simplifies the measurement of goodwill by eliminating Step 2 from the goodwill impairment test. This ASU will become effective for the Company on January 1, 2020. The adoption of ASU No. 2017-04 is not expected to have a material impact on the Company's financial statements.

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In March 2017, the FASB issued ASU No. 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." The amendments in this update shorten the amortization period for certain callable debt securities held at a premium and require the premium to be amortized to the earliest call date. This ASU will become effective for the Company on January 1, 2019. The adoption of ASU No. 2017-08 is not expected to have a material impact on the Company's financial statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." This amendment expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU will become effective for the Company on January 1, 2019. The adoption of ASU No. 2017-12 is not expected to have a material impact on the Company's financial statements.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This amendment permits entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act ("TCJA") to retained earnings. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permissible. The Company elected to early adopt this amendment as of December 31, 2017 and the December 31, 2017 balance sheet reflects this adoption.

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Note C –Investments

The amortized cost and estimated fair values of the Company's securities are shown in the following table (in thousands):

| | March 31, 2018 | | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Securities available-for-sale: | | | | | | | | |
| U.S. Treasuries and U.S. government agencies | $1 | $ — | $ — | $1 | $2 | $ — | $ — | $2 |
| Obligations of states and political subdivisions | 94,474 | 709 | 1,010 | 94,173 | 94,552 | 2,051 | 407 | 96,196 |
| Mortgage-backed securities: | | | | | | | | |
| U.S. government agencies | 442,044 | 462 | 15,112 | 427,394 | 425,559 | 1,093 | 7,305 | 419,347 |
| Private label | 599 | 3 | — | 602 | 649 | 3 | — | 652 |
| Trust preferred securities | 4,767 | 26 | — | 4,793 | 4,764 | 26 | 54 | 4,736 |
| Corporate securities[(1)] | 17,102 | 98 | — | 17,200 | 21,916 | 475 | 123 | 22,268 |
| Total Debt Securities | 558,987 | 1,298 | 16,122 | 544,163 | 547,442 | 3,648 | 7,889 | 543,201 |
| Marketable equity securities | — | — | — | — | 2,136 | 3,563 | — | 5,699 |
| Investment funds | 1,525 | — | 60 | 1,465 | 1,525 | — | 36 | 1,489 |
| Total Securities Available-for-Sale | $560,512 | $ 1,298 | $ 16,182 | $545,628 | $551,103 | $ 7,211 | $ 7,925 | $550,389 |
| Securities held-to-maturity: | | | | | | | | |
| Mortgage-backed securities: | | | | | | | | |
| U.S. government agencies | $58,277 | $88 | $219 | $58,146 | $60,449 | $1,222 | $25 | $61,646 |
| Trust preferred securities | 4,000 | — | — | 4,000 | 4,000 | — | — | 4,000 |
| Total Securities Held-to-Maturity | $62,277 | $88 | $219 | $62,146 | $64,449 | $1,222 | $25 | $65,646 |
| Other investment securities: | | | | | | | | |
| Non-marketable equity securities | $11,581 | $— | $— | $11,581 | $14,147 | $— | $— | $14,147 |
| Marketable equity securities[(1)] | 6,947 | — | — | 10,584 | — | — | — | — |
| Total Other Investment Securities | $18,528 | $— | $— | $22,165 | $14,147 | $— | $— | $14,147 |

(1) Effective January 1, 2018, the Company's equity and perpetual preferred securities are measured at fair value through net income.

Marketable equity securities consist of investments made by the Company in equity positions of various regional community banks. Included within this portfolio are ownership positions in the following community bank holding companies: First National Corporation (FXNC) (4%) and Eagle Financial Services, Inc. (EFSI) (1.5%). Securities with limited marketability, such as stock in the Federal Reserve Bank ("Federal Reserve") and the Federal Home Loan Bank ("FHLB"), are carried at cost and are reported as non-marketable equity securities in the table above.

Certain investment securities owned by the Company were in an unrealized loss position (i.e., amortized cost basis exceeded the estimated fair value of the securities). The following table shows the gross unrealized losses and fair value of the Company's investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

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| | March 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than Twelve Months | | Twelve Months or Greater | | Total | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Securities available-for-sale: | | | | | | |
| Obligations of states and political subdivisions | $24,204 | $ 211 | $18,955 | $ 799 | $43,159 | $ 1,010 |
| Mortgage-backed securities: | | | | | | |
| U.S. Government agencies | 266,824 | 7,208 | 134,047 | 7,904 | 400,871 | 15,112 |
| Corporate securities | — | — | — | — | — | — |
| Investment funds | 1,500 | 60 | — | — | 1,500 | 60 |
| Total available-for-sale | $292,528 | $ 7,479 | $153,002 | $ 8,703 | $445,530 | $ 16,182 |
| | | | | | | |
| Securities held-to-maturity: | | | | | | |
| Mortgage-backed securities | | | | | | |
| U.S. Government Agencies | $39,433 | $ 219 | $— | $ — | $39,433 | $ 219 |
| Total held-to-maturity | $39,433 | $ 219 | $— | $ — | $39,433 | $ 219 |

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than Twelve Months | | Twelve Months or Greater | | Total | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Securities available-for-sale: | | | | | | |
| Obligations of states and political subdivisions | $4,913 | $ 28 | $19,440 | $ 379 | $24,353 | $ 407 |
| Mortgage-backed securities: | | | | | | |
| U.S. Government agencies | 172,807 | 1,887 | 140,226 | 5,418 | 313,033 | 7,305 |
| Trust preferred securities | 4,475 | 54 | — | — | 4,475 | 54 |
| Corporate securities | 3,357 | 49 | 2,350 | 74 | 5,707 | 123 |
| Investment funds | 1,500 | 36 | — | — | 1,500 | 36 |
| Total available-for-sale | $187,052 | $ 2,054 | $162,016 | $ 5,871 | $349,068 | $ 7,925 |
| | | | | | | |
| Securities held-to-maturity | | | | | | |
| Mortgage-backed securities | | | | | | |
| U.S. Government agencies | $7,182 | $ 25 | $— | $ — | $7,182 | $ 25 |
| Total held-to-maturity | $7,182 | $ 25 | $— | $ — | $7,182 | $ 25 |

During the three months ended March 31, 2018 and 2017, the Company had no investment impairment losses. At March 31, 2018, the cumulative amount of credit-related investment impairment losses that have been recognized by the Company on investments that remain in the Company's investment portfolio as of that date was $1.8 million ($0.2 million related to the Company's debt securities and $1.6 million related to the Company's equity securities).

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary would be reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost; (ii) the financial condition, capital strength, and near-term (within 12 months) prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; and (v) the intent to sell the investment security and if it's more likely than not that the Company will not have to sell the security before recovery of its cost basis. In addition, management also employs a continuous monitoring process in regards to its marketable equity securities, specifically its portfolio of regional community bank holdings. Although the regional community bank stocks that are owned by the Company are publicly traded, the trading activity for these stocks is minimal, with trading volumes of less than 0.4% of each respective company being traded on

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a daily basis. As part of management's review process for these securities, management reviews the financial condition of each respective regional community bank for any indications of financial weakness.

Management has the ability and intent to hold the securities classified as held-to-maturity until they mature, at which time the Company expects to receive full value for the securities. Furthermore, as of March 31, 2018, management does not intend to sell an impaired security and it is not more than likely that it will be required to sell the security before the recovery of its amortized cost basis. The unrealized losses on debt securities are primarily the result of interest rate changes, credit spread fluctuations on agency-issued mortgage related securities, general financial market uncertainty and unprecedented market volatility. These conditions should not prohibit the Company from receiving its contractual principal and interest payments on its debt securities. The fair value is expected to recover as the securities approach their maturity date or repricing date. As of March 31, 2018, management believes the unrealized losses detailed in the table above are temporary and no additional impairment loss has been recognized in the Company's consolidated income statement. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss will be recognized in net income in the period the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

The amortized cost and estimated fair value of debt securities at March 31, 2018, by contractual maturity, are shown in the following table (in thousands). Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. Mortgage-backed securities have been allocated to their respective maturity groupings based on their contractual maturity.

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Securities Available-for-Sale | | |
| Due in one year or less | $2,715 | $2,715 |
| Due after one year through five years | 13,888 | 13,850 |
| Due after five years through ten years | 76,197 | 73,698 |
| Due after ten years | 470,998 | 458,604 |
| Total | $563,798 | $548,867 |
| | | |
| Securities Held-to-Maturity | | |
| Due in one year or less | $— | $— |
| Due after one year through five years | — | — |
| Due after five years through ten years | — | — |
| Due after ten years | 62,277 | 62,146 |
| Total | $62,277 | $62,146 |

Gross gains and gross losses realized by the Company from investment security transactions are summarized in the table below (in thousands).

| | Three months ended March 31, 2018 | 2017 |
|---|---|---|
| Equity and perpetual preferred security unrealized gains recognized | $180 | $— |
| Gross realized gains on securities sold | — | 4,276 |

| | | |
|---|---|---|
| Gross realized losses on securities sold | — | — |
| Net investment security gains | $— | $4,276 |

During the three months ended March 31, 2018 a $0.2 million unrealized gain was recognized in other income in the consolidated statements of income as a result of the change in the fair value of equity and perpetual preferred securities due to the adoption of ASU 2016-01. Additionally, $2.7 million, net of deferred taxes, was reclassified from other comprehensive income to retained earnings on the consolidated balance sheets to recognize the prior period fair value impact of these securities.

During the three months ended March 31, 2017 the Company realized $4.3 million of investment gains. These gains represented partial recoveries of impairment charges previously recognized on pooled trust preferred securities. As a result of these sales, the Company no longer holds any pooled trust preferred securities in its investment portfolio.

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The carrying value of securities pledged to secure public deposits and for other purposes as required or permitted by law approximated $448 million and $429 million at March 31, 2018 and December 31, 2017, respectively.

Note D –Loans

The following summarizes the Company’s major classifications for loans (in thousands):

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| Residential real estate | $1,465,215 | $1,468,278 |
| Home equity | 138,477 | 139,499 |
| Commercial and industrial | 204,592 | 208,484 |
| Commercial real estate | 1,296,304 | 1,277,576 |
| Consumer | 29,570 | 29,162 |
| DDA overdrafts | 3,523 | 4,411 |
| Gross loans | 3,137,681 | 3,127,410 |
| Allowance for loan losses | (18,381) | (18,836) |
| Net loans | $3,119,300 | $3,108,574 |

Construction loans of $26.6 million and $25.3 million are included within residential real estate loans at March 31, 2018 and December 31, 2017, respectively. Construction loans of $30.9 million and $28.9 million are included within commercial real estate loans at March 31, 2018 and December 31, 2017, respectively. The Company’s commercial and residential real estate construction loans are primarily secured by real estate within the Company’s principal markets. These loans were originated under the Company’s loan policy, which is focused on the risk characteristics of residential and commercial real estate lending, including specific risks related to construction lending. Adequate consideration has been given to these loans in establishing the Company’s allowance for loan losses.

Note E – Allowance For Loan Losses

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses on a quarterly basis to provide for probable losses inherent in the portfolio. Management assesses the risk in each loan type based on historical trends, the general economic environment of its local markets, individual loan performance and other relevant factors.

Individual credits are selected throughout the year for detailed loan reviews, which are utilized by management to assess the risk in the portfolio and the adequacy of the allowance. Due to the nature of commercial lending, evaluation of the adequacy of the allowance as it relates to these loan types is often based more upon specific credit reviews, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for economic conditions and other inherent risk factors.

The following table summarizes the activity in the allowance for loan loss, by portfolio loan classification, for the three months ended March 31, 2018 and 2017 (in thousands). The allocation of a portion of the allowance in one portfolio segment does not preclude its availability to absorb losses in other portfolio segments. The following table also presents the balance in the allowance for loan loss disaggregated on the basis of the Company’s impairment measurement method and the related recorded investment in loans, by portfolio segment, as of March 31, 2018 and December 31, 2017 (in thousands).

| | Commercial | Residential | | DDA |
|---|---|---|---|---|

| | Commercial and Industrial | Real Estate | Real Estate | Home Equity | Consumer | Overdrafts | Total |
|---|---|---|---|---|---|---|---|
| Three months ended March 31, 2018 | | | | | | | |
| Allowance for loan loss | | | | | | | |
| Beginning balance | $ 4,571 | $ 6,183 | $ 5,212 | $1,138 | $ 62 | $ 1,670 | $18,836 |
| Charge-offs | (339 ) | (157 ) | (131 ) | (71 ) | (99 ) | (636 ) | (1,433 ) |
| Recoveries | 2 | 223 | 106 | — | 46 | 420 | 797 |
| Provision for acquired loans | — | — | — | — | — | — | — |

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| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Provision | 529 | (480) | (244) | 133 | 203 | 40 | 181 |
| Ending balance | $4,763 | $5,769 | $4,943 | $1,200 | $212 | $1,494 | $18,381 |
| | | | | | | | |
| Three months ended March 31, 2017 | | | | | | | |
| Allowance for loan loss | | | | | | | |
| Beginning balance | $4,206 | $6,573 | $6,680 | $1,417 | $82 | $772 | $19,730 |
| Charge-offs | (53) | (180) | (626) | (121) | (6) | (636) | (1,622) |
| Recoveries | 2 | 11 | 25 | — | 11 | 371 | 420 |
| Provision for acquired loans | — | (19) | — | — | — | — | (19) |
| Provision | 128 | (381) | 644 | 3 | (23) | 329 | 700 |
| Ending balance | $4,283 | $6,004 | $6,723 | $1,299 | $64 | $836 | $19,209 |
| | | | | | | | |
| As of March 31, 2018 | | | | | | | |
| Allowance for loan loss | | | | | | | |
| Evaluated for impairment: | | | | | | | |
| Individually | $— | $172 | $— | $— | $— | $— | $172 |
| Collectively | 4,759 | 5,530 | 4,843 | 1,200 | 208 | 1,494 | 18,034 |
| Acquired with deteriorated credit quality | 4 | 67 | 100 | — | 4 | — | 175 |
| Total | $4,763 | $5,769 | $4,943 | $1,200 | $212 | $1,494 | $18,381 |
| | | | | | | | |
| Loans | | | | | | | |
| Evaluated for impairment: | | | | | | | |
| Individually | $849 | $8,757 | $— | $— | $— | $— | $9,606 |
| Collectively | 203,537 | 1,282,064 | 1,462,622 | 138,477 | 29,454 | 3,523 | 3,119,677 |
| Acquired with deteriorated credit quality | 206 | 5,483 | 2,593 | — | 116 | — | 8,398 |
| Total | $204,592 | $1,296,304 | $1,465,215 | $138,477 | $29,570 | $3,523 | $3,137,681 |
| | | | | | | | |
| As of December 31, 2017 | | | | | | | |
| Allowance for loan loss | | | | | | | |
| Evaluated for impairment: | | | | | | | |
| Individually | $— | $647 | $— | $— | $— | $— | $647 |
| Collectively | 4,567 | 5,313 | 5,112 | 1,138 | 58 | 1,670 | 17,858 |
| Acquired with deteriorated credit quality | 4 | 223 | 100 | — | 4 | — | 331 |
| Total | $4,571 | $6,183 | $5,212 | $1,138 | $62 | $1,670 | $18,836 |
| | | | | | | | |
| Loans | | | | | | | |
| Evaluated for impairment: | | | | | | | |
| Individually | $849 | $8,818 | $— | $— | $— | $— | $9,667 |
| Collectively | 207,429 | 1,263,076 | 1,465,685 | 139,499 | 29,046 | 4,411 | 3,109,146 |
| Acquired with deteriorated credit quality | 206 | 5,682 | 2,593 | — | 116 | — | 8,597 |
| Total | $208,484 | $1,277,576 | $1,468,278 | $139,499 | $29,162 | $4,411 | $3,127,410 |

Credit Quality Indicators

All commercial loans within the portfolio are subject to internal risk grading.  All non-commercial loans are evaluated based on payment history.  The Company’s internal risk ratings for commercial loans are:  Pass, Special Mention, Substandard and Doubtful.  Each internal risk rating is defined in the loan policy using the following criteria:  balance sheet yields; ratios and leverage; cash flow spread and coverage; prior history; capability of management; market position/industry; potential impact of changing economic, legal, regulatory or environmental conditions; purpose; structure; collateral support; and guarantor support.  Risk grades are generally assigned by the primary lending officer and are periodically evaluated by the Company’s

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internal loan review process. Based on an individual loan's risk grade, estimated loss percentages are applied to the outstanding balance of the loan to determine the amount of probable loss.

The Company categorizes loans into risk categories based on relevant information regarding the customer's debt service ability, capacity, overall collateral position along with other economic trends, and historical payment performance. The risk grades for each credit are updated when the Company receives current financial information, the loan is reviewed by the Company's internal loan review and credit administration departments, or the loan becomes delinquent or impaired. The risk grades are updated a minimum of annually for loans rated exceptional, good, acceptable, or pass/watch. Loans rated special mention, substandard or doubtful are reviewed at least quarterly. The Company uses the following definitions for its risk ratings:

| Risk Rating | Description |
| --- | --- |
| Pass ratings: | |
| (a) Exceptional | Loans classified as exceptional are secured with liquid collateral conforming to the internal loan policy. Loans rated within this category pose minimal risk of loss to the bank. |
| (b) Good | Loans classified as good have similar characteristics that include a strong balance sheet, satisfactory debt service coverage ratios, strong management and/or guarantors, and little exposure to economic cycles. Loans in this category generally have a low chance of loss to the bank. |
| (c) Acceptable | Loans classified as acceptable have acceptable liquidity levels, adequate debt service coverage ratios, experienced management, and have average exposure to economic cycles. Loans within this category generally have a low risk of loss to the bank. |
| (d) Pass/watch | Loans classified as pass/watch have erratic levels of leverage and/or liquidity, cash flow is volatile and the borrower is subject to moderate economic risk. A borrower in this category poses a low to moderate risk of loss to the bank. |
| Special mention | Loans classified as special mention have a potential weakness(es) that deserves management's close attention. The potential weakness could result in deterioration of the loan repayment or the bank's credit position at some future date. A loan rated in this category poses a moderate loss risk to the bank. |
| Substandard | Loans classified as substandard reflect a customer with a well defined weakness that jeopardizes the liquidation of the debt. Loans in this category have the possibility that the bank will sustain some loss if the deficiencies are not corrected and the bank's collateral value is weakened by the financial deterioration of the borrower. |
| Doubtful | Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that make collection of the full contract amount highly improbable. Loans rated in this category are most likely to cause the bank to have a loss due to a collateral shortfall or a negative capital position. |

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The following table presents the Company’s commercial loans by credit quality indicators, by portfolio loan classification (in thousands):

| | Commercial and Industrial | Commercial Real Estate | Total |
|---|---|---|---|
| March 31, 2018 | | | |
| Pass | $ 171,815 | $ 1,252,937 | $ 1,424,752 |
| Special mention | 25,524 | 7,078 | 32,602 |
| Substandard | 7,253 | 36,289 | 43,542 |
| Doubtful | — | — | — |
| Total | $ 204,592 | $ 1,296,304 | $ 1,500,896 |
| | | | |
| December 31, 2017 | | | |
| Pass | $ 175,951 | $ 1,231,256 | $ 1,407,207 |
| Special mention | 25,872 | 8,068 | 33,940 |
| Substandard | 6,661 | 38,252 | 44,913 |
| Doubtful | — | — | — |
| Total | $ 208,484 | $ 1,277,576 | $ 1,486,060 |

The following table presents the Company's non-commercial loans by payment performance, by portfolio loan classification (in thousands):

| | Performing | Non-Performing | Total |
|---|---|---|---|
| March 31, 2018 | | | |
| Residential real estate | $ 1,461,802 | $ 3,413 | $ 1,465,215 |
| Home equity | 138,341 | 136 | 138,477 |
| Consumer | 29,570 | — | 29,570 |
| DDA overdrafts | 3,523 | — | 3,523 |
| Total | $ 1,633,236 | $ 3,549 | $ 1,636,785 |
| | | | |
| December 31, 2017 | | | |
| Residential real estate | $ 1,465,445 | $ 2,833 | $ 1,468,278 |
| Home equity | 139,239 | 260 | 139,499 |
| Consumer | 29,162 | — | 29,162 |
| DDA overdrafts | 4,411 | — | 4,411 |
| Total | $ 1,638,257 | $ 3,093 | $ 1,641,350 |

Aging Analysis of Accruing and Non-Accruing Loans

Interest income on loans is accrued and credited to operations based upon the principal amount outstanding, using methods that generally result in level rates of return. Loan origination fees, and certain direct costs, are deferred and amortized as an adjustment to the yield over the term of the loan. The accrual of interest generally is discontinued when a loan becomes 90 days past due as to principal or interest for all loan types. However, any loan may be placed on non-accrual status if the Company receives information that indicates a borrower is unable to meet the contractual terms of its respective loan agreement. Other indicators considered for placing a loan on non-accrual status include the borrower’s involvement in bankruptcies, foreclosures, repossessions, litigation and any other situation resulting in doubt as to whether full collection of contractual principal and interest is attainable. When interest accruals are discontinued, unpaid interest recognized in income in the current year is reversed, and interest accrued in prior years is charged to the allowance for loan losses.  Management may elect to continue the accrual of interest when the net realizable value of collateral exceeds the principal balance and related accrued interest, and the loan is in the process of collection.

Generally for all loan classes, interest income during the period the loan is non-performing is recorded on a cash basis after recovery of principal is reasonably assured.  Cash payments received on nonperforming loans are typically applied directly against the outstanding principal balance until the loan is fully repaid.  Generally, loans are restored to accrual status when the

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obligation is brought current, the borrower has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Generally, all loan types are considered past due when the contractual terms of a loan are not met and the borrower is 30 days or more past due on a payment. Furthermore, residential and home equity loans are generally subject to charge-off when the loan becomes 120 days past due, depending on the estimated fair value of the collateral less cost to dispose, versus the outstanding loan balance. Commercial loans are generally charged off when the loan becomes 120 days past due. Open-end consumer loans are generally charged off when the loan becomes 180 days past due.

The following table presents an aging analysis of the Company’s accruing and non-accruing loans, by portfolio loan classification (in thousands):

| | March 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Accruing | | | | | |
| | Current | 30-59 days | 60-89 days | Over 90 days | Non-accrual | Total |
| Residential real estate | $1,456,243 | $4,353 | $1,206 | $82 | $ 3,331 | $1,465,215 |
| Home equity | 137,727 | 458 | 157 | 1 | 134 | 138,477 |
| Commercial and industrial | 203,468 | 61 | — | — | 1,063 | 204,592 |
| Commercial real estate | 1,289,722 | 1,520 | — | — | 5,062 | 1,296,304 |
| Consumer | 29,549 | 21 | — | — | — | 29,570 |
| DDA overdrafts | 3,092 | 422 | 1 | 8 | — | 3,523 |
| Total | $3,119,801 | $6,835 | $1,364 | $91 | $ 9,590 | $3,137,681 |

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Accruing | | | | | |
| | Current | 30-59 days | 60-89 days | Over 90 days | Non-accrual | Total |
| Residential real estate | $1,458,746 | $5,990 | $709 | $19 | $ 2,814 | $1,468,278 |
| Home equity | 138,480 | 671 | 88 | 92 | 168 | 139,499 |
| Commercial and industrial | 206,447 | 549 | 1 | 142 | 1,345 | 208,484 |
| Commercial real estate | 1,269,520 | 1,841 | 245 | — | 5,970 | 1,277,576 |
| Consumer | 29,108 | 39 | 13 | 2 | — | 29,162 |
| DDA overdrafts | 3,849 | 541 | 14 | 7 | — | 4,411 |
| Total | $3,106,150 | $9,631 | $1,070 | $262 | $ 10,297 | $3,127,410 |

The following table presents the Company’s impaired loans, by class (in thousands). The difference between the unpaid principal balance and the recorded investment generally reflects amounts that have been previously charged-off. There are no impaired residential, home equity, or consumer loans.

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| | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded: | | | | | | |
| Commercial and industrial | $849 | $3,013 | $ — | $849 | $ 3,013 | $ — |
| Commercial real estate | 5,782 | 7,607 | — | 3,036 | 4,861 | — |
| Total | $6,631 | $10,620 | $ — | $3,885 | $ 7,874 | $ — |
| | | | | | | |
| With an allowance recorded: | | | | | | |
| Commercial and industrial | $— | $— | $ — | $— | $ — | $ — |
| Commercial real estate | 2,975 | 2,975 | 172 | 5,782 | 5,782 | 647 |
| Total | $2,975 | $2,975 | $ 172 | $5,782 | $ 5,782 | $ 647 |

The following table presents information related to the average recorded investment and interest income recognized on the Company's impaired loans, by class (in thousands):

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded: | | | | |
| Commercial and industrial | $774 | — | $1,365 | $ — |
| Commercial real estate | 3,008 | 3 | 3,118 | 5 |
| Total | $3,782 | $ 3 | $4,483 | $ 5 |
| | | | | |
| With an allowance recorded: | | | | |
| Commercial and industrial | $— | $ — | $— | $ — |
| Commercial real estate | 5,750 | 52 | 2,832 | 19 |
| Total | $5,750 | $ 52 | $2,832 | $ 19 |

Approximately $0.1 million and $0.2 million of interest income would have been recognized during the three months ended March 31, 2018 and 2017, respectively, if such loans had been current in accordance with their original terms. There were no commitments to provide additional funds on non-accrual, impaired or other potential problem loans at March 31, 2018.

Loan Modifications

The Company's policy on loan modifications typically does not allow for modifications that would be considered a concession from the Company. However, when there is a modification, the Company evaluates each modification to determine if the modification constitutes a troubled debt restructuring ("TDR") in accordance with ASU 2011-02, whereby a modification of a loan would be considered a TDR when both of the following conditions are met: (1) a borrower is experiencing financial difficulty and (2) the modification constitutes a concession. When determining whether the borrower is experiencing financial difficulties, the Company reviews whether the borrower is currently in payment default on any of its debt or whether it is probable that the borrower would be in payment default in the foreseeable future without the modification. Other indicators of financial difficulty include whether the borrower has declared or is in the process of declaring bankruptcy, the borrower's ability to continue as a going concern, and the borrower's projected cash flow to service its debt (including principal and interest) in accordance with the contractual terms for the foreseeable future, without a modification.

Regulatory guidance requires loans to be accounted for as collateral-dependent loans when borrowers have filed Chapter 7 bankruptcy, the debt has been discharged by the bankruptcy court, and the borrower has not reaffirmed the debt. The filing of bankruptcy is deemed to be evidence that the borrower is in financial difficulty and the discharge of the debt by the bankruptcy court is deemed to be a concession granted to the borrower.

The following tables set forth the Company’s TDRs (in thousands):

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| | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Accruing | Non-Accruing | Total | Accruing | Non-Accruing | Total |
| Commercial and industrial | $125 | $ — | $125 | $135 | $ — | $135 |
| Commercial real estate | 8,324 | — | 8,324 | 8,381 | — | 8,381 |
| Residential real estate | 20,786 | 256 | 21,042 | 21,005 | 84 | 21,089 |
| Home equity | 3,015 | 40 | 3,055 | 3,047 | 50 | 3,097 |
| Consumer | — | — | — | — | — | — |
| Total | $32,250 | $ 296 | $32,546 | $32,568 | $ 134 | $32,702 |

| | New TDRs Three months ended March 31, 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre Modification Outstanding Recorded Investment | Post Modification Outstanding Recorded Investment | Number of Contracts | Pre Modification Outstanding Recorded Investment | Post Modification Outstanding Recorded Investment |
| Commercial and industrial | — | $ — | $ — | — | $ — | $ — |
| Commercial real estate | — | — | — | 1 | 3,015 | 3,015 |
| Residential real estate | 7 | 412 | 412 | 9 | 1,130 | 1,130 |
| Home equity | 4 | 77 | 77 | 2 | 58 | 58 |
| Consumer | — | — | — | — | — | — |
| Total | 11 | $ 489 | $ 489 | 12 | $ 4,203 | $ 4,203 |

Note F – Long-Term Debt

The components of long-term debt are summarized below (in thousands):

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| Junior subordinated debentures owed to City Holding Capital Trust III, due 2038, interest at a rate of 5.62% and 5.09%, respectively | $ 16,495 | $ 16,495 |

The Company formed a statutory business trust, City Holding Capital Trust III ("Capital Trust III"), under the laws of Delaware. Capital Trust III was created for the exclusive purpose of (i) issuing trust-preferred capital securities ("Capital Securities"), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures ("Debentures") issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trust are not included in the Company's consolidated financial statements.

Distributions on the Debentures are cumulative and will be payable quarterly at an interest rate of 3.50% over the three month LIBOR rate, reset quarterly. Interest payments are due in March, June, September and December each year until maturity. The Debentures are redeemable prior to maturity at the option of the Company (i) in whole at any time or in part from time to time, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain predefined events.

Payments of distributions on the Capital Securities and payments on redemption of the Capital Securities are guaranteed by the Company. The Company also entered into an agreement as to expenses and liabilities with the trust pursuant to which it agreed, on a subordinated basis, to pay any cost, expenses or liabilities of the trust other than those arising under the Capital Securities. The obligations of the Company under the Debentures, the related indentures, the trust agreement establishing the trust, the guarantees and the agreements as to expenses and liabilities, in the aggregate, constitute a full and unconditional guarantee by the Company of the trust's obligations under the Capital Securities. The Capital Securities issued by the statutory business trust qualify as Tier 1 capital for the Company under current Federal Reserve Board guidelines.

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Note G –Derivative Instruments

The Company enters into derivative transactions principally to protect against the risk of adverse price or interest rate movements on the value of certain assets and liabilities on future cash flows. As of March 31, 2018 and December 31, 2017, the Company has derivative financial instruments not included in hedge relationships. These derivatives consist of interest rate swaps and floors used for interest rate management purposes and derivatives executed with commercial banking customers to facilitate their interest rate management strategies. For the majority of these instruments the Company acts as an intermediary for its customers. Changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Company's results of operations. The Company also has an interest rate swap that serves as a fair value hedge for changes in long term fixed interest rates related to commercial real estate loans. Hedge ineffectiveness is assessed quarterly and any ineffectiveness is recorded as non-interest expense. For the three months ended March 31, 2018 and 2017, hedge ineffectiveness was less than $0.1 million and the change in fair value was less than $0.1 million, for each respective period.

The following table summarizes the notional and fair value of these derivative instruments (in thousands):

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Non-hedging interest rate derivatives: | | | | |
| Customer counterparties: | | | | |
| Loan interest rate swap - assets | $86,856 | $2,039 | $225,480 | $4,877 |
| Loan interest rate swap - liabilities | 426,241 | 19,452 | 314,450 | 9,513 |
| Financial institution counterparties: | | | | |
| Loan interest rate swap - assets | 432,755 | 19,620 | 320,949 | 9,591 |
| Loan interest rate swap - liabilities | 86,856 | 2,039 | 218,924 | 4,877 |
| Derivatives designated as hedges of fair value: | | | | |
| Financial institution counterparties: | | | | |
| Loan interest rate swap - assets | 3,961 | 93 | 4,326 | 34 |

The following table summarizes the change in fair value of these derivative instruments (in thousands):

| | Three months ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Change in fair value non-hedging interest rate derivatives: | | |
| Other expense | $90 | $45 |
| Change in fair value hedging interest rate derivatives: | | |
| Other expense | 1 | (4) |

Certain financial instruments, including derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements. The Company's derivative transactions with financial institution counterparties are generally executed under International Swaps and Derivative Association ("ISDA") master agreements which include "right of setoff" provisions. In such cases there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. Nonetheless, the Company does not generally offset financial instruments for financial reporting purposes. Information about financial instruments that are eligible for offset in the consolidated balance sheet as of March 31, 2018 is presented in the following tables (in thousands):

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| Description | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Assets Presented in the Statement of Financial Position | Gross Amounts Not Offset in the Balance Sheet: Netting Adjustment per Applicable Master Netting Arrangements | Fair Value of Financial Collateral | Total of Gross Amounts Not Offset in the Statement of Financial Position Including Applicable Netting Agreement and Fair Value of Collateral | Net Amount |
|---|---|---|---|---|---|---|---|
| | (a) | (b) | (c)=(a)-(b) | | | (d) | (c)-(d) * |
| Non-hedging derivative assets: | | | | | | | |
| Interest rate swap agreements - customer counterparties | $ 2,039 | $ — | $ 2,039 | $ — | $ 2,039 | $ 2,039 | $ — |
| Interest rate swap agreements - financial institution counterparties | $ 19,620 | $ — | $ 19,620 | $ — | $ — | $ — | $ 19,620 |
| Hedging derivative assets: | | | | | | | |
| Interest rate swap agreements - financial institution counterparties | $ 93 | $ — | $ 93 | $ — | $ 70 | $ 70 | $ 23 |
| Non-hedging derivative liabilities: | | | | | | | |
| Interest rate swap agreements - customer counterparties | $ 19,452 | $ — | $ 19,452 | $ — | $ 19,452 | $ 19,452 | $ — |
| Interest rate swap agreements - financial institution counterparties | $ 2,039 | $ — | $ 2,039 | $ — | $ 14,671 | $ 14,671 | $ — |

* For instances where the fair value of financial collateral meets or exceeds the amounts presented in the Consolidated Balance Sheets, no value is displayed to represent full collateralization.

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Note H –Employee Benefit Plans

Pursuant to the terms of the City Holding Company 2003 Incentive Plan and the City Holding Company 2013 Incentive Plan (the "2003 Plan" and "2013 Plan", respectively), the Compensation Committee of the Board of Directors, or its delegate, may, from time to time, grant stock options, stock appreciation rights ("SARs"), or restricted stock awards to employees, directors and individuals who provide service to the Company (collectively, "Plan Participants"). The 2003 Plan expired in April of 2013 and the 2013 Plan was approved by the Company's shareholders in April 2013. A maximum of 750,000 shares of the Company's common stock may be issued upon the exercise of stock options, SARs and stock awards under the 2013 Plan. These limitations may be adjusted in the event of a change in the number of outstanding shares of common stock by reason of a stock dividend, stock split or other similar event. Specific terms of options and SARs awarded, including vesting periods, exercise prices (stock price at date of grant) and expiration dates are determined at the date of grant and are evidenced by agreements between the Company and the awardee. The exercise price of the option grants equals the market price of the Company's common stock on the date of grant. All incentive stock options and SARs will be exercisable up to 10 years from the date granted and all options and SARs are exercisable for the period specified in the individual agreement. As of March 31, 2018, approximately 541,000 shares were still available to be issued under the 2013 Plan.

Each award from the 2003 Plan and 2013 Plan is evidenced by an award agreement that specifies the option price, the duration of the option, the number of shares to which the option pertains, and such other provisions as the Compensation Committee, or its delegate, determines. The option price for each grant is equal to the fair market value of a share of the Company's common stock on the date of the grant. Options granted expire at such time as the Compensation Committee, or its delegate, determines at the date of the grant and in no event does the exercise period exceed a maximum of ten years. Upon a change-in-control of the Company, as defined in the 2003 Plan and 2013 Plan, all outstanding options and awards shall immediately vest.

Certain stock options and restricted stock awards granted pursuant to the 2013 Plan have performance-based vesting requirements. These shares will vest in three separate annual installments of approximately 33.33% per installment on the third, fourth and fifth anniversaries of the grant date, subject further to performance-based vesting requirements. To meet the performance-based vesting requirement, the Company's mean return on average assets of the three, four and five year period prior to the respective vesting date must meet or exceed the median return on average assets over the 20 year period immediately preceding the vesting date of all FDIC insured depository institutions. The mean return on average assets excludes merger and acquisition expenses and other nonrecurring items as determined by the Board of Directors of the Company.

In 2018, the Board of Directors granted the named executive officers ("NEOs") restricted stock units ("RSUs") and performance share units ("PSUs"). The RSUs will vest in three separate annual installments of approximately 33.33% per installment on the first, second and third anniversaries of the grant date, subject to a two-year holding period. The PSUs will vest on the third anniversary of the grant date. The payout for the PSUs will be determined based on (1) the Company's three-year relative average return on assets ("ROA") during the three-year performance period relative to the ROA for the selected peer companies and (2) the Company's total shareholder return ("TSR") relative to the TSR of the selected peer companies during the three-year performance period. If the three-year relative ROA is at or below the 25th percentile, 0% of the PSU grant will be earned; at the 50th percentile, 100% of the PSU grant will be earned; or at the 100th percentile, 200% of the PSU grant will be earned. The payout of the PSUs will be increased or decreased as determined by a modifier based on the Company's TSR. If the three-year relative TSR is at or below the 25th percentile, the number of PSUs granted will be reduced by 25%; at the 50th percentile, the number of PSUs granted will not be adjusted; or at or above the 75th percentile, the number of PSUs granted will be increased by 25%.

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Stock Options

A summary of the Company’s stock option activity and related information is presented below:

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding at January 1 | 87,605 | $ 47.15 | 86,613 | $ 41.08 |
| Granted | — | — | 17,631 | 66.32 |
| Exercised | (7,387 ) | 37.85 | (1,250 ) | 30.38 |
| Outstanding at March 31 | 80,218 | $ 48.00 | 102,994 | $ 45.53 |
| Exerciseable at March 31 | 24,943 | $ 40.38 | 23,276 | $ 36.70 |

Information regarding stock option exercises and stock-based compensation expense associated with stock options is provided in the following table (in thousands):

| | Three months ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Proceeds from stock option exercises | $280 | $ 38 |
| Intrinsic value of stock options exercised | 220 | 44 |
| Stock-based compensation expense associated with stock options | $54 | $ 65 |

| At period-end: | March 31, 2018 |
|---|---|
| Unrecognized stock-based compensation expense associated with stock options | $328 |
| Weighted average period (in years) in which the above amount is expected to be recognized | 2.4 |

Shares issued in connection with stock option exercises are issued from available treasury shares. If no treasury shares are available, new shares would be issued from available authorized shares. During the three months ended March 31, 2018 and 2017, all shares issued in connection with stock option exercises were issued from available treasury stock. For the stock options that have performance-based criteria, management has evaluated those criteria and has determined that, as of March 31, 2018, the criteria were probable of being met.

Additional information regarding stock options outstanding and exercisable at March 31, 2018 is provided in the following table:

| Ranges of Exercise Prices | No. of Options Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value (in thousands) | No. of Options Currently Exercisable | Weighted-Average Exercise Price of Options Currently Exercisable | Weighted-Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value of Options Currently Exercisable (in thousands) |
|---|---|---|---|---|---|---|---|---|
| | 500 | $ 30.38 | 0.7 | $ 19 | 500 | $ 30.38 | 0.7 | $ 19 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| \$30.00 - \$34.99 | | | | | | | | |
| 35.00 - 39.99 | 15,475 | 37.74 | 4.9 | 477 | 15,475 | 37.74 | 4.9 | 477 |
| 40.00 - 44.99 | 33,651 | 43.92 | 7.4 | 829 | 4,650 | 44.43 | 6.0 | 112 |
| 45.00 - 49.99 | 12,961 | 46.61 | 6.9 | 284 | 4,318 | 46.61 | 6.9 | 95 |
| 50.00 - 70.00 | 17,631 | 66.32 | 8.9 | 40 | — | — | — | — |
| | 80,218 | | | \$ 1,649 | 24,943 | | | \$ 703 |

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The fair value of the options is estimated at the date of grant using a Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of options granted:

| | Three months ended March 31, 2017 | |
|---|---|---|
| Risk-free interest rate | 2.12 | % |
| Expected dividend yield | 2.60 | % |
| Volatility factor | 25.80 | % |
| Expected life of option | 7.0 years | |

Restricted Shares

The Company records compensation expense with respect to restricted shares in an amount equal to the fair value of the common stock covered by each award on the date of grant. The restricted shares awarded become fully vested after various periods of continued employment from the respective dates of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Compensation is being charged to expense over the respective vesting periods.

Restricted shares are forfeited if the awardee officer or employee terminates his employment with the Company prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases and any compensation cost previously recognized is reversed in the period of forfeiture. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, and have the right to vote all shares subject to such grant and receive all dividends with respect to such shares, whether or not the shares have vested. For restricted shares that have performance-based criteria, management has evaluated those criteria and has determined that, as of March 31, 2018, the criteria were probable of being met.

A summary of the Company's restricted shares activity and related information is presented below:

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| | Restricted Awards | Average Market Price at Grant | Restricted Awards | Average Market Price at Grant |
| Outstanding at January 1 | 170,033 | $ 44.34 | 180,622 | $ 39.31 |
| Granted | 23,163 | 68.63 | 10,609 | 66.33 |
| Forfeited | — | — | (750) | 42.05 |
| Vested | (20,864) | 40.44 | (18,438) | 37.50 |
| Outstanding at March 31 | 172,332 | $ 48.08 | 172,043 | $ 41.16 |

Information regarding stock-based compensation associated with restricted shares is provided in the following table (in thousands):

Three months

| | ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Stock-based compensation expense associated with restricted shares | $379 | $355 |

| At period-end: | March 31, 2018 |
|---|---|
| Unrecognized stock-based compensation expense associated with restricted shares | $4,432 |
| Weighted average period (in years) in which the above amount is expected to be recognized | 3.5 |

Shares issued in connection with restricted stock awards are issued from available treasury shares. If no treasury shares are available, new shares would be issued from available authorized shares. During the three months ended March 31, 2018 and 2017, all shares issued in connection with restricted stock awards were issued from available treasury stock.

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Benefit Plans

The Company provides retirement benefits to its employees through the City Holding Company 401(k) Plan and Trust (the “401(k) Plan”), which is intended to be compliant with Employee Retirement Income Security Act (ERISA) section 404(c). The Company also maintains two frozen defined benefit pension plans (the “Defined Benefit Plans”), which were inherited from the Company's acquisition of the plan sponsors (Horizon Bancorp, Inc. and Community Financial Corporation). During 2017, the Company initiated the process to terminate the Community Defined Benefit plan. The Company anticipates making a $1.6 million contribution in late 2018 or early 2019 (which has been accrued at March 31, 2018), when the termination process is expected to be completed.

The following table presents details of the Company's activities pursuant to these plans (in thousands):

| | Three months ended March 31, 2018 | 2017 |
|---|---|---|
| Components of net periodic cost: | | |
| Interest cost | $147 | $193 |
| Expected return on plan assets | (270 ) | (294 ) |
| Net amortization and deferral | 218 | 215 |
| Net Periodic Pension Cost | $95 | $114 |
| | | |
| 401(k) Plan expense | $218 | $251 |
| | | |
| Defined Benefit Plan contributions | $— | $— |

The components of net periodic benefit cost are included in the line item "other expenses" in the consolidated statements of income.

Note I –Commitments and Contingencies

The Company is a party to certain financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The Company has entered into agreements with certain customers to extend credit or provide a conditional commitment to provide payment on drafts presented in accordance with the terms of the underlying credit documents. The Company also provides overdraft protection to certain demand deposit customers that represent an unfunded commitment. Overdraft protection commitments, which are included with other commitments below, are uncollateralized and are paid at the Company’s discretion. Conditional commitments generally include standby and commercial letters of credit. Standby letters of credit represent an obligation of the Company to a designated third party contingent upon the failure of a customer of the Company to perform under the terms of the underlying contract between the customer and the third party. Commercial letters of credit are issued specifically to facilitate trade or commerce. Under the terms of a commercial letter of credit, drafts will be drawn when the underlying transaction is consummated, as intended, between the customer and a third party. The funded portion of these financial instruments is reflected in the Company’s balance sheet, while the unfunded portion of these commitments is not reflected in the balance sheet. The table below presents a summary of the contractual obligations of the Company resulting from significant commitments (in thousands):

| | March 31, 2018 | December 31, 2017 |
|---|---|---|

| | | |
|---|---|---|
| Commitments to extend credit: | | |
| Home equity lines | $ 196,946 | $ 194,477 |
| Commercial real estate | 45,832 | 66,901 |
| Other commitments | 159,622 | 184,895 |
| Standby letters of credit | 7,098 | 7,151 |
| Commercial letters of credit | 863 | 831 |

Loan commitments and standby and commercial letters of credit have credit risks essentially the same as those involved in extending loans to customers and are subject to the Company’s standard credit policies. Collateral is obtained based on

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management's credit assessment of the customer. Management does not anticipate any material losses as a result of these commitments.

The Company is engaged in various legal actions that it deems to be in the ordinary course of business. As these legal actions are resolved, the Company could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately resolved. There can be no assurance that current legal actions will have an immaterial impact on financial results, either positive or negative, or that no material legal actions may be presented in the future.

Note J – Accumulated Other Comprehensive Loss

The activity in accumulated other comprehensive loss is presented in the tables below (in thousands). All amounts are shown net of tax, which is calculated using a combined federal and state income tax rate approximating 23% for the three months ended March 31, 2018 and 37% for the three months ended March 31, 2017.

| | Accumulated Other Comprehensive Income (Loss) | | |
|---|---|---|---|
| | Defined Benefit Pension Plans | Unrealized Gains (Losses) on Securities Available-for-Sale | Total |
| Balance at December 31, 2016 | $(4,660) | $ (2,352) | $(7,012) |
| Other comprehensive income before reclassifications | — | 3,571 | 3,571 |
| Amounts reclassified from other comprehensive loss | — | (2,698) | (2,698) |
| | — | 873 | 873 |
| Balance at March 31, 2017 | $(4,660) | $ (1,479) | $(6,139) |
| Balance at December 31, 2017 | $(5,033) | $ (611) | $(5,644) |
| Other comprehensive loss before reclassifications | — | (8,218) | (8,218) |
| Amounts reclassified from other comprehensive loss | — | — | — |
| | — | (8,218) | (8,218) |
| Adoption of new accounting pronouncement | — | (2,657) | (2,657) |
| Balance at March 31, 2018 | $(5,033) | $ (11,486) | $(16,519) |

As a result of the adoption of ASU 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," the Company reclassified $2.7 million of unrealized gains and losses net of tax, relating to its equity and perpetual preferred securities, from other comprehensive income to retained earnings on January 1, 2018.

Amount reclassified from Other

| | Comprehensive Loss Three months ended March 31, 2018 | 2017 | Affected line item in the Statements of Income |
|---|---|---|---|
| Securities available-for-sale: | | | |
| Net unrealized securities gains (losses) reclassified into earnings | $ — | $ (4,276) | Security gains (losses) |
| Related income tax expense | — | 1,578 | Income tax expense |
| Net effect on accumulated other comprehensive loss | $ — | $ (2,698) | |

Note K –Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share using the two class method (in thousands, except per share data):

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| | Three months ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| Net income available to common shareholders | $17,616 | $16,026 |
| Less: earnings allocated to participating securities | (195 ) | (177 ) |
| Net earnings allocated to common shareholders | $17,421 | |