INTERNATIONAL BANCSHARES CORP
Form 10-Q
November 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from to

Commission file number 000-09439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas	74-2157138

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

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)

(Zip Code)

(956) 722-7611

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically 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 and post such files). Yes No

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

Class	Shares Issued and Outstanding
Common Stock, $1.00 par value	66,155,136 shares outstanding at November 5, 2018

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	September 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	$ 285,664	$ 265,357
Investment securities:		
Held to maturity debt securities (Fair value of $2,400 on September 30, 2018 and $2,400 on December 31, 2017)	2,400	2,400
Available for sale debt securities (Amortized cost of $3,631,419 on September 30, 2018 and $4,196,263 on December 31, 2017)	3,509,896	4,124,185
Equity securities with readily determinable fair values	6,013	27,885
Total investment securities	3,518,309	4,154,470
Loans	6,475,141	6,348,172
Less allowance for probable loan losses	(60,654)	(67,687)
Net loans	6,414,487	6,280,485
Bank premises and equipment, net	510,493	514,454
Accrued interest receivable	34,391	34,456
Other investments	609,997	571,415
Goodwill	282,532	282,532
Other assets	189,628	81,529
Total assets	$ 11,845,501	$ 12,184,698

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	September 30, 2018	December 31, 2017
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand—non-interest bearing	$ 3,431,773	$ 3,243,255
Savings and interest bearing demand	3,231,193	3,245,131
Time	1,982,635	2,056,506
Total deposits	8,645,601	8,544,892
Securities sold under repurchase agreements	333,803	353,805
Other borrowed funds	674,900	1,195,225
Junior subordinated deferrable interest debentures	160,416	160,416
Other liabilities	171,936	91,380
Total liabilities	9,986,656	10,345,718
Shareholders' equity:		
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 96,083,354 shares on September 30, 2018 and 96,019,028 shares on December 31, 2017	96,083	96,019
Surplus	144,660	171,816
Retained earnings	2,005,606	1,891,805
Accumulated other comprehensive loss	(95,184)	(28,397)
	2,151,165	2,131,243
Less cost of shares in treasury, 29,940,843 shares on September 30, 2018 and 29,939,545 on December 31, 2017	(292,320)	(292,263)
Total shareholders' equity	1,858,845	1,838,980
Total liabilities and shareholders' equity	$ 11,845,501	$ 12,184,698

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Interest income:				
Loans, including fees	$ 95,828	$ 83,394	$ 275,744	$ 238,261
Investment securities:				
Taxable	20,213	21,003	62,121	60,998
Tax-exempt	1,981	2,409	6,263	7,357
Other interest income	352	139	719	484
Total interest income	118,374	106,945	344,847	307,100
Interest expense:				
Savings deposits	3,353	1,599	8,872	4,241
Time deposits	3,493	2,426	9,172	7,203
Securities sold under repurchase agreements	468	1,177	1,839	5,391
Other borrowings	4,358	3,396	13,426	7,234
Junior subordinated deferrable interest debentures	1,828	1,395	5,119	3,967
Total interest expense	13,500	9,993	38,428	28,036
Net interest income	104,874	96,952	306,419	279,064
Provision for probable loan losses	4,280	6,591	3,212	9,096
Net interest income after provision for probable loan losses	100,594	90,361	303,207	269,968
Non-interest income:				
Service charges on deposit accounts	18,391	18,706	53,658	54,494
Other service charges, commissions and fees				
Banking	13,100	13,095	35,374	34,505
Non-banking	1,885	1,853	5,273	5,052
Investment securities transactions, net	(141)	—	(141)	(1,612)
Other investments, net	5,625	4,938	16,192	12,036
Other income	3,643	2,774	13,425	8,569
Total non-interest income	$ 42,503	$ 41,366	$ 123,781	$ 113,044

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Non-interest expense:				
Employee compensation and benefits	$ 35,360	$ 33,787	$ 104,670	$ 99,256
Occupancy	6,839	6,416	20,077	18,824
Depreciation of bank premises and equipment	6,460	6,407	19,097	18,936
Professional fees	4,063	3,577	10,010	11,143
Deposit insurance assessments	928	1,007	2,902	2,310
Net expense, other real estate owned	911	(407)	3,289	989
Amortization of identified intangible assets	—	—	—	25
Advertising	2,020	2,064	5,667	6,448
Early termination fee—securities sold under repurchase agreements	—	—	—	5,765
Software and software maintenance	4,481	4,302	12,943	12,155
Other	17,005	14,558	48,922	45,199
Total non-interest expense	78,067	71,711	227,577	221,050
Income before income taxes	65,030	60,016	199,411	161,962
Provision for income taxes	13,935	20,388	42,009	49,761
Net income	$ 51,095	$ 39,628	$ 157,402	$ 112,201
Basic earnings per common share:				
Weighted average number of shares outstanding	66,136,091	66,060,829	66,114,482	66,036,501
Net income	$ 0.77	$ 0.60	$ 2.38	$ 1.70
Fully diluted earnings per common share:				
Weighted average number of shares outstanding	66,423,209	66,745,350	66,739,899	66,736,250
Net income	$ 0.77	$ 0.59	$ 2.36	$ 1.68

See accompanying notes to consolidated financial statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

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	$ 51,095	$ 39,628	$ 157,402	$ 112,201
Other comprehensive income, net of tax:				
Net unrealized holding (losses) gains on securities available for sale arising during period (net of tax effects of $(4,193), $198, $(17,787) and $10,290)	(15,772)	368	(66,912)	19,110
Reclassification adjustment for losses on securities available for sale included in net income (net of tax effects of $30, $0, $30 and $564)	111	—	111	1,048
	(15,661)	368	(66,801)	20,158
Comprehensive income	$ 35,434	$ 39,996	$ 90,601	$ 132,359

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2018	2017
Operating activities:		
Net income	$ 157,402	$ 112,201
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	3,212	9,096
Specific reserve, other real estate owned	3,033	330
Depreciation of bank premises and equipment	19,097	18,936
Gain on sale of bank premises and equipment	(293)	(30)
Gain on sale of other real estate owned	(1,317)	(267)
Accretion of investment securities discounts	(209)	(307)
Amortization of investment securities premiums	15,620	18,068
Investment securities transactions, net	141	1,612
Unrealized loss on equity securities with readily determinable fair values	312	—
Amortization of identified intangible assets	—	25
Stock based compensation expense	755	699
Earnings from affiliates and other investments	(12,247)	(9,538)
Deferred tax expense (benefit)	1,373	(26)
Decrease (increase) in accrued interest receivable	65	(106)
(Increase) decrease in other assets	(48,747)	6,516
Net increase in other liabilities	40,533	17,314
Net cash provided by operating activities	178,730	174,523
Investing activities:		
Proceeds from maturities of securities	1,075	—
Proceeds from sales and calls of available for sale securities	37,675	279,419
Proceeds from sales of equity securities with readily determinable fair values	21,607	—
Purchases of available for sale securities	(47,346)	(944,241)
Principal collected on mortgage backed securities	529,956	573,713
Net increase in loans	(168,823)	(245,019)
Purchases of other investments	(34,914)	(10,282)
Distributions from other investments	2,894	349
Purchases of bank premises and equipment	(16,256)	(10,303)

Proceeds from sales of bank premises and equipment	1,413	2,194
Proceeds from sales of other real estate owned	3,633	11,139
Net cash provided by (used in) investing activities	$ 330,914	$ (343,031)

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2018	2017
Financing activities:		
Net increase in non-interest bearing demand deposits	$ 188,518	$ 86,778
Net (decrease) increase in savings and interest bearing demand deposits	(13,938)	49,654
Net decrease in time deposits	(73,871)	(132,980)
Net decrease in securities sold under repurchase agreements	(20,002)	(126,952)
Net (decrease) increase in other borrowed funds	(520,325)	334,125
Repurchase of outstanding common stock warrant	(29,005)	—
Purchase of treasury stock	(57)	(132)
Proceeds from stock transactions	1,158	1,185
Payments of cash dividends - common	(21,815)	(21,793)
Net cash (used in) provided by financing activities	(489,337)	189,885
Increase in cash and cash equivalents	20,307	21,377
Cash and cash equivalents at beginning of period	265,357	269,198
Cash and cash equivalents at end of period	$ 285,664	$ 290,575
Supplemental cash flow information:		
Interest paid	$ 37,051	$ 9,735
Income taxes paid	39,715	54,442
Non-cash investing and financing activities:		
Net transfers from loans to other real estate owned	$ 31,609	$ 1,538
Dividends declared, not yet paid on common stock	27,784	21,801

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 — Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (the "Corporation") and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the "Company") conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo ("IBC"), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville, International Bank of Commerce, Oklahoma and the Corporation's wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Trading Company, Premier Tierra Holdings, Inc., IBC Charitable and Community Development Corporation, and IBC Capital Corporation. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. These financial statements should be read in conjunction with the financial statements and the notes thereto in the Company's latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2017 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("US GAAP") for complete financial statements. Certain reclassifications have been made to make prior periods comparable. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results for the year ending December 31, 2018 or any future period.

The Company operates as one segment. The operating information used by the Company's chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has five active operating subsidiaries, the bank subsidiaries. The Company applies the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"), FASB ASC 280, "Segment Reporting," in determining its reportable segments and related disclosures.

The Company has evaluated all events or transactions that occurred through the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

On January 1, 2018, the Company adopted the provisions of ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," and ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments – Overall," which affects current US GAAP as it relates to the accounting for equity investments, financial liability under the fair value option, and the presentation and disclosure requirements for financial instruments. ASU 2016-01 also supersedes the guidance that requires: (i) the classification of equity securities with readily determinable fair values into different categories, and (ii) recognition in changes in fair value of available-for-sale securities in other comprehensive income. The main effect resulting from the adoption of the new standards is that beginning on January 1, 2018, equity securities with readily determinable fair values are now reported in a single line item on the face of the Company's consolidated statement of condition under the caption, "Equity securities with readily determinable fair values." Additionally, the changes in fair value of the equity securities is now recognized in net income and is included in other non-interest expense on the face of the Company's consolidated income statement. Prior to January 1, 2018, the equity securities were classified as available-for-sale and stated at fair value with unrealized gains and losses included in accumulated comprehensive income, net of tax and had a net unrealized loss of $189,000. Other equity securities without readily determinable fair values are recorded at cost less any impairment, if any, and included in other investments in the Company's consolidated financial statements.

On January 1, 2018, the Company adopted the provisions of ASU 2014-09 to ASC 606, “Revenue from Contracts with Customers.” ASC 606 sets a common standard that defines revenue and the principles for recognizing revenue. The core principle of the accounting standards update requires an entity to recognize revenue in a manner that reflects the consideration that an entity is expected to receive in exchange for goods or services as performance obligations are satisfied. The Company’s revenue is primarily comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASC 606. The Company has evaluated the impact of the accounting standards update on certain other non-interest revenue streams that the provisions of the update apply to and has determined that the adoption of the new provisions to ASC 606 did not have a significant impact to the Company’s consolidated financial statements or operations.

The Company adopted the provisions of ASU 2018-02 to ASC 220, “Income Statement- Reporting Comprehensive Income” in the second quarter of 2018. ASU 2018-02 amends current guidance surrounding the reclassification of certain tax effects from accumulated other comprehensive income (loss) as a result of the 2017 Tax Cuts and Jobs Act and the related impact to comprehensive income (loss) as a result of the application of existing guidance with respect to changes in tax rates. Under prior guidance, entities were to evaluate the carrying value of deferred tax assets and liabilities and adjust them for the tax effect of the rate change and record that change through earnings. The result is that the tax effects for items that normally would only be recognized in comprehensive income would be recognized through earnings and would result in stranded tax effects in other comprehensive income (loss) for the impact of the rate change. ASU 2018-02 allows for a reclassification from accumulated other comprehensive income (loss) to retained earnings for the stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act. The Company recorded a one-time reclassification of $5,979,000 between accumulated comprehensive income (loss) and retained earnings as a result of the adoption of the accounting standards update.

Note 2 — Fair Value Measurements

ASC Topic 820, “Fair Value Measurements and Disclosures” (“ASC 820”), defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs - Observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Inputs - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of September 30, 2018 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in Thousands)		
	Assets/Liabilities Measured at Fair Value September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale debt securities				
Residential mortgage-backed securities	$ 3,320,727	$ —	$ 3,320,727	$ —
States and political subdivisions	189,169	—	189,169	—
Equity Securities	6,013	6,013	—	—
	$ 3,515,909	$ 6,013	$ 3,509,896	$ —

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of December 31, 2017 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in Thousands)		
	Assets/Liabilities Measured at Fair Value December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale securities				
Residential mortgage - backed securities	$ 3,891,233	$ —	$ 3,891,233	$ —
States and political subdivisions	232,951	—	232,951	—
Equity Securities	27,886	27,886	—	—
	$ 4,152,070	$ 27,886	$ 4,124,184	$ —

Available-for-sale debt securities are classified within Level 2 of the valuation hierarchy. Equity securities with readily determinable fair values are classified within Level 1. For debt investments classified as Level 2 in the fair value hierarchy, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Certain financial assets and financial liabilities are measured at fair value on a non-recurring basis. The instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended September 30, 2018 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended September 30, 2018	Fair Value Measurements at Reporting Date Using (in thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision (Credit) During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 8,665	$ —	$ —	$ 8,665	$ 716
Other real estate owned	8,886	—	—	8,886	3,033

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2017 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended December 31, 2017	Fair Value Measurements at Reporting Date Using (in thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net (Credit) Provision During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 11,210	$ —	$ —	$ 11,210	$ 2,138
Other real estate owned	2,000	—	—	2,000	710

The Company's assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within Level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, "Receivables". Impaired loans are primarily comprised of collateral-dependent commercial loans. As the primary sources of loan repayments decline, the secondary repayment source, the collateral, takes on greater significance. Correctly evaluating the fair value becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for the Company's appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations, and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are "as is" (the property's highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of September 30, 2018, the Company had $22,948,000 of impaired commercial collateral dependent loans, of which $16,083,000 had an appraisal performed within the immediately preceding twelve months, and of which $0 had an evaluation performed within the immediately preceding twelve months. As of December 31, 2017, the Company had $53,267,000 of impaired commercial collateral dependent loans, of which $18,585,000 had an appraisal performed within the immediately preceding twelve months and of which $0 had an evaluation performed within the immediately preceding twelve months.

The determination to either seek an appraisal or to perform an evaluation begins in weekly credit quality meetings, where the committee analyzes the existing collateral values of the impaired loans and where obsolete appraisals are identified. In order to determine whether the Company would obtain a new appraisal or perform an internal evaluation to determine the fair value of the collateral, the credit committee reviews the existing appraisal to determine if the collateral value is reasonable in view of the current use of the collateral and the economic environment related to the collateral. If the analysis of the existing appraisal does not find that the collateral value is reasonable under the current circumstances, the Company would obtain a new appraisal on the collateral or perform an internal evaluation of the collateral. The ultimate decision to get a new appraisal rests with the independent credit administration group. A new appraisal is not required if an internal evaluation, as performed by in-house experts, is able to appropriately update the original appraisal assumptions to reflect current market conditions and provide an estimate of the collateral's market value for impairment analysis. The internal evaluations must be in writing and contain sufficient information detailing the analysis, assumptions and conclusions, and they must support performing an evaluation in lieu of ordering a new appraisal.

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within Level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write-downs are made, accordingly, through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the three and nine months ended September 30, 2018 and the twelve months ended December 31, 2017, the Company recorded $8,000, $170,000 and $30,000, respectively, in charges to the allowance for probable loan losses in connection with loans transferred to other real estate owned. For the three and nine months ended September 30, 2018 and the twelve months ended December 31, 2017, the Company recorded $635,000, $3,033,000 and $710,000, respectively, in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for the Company's financial instruments at September 30, 2018 and December 31, 2017 are outlined below.

Cash and Cash Equivalents

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Time Deposits with Banks

The carrying amounts of time deposits with banks approximate fair value.

Investment Securities Held-to-Maturity

The carrying amounts of investments held-to-maturity approximate fair value.

Investment Securities

For investment securities, which include U.S. Treasury securities, obligations of other U.S. government agencies, obligations of states and political subdivisions and mortgage pass-through and related securities, fair values are from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. See disclosures of fair value of investment securities in Note 6.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type, such as commercial, real estate and consumer loans, as outlined by regulatory reporting guidelines. Each category is segmented into fixed and variable interest rate terms and by performing and non-performing categories.

For variable rate performing loans, the carrying amount approximates the fair value. For fixed-rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed-rate performing loans are within Level 3 of the fair value hierarchy. At September 30, 2018, and December 31, 2017, the carrying amount of fixed-rate performing loans was $1,543,620,000 and $1,505,531,000, respectively, and the estimated fair value was $1,485,318,000 and $1,454,434,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of September 30, 2018 and December 31, 2017. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value hierarchy. At September 30, 2018 and December 31, 2017, the carrying amount of time deposits was $1,982,635,000 and $2,056,506,000, respectively, and the estimated fair value was $1,984,627,000 and $2,058,621,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements include short- and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at September 30, 2018 and December 31, 2017. The fair value of the long-term instruments is based on established market spreads using option adjusted spread methodology. Long-term repurchase agreements are within Level 3 of the fair value hierarchy. The only remaining long-term repurchase agreement outstanding matured in the first quarter of 2018 and was not renewed. At December 31, 2017, the carrying amount of long-term repurchase agreements was $100,000,000 and the estimated fair value was $99,504,000.

Junior Subordinated Deferrable Interest Debentures

The Company currently has floating-rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating-rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at September 30, 2018 and December 31, 2017.

Other Borrowed Funds

The Company currently has short- and long-term borrowings issued from the Federal Home Loan Bank ("FHLB"). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at September 30, 2018 and December 31, 2017. The long-term borrowings outstanding at September 30, 2018 are fixed-rate borrowings and the fair value is based on established market spreads for similar types of borrowings. The fixed rate long-term borrowings are included in Level 2 of the fair value hierarchy. At September 30, 2018 and December 31, 2017, the carrying amount of the fixed rate long-term FHLB borrowings was $425,000,000 and $250,000,000, respectively, and the estimated fair value was $423,568,000 and $249,728,000, respectively.

Commitments to Extend Credit and Letters of Credit

Commitments to extend credit and fund letters of credit are principally at current interest rates, and, therefore, the carrying amount approximates fair value.

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-statement of condition financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include the bank premises and equipment and core deposit value. In addition, the tax ramifications related to the effect of fair value estimates have not been considered in the above estimates.

Note 3 — Loans

A summary of loans, by loan type at September 30, 2018 and December 31, 2017 is as follows:

	September 30, 2018	December 31, 2017
	(Dollars in Thousands)	
Commercial, financial and agricultural	$ 3,247,464	$ 3,322,668
Real estate - mortgage	1,147,632	1,133,525
Real estate - construction	1,878,440	1,683,550
Consumer	46,646	49,543
Foreign	154,959	158,886
Total loans	$ 6,475,141	$ 6,348,172

Note 4 — Allowance for Probable Loan Losses

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the bank subsidiaries. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each bank subsidiary is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance for probable loan losses is derived from the following elements: (i) allowances established on specific impaired loans, which are based on a review of the individual characteristics of each loan, including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates; (ii) allowances based on actual historical loss experience for similar types of loans in the Company's loan portfolio; and (iii) allowances based on general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things. All segments of the loan portfolio continue to be impacted by economic uncertainty as the economy recovers from the recent prolonged downturn.

The Company's management continually reviews the allowance for loan losses of the bank subsidiaries using the amounts determined from the allowances established on specific impaired loans, the allowance established on quantitative historical loss percentages, and the allowance based on qualitative data to establish an appropriate amount to maintain in the Company's allowance for loan losses. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company's estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses. While the calculation of the allowance for probable loan losses utilizes management's best judgment and all information reasonably available, the adequacy of the allowance is dependent on a variety of factors beyond the Company's control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

The loan loss provision is determined using the following methods. On a weekly basis, loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on the Company's internal classified report. Additionally, the Company's credit department reviews the majority of the Company's loans for proper internal classification purposes, regardless of whether they are past due, and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, the Company determines if a loan should be placed on an internal classified report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

A summary of the transactions in the allowance for probable loan losses by loan class is as follows:

	Three Months Ended September 30, 2018								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Tot
	(Dollars in Thousands)								
Balance at June 30,	$ 16,596	$ 14,703	$ 18,296	$ 1,574	$ 3,591	$ 6,793	$ 450	$ 850	$ 6
Losses charged to allowance	(6,798)	—	—	—	(74)	(133)	(80)	(3)	(
Recoveries credited to allowance	489	4	19	—	23	53	12	9	6
Net (losses) recoveries charged to allowance	(6,309)	4	19	—	(51)	(80)	(68)	6	(
Provision charged to operations	3,039	397	1,050	(138)	(354)	194	57	35	4
Balance at September 30,	$ 13,326	$ 15,104	$ 19,365	$ 1,436	$ 3,186	$ 6,907	$ 439	$ 891	$ 6

	Three Months Ended September 30, 2017								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at June 30,	$ 25,140	$ 13,249	$ 17,472	$ 997	$ 2,314	$ 4,357	$ 488	$ 902	$ 64,919
Losses charged to allowance	(4,249)	(213)	—	—	(16)	(202)	(63)	—	(4,743)
Recoveries credited to allowance	631	17	341	—	—	85	6	5	1,085
Net (losses) recoveries charged to allowance	(3,618)	(196)	341	—	(16)	(117)	(57)	5	(3,658)
Provision charged to operations	5,473	(1,168)	371	—	817	995	82	21	6,591
Balance at September 30,	$ 26,995	$ 11,885	$ 18,184	$ 997	$ 3,115	$ 5,235	$ 513	$ 928	$ 67,852

	Nine Months Ended September 30, 2018								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
alance at ecember 31,	$ 27,905	$ 11,675	$ 16,663	$ 1,109	$ 2,950	$ 6,103	$ 440	$ 842	$ 67,687
osses charged to lowance	(11,798)	(1)	(70)	—	(118)	(172)	(262)	(3)	(12,424)
ecoveries credited allowance	1,520	8	229	—	25	348	39	10	2,179
et (losses) coveries charged allowance	(10,278)	7							