FIDELITY SOUTHERN CORP
Form 10-Q
November 02, 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
Commission file number 001-34981

Fidelity Southern Corporation
(Exact name of registrant as specified in its charter)

Georgia	58-1416811
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3490 Piedmont Road, Suite 1550 Atlanta, Georgia	30305
(Address of principal executive offices)	(Zip Code)

(404) 639-6500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ¨ Accelerated filer ý Non-accelerated filer o Smaller reporting company o

Emerging growth company o
If an emerging growth company, indicate by check mark if the 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 ý
As of October 31, 2018 (the most recent practicable date), the Registrant had outstanding 27,270,168 shares of Common Stock.

FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
Quarterly Report on Form 10-Q
For the Three and Nine Months Ended September 30, 2018

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

($ in thousands)	(Unaudited) September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 52,125	$ 33,874
Interest-bearing deposits with banks	126,046	104,032
Federal funds sold	4,501	48,396
Cash and cash equivalents	182,672	186,302
Investment securities available-for-sale	209,180	120,121
Investment securities held-to-maturity (fair value of $19,714 and $21,685, respectively)	20,383	21,689
Loans held-for-sale (includes loans at fair value of $328,090 and $269,140, respectively)	371,319	357,755
Loans	3,706,953	3,580,966
Allowance for loan losses	(31,157)	(29,772)
Loans, net of allowance for loan losses	3,675,796	3,551,194
Premises and equipment, net	91,359	88,463
Other real estate, net	8,031	7,621
Bank owned life insurance	71,092	71,883
Servicing rights, net	116,982	112,615
Other assets	65,242	59,215
Total assets	$ 4,812,056	$ 4,576,858
Liabilities		
Deposits		
Noninterest-bearing demand deposits	$ 1,249,391	$ 1,125,598
Interest-bearing deposits	2,800,578	2,741,602
Total deposits	4,049,969	3,867,200
Short-term borrowings	163,562	150,580
Subordinated debt, net	120,680	120,587
Other liabilities	45,747	36,859
Total liabilities	4,379,958	4,175,226
Shareholders’ equity		
Preferred stock, no par value. Authorized 10,000,000; zero issued and outstanding	—	—
Common stock, no par value. Authorized 50,000,000; issued and outstanding 27,260,681 and 27,019,201, respectively	226,605	217,555
Accumulated other comprehensive (loss)/income, net of tax	(2,270)	383
Retained earnings	207,763	183,694
Total shareholders’ equity	432,098	401,632
Total liabilities and shareholders’ equity	$ 4,812,056	$ 4,576,858

See accompanying notes to unaudited consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ in thousands, except per share data)	2018	2017	2018	2017
Interest income:				
Loans, including fees	$44,746	$37,290	$127,440	$110,933
Investment securities:				
Taxable interest income	1,542	982	3,925	3,280
Nontaxable interest income	104	29	250	109
Other	480	804	1,559	2,003
Total interest income	46,872	39,105	133,174	116,325
Interest expense:				
Deposits	5,655	4,163	14,791	11,503
Short-term borrowings	818	16	3,540	910
Subordinated debt	1,652	1,532	4,856	4,538
Total interest expense	8,125	5,711	23,187	16,951
Net interest income	38,747	33,394	109,987	99,374
Provision for loan losses	360	1,425	4,776	4,275
Net interest income after provision for loan losses	38,387	31,969	105,211	95,099
Noninterest income:				
Service charges on deposit accounts	1,690	1,553	4,630	4,489
Other fees and charges	2,464	2,197	7,148	6,060
Mortgage banking activities	23,520	25,040	81,465	77,865
Indirect lending activities	1,120	1,901	4,538	9,967
SBA lending activities	914	1,460	3,288	3,959
Trust and wealth management fees	588	325	1,694	853
Other	3,366	1,162	5,009	2,871
Total noninterest income	33,662	33,638	107,772	106,064
Noninterest expense:				
Salaries and employee benefits	28,805	26,331	84,581	77,621
Commissions	9,523	9,244	28,271	26,126
Occupancy and equipment	4,654	4,508	14,127	13,371
Professional and other services	4,243	4,604	13,676	13,723
Other	8,360	8,150	28,524	27,119
Total noninterest expense	55,585	52,837	169,179	157,960
Income before income tax expense	16,464	12,770	43,804	43,203
Income tax expense	3,722	4,836	9,905	15,850
Net income	$12,742	$7,934	$33,899	$27,353
Earnings per common share:				
Basic	$0.47	$0.30	$1.25	$1.03
Diluted	$0.47	$0.30	$1.25	$1.03
Cash dividends declared per common share	$0.12	$0.12	$0.36	$0.36
Net income	$12,742	$7,934	$33,899	$27,353

Other comprehensive (loss)/income, net of tax:				
Change in net unrealized (losses)/gains on available-for-sale debt securities, net of tax effect of ($391), $3, ($911), and $167, respectively	(1,174)	5	(2,733)	272
Total other comprehensive (loss)/income, net of tax	(1,174)	5	(2,733)	272
Comprehensive income	$11,568	$7,939	$31,166	$27,625

See accompanying notes to unaudited consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS’ EQUITY
(UNAUDITED)

	Preferred Stock		Common Stock		Accumulated Other Comprehensive Income/(Loss), Net of Tax	Retained Earnings	Total
(in thousands)	Shares	Amount	Shares	Amount			
Balance at December 31, 2016	—	$ —	26,318	$205,309	$ 692	$156,646	$362,647
Net income						27,353	27,353
Other comprehensive income, net of tax					272		272
Comprehensive income							27,625
Common stock issued under various employee plans, net			497	7,324			7,324
Cash dividends paid						(9,528)	(9,528)
Balance at September 30, 2017	—	$ —	26,815	$212,633	$ 964	$174,471	$388,068
Balance at December 31, 2017	—	$ —	27,019	$217,555	$ 383	$183,694	$401,632
Net income						33,899	33,899
Impact of adoption of new accounting standard (1)					80	(80)	—
Other comprehensive loss, net of tax					(2,733)		(2,733)
Comprehensive income							31,166
Common stock issued under various employee plans, net			242	9,050			9,050
Cash dividends paid						(9,750)	(9,750)
Balance at September 30, 2018	—	$ —	27,261	$226,605	$ (2,270)	$207,763	$432,098

(1) Represents the impact of the adoption of Accounting Standards Update ("ASU") No. 2018-02.
See accompanying notes to unaudited consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
(in thousands)	2018	2017
Cash flows from operating activities:		
Net income	$33,899	$ 27,353
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	4,776	4,275
Depreciation and amortization of premises and equipment	3,252	3,316
Amortization of FDIC indemnification asset, net	4	1,159
Accretion of purchase discounts or premiums, net	(463)	(1,645)
Other amortization	663	1,081
Impairment of other real estate	447	951
Amortization and impairment of servicing rights, net	9,107	13,305
Share-based compensation expense	4,190	3,105
Postretirement benefits, net	1,854	2,033
Gains on loan sales, including origination/sale of servicing rights	(58,578)	(67,255)
Net gain on sales of other real estate	(40)	(847)
Income on bank owned life insurance	(3,771)	(1,304)
Net change in deferred income tax	2,512	7,656
Net change in fair value of loans held-for-sale	(1,139)	(2,771)
Originations of loans held-for-sale	(2,247,546)	(2,272,714)
Proceeds from sales of loans held-for-sale	2,269,637	2,441,839
Net payments (paid to) received from FDIC under loss-share agreements	(888)	487
(Increase) decrease in other assets	(2,452)	5,914
Increase in other liabilities	5,222	1,200
Net cash provided by operating activities	20,686	167,138
Cash flows from investing activities:		
Purchases of investment securities available-for-sale	(107,311)	—
Maturities, calls, and repayment of investment securities available-for-sale	14,224	18,955
Maturities, calls and repayment of investment securities held-to-maturity	1,243	1,435
Purchases of FHLB stock	(15,258)	(6,681)
Redemption of FHLB stock	14,025	15,938
Net increase in loans	(132,395)	(110,881)
Proceeds from the sale of servicing rights	12,843	—
Proceeds from bank owned life insurance	2,901	—
Proceeds from sales of other real estate	699	7,897
Purchases of premises and equipment	(6,148)	(5,337)
Net cash used in investing activities	(215,177)	(78,674)

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued
(UNAUDITED)

(in thousands)	Nine Months Ended September 30, 2018	2017
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	$123,793	$147,814
Net increase in interest-bearing deposits	58,976	159,952
Net decrease in other short-term borrowings	(12,018)	(3,605)
Proceeds from FHLB advances	2,295,000	350,000
Repayments on FHLB advances	(2,270,000)	(575,000)
Proceeds from the issuance of common stock, net	4,860	4,219
Cash dividends paid on common stock	(9,750)	(9,528)
Net cash provided by financing activities	190,861	73,852
Net (decrease) increase in cash and cash equivalents	(3,630)	162,316
Cash and cash equivalents, beginning of period	186,302	149,711
Cash and cash equivalents, end of period	$182,672	$312,027
Supplemental cash flow information and non-cash disclosures:		
Cash paid during the period for:		
Interest on deposits and borrowings	$21,882	$15,836
Income taxes	5,083	7,896
Transfers of loans from held-for-sale to held for investment	2,796	3,109
Transfers of loans to other real estate	1,516	1,812

See accompanying notes to unaudited consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2018
(UNAUDITED)

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements include the accounts of Fidelity Southern Corporation ("FSC" or "Fidelity") and its wholly-owned subsidiaries. FSC owns 100% of Fidelity Bank (the "Bank") and LionMark Insurance Company, an insurance agency offering consumer credit related insurance products. FSC also owns three subsidiaries established to issue trust preferred securities, which are not consolidated for financial reporting purposes in accordance with current accounting guidance, as FSC is not the primary beneficiary. The "Company" or "our," as used herein, includes FSC and its consolidated subsidiaries, unless the context otherwise requires.

These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") followed within the financial services industry for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information or notes required for complete financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses; the calculations of, amortization of, and the potential impairment of capitalized servicing rights; the valuation of loans held-for-sale and certain derivatives; the valuation of real estate or other assets acquired in connection with foreclosures or in satisfaction of loans; estimates used for fair value acquisition accounting, goodwill impairment testing and valuation of deferred income taxes. In addition, the actual lives of certain amortizable assets and income items are estimates subject to change. The Company principally operates in one business segment, which is community banking.

In the opinion of management, all adjustments, consisting of normal and recurring items, considered necessary for a fair presentation of the consolidated financial statements for the interim periods have been included. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain amounts reported in prior periods have been reclassified to conform to current year presentation. These reclassifications did not have a material effect on previously reported net income, shareholders' equity or cash flows.

Operating results for the nine-month period ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission ("SEC").

The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in the 2017 Annual Report on Form 10-K filed with the SEC. There were no new accounting policies or changes to existing policies adopted during the first nine months of 2018 which had a significant effect on the Company's results of operations or statement of financial condition. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.

Contingencies

Due to the nature of their activities, the Company and its subsidiaries are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of September 30, 2018. Although the ultimate outcome of all claims and lawsuits outstanding as of September 30, 2018 cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on the Company's results of operations or financial condition.

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Tax Cuts and Jobs Act

Public Law No. 115-97, known as the Tax Cuts and Jobs Act (the "Tax Act"), was enacted on December 22, 2017 and reduced the U.S. Federal corporate tax rate from 35% to 21% effective January 1, 2018. Additionally, on December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for provisions of the Tax Act. SAB 118 provides a measurement period of up to one year from the enactment date to complete the accounting. Any adjustments during this measurement period will be included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments are determined. Based on the information available and current interpretation of the provisions of the Tax Act, the Company completed the remeasurement of its net deferred tax liability at December 31, 2017 which reduced income tax expense by $4.9 million for the fourth quarter of 2017. For the three and nine months ended September 30, 2018, no further adjustments were recorded related to the remeasurement of the Company's net deferred tax liability balance as a result of the Tax Act. The final impact of the Tax Act may differ from estimates used to calculate the remeasurement of its net deferred tax liability balance as a result of changes in management’s interpretations and assumptions, as well as new guidance that may be issued by the Internal Revenue Service.

Recently Adopted Accounting Pronouncements

In March 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ("ASU") No. 2018-05, “Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SAB 118). This ASU was effective upon issuance. The adoption of this ASU did not have a significant impact on the Company's Consolidated Financial Statements.

In March 2018, the FASB issued ASU No. 2018-04, “Investments-Debt Securities (Topic 320) and Regulated Operations (Topic 980): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273. For public business entities, the Update was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this ASU did not have a significant impact on the Company's Consolidated Financial Statements.

In February 2018, the FASB issued ASU No. 2018-03, “Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2018-03"). This guidance amended ASU No. 2016-01, “Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”) on recognizing and measuring financial instruments to clarify certain aspects of the guidance originally issued in January 2016. The adoption of this Update effective January 1, 2018 did not have a significant impact on the Company's Consolidated 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” ("ASU 2018-02"), that allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act that passed U.S. Congress in December 2017. The Company elected to early adopt this guidance effective January 1, 2018. The adoption of ASU 2018-02 resulted in a reclassification of stranded tax effects of $80,000 to accumulated other comprehensive income (loss) from retained earnings.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting,” (“ASU 2017-09”) that provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated 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,” (“ASU 2017-07”) that will change how employers who sponsor defined benefit pension and/or other postretirement benefit plans present the net periodic benefit cost in the income statement. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” (“ASU 2017-04”) which simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. The new guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and is required to be applied prospectively, with early adoption permitted for any

impairment tests performed on testing dates after January 1, 2017. The early adoption of this ASU in the fourth quarter of 2017 did not have a significant impact on the Company's Consolidated Financial Statements.
In January 2017, the FASB issued ASU No. 2017-03, "Accounting Changes and Error Corrections (Topic 250) and Investments-Equity Method and Joint Ventures (Topic 323)," ("ASU 2017-03"). ASU 2017-03 amends the Codification for SEC staff announcements made at two Emerging Issues Task Force (EITF) meetings. That Topic required registrants to disclose the effect that recently issued accounting standards will have on their financial statements when adopted in a future period. The Company adopted this guidance in the fourth quarter of 2016. The adoption of this ASU did not have a significant impact on the Company's Consolidated Financial Statements.

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In January 2017, the FASB issued ASU No. 2017-01, “Business Combinations (Topic 805) - Clarifying the Definition of a Business,” (“ASU 2017-01”) which provides clarification on 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. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated Financial Statements.

In December 2016, the FASB issued ASU No. 2016-20, “Technical Corrections and Improvements to Topic 606: Revenue from Contracts with Customers.” ASU 2016-20 updates the new revenue standard by clarifying issues that had arisen from ASU No. 2014-09 but does not change the core principle of the new standard. In August 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date” which deferred the effective date of ASU No. 2014-09, “Revenue from Contracts with Customers,” (“ASU 2014-09”) by one year to annual reporting periods beginning after December 15, 2017, and interim reporting periods therein. The FASB had previously issued ASU 2014-09 in May 2014. The Company adopted the guidance on January 1, 2018 utilizing the modified retrospective approach. The Company did not record a cumulative effect adjustment to opening retained earnings as the adoption of ASU 2014-09 did not have a significant impact on the Company's Consolidated Financial Statements. The Company also completed its evaluation of the expanded disclosure requirements for disaggregation of revenue and other information regarding material contracts and began presenting the required disclosures in its Consolidated Financial Statements for the quarter ended March 31, 2018. See Note 11. Revenue Recognition for more information.

In November 2016, the FASB issued ASU No. 2016-18, “Statement of Cash Flows (Topic 230) - Restricted Cash,” (“ASU 2016-18”). The ASU was to be applied retrospectively beginning in fiscal year 2018, including interim periods therein with early adoption permitted, including adoption in an interim period, with retrospective application. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated Financial Statements.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory,” (“ASU 2016-16”) that addresses the income tax consequences of intra-entity transfers of assets other than inventory. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated Financial Statements.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” (“ASU 2016-15”) intended to reduce diversity in practice in how certain cash receipts and cash payments are classified in the statement of cash flows. The adoption of this ASU effective January 1, 2018 did not have a significant impact on the Company’s Consolidated Financial Statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

In August 2018, the FASB issued Accounting Standards Update (“ASU”) 2018-13, “Fair Value Measurement (Topic 820), which changes the fair value measurement disclosure requirements of ASC 820. The amendments in this ASU were the result of a broader disclosure project called FASB Concepts Statement, Conceptual Framework for Financial Reporting - Chapter 8: Notes to Financial Statements, which the Board finalized on August 28, 2018. The ASU is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods therein with early adoption permitted for any eliminated or modified disclosures upon issuance of this ASU. The adoption of this ASU is not expected to have a significant impact on the Company's Consolidated Financial Statements.

In August 2017, the FASB issued ASU No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,” (“ASU 2017-12”) that is intended to improve and simplify rules relevant to hedge accounting. This ASU refines and expands hedge accounting for both financial (e.g., interest rate) and commodity risks. ASU 2017-12 is intended to improve transparency and accounting through a focus on: (1) measurement and hedging strategies; (2) presentation and disclosure; and (3) easing the administrative burden that hedge accounting can create for an entity. Entities will (a) measure the hedged item in a partial-term fair value hedge of interest rate risk by assuming the hedged item has a term that reflects only the designated cash flows being hedged; (b) consider only how changes in the benchmark interest rate affect a decision to settle a pre-payable instrument before its scheduled maturity when calculating the fair value of the hedged item; and (c) measure the fair value of the hedged item using the benchmark rate component of the contracted coupon cash flows determined at inception. The amendments in this

ASU shall take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted in any interim period or fiscal years before the effective date of the standard. The adoption of this ASU is not expected to have a significant impact on the Company's Consolidated Financial Statements based on its current hedging strategies. However, the Company is currently evaluating this ASU to determine whether its provisions will enhance its risk management strategies.

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," ("ASU 2017-08") that amends the amortization period for certain purchased callable debt securities held at a premium. The guidance is effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods therein. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. These amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the adoption period. In addition, in the period of adoption, disclosures should be provided about a change in accounting principle. The adoption of this ASU is not expected to have a significant impact on the Company’s Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13 which significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today’s guidance delays recognition of credit losses. The standard will replace today’s “incurred loss” approach with an “expected loss” model. The new model, referred to as the current expected credit loss (“CECL”) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale (“AFS”) securities. For AFS securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. All other things being equal, higher credit losses will result in lower regulatory capital ratios for the Company. The ASU also simplifies the accounting model for purchased credit-impaired securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity’s assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. The standard will take effect for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application for all organizations will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company has established a working group which includes representatives from various internal departments with the expertise needed to implement the guidance. The working group has assigned key tasks to complete and established a timeline to be followed. The team is meeting regularly to review progress on the assigned tasks and to share current information on industry practices. Members of the working group are also attending conferences and meetings with peer banks to keep current on evolving interpretations of the guidance. As part of its implementation plan, the Company has allocated staff and put resources in place to evaluate the appropriate model options and is collecting, reviewing, and validating historical loan data for use in these models. The Company is implementing a software package supported by a third-party vendor to automate the calculation of the allowance for loan losses under the new methodology. Management is continuing to evaluate the impact that the guidance will have on the Company’s Consolidated Financial Statements and its regulatory capital ratios through its effective date.

In February 2016, the FASB issued ASU No. 2016-02, "Leases". Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee’s obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity’s leasing activities. The new standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. In transition, lessees are required to recognize and measure leases at the beginning of the earliest period presented in the financial statements using a modified retrospective approach. In July 2018, the FASB issued ASU No. 2018-11, “Leases - Targeted Improvements” to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new lease standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January

1, 2019 for the Company). The Company expects to elect both transition options. As the Company expects to elect the transition option provided in ASU No. 2018-11, the modified retrospective approach will be applied on January 1, 2019 (as opposed to January 1, 2017). The Company also expects to elect certain relief options offered in ASU 2016-02 including the package of practical expedients, including the option not to recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e., leases with terms of twelve months or less). The Company has several lease agreements, such as branches and mortgage offices, which are currently considered operating leases, and therefore, not recognized on the Company’s consolidated statements of condition. The Company expects the new guidance will require these lease agreements to be recognized on the consolidated statements of condition as a right-of-use asset and a corresponding lease liability. Therefore, the Company’s preliminary evaluation indicates the provisions of ASU No. 2016-02 are expected to impact the Company’s consolidated statements of condition, along with the Company’s regulatory capital ratios. The Company does not expect the new guidance to have a material impact on the Company’s consolidated statements of income. The Company has implemented a new software supported by a third-party vendor to help automate the calculation of the right of use asset and the corresponding lease liability. As of September 30, 2018, the Company’s total outstanding lease obligations, all of which are classified as operating leases, was approximately $19.3 million, or 0.40% of total assets.

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

2. Investment Securities

Management's primary objective in managing the investment securities portfolio includes maintaining a portfolio of high quality investments with competitive returns while providing for pledging and liquidity needs within overall asset and liability management parameters. The Company is required under federal regulations to maintain adequate liquidity to ensure safe and sound operations. As such, management regularly evaluates the investment portfolio for cash flows, the level of loan production and sales, current interest rate risk strategies and the potential future direction of market interest rate changes. Individual investment securities differ in terms of default, interest rate, liquidity and expected rate of return risk.

The following table summarizes the amortized cost and fair value of debt securities and the related gross unrealized gains and losses at September 30, 2018, and December 31, 2017:

	September 30, 2018			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities available-for-sale:				
Obligations of U.S. Government sponsored enterprises	$22,154	$ 15	$ (457)	$21,712
Municipal securities	8,270	166	(81)	8,355
SBA pool securities	11,240	—	(462)	10,778
Residential mortgage-backed securities	148,417	256	(1,340)	147,333
Commercial mortgage-backed securities	22,015	—	(1,013)	21,002
Total available-for-sale	$212,096	$ 437	$ (3,353)	$209,180
Investment securities held-to-maturity:				
Municipal securities	$8,527	$ —	$ (313)	$8,214
Residential mortgage-backed securities	7,928	52	(408)	7,572
Commercial mortgage-backed securities	3,928	—	—	3,928
Total held-to-maturity	$20,383	$ 52	$ (721)	$19,714

	December 31, 2017			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities available-for-sale:				
Obligations of U.S. Government sponsored enterprises	$22,182	$ 141	$ (98)	$22,225
Municipal securities	9,318	340	(23)	9,635
SBA pool securities	13,031	6	(127)	12,910
Residential mortgage-backed securities	50,251	803	(76)	50,978
Commercial mortgage-backed securities	24,721	6	(354)	24,373
Total available-for-sale	$119,503	$ 1,296	$ (678)	$120,121
Investment securities held-to-maturity:				
Municipal securities	$8,588	$ 53	$ —	$8,641
Residential mortgage-backed securities	9,100	99	(156)	9,043
Commercial mortgage-backed securities	4,001	—	—	4,001
Total held-to-maturity	$21,689	$ 152	$ (156)	$21,685

The Company held 50 and 19 investment securities available-for-sale that were in an unrealized loss position at September 30, 2018, and December 31, 2017, respectively. There were eight and six investment securities held-to-maturity that were in an unrealized loss position at September 30, 2018, and December 31, 2017, respectively.

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The following table reflects the gross unrealized losses and fair values of the investment securities with unrealized losses, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position:

	September 30, 2018			
	Less Than 12 Months		12 Months or Longer	
(in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale:				
Obligations of U.S. Government sponsored enterprises	$14,711	$ (289)	$4,895	$ (168)
Municipal securities	2,809	(44)	1,022	(37)
SBA pool securities	3,909	(112)	6,868	(350)
Residential mortgage-backed securities	120,494	(1,155)	4,419	(185)
Commercial mortgage-backed securities	—	—	21,003	(1,013)
Total available-for-sale	$141,923	$ (1,600)	$38,207	$ (1,753)
Investment securities held-to-maturity:				
Municipal securities	$8,214	$ (313)	$—	$ —
Residential mortgage-backed securities	—	—	6,512	(408)
Total held-to-maturity	$8,214	$ (313)	$6,512	$ (408)

	December 31, 2017			
	Less Than 12 Months		12 Months or Longer	
(in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale:				
Obligations of U.S. Government sponsored enterprises	$14,974	$ (98)	$—	$ —
Municipal securities	—	—	1,050	(23)
SBA pool securities	3,285	(42)	4,979	(85)
Residential mortgage-backed securities	1,835	(8)	5,383	(68)
Commercial mortgage-backed securities	10,051	(89)	12,360	(265)
Total available-for-sale	$30,145	$ (237)	$23,772	$ (441)
Investment securities held-to-maturity:				
Residential mortgage-backed securities	$—	$ —	$7,652	$ (156)
Total held-to-maturity	$—	$ —	$7,652	$ (156)

At September 30, 2018 and December 31, 2017, the unrealized losses on investment securities were unrelated to credit losses. Management does not intend to sell the temporarily impaired securities and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost, which may be maturity. The unrealized loss position has increased during 2017 and 2018, primarily in the mortgage-backed securities and SBA pool securities categories, and is the result of the increase in interest rates.

As part of the Company’s evaluation of its intent and ability to hold investments for a period of time sufficient to allow for any anticipated recovery in the market, the Company considers its investment strategy, cash flow needs, liquidity position, capital adequacy and interest rate risk position.

Accordingly, as of September 30, 2018, management has reviewed its portfolio for other-than-temporary-impairment and believes the impairment detailed in the table above is temporary, and no other-than-temporary impairment loss has been recognized in the Company's Consolidated Statements of Comprehensive Income. Management continues to monitor all of its securities with a high degree of scrutiny. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of these securities may be sold or are other than temporarily impaired, which would require a charge to earnings in such periods.

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The amortized cost and fair value of investment securities at September 30, 2018, and December 31, 2017, are categorized in the following table by remaining contractual maturity. The amortized cost and fair value of securities not due at a single maturity (i.e., mortgage-backed securities) are shown separately and the fair value is calculated based on estimated average remaining life:

(in thousands)	September 30, 2018 Amortized Cost	September 30, 2018 Fair Value	December 31, 2017 Amortized Cost	December 31, 2017 Fair Value
Investment securities available-for-sale:				
Obligations of U.S. Government sponsored enterprises				
Due after one year through five years	$21,151	$20,696	$21,179	$21,160
Due after five years through ten years	1,003	1,016	1,003	1,065
Municipal securities				
Due after one year through five years	1,490	1,452	1,503	1,488
Due after five years through ten years	2,440	2,507	2,753	2,877
Due after ten years	4,340	4,396	5,062	5,270
SBA pool securities				
Due after five years through ten years	6,733	6,521	7,967	7,931
Due after ten years	4,507	4,257	5,064	4,979
Residential mortgage-backed securities	148,417	147,333	50,251	50,978
Commercial mortgage-backed securities	22,015	21,002	24,721	24,373
Total available-for-sale	$212,096	$209,180	$119,503	$120,121
Investment securities held-to-maturity:				
Municipal securities				
Due after five years through ten years	$1,588	$1,549	$1,588	$1,641
Due after ten years	6,939	6,665	7,000	7,000
Residential mortgage-backed securities	7,928	7,572	9,100	9,043
Commercial mortgage-backed securities	3,928	3,928	4,001	4,001
Total held-to-maturity	$20,383	$19,714	$21,689	$21,685

There were three investment securities available-for-sale called, matured, or paid off during the nine months ended September 30, 2018, and five investment securities called, matured, or paid off during the nine months ended September 30, 2017. There were no gross gains or losses for the investment securities that were called, matured, or paid off during the nine months ended September 30, 2018, or 2017.

There were no transfers from investment securities available-for-sale to investment securities held-to-maturity during the nine months ended September 30, 2018, or 2017.

The following table summarizes the investment securities that were pledged as collateral at September 30, 2018, and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Public deposits	$84,852	$ 60,415
Securities sold under repurchase agreements	21,327	19,485
Total pledged securities	$106,179	$ 79,900

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3. Loans Held-for-Sale

Residential mortgage loans held-for-sale are carried at fair value and SBA and indirect automobile loans held-for-sale are carried at the lower of cost or fair value. The following table summarizes loans held-for-sale at September 30, 2018, and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Residential mortgage	$ 328,090	$ 269,140
SBA	18,229	13,615
Indirect automobile	25,000	75,000
Total loans held-for-sale	$ 371,319	$ 357,755

During the nine months ended September 30, 2018, and 2017, the Company transferred loans with unpaid principal balances of $2.8 million and $3.1 million, respectively, to the held for investment residential mortgage portfolio.

The Company had no residential mortgage loans held-for-sale pledged to the FHLB at September 30, 2018. The Company had residential mortgage loans held-for-sale with unpaid principal balances of $154.2 million pledged to the FHLB at December 31, 2017.

4. Loans

Loans outstanding, by class, are summarized in the following table at carrying value and include net unamortized costs of $31.5 million and $35.9 million at September 30, 2018, and December 31, 2017, respectively. Acquired loans represent previously acquired loans including $2.3 million in loans covered under Loss Share Agreements with the FDIC at December 31, 2017. On June 27, 2018, the Bank entered into an agreement with the Federal Deposit Insurance Corporation (the "FDIC") to terminate the loss share agreements entered into with the FDIC in 2011 and 2012. Fidelity made a cash payment, previously accrued, of approximately $632,000 to the FDIC as consideration for the early termination of the agreements. As a result, at September 30, 2018 there were no loans covered by Loss Share Agreements.

Legacy loans represent existing portfolio loans originated by the Bank prior to each acquisition, additional loans originated subsequent to each acquisition and Government National Mortgage Association ("GNMA") optional repurchase loans (collectively, “legacy loans”).

	September 30, 2018		
	Loans		
(in thousands)	Legacy	Acquired	Total
Commercial	$829,061	$111,369	$940,430
SBA	156,613	6,534	163,147
Total commercial loans	985,674	117,903	1,103,577
Construction	259,907	2,141	262,048
Indirect automobile	1,588,419	—	1,588,419
Installment loans and personal lines of credit	28,214	1,046	29,260
Total consumer loans	1,616,633	1,046	1,617,679
Residential mortgage	553,644	17,437	571,081
Home equity lines of credit	140,332	12,236	152,568
Total mortgage loans	693,976	29,673	723,649
Total loans	$3,556,190	$150,763	$3,706,953

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	December 31, 2017		
	Loans		
(in thousands)	Legacy	Acquired	Total
Commercial	$675,544	$135,655	$811,199
SBA	133,186	8,022	141,208
Total commercial loans	808,730	143,677	952,407
Construction	243,112	5,205	248,317
Indirect automobile	1,716,156	—	1,716,156
Installment loans and personal lines of credit	24,158	1,837	25,995
Total consumer loans	1,740,314	1,837	1,742,151
Residential mortgage	461,194	28,527	489,721
Home equity lines of credit	131,049	17,321	148,370
Total mortgage loans	592,243	45,848	638,091
Total loans	$3,384,399	$196,567	$3,580,966

The Company has extended loans to certain officers and directors. The Company does not believe these loans involve more than the normal risk of collectability or present other unfavorable features when originated. None of the related party loans were classified as nonaccrual, past due, restructured, or potential problem loans at September 30, 2018, or December 31, 2017.

Nonaccrual Loans

The accrual of interest income is generally discontinued when a loan becomes 90 days past due. Past due status is based on the contractual terms of the loan agreement. A loan may be placed on nonaccrual status sooner if reasonable doubt exists as to the full, timely collection of principal or interest. When a loan is placed on nonaccrual status, previously accrued and uncollected interest is reversed against current period interest income. If a borrower on a residential mortgage loan previously sold makes no payment for three consecutive months, the Company, as servicer, may exercise its option to repurchase the delinquent loan from its securitized loan pool in an amount equal to 100% of the loan's remaining principal balance less the principal payments advanced to the pool prior to the buyback, in which case no previously accrued interest would be reversed since the loan was previously sold. Interest advanced to the pool prior to the buyback is capitalized for future reimbursement as part of the government guarantee. Subsequent interest collected on nonaccrual loans is recorded as a principal reduction. Nonaccrual loans are returned to accrual status when all contractually due principal and interest amounts are brought current and the future payments are reasonably assured.

Loans in nonaccrual status are presented by class of loans in the following table. The Company has repurchased certain GNMA government-guaranteed loans, which are accounted for in nonaccrual status. The Company's loss exposure on government-guaranteed loans is mitigated by the government guarantee in whole or in part. Purchased credit impaired ("PCI") loans are considered to be performing due to the application of the accretion method and are excluded from the table.

(in thousands)	September 30, 2018	December 31, 2017
Commercial	$ 12,187	$ 11,314
SBA	5,589	2,503
Total commercial loans	17,776	13,817
Construction	242	4,520
Indirect automobile	1,490	1,912
Installment loans and personal lines of credit	397	440
Total consumer loans	1,887	2,352

Residential mortgage	30,045	23,169
Home equity lines of credit	3,223	3,154
Total mortgage loans	33,268	26,323
Total nonaccrual loans	$ 53,173	$ 47,012

If such nonaccrual loans had been on a full accrual basis, interest income on these loans for the three months ended September 30, 2018, and 2017, would have been $546,000 and $559,000, respectively. For the nine months ended September 30, 2018, and 2017, the interest income on these loans would have been $1.5 million and $1.1 million, respectively. Residential mortgage loans

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on nonaccrual status include $27.2 million and $19.5 million in repurchased GNMA government-guaranteed loans at September 30, 2018, and December 31, 2017, respectively.

Accruing loans delinquent 30-89 days, 90 days or more, and troubled debt restructured loans ("TDRs") accruing interest, including PCI loans, presented by class of loans at September 30, 2018, and December 31, 2017, were as follows:

(in thousands)	September 30, 2018			December 31, 2017		
	Accruing Delinquent 30-89 Days	Accruing Delinquent 90 Days or More	TDRs Accruing	Accruing Delinquent 30-89 Days	Accruing Delinquent 90 Days or More	TDRs Accruing
Commercial	$ 1,932	$ 5,915	$ 8,063	$ 3,821	$ 5,722	$ 8,468
SBA	1,438	97	1,420	5,560	70	3,800
Construction	—	46	—	—	102	—
Indirect automobile	2,659	26	2,282	3,971	87	1,960
Installment and personal lines of credit	9	—	31	449	—	33
Residential mortgage	514	2,761	2,384	7,447	268	495
Home equity lines of credit	306	13	354	831	64	51
Total	$ 6,858	$ 8,858	$ 14,534	$ 22,079	$ 6,313	$ 14,807

TDR Loans

During the three months ended September 30, 2018, loans in the amount of $4.7 million were restructured and modified for term, and $2.3 million of loans were modified for interest. The modified loans were commercial, mortgage, indirect automobile, installment and home equity lines of credit. During the nine months ended September 30, 2018, the amount of loans that were modified for term was $9.2 million, which were commercial, installment, mortgage, indirect automobile and home equity loans. There were $2.3 million of mortgage and commercial loans modified for interest rate. During the three months ended September 30, 2017, no loans were modified for term or interest. During the the nine months ended September 30, 2017, there were TDR loans of $4.4 million modified for term and $2.8 million modified for interest rate, all of which were commercial loans. Modified PCI loans are not removed from their accounting pool and accounted for as TDRs, even if those loans would otherwise be deemed TDRs.

During the three months ended September 30, 2018, and 2017, the amount of loans which were restructured in the past twelve months and subsequently redefaulted was $4.0 million and $54,000, respectively. The defaulted loans were commercial, mortgage indirect, and home equity lines of credit. During the nine months ended September 30, 2018, and 2017, $6.6 million and $252,000 respectively, of loans were restructured and subsequently defaulted, which was comprised of commercial, mortgage, indirect, and HELOCs. The Company defines subsequently redefaulted as a payment default within 12 months of the restructuring date.

The Company had total TDRs with a balance of $23.2 million and $20.7 million at September 30, 2018, and December 31, 2017, respectively. There were $36,000 in net charge-offs of TDR loans for the three and nine months ended September 30, 2018 and net charge-offs of $50,000 and $105,000 for the three and nine months ended September 30, 2017. Net charge-offs on such loans are factored into the rolling historical loss rate, which is used in the calculation of the allowance for loan losses.

The Company was not committed to lend additional amounts to customers with outstanding loans classified as TDRs as of September 30, 2018 or December 31, 2017.

Pledged Loans

Presented in the following table is the unpaid principal balance of loans held for investment that were pledged to the Federal Home Loan Bank of Atlanta ("FHLB of Atlanta") as collateral for borrowings under a blanket lien arrangement at September 30, 2018, and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Commercial	$ 294,275	$ 242,695
Home equity lines of credit	96,957	94,526

Residential mortgage	407,713	351,591
Total	$ 798,945	$ 688,812

Indirect automobile loans with an unpaid principal balance of approximately $330.0 million at September 30, 2018, and December 31, 2017, respectively, were pledged to the Federal Reserve Bank of Atlanta ("FRB") as collateral for potential Discount Window borrowings under a blanket lien arrangement.

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Impaired Loans

The following tables present by class the unpaid principal balance, recorded investment and related allowance for impaired legacy loans and acquired non PCI loans at September 30, 2018, and December 31, 2017. Legacy impaired loans include all TDRs and all other nonaccrual loans, excluding nonaccrual loans below the Company's specific review threshold:

(in thousands)	September 30, 2018 Unpaid Principal Balance	Recorded Investment[1]	Related Allowance	December 31, 2017 Unpaid Principal Balance	Recorded Investment[1]	Related Allowance
Impaired Loans with Allowance						
Commercial	$8,345	$ 8,210	$ 1,012	$11,877	$ 11,824	$ 839
SBA	2,679	3,074	185	6,634	5,664	294
Construction	—	—	—	—	—	—
Installment and personal lines of credit	321	263	204	343	290	219
Residential mortgage	3,824	3,787	653	4,838	4,799	616
Home equity lines of credit	806	643	354	831	745	633
Loans	$15,975	$ 15,977	$ 2,408	$24,523	$ 23,322	$ 2,601

(in thousands)	September 30, 2018 Unpaid Principal Balance	Recorded Investment[1]	December 31, 2017 Unpaid Principal Balance	Recorded Investment[1]
Impaired Loans with No Allowance				
Commercial	$15,325	$ 13,588	$14,839	$ 12,509
SBA	6,511	3,982	1,815	1,133
Construction	976	242	5,995	4,520
Installment and personal lines of credit	1,445	163	1,445	163
Residential mortgage	36,339	35,441	21,955	21,398
Home equity lines of credit	2,699	2,518	2,452	2,318
Loans	$63,295	$ 55,934	$48,501	$ 42,041

[1]The primary difference between the unpaid principal balance and recorded investment represents charge-offs previously taken; it excludes accrued interest receivable due to materiality. Related allowance is calculated on the recorded investment, not the unpaid principal balance.

Included in impaired loans with no allowance are $27.2 million and $19.5 million in government-guaranteed residential mortgage loans at September 30, 2018, and December 31, 2017, respectively. These loans are collateralized by first mortgages on the underlying real estate collateral and are individually reviewed for a specific allowance.

The average recorded investment in impaired loans and interest income recognized for the three and nine months ended September 30, 2018, and 2017, by class, are summarized in the table below. Impaired loans include legacy impaired loans, all TDRs and all other nonaccrual loans including GNMA optional repurchase loans.

(in thousands)	Three Months Ended September 30, 2018 Average Recorded Investment	Interest Income Recognized	2017 Average Recorded Investment	Interest Income Recognized
Commercial	$22,623	$ 72	$24,544	$ 166
SBA	7,585	25	6,583	24
Construction	247	—	5,102	183
Indirect automobile	3,278	73	2,754	77
Installment and personal lines of credit	429	45	559	63
Residential mortgage	37,774	352	20,135	117

Home equity lines of credit	2,895	11	2,961	39
Total	$74,831	$ 578	$62,638	$ 669

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	Nine Months Ended September 30,			
	2018		2017	
(in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial	$23,551	$ 344	$22,725	$ 552
SBA	7,631	282	8,099	214
Construction	2,095	7	5,816	184
Indirect automobile	3,212	229	2,472	185
Installment and personal lines of credit	438	146	469	142
Residential mortgage	34,526	799	16,272	224
Home equity lines of credit	3,309	38	2,426	78
Total	$74,762	$ 1,845	$58,279	$ 1,579

Credit Quality Indicators

The Company uses an asset quality ratings system to assign a numeric indicator of the credit quality and level of existing credit risk inherent in a loan ranging from 1 to 8, where a higher rating represents higher risk. Management regularly reviews loans in the portfolio to assess credit quality indicators and to determine appropriate loan classification and grading in accordance with the Company's internal loan policy. These ratings are adjusted periodically as the Company becomes aware of changes in the credit quality of the underlying loans through its ongoing monitoring of the credit quality of the loan portfolio.

Indirect automobile loans typically receive a risk rating only when being downgraded to an adverse rating which typically occurs when payments of principal and interest are greater than 90 days past due. The Company uses a number of factors, including FICO scoring, to help evaluate the likelihood consumer borrowers will pay their credit obligations as agreed. The weighted-average FICO score for the indirect automobile portfolio was 768 and 762 at September 30, 2018, and December 31, 2017, respectively.

The following are definitions of the Company's loan rating categories:

•Pass – Pass loans include loans rated satisfactory with high, good, average or acceptable business and credit risk.

•Special Mention – A special mention loan has potential weaknesses that deserve management's close attention.

•Substandard – A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. A substandard asset has a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt.

•Doubtful – Doubtful loans have all the weaknesses inherent in assets classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

•Loss – Loss loans are considered uncollectable and of such little value that their continuance as recorded assets is not warranted.

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The following tables present the recorded investment in loans, by loan class and risk rating category, as of September 30, 2018, and December 31, 2017:

(in thousands)	September 30, 2018							
Asset Rating	Commercial	SBA	Construction	Indirect Automobile	Installment and Personal Lines of Credit	Residential Mortgage	Home Equity Lines of Credit	Total
Pass	$900,611	$150,685	$ 246,987	$—	$ 28,691	$ 531,567	$148,253	$2,006,794
Special Mention	14,882	4,881	14,774	—	100	775	810	36,222
Substandard	24,937	7,581	287	4,658	469	38,739	3,505	80,176
	940,430	163,147	262,048	4,658	29,260	571,081	152,568	2,123,192
Ungraded Performing	—	—	—	1,583,761	—	—	—	1,583,761
Total	$940,430	$163,147	$ 262,048	$1,588,419	$ 29,260	$ 571,081	$152,568	$3,706,953

(in thousands)	December 31, 2017							
Asset Rating	Commercial	SBA	Construction	Indirect Automobile	Installment and Personal Lines of Credit	Residential Mortgage	Home Equity Lines of Credit	Total
Pass	$758,271	$129,629	$ 235,987	$—	$ 25,229	$ 461,650	$145,082	$1,755,848
Special Mention	21,264	6,847	7,699	—	231	—	—	36,041
Substandard	31,664	4,732	4,631	4,972	535	28,071	3,288	77,893
	811,199	141,208	248,317	4,972	25,995	489,721	148,370	1,869,782
Ungraded Performing	—	—	—	1,711,184	—	—	—	1,711,184
Total	$811,199	$141,208	$ 248,317	$1,716,156	$ 25,995	$ 489,721	$148,370	$3,580,966

Acquired Loans

The carrying amount and outstanding balance at September 30, 2018 of the PCI loans from acquisitions prior to 2018 was $22.2 million and $28.6 million, respectively, and $26.6 million and $35.3 million, respectively, at December 31, 2017. There were no loans acquired during the nine months ended September 30, 2018.

Changes in the accretable yield, or income expected to be collected on PCI loans, for the nine months ended September 30, 2018, and 2017, were as follows:

	For the Nine Months Ended September 30,	
(in thousands)	2018	2017
Beginning balance	$3,005	$4,403
Accretion of income	(1,295)	(1,776)
Other activity, net [1]	905	1,351
Ending balance	$2,615	$3,978

[1]Includes changes in cash flows expected to be collected due to changes in timing of liquidation events and prepayment assumptions.

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5. Allowance for Loan Losses

A summary of changes in the allowance for loan losses ("ALL") by loan portfolio type is as follows:

	Three Months Ended September 30, 2018						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Beginning balance	$10,198	$2,099	$ 2,685	$ 9,708	$ 6,933	$ —	$31,623
Charge-offs	(72)	(6)	—	(1,327)	(179)	—	(1,584)
Recoveries	408	12	87	244	7	—	758
Net recoveries / (charge-offs)	336	6	87	(1,083)	(172)	—	(826)
Provision for loan losses	(418)	75	(154)	420	437	—	360
Ending balance	$10,116	$2,180	$ 2,618	$ 9,045	$ 7,198	$ —	$31,157

	Three Months Ended September 30, 2017						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Beginning balance	$9,971	$1,949	$ 2,364	$10,265	$ 5,690	$ 186	$30,425
Charge-offs	(327)	(81)	—	(1,342)	—	—	(1,750)
Recoveries	103	6	204	330	6	—	649
Net (charge-offs) / recoveries	(224)	(75)	204	(1,012)	6	—	(1,101)
Decrease in FDIC indemnification asset	(46)	—	—	—	—	—	(46)
Provision for loan losses [(1)]	(4)	34	(228)	1,432	208	(17)	1,425
Ending balance	$9,697	$1,908	$ 2,340	$10,685	$ 5,904	$ 169	$30,703

	Nine Months Ended September 30, 2018						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Beginning balance	$7,846	$1,968	$ 2,396	$10,758	$ 5,928	$ 876	$29,772
Charge-offs	(685)	(246)	(38)	(4,147)	(621)	—	(5,737)
Recoveries	542	42	661	1,076	25	—	2,346
Net (charge-offs) / recoveries	(143)	(204)	623	(3,071)	(596)	—	(3,391)
Provision for loan losses	2,413	416	(401)	1,358	1,866	(876)	4,776
Ending balance	$10,116	$2,180	$ 2,618	$9,045	$ 7,198	$ —	$31,157

	Nine Months Ended September 30, 2017						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Beginning balance	$9,331	$1,978	$ 2,176	$9,812	$ 5,755	$ 779	$29,831
Charge-offs	(583)	(166)	—	(4,877)	(41)	—	(5,667)
Recoveries	564	57	793	962	43	—	2,419
Net (charge-offs) / recoveries	(19)	(109)	793	(3,915)	2	—	(3,248)
Decrease in FDIC indemnification asset	(155)	—	—	—	—	—	(155)
Provision for loan losses [(1)]	540	39	(629)	4,788	147	(610)	4,275
Ending balance	$9,697	$1,908	$ 2,340	$10,685	$ 5,904	$ 169	$30,703

(1) Net of benefit attributable to FDIC indemnification asset.

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The following tables present, by loan portfolio type, the balance in the ALL disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans:

	September 30, 2018						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Individually evaluated	$1,012	$185	$ —	$204	$1,007	$ —	$2,408
Collectively evaluated	9,031	1,995	2,593	8,841	6,155	—	28,615
Acquired with deteriorated credit quality	73	—	25	—	36	—	134
Total ALL	$10,116	$2,180	$ 2,618	$9,045	$7,198	$ —	$31,157
Individually evaluated	$21,798	$7,056	$ 242	$426	$42,389	$ —	$71,911
Collectively evaluated	901,305	155,671	261,476	1,617,244	677,044	—	3,612,740
Acquired with deteriorated credit quality	17,327	420	330	9	4,216	—	22,302
Total loans	$940,430	$163,147	$ 262,048	$1,617,679	$723,649	$ —	$3,706,953

	December 31, 2017						
	Commercial Loans						
(in thousands)	Commercial	SBA	Construction	Consumer	Mortgage	Unallocated	Total
Individually evaluated	$839	$294	$ —	$219	$1,249	$ —	$2,601
Collectively evaluated	6,935	1,674	2,371	10,539	4,567	876	26,962
Acquired with deteriorated credit quality	72	—	25	—	112	—	209
Total ALL	$7,846	$1,968	$ 2,396	$10,758	$5,928	$ 876	$29,772
Individually evaluated	$24,333	$6,797	$ 4,520	$453	$29,260	$ —	$65,363
Collectively evaluated	766,143	133,955	243,344	1,741,635	603,895	—	3,488,972
Acquired with deteriorated credit quality	20,723	456	453	63	4,936	—	26,631
Total loans	$811,199	$141,208	$ 248,317	$1,742,151	$638,091	$ —	$3,580,966

The determination of the overall allowance for credit losses has two components, the allowance for originated loans and the allowance for acquired loans. At December 31, 2017, the allowance for originated loans consisted of specific, general and unallocated components. Beginning in 2018, the unallocated component of the allowance for originated loans was reallocated.

The ALL for acquired loans is evaluated at each reporting date subsequent to acquisition. Total loans include acquired loans of $150.8 million and $196.6 million at September 30, 2018, and December 31, 2017, respectively, which were recorded at fair value when acquired. For acquired performing loans, an allowance is determined for each loan pool using a methodology similar to that used for originated loans and then compared to the remaining fair value discount for that pool. For PCI loans, decreases in cash flows expected to be collected is generally recognized by recording an allowance for loan losses. Subsequent increases in cash flows result in a reversal of the allowance for loan losses to the extent of prior charges, or in the prospective recognition of interest income.

6. Other Real Estate

The following table segregates the other real estate ("ORE") by type:

(in thousands)	September 30, 2018	December 31, 2017
Commercial	$ 2,317	$ 1,422
Residential	346	258
Undeveloped property	5,368	5,941
Total ORE, net	$ 8,031	$ 7,621

The following table summarizes the changes in ORE:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Beginning balance	$6,834	$9,382	$7,621	$14,814
Transfers of loans to ORE	1,384	112	1,516	1,812
Sales	(59)	(811)	(659)	(7,051)
Write-downs	(128)	(59)	(447)	(951)
Ending balance	$8,031	$8,624	$8,031	$8,624

At September 30, 2018, and December 31, 2017, the recorded investment of residential mortgage loans formally in the process of foreclosure proceedings was approximately $4.6 million and $3.0 million, respectively. Of these amounts, $3.6 million and $2.1 million, respectively, are residential mortgage loans where the Company has the intent to convey the property to the respective government agency guaranteeing the loan. Upon foreclosure, a separate other receivable in the amount expected to be recovered from the guarantee will be recognized and reported as part of other assets in the accompanying Consolidated Balance Sheets.

7. Fair Value of Financial Instruments

Valuation Methodologies and Fair Value Hierarchy

The primary financial instruments that the Company carries at fair value include investment securities available-for-sale, derivative financial instruments used to hedge the value of its mortgage pipeline and mortgage loans held for sale portfolio including Interest Rate Lock Commitments (“IRLCs”), and residential mortgage loans held-for-sale.

Debt securities issued by U.S. Government corporations and agencies, debt securities issued by U.S. states and political subdivisions, and agency residential and commercial mortgage-backed securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent third party pricing service. We have processes in place to evaluate such third party pricing services to ensure information obtained and valuation techniques are appropriate. 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. The investments in the Company’s portfolio are generally not quoted on an exchange but are actively traded in the secondary institutional markets.

The fair value of mortgage loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics. The fair value measurements consider observable data that may include market trade pricing from brokers and investors and the mortgage-backed security markets. As such, the Company classifies these loans as Level 2.

The Company classifies IRLCs on residential mortgage loans held-for-sale, which are derivatives under GAAP, on a gross basis within other assets or other liabilities. The fair value of these commitments, while based on interest rates observable in the market, is highly dependent on the ultimate closing of the loans. These “pull-through” rates are based on both the Company’s historical data and the current interest rate environment and reflect the Company’s best estimate of the likelihood that a commitment will ultimately result in a closed loan. The loan servicing value is also included in the fair value of IRLCs. Because these inputs are not transparent in market trades, IRLCs are considered to be Level 3 assets.

Derivative financial instruments are primarily transacted in the secondary mortgage and institutional dealer markets and priced with observable market assumptions at a mid-market valuation point, with appropriate valuation adjustments for liquidity and credit risk. For purposes of valuation adjustments to its derivative positions, the Company has evaluated liquidity premiums that may be demanded by market participants, as well as the credit risk of its counterparties and its own credit if applicable. To date, no material losses due to a counterparty’s inability to pay any net uncollateralized position have occurred. Derivative financial instruments are considered to be Level 3.

The credit risk associated with the underlying cash flows of an instrument carried at fair value was a consideration in estimating the fair value of certain financial instruments. Credit risk was considered in the valuation through a variety of inputs, as applicable, including, the actual default and loss severity of the collateral, and level of subordination. The assumption used to estimate credit risk applied relevant information that a market participant would likely use in valuing an instrument. Because mortgage loans held-for-sale are generally sold within several weeks of origination, they are unlikely to demonstrate any of the credit weaknesses discussed above and as a result, the amount of any credit related adjustments to fair value during the three and nine months ended September 30, 2018, and 2017, was insignificant.

Recurring Fair Value Measurements

The following tables present certain information regarding the financial assets measured at fair value on a recurring basis by level within the fair value hierarchy based on the inputs used to estimate the fair value at the measurement date. There were no transfers between Levels 1, 2, and 3, during the three and nine months ended September 30, 2018, and 2017.

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	September 30, 2018			
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment securities available-for-sale	$209,180	$—	$209,180	$ —
Mortgage loans held-for-sale	328,090	—	328,090	—
Other assets [(1)]	6,617	—	—	6,617
Other liabilities [(1)]	(188)	—	—	(188)

	December 31, 2017			
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment securities available-for-sale	$120,121	$—	$120,121	$ —
Mortgage loans held-for-sale	269,140	—	269,140	—
Other assets [(1)]	4,168	—	—	4,168
Other liabilities [(1)]	(691)	—	—	(691)

[(1)]Includes mortgage-related IRLCs and derivative financial instruments to hedge interest rate risk. IRLCs are recorded on a gross basis.

The following table presents a reconciliation of all other assets and other liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three and nine months ended September 30, 2018, and 2017. The changes in the fair value of economic hedges were recorded in noninterest income from mortgage banking activities in the Consolidated Statements of Comprehensive Income and are designed to partially offset the change in fair value of the derivative financial instruments referenced in the following table:

	As of or for the Three Months Ended September 30,			
	2018		2017	
(in thousands)	Other Assets[(1)]	Other Liabilities[(1)]	Other Assets[(1)]	Other Liabilities[(1)]
Beginning balance	$7,126	$ (2,138)	$7,181	$ (560)
Total gains / (losses) included in earnings:				
Issuances	6,617	(188)	5,389	(324)
Settlements and closed loans	(7,146)	2,138	(7,246)	560
Expirations	20	—	65	—
Ending balance	$6,617	$ (188)	$5,389	$ (324)

	As of or for the Nine Months Ended September 30,			
	2018		2017	

(in thousands)	Other Assets[1]	Other Liabilities[1]	Other Assets[1]	Other Liabilities[1]
Beginning balance	$4,168	$ (691)	$7,111	$ (1,065)
Total gains / (losses) included in earnings:				
Issuances	21,323	(3,967)	20,595	(3,233)
Settlements and closed loans	(18,925)	4,470	(22,629)	3,974
Expirations	51	—	312	—
Ending balance	$6,617	$ (188)	$5,389	$ (324)

[1]Includes mortgage-related IRLCs and derivative financial instruments entered to hedge interest rate risk.

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Nonrecurring Fair Value Measurements

Certain financial assets held by the Company are not included in the tables above, but are measured at fair value on a nonrecurring basis. The following tables present the assets that had changes in their recorded fair value and still held at the end of the reporting period by level within the fair value hierarchy based on the inputs used to estimate the fair value at the measurement date.

	September 30, 2018			
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$18,624	$—	$—	$ 18,624
ORE, net	1,702	—	—	1,702
Residential mortgage servicing rights	41,545	—	—	41,545

	December 31, 2017			
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$23,257	$—	$—	$ 23,257
ORE, net	4,993	—	—	4,993
Residential mortgage servicing rights	57,895	—	—	57,895
SBA servicing rights	1,027	—	—	1,027

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Quantitative Information about Level 3 Fair Value Measurements

The following table shows the valuation technique and range, including weighted average, of the significant unobservable inputs and assumptions used in the fair value measurement of the Company's Level 3 assets and liabilities:

($ in thousands)	Fair Value at September 30, 2018	Fair Value at December 31, 2017	Valuation Technique	Unobservable Inputs	Range/Weighted Average at September 30, 2018	Range/Weighted Average at December 31, 2017
Nonrecurring:						
Impaired loans	$18,624	$ 23,257	Appraised value less estimated selling costs	Estimated selling costs	0% - 10.00% 10.00%	0% - 10.00% 10.00%
Other real estate	1,702	4,993	Discounted appraisals less estimated selling costs	Estimated selling costs	0% - 10.00% 10.00%	0% - 10.00% 9.61%
Residential mortgage servicing rights	41,545	57,895	Discounted cash flows	Discount rate	10.39% - 11.88% 10.76%	9.64% - 11.13% 9.95%
				Modeled prepayment speeds	6.53% - 9.89% 6.85%	7.60% - 15.75% 8.19%
SBA servicing rights	—	1,027	Discounted cash flows	Discount rate	N/A	13.12%
				Modeled prepayment speeds	N/A	11.33%
Recurring:						
IRLCs	$4,087	$ 3,439	Pricing model	Modeled pull-through ratio	85.50%	84.50%
Forward commitments	2,342	38	Investor pricing	Pricing spreads	98.48% - 104.23% 101.27%	90.00% - 104.94% 102.64%

The tables above exclude the initial measurement of assets and liabilities that were acquired as part of acquisitions accounted for as business combinations. These assets and liabilities were recorded at their fair value upon acquisition and were not remeasured during the periods presented unless specifically required by GAAP. Acquisition date fair values represent either Level 2 fair value measurements (investment securities, ORE, property, equipment and borrowings) or Level 3 fair value measurements (loans, deposits and core deposit intangible asset).

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value less estimated selling costs. A loan is considered impaired if it is probable that the Company will be unable to collect all amounts contractually due according to the terms of the loan agreement. Measuring the impairment of loans using the present value of expected future cash flows, discounted at the loan's effective interest rate, is not considered a fair value measurement. For collateral-dependent loans, fair value is measured based on the value of the collateral securing these loans and is classified as Level 3 in the fair value hierarchy. Collateral may include real estate or business assets, including equipment, inventory and accounts receivable. The value of real estate collateral is determined based on appraisals prepared by qualified licensed appraisers ordered by the Company's internal appraisal department, which is independent of the Company's lending function. If significant, the value of business equipment is based on an appraisal by qualified licensed appraisers ordered by the Company; otherwise, the equipment's net book value on the business's financial statements is the basis for the value of business equipment. Inventory and accounts receivable collateral are valued based on independent field examiner review or aging reports. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

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Foreclosed assets are adjusted to fair value less estimated selling costs upon transfer of the loans to ORE, which becomes the new carrying value of the ORE. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based on independent market prices, appraised values of the collateral, sales agreements, or management's estimation of the value of the collateral using market data including recent sales activity for similar assets in the property's market. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the property. Management continues to evaluate the appropriateness of appraised values on at least an annual basis.

Mortgage and SBA servicing rights are initially recorded at fair value when loans are sold with servicing retained. These assets are then amortized in proportion to and over the period of estimated net servicing income. On at least a quarterly basis, these servicing assets are assessed for impairment based on fair value. Management uses a model operated and maintained by an independent third party to assist in determining fair value which stratifies the servicing portfolio into homogeneous subsets with unique behavior characteristics. The model then converts those characteristics into income and expense streams, adjusts those streams for estimated prepayments, present values the adjusted streams, and combines the present values into a total. If the cost basis of any loan stratification tranche is higher than the present value of the tranche, an impairment is recorded. Management periodically obtains an independent review of the valuation assumptions to validate the fair value estimate and the reasonableness of the assumptions used in measuring fair value. See Note 10 for additional disclosures related to assumptions used in the fair value calculation for mortgage and SBA servicing rights.

Management makes certain estimates and assumptions related to costs to service varying types of loans and pools of loans, prepayment speeds, the projected lives of loans and pools of loans sold servicing retained, and discount factors used in calculating the present values of servicing fees projected to be received. Management periodically obtains an independent review of the valuation assumptions to validate the fair value estimate and the reasonableness of the assumptions used in measuring fair value.

No less frequently than quarterly, management reviews the status of mortgage loans held-for-sale for which the fair value option has been elected. Management also evaluates pools of servicing assets at least quarterly to determine if there is any impairment to those assets due to such factors as earlier than estimated repayments or significant prepayments. Any impairment identified in these servicing assets results in reductions in their carrying values through a valuation allowance and a corresponding decrease in servicing income.

The significant unobservable input used in the fair value measurement of the Company's IRLCs is the pull-through ratio, which represents the percentage of loans currently in a lock position which management estimates will ultimately close. Generally, the fair value of an IRLCs is positive (negative) if the prevailing interest rate is lower (higher) than the IRLCs rate. Therefore, an increase in the pull-through ratio (i.e., higher percentage of loans are estimated to close) will result in the fair value of the IRLCs increasing if in a gain position, or decreasing if in a loss position. The pull-through ratio is largely dependent on the processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The pull-through ratio is estimated based on calculations provided by the secondary marketing department using historical data. The estimated pull-through ratio is periodically reviewed by the Company's Secondary Marketing Department of the Mortgage Banking Division for reasonableness.

Forward commitments are instruments that are used to hedge the value of the IRLCs and mortgage loans held-for-sale. The Company takes investor commitments to sell a loan or pool of newly originated loans to an investor for an agreed upon price for delivery in the future. This type of forward commitment is also known as a mandatory commitment. Generally, the fair value of a forward commitment is negative (positive) if the prevailing interest rate is lower (higher) than the current commitment interest rate. The value of these commitments is ultimately determined by the investor that sold the commitment and represents a significant unobservable input used in the fair value measurement of the Company's forward commitments.

Fair Value Option

The Company records mortgage loans held-for-sale at fair value. The Company chose to fair value these mortgage loans held-for-sale to align results with the underlying economic changes in value of the loans and related hedge instruments. Interest income on residential mortgage loans held-for-sale is recorded on an accrual basis in the Consolidated Statements of Comprehensive Income under the heading “Interest Income: Loans, including fees.”
The servicing value is included in the fair value of the mortgage loans held-for-sale and initially recognized at the time the Company enters into IRLCs with borrowers. The mark-to-market adjustments related to loans held-for-sale and the associated economic hedges are reported as part of noninterest income from mortgage banking activities in the consolidated statements of comprehensive income.

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The following table presents the difference between the aggregate fair value and the aggregate unpaid principal balance of loans held-for-sale for which the fair value option ("FVO") has been elected as of September 30, 2018, and December 31, 2017. Both of the aggregate fair value and the unpaid principal balance of loans held-for-sale that were 90 days or more past due or in nonaccrual status at September 30, 2018, were $237,000, resulting in no difference between the aggregate fair value and the unpaid principal balance. There were no loans held-for-sale that were 90 days or more past due or in nonaccrual status at December 31, 2017.

(in thousands)	Aggregate Fair Value September 30, 2018	Aggregate Unpaid Principal Balance at September 30, 2018	Aggregate Fair Value Over Unpaid Principal
Residential mortgage loans held-for-sale	$ 328,090	$ 322,722	$ 5,368

(in thousands)	Aggregate Fair Value December 31, 2017	Aggregate Unpaid Principal Balance at December 31, 2017	Aggregate Fair Value Over Unpaid Principal
Residential mortgage loans held-for-sale	$ 269,140	$ 262,315	$ 6,825

Net fair value (losses)/gains related to mortgage banking activities for items measured at fair value pursuant to election of FVO for the three months ended September 30, 2018, and 2017, were $(4.4) million and $(718,000), respectively, and $(1.5) million and $4.0 million for the nine months ended September 30, 2018, and 2017, respectively.

Fair Value of Financial Instruments

The estimated fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. In cases where quoted market prices for the Company's various financial instruments are not available, fair values are based on settlements using present value or other valuation techniques. Those techniques are significantly affected by the imprecision in estimating unobservable inputs and the assumptions used, including the discount rate and estimates of future cash flows. While the Company believes its valuation methods are appropriate, the derived fair value estimates cannot be substantiated by comparison to independent markets, and, in many cases, could not be realized in immediate settlement of the instruments. In that regard, the aggregate fair value amounts presented in the tables below do not represent the underlying value of the Company.

The following tables include the carrying amount and estimated fair value, as well as the level within the fair value hierarchy, of the Company's financial instruments. The fair value estimates presented are based upon relevant information available to management as of September 30, 2018, and December 31, 2017:

		Fair Value Measurements at September 30, 2018			
(in thousands)	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Financial instruments (assets):					
Cash and cash equivalents	$ 182,672	$ 182,672	$ —	$ —	$ 182,672
Investment securities available-for-sale	209,180	—	209,180	—	209,180

Investment securities held-to-maturity	20,383	—	15,786	3,928	19,714
Total loans, net [1]	4,047,115	—	328,090	3,461,342	3,789,432
Financial instruments (liabilities):					
Noninterest-bearing demand deposits	$1,249,391	$—	$ —	$ 1,249,391	$1,249,391
Interest-bearing deposits	2,800,578	—	—	2,793,701	2,793,701
Short-term borrowings	163,562	—	163,562	—	163,562
Subordinated debt	120,680	—	111,491	—	111,491

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(in thousands)	Carrying Amount	Fair Value Measurements at December 31, 2017 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Financial instruments (assets):					
Cash and cash equivalents	$186,302	$186,302	$ —	$ —	$186,302
Investment securities available-for-sale	120,121	—	120,121	—	120,121
Investment securities held-to-maturity	21,689	—	17,684	4,001	21,685
Total loans, net [(1)]	3,908,949	—	269,140	3,466,839	3,735,979
Financial instruments (liabilities):					
Noninterest-bearing demand deposits	$1,125,598	$—	$ —	$ 1,125,598	$1,125,598
Interest-bearing deposits	2,741,602	—	—	2,739,204	2,739,204
Short-term borrowings	150,580	—	150,580	—	150,580
Subordinated debt	120,587	—	114,402	—	114,402

[(1)]Includes $328,090 and $269,140 in residential mortgage loans held-for-sale at September 30, 2018, and December 31, 2017, respectively, for which the Company has elected FVO.

The carrying amounts reported in the Consolidated Balance Sheets for cash and cash equivalents reasonably approximates the fair values of those assets. For investment securities, fair value equals quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or dealer quotes.

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the remaining maturities using estimated market discount rates that reflect the credit and interest rate risk inherent in the loans along with a market risk premium and liquidity discount.

Fair value for significant nonperforming loans is estimated taking into consideration recent external appraisals of the underlying collateral for loans that are collateral dependent. If appraisals are not available or if the loan is not collateral dependent, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of deposits with no stated maturities, such as noninterest-bearing demand deposits, savings, interest-bearing demand, and money market accounts, is equal to the amount payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows based on the discount rates currently offered for deposits of similar remaining maturities.

The fair value of the Company’s borrowings is estimated based on the quoted market price for the same or similar issued or on the current rates offered for debt of the same remaining maturities.

For off-balance sheet instruments, fair values are based on rates currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties’ credit standing for loan commitments and letters of credit. Fees related to these instruments were immaterial at September 30, 2018, and December 31, 2017, and the carrying amounts represent a reasonable approximation of their fair values. Loan commitments, letters and lines of credit, and similar obligations typically have variable interest rates and clauses that deny funding if the customer’s credit quality deteriorates. Therefore, the fair values of these items are not significant and are not included in the foregoing schedule.

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8. Derivative Financial Instruments

The Company uses derivative financial instruments to hedge the value of its mortgage pipeline and its mortgage loans held for sale. These instruments are not designated as hedges and are not speculative in nature.

Gains/(losses) of $1.4 million and $(1.6) million were recorded for the three months ended September 30, 2018, and 2017, respectively, and gains of $3.0 million and $2.7 million were recorded for the nine months ended September 30, 2018, and 2017, respectively, for all mortgage-related derivatives, and are included in the Consolidated Statements of Comprehensive Income as part of noninterest income from mortgage banking activities.

Derivatives contracts are used to help offset changes in fair value and are written in amounts referred to as notional amounts. Notional amounts provide a basis for calculating payments between counterparties but do not represent amounts to be exchanged between the parties, and are not a measure of financial risk. The notional amounts of the Company's derivative positions at September 30, 2018, and December 31, 2017 were as follows:

(in thousands)	Contract or Notional Amount as of September 30, 2018	December 31, 2017
Forward rate commitments	$532,983	$ 430,389
Interest rate lock commitments	247,151	172,293
Total derivatives contracts	$780,134	$ 602,682

The Company's derivative contracts are not subject to master netting arrangements.

9. Earnings Per Common Share

Earnings per common share ("EPS") were calculated as follows:

(in thousands, except per share data)	Three Months Ended September 30, 2018	2017
Net income	$12,742	$7,934
Weighted average common shares outstanding - basic (1)	27,229	26,729
Effect of dilutive stock options (2)	108	120
Weighted average common shares outstanding – diluted	27,337	26,849
EPS:		
Basic	$0.47	$0.30
Diluted	$0.47	$0.30

($ in thousands, except per share data)	Nine Months Ended September 30, 2018	2017
Net income	$33,899	$27,353
Weighted average common shares outstanding - basic (1)	27,112	26,500
Effect of dilutive stock options (2)	111	125
Weighted average common shares outstanding – diluted	27,223	26,625
EPS:		
Basic	$1.25	$1.03
Diluted	$1.25	$1.03

(1)Includes participating securities related to unvested restricted stock awards, net of forfeitures during the period, if any.
(2)Effect of dilutive stock options includes the dilutive effect of additional potential common shares issuable under contracts outstanding during each respective period.
As of September 30, 2018, and 2017, there were 495,832 and 557,500 common stock options, respectively, that were excluded as potentially dilutive. These shares were not included in the computation of diluted EPS because they were anti-dilutive in the period (i.e., the options' exercise price was greater than the average market price of the common shares).

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10. Certain Transfers of Financial Assets

Servicing rights

The Company sells certain residential mortgage loans, SBA loans and indirect automobile loans to third parties. All such transfers are accounted for as sales and the continuing involvement in the loans sold is limited to certain servicing responsibilities. Loan servicing rights are initially recorded at fair value and subsequently recorded at the lower of cost or fair value and are amortized over the remaining service life of the loans, with consideration given to prepayment assumptions. The carrying value of the loan servicing rights assets is shown in the table below:

(in thousands)	September 30, 2018	December 31, 2017
Loan servicing rights		
Residential mortgage	$ 106,876	$ 100,679
SBA	4,518	4,818
Indirect automobile	5,588	7,118
Total servicing rights	$ 116,982	$ 112,615

Residential Mortgage Loans

The Company typically sells certain first-lien residential mortgage loans to third party investors, primarily Federal National Mortgage Association (“Fannie Mae”), Government National Mortgage Association ("Ginnie Mae"), and Federal Home Loan Mortgage Corporation (“Freddie Mac”). The Company retains the related mortgage servicing rights (“MSRs”) and receives servicing fees on certain of these loans. During the three months ended September 30, 2018, and 2017, the Company sold $658.7 million and $644.6 million in residential mortgage loans, respectively, with servicing retained. During the nine months ended September 30, 2018, and 2017, the Company sold $1.8 billion and $1.7 billion, respectively, in residential mortgage loans with servicing retained.

The net gain on loan sales, MSRs amortization and recoveries/impairment, and ongoing servicing fees on the portfolio of loans serviced for others are recorded in the Consolidated Statements of Comprehensive Income as part of noninterest income from mortgage banking activities. During the three months ended September 30, 2018, and 2017, the Company recorded gains on sales of residential mortgage loans of $16.4 million and $19.7 million, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded gains on sales of residential mortgage loans of $54.3 million and $59.7 million, respectively.

During the three months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $6.4 million and $5.6 million, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $18.8 million and $16.3 million, respectively. Servicing fee income includes servicing fees, late fees and ancillary fees earned for each period.

On August 30, 2018, the Bank sold MSRs relating to certain single-family mortgage loans serviced for the Fannie Mae and the Freddie Mac, with an aggregate unpaid principal balance of approximately $1.1 billion, effective as of August 31, 2018. The sale represented approximately 12% of the Bank’s total single-family mortgage servicing portfolio as of August 31, 2018. The Bank finalized the servicing transfer for these loans on October 16, 2018. These loans were excluded from the Company's MSRs portfolio at September 30, 2018.

The table below is an analysis of the activity in the Company’s MSRs and impairment:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Residential mortgage servicing rights				
Beginning carrying value, net	$114,781	$94,750	$100,679	$86,131
Additions	9,121	8,445	24,754	22,203
Amortization	(3,369)	(3,559)	(10,127)	(10,051)
Sales	(16,248)	—	(16,248)	—
Recoveries / (impairment), net [1]	2,591	(544)	7,818	809
Ending carrying value, net	$106,876	$99,092	$106,876	$99,092

(1)Principally reflects changes in market interest rates and prepayment speeds, both of which affect future cash flow projections.

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(in thousands)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
Residential mortgage servicing impairment				
Beginning balance	$4,590	$7,799	$9,818	$9,152
Additions	690	1,766	765	4,127
Recoveries	(85)	(1,222)	(5,388)	(4,936)
Sales	(3,195)	—	(3,195)	—
Ending balance	$2,000	$8,343	$2,000	$8,343

The fair value of MSRs, key metrics, and the sensitivity of the fair value to adverse changes in model inputs and/or assumptions are summarized below:

($ in thousands)	September 30, 2018	December 31, 2017
Residential Mortgage Servicing Rights		
Fair Value	$ 111,616	$ 103,725
Composition of residential loans serviced for others:		
Fixed-rate	99.57 %	99.55 %
Adjustable-rate	0.43 %	0.45 %
Total	100.00 %	100.00 %
Remaining term (years)	26.1	25.7
Modeled prepayment speed	6.85 %	8.19 %
Decline in fair value due to a 10% adverse change	$ (3,285)	$ (3,497)
Decline in fair value due to a 20% adverse change	(6,326)	(6,796)
Weighted average discount rate	10.76 %	9.95 %
Decline in fair value due to a 10% adverse change	$ (5,196)	$ (4,299)
Decline in fair value due to a 20% adverse change	(9,974)	(8,223)

As demonstrated in the table above, the Company's methodology is highly sensitive to changes in model inputs and/or assumptions. The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in fair value based on adverse changes in model inputs and/or assumptions generally cannot be extrapolated because the relationship of the change in input or assumption to the change in fair value may not be linear. In addition, the effect of an adverse variation in a particular input or assumption on the fair value of the MSRs is calculated without changing any other input or assumptions. In reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the effect of the change.

Information about the asset quality of residential mortgage loans serviced by the Company is shown in the table below:

Residential mortgage loans serviced	September 30, 2018			Net
		Delinquent (days)		
(in thousands)	Unpaid Principal Balance	30 to 89	90+	Charge-offs for the Nine Months Ended September 30, 2018
Serviced for others [(1)]	$9,796,464	$20,367	$17,391	$ —
Held-for-sale [(2)]	322,722	—	237	—
Held-for-investment [(3)]	570,696	1,532	23,577	26
Total residential mortgage loans serviced	$10,689,882	$21,899	$41,205	$ 26

(1) Balances for September 30, 2018 include approximately $1.1 billion of sub-serviced loans as a result of the August 30, 2018 MSRs sale. Servicing on these loans transferred to the Purchaser on October 1, 2018 and October 16, 2018.
(2) There were no loans held-for-sale that were 30-89 days past due recorded under the fair value option for mortgage loans held-for-sale. There were no applicable discounts for loans held-for-sale that were 90+ days past due.
(3) Delinquent loans held-for-investment include repurchased loans covered by government agency guarantees that were 30-89 days past due and 90+ days past due of $913,000 and $19.4 million, respectively.
Loans serviced for others are not included in the Consolidated Balance Sheets as they are not assets of the Company.

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Mortgage Recourse Liability

During the last five years ended September 30, 2018, the Company has sold approximately 49,000 loans with a principal balance of approximately $12.2 billion. Purchasers generally have recourse to return a sold loan to the Company under limited circumstances. As seller, the Company has made various representations and warranties related to, among other things, the ownership of the loans, the validity of the liens, the loan selection and origination process, and the compliance with origination criteria established by the purchasers. In the event of a breach of these representations and warranties, the Company is obligated to repurchase loans with identified defects and/or to indemnify the purchasers. Some of these conditions include underwriting errors or omissions, fraud or material misstatements, and invalid collateral values. The contractual obligation arises only when the breach of representations and warranties is discovered and repurchase/indemnification is demanded. Generally, the maximum amount the Company would be required to pay would be equal to the unpaid principal balance of such loans that are deemed to have defects that were sold to purchasers, plus accrued interest, return of the premium received at the time of the loan sale, and reimbursement of certain expenses. To date, the claims to the Company from the purchasers to be paid upon repurchase or paid because of indemnification have been insignificant. In addition, the Company’s loan sale contracts define a condition in which the borrower defaults during a short period of time as an early payment default (“EPD”). In the event of an EPD, the Company may be required to return the premium paid for the loan, pay certain administrative fees, and may be required to repurchase the loan or indemnify the purchaser unless an EPD waiver is obtained. The Company also makes a number of representations and warranties that it will service the originated loans in accordance with investor servicing guidelines and standards.

Management recognizes the potential risk from costs related to breaches of representations and warranties made in connection with residential loan sales and subsequent required repurchases, indemnifications, and EPD claims. As a result, the Company has established a liability to cover potential costs related to these events based on historical experience, adjusted for any risk factors not captured in the historical losses, current business volume, and known claims outstanding. The recourse liability totaled $1.4 million at September 30, 2018, and December 31, 2017, respectively, and management believes this amount is adequate for potential exposure related to loan sale indemnification, repurchase loans, and EPD claims. There is a significant degree of judgment involved in estimating the recourse liability as the estimation process is inherently uncertain and subject to imprecision. Management will continue to monitor the adequacy of the reserve level and may decide that further additions to the reserve are appropriate in the future. However, there can be no assurance that the current balance of this reserve will prove sufficient to cover actual future losses.

It should be noted that the Company’s historical loan sale activity began to increase at a time when underwriting requirements were strengthened from prior years and limited documentation conventional loans (i.e., non-government insured) were no longer eligible for purchase in the secondary market. Accordingly, the population of conventional loans the Company has sold has been underwritten based on fully documented information. While this does not eliminate all risk of repurchase or indemnification costs, management believes it significantly mitigates that risk.

SBA Loans

The Company customarily executes certain transfers of selected government loans to commercial borrowers, primarily SBA loans, with third parties in the secondary market. These loans, which are typically partially guaranteed by the SBA or otherwise credit enhanced, are generally secured by business property such as real estate, inventory, equipment, and accounts receivable. During the three months ended September 30, 2018, and 2017, the Company sold $14.2 million and $15.8 million in government loans, respectively, with servicing retained. During the nine months ended September 30, 2018, and 2017, the Company sold $35.6 million and $39.5 million in government loans, respectively, with servicing retained.

The Company retains the loan servicing rights and receives ongoing servicing fees on the portfolio of loans serviced for others. The net gain on SBA loan sales, amortization and recoveries/impairment of servicing rights, and ongoing servicing fees are recorded in the Consolidated Statements of Comprehensive Income as part of noninterest income from SBA lending activities. During the three months ended September 30, 2018, and 2017, the Company recorded gains on sales of SBA loans of $843,000 and $1.3 million, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded gains on sales of SBA loans of $2.8 million and $3.6 million, respectively.

During the three months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $551,000 and $607,000, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $1.6 million and $1.9 million, respectively. Servicing fee income includes servicing fees, late fees and ancillary fees earned for each period.

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The table below is an analysis of the activity in the Company’s SBA loan servicing rights and impairment:

(in thousands)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
SBA loan servicing rights				
Beginning carrying value, net	$4,658	$5,312	$4,818	$5,707
Additions	339	429	883	1,091
Amortization	(479)	(393)	(1,314)	(1,387)
Recoveries / (impairment), net [1]	—	(40)	131	(103)
Ending carrying value, net	$4,518	$5,308	$4,518	$5,308

[1] Principally reflects changes in market interest rates and prepayment speeds, both of which affect future cash flow projections.

(in thousands)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
SBA servicing rights impairment				
Beginning balance	$ 3	$ 63	$134	$—
Additions	—	40	—	103
Recoveries	—	—	(131)	—
Ending balance	$ 3	$ 103	$3	$103

The fair value of the SBA loan servicing rights, key metrics, and the sensitivity of the fair value to adverse changes in the model inputs and/or assumptions are summarized below:

($ in thousands)	September 30, 2018	December 31, 2017
SBA loan servicing rights		
Fair Value	$ 4,887	$ 5,275
Composition of loans serviced for others:		
Fixed-rate	— %	— %
Adjustable-rate	100.00 %	100.00 %
Total	100.00 %	100.00 %
Remaining term (years)	18.4	18.9
Modeled prepayment speed	12.37 %	11.33 %
Decline in fair value due to a 10% adverse change	$ (179)	$ (181)
Decline in fair value due to a 20% adverse change	(347)	(351)
Weighted average discount rate	13.88 %	13.13 %
Decline in fair value due to a 10% adverse change	$ (190)	$ (199)
Decline in fair value due to a 20% adverse change	(366)	(384)

As demonstrated in the table above, the Company’s methodology is highly sensitive to changes in model inputs and/or assumptions. The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in fair value based on adverse changes in model inputs and/or assumptions generally cannot be extrapolated because the relationship of the change in input or assumption to the change in fair value may not be linear. In addition, the effect of an adverse variation in a particular input or assumption on the value of the SBA loan servicing rights is calculated without changing any other input or assumption. In reality, changes in one factor may magnify or counteract the effect of the change.

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Information about the asset quality of SBA loans serviced by the Company is shown in the table below:

SBA loans serviced	September 30, 2018			Net Charge-offs for the Nine Months Ended September 30, 2018
	Unpaid Principal Balance	Delinquent (days)		
(in thousands)		30 to 89	90+	
Serviced for others	$246,763	$4,479	$1,324	$ —
Held-for-sale	18,229	—	—	—
Held-for-investment	163,147	1,865	5,531	204
Total SBA loans serviced	$428,139	$6,344	$6,855	$ 204

Loans serviced for others are not included in the Consolidated Balance Sheets as they are not assets of the Company.

Indirect Automobile Loans

The Company purchases, on a nonrecourse basis, consumer installment contracts secured by new and used vehicles purchased by consumers from franchised motor vehicle dealers and select independent dealers. A portion of the indirect automobile loans is sold with servicing retained and the Company receives ongoing servicing fees on the portfolio of loans serviced for others. During the three months ended September 30, 2018, and 2017, the Company sold $18.6 million and $27.1 million in indirect automobile loans, respectively, with servicing retained. During the nine months ended September 30, 2018, and 2017, the Company sold $133.9 million and $371.5 million in indirect automobile loans, respectively, with servicing retained.

The gain on loan sales, amortization of servicing rights, and ongoing servicing fees are recorded in the Consolidated Statements of Comprehensive Income as part of noninterest income from indirect lending activities. During the three months ended September 30, 2018, and 2017, the Company recorded gains on sales of indirect automobile loans of $177,000 and $445,000, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded gains on sales of indirect automobile loans of $1.4 million and $5.8 million, respectively.

During the three months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $1.7 million, and $2.3 million, respectively. During the nine months ended September 30, 2018, and 2017, the Company recorded servicing fee income of $5.6 million, and $6.8 million, respectively. Servicing fee income includes servicing fees, late fees and ancillary fees earned for each period.

The table below is an analysis of the activity in the Company's indirect automobile loan servicing rights:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Indirect automobile loan servicing rights				
Beginning carrying value	$6,265	$8,154	$7,118	$7,457
Additions	124	182	890	2,606
Amortization	(801)	(846)	(2,420)	(2,573)
Ending carrying value	$5,588	$7,490	$5,588	$7,490

The Company has not recorded impairment on its indirect automobile loan servicing rights.

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The fair value of the indirect automobile loan servicing rights, key metrics, and the sensitivity of the fair value to adverse changes in model inputs and/or assumptions are summarized below:

($ in thousands)	September 30, 2018		December 31, 2017	
Indirect automobile loan servicing rights				
Fair value	$ 5,589		$ 7,436	
Composition of loans serviced for others:				
Fixed-rate	100.00	%	100.00	%
Adjustable-rate	—	%	—	%
Total	100.00	%	100.00	%
Remaining term (years)	4.3		4.5	
Modeled prepayment speed	20.59	%	20.59	%
Decline in fair value due to a 10% adverse change	$ (137	)	$ (192	)
Decline in fair value due to a 20% adverse change	(269	)	(377	)
Weighted average discount rate	8.16	%	7.18	%
Decline in fair value due to a 10% adverse change	$ (56	)	$ (69	)
Decline in fair value due to a 20% adverse change	(110	)	(137	)

As demonstrated in the table above, the Company’s methodology is highly sensitive to changes in model inputs and/or assumptions. The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in fair value based on adverse changes in model inputs and/or assumptions generally cannot be extrapolated because the relationship of the change in input or assumption to the change in fair value may not be linear. In addition, the effect of an adverse variation in a particular input or assumption on the fair value of the indirect automobile loan servicing rights is calculated without changing any other input or assumption. In reality, changes in one factor may magnify or counteract the effect of the change.

Information about the asset quality of the indirect automobile loans serviced by the Company is shown in the table below:

Indirect automobile loans serviced	September 30, 2018			Net Charge-offs for the Nine Months Ended September 30, 2018
	Unpaid Principal Balance	Delinquent (days)		
(in thousands)		30 to 89	90+	
Serviced for others	$838,573	$2,557	$1,568	$ 2,757
Held-for-sale	25,000	—	—	—
Held-for-investment	1,588,419	3,812	2,328	3,080
Total indirect automobile loans serviced	$2,451,992	$6,369	$3,896	$ 5,837

Loans serviced for others are not included in the Consolidated Balance Sheets as they are not assets of the Company.

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11. Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09, “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in Note 1. Basis of Presentation and Summary of Significant Accounting Policies, the implementation of the new guidance did not have a material impact on the measurement or recognition of revenue. The Company did not record a cumulative effect adjustment to opening retained earnings. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with our servicing rights activities, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts fees is mainly composed of maintenance fees, service fees, stop payment fees, and non-sufficient funds ("NSF") fees. The Company’s performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Debit Card Fees, Credit Card Fees, and Merchant Fees

Fees, exchange, and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily derived from interchange fees earned whenever the Company’s debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company's card-holder uses a non-Company ATM or a non-Company card-holder uses the Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and/or credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier’s checks, and other services. The Company’s performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Trust and Wealth Management

Trust and wealth management income is primarily comprised of fees earned from personal trust administration, estate settlement, investment management, employee benefit plan administration, custody, United States tax code sections 1031/1033 exchanges ("Sections 1031/1033 exchanges") and escrow accounts. Personal trust administration, investment management, employee benefit plan administration and custody fees are generally earned/accrued monthly with billings typically done monthly, and are based on the assets/trust under management or administration and services with certain annual minimum fees provided as outlined in the applicable fee schedule. Sections 1031/1033 exchanges and escrow accounts fees are based on a contractual agreement. The Company’s fiduciary obligations are generally satisfied over time and the resulting fees are recognized monthly, based upon the monthly average market value of the assets under management and the applicable fee rate. Payment is typically received in the following month. The Company does not earn performance-based incentives.

Insurance Commissions

The Company earns insurance commissions through LionMark Insurance Company, Inc., a wholly owned subsidiary that markets credit loss protection insurance products on an agency basis. The contract between the Company and the Agent is primarily for vendor single interest coverage (“VSI insurance”) and does not involve goods or services that are distinct in nature. The performance obligation is essentially completed upon the sale of the individual VSI insurance contracts.

Gain or Loss of ORE

The Company recognizes the sale of ORE, along with any associated gain or loss, when control of the property transfers to the buyer. Generally, the standard includes the following indicators that control of a promised asset has been transferred:

- The seller has a present right to payment for the asset.
- The buyer has legal title of the asset.
- The seller has transferred physical possession of the asset.
- The buyer has the significant risks and rewards of ownership of the asset.
- The buyer has accepted the asset.

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The Company at times may finance an ORE sale and will need to apply judgment in evaluating, at contract inception, whether the contract conditions are met, including whether it is probable that the Company shall collect substantially all of the entitled consideration by assessing both the buyer's intent and ability (i.e., capacity) to pay substantially all the amount to which the Company is entitled. The Company enhanced its ORE internal business operating procedures to ensure that such financed ORE sale gain or loss is recognized once all the new standard requirements are met.
The following table presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2018, and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ in thousands)	2018	2017	2018	2017
Noninterest income:				
In-scope of Topic 606:				
Service charges on deposit accounts	$1,690	$1,553	$4,630	$4,489
Other fees and charges	2,242	2,091	6,512	5,763
Trust and wealth management	588	325	1,694	853
Other:				
Insurance commissions	10	195	435	598
(Loss)/gain on ORE	(2)	479	40	856
Total other	$8	$674	$475	$1,454
Noninterest income (in-scope of Topic 606)	4,528	4,643	13,311	12,559
Noninterest income (out-of-scope of Topic 606)	29,134	28,995	94,461	93,505
Total noninterest income	$33,662	$33,638	$107,772	$106,064

Contract Balances

Typically, a contract asset balance occurs when an entity performs a service for a customer before the customer payment of consideration, creating a contract receivable, or before payment is due, creating a contract asset. On the other hand, a contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment of consideration from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees, and insurance commissions based on the terms and conditions of the associated contracts. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2018, and December 31, 2017, the Company did not have any significant contract balances.

Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. The Company did not capitalize any contract acquisition costs upon adoption of Topic 606.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis reviews important factors affecting our financial condition at September 30, 2018 compared to December 31, 2017, and compares the results of operations for the three and nine months ended September 30, 2018, and 2017. These comments should be read in conjunction with our consolidated financial statements and accompanying notes appearing in this Quarterly Report on Form 10-Q and the "Risk Factors" set forth in our Annual Report on Form 10-K for the year ended December 31, 2017. All percentage and dollar variances noted in the following analysis are calculated from the balances presented in the accompanying consolidated financial statements.

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations relating to present or future trends or factors generally affecting the banking industry and specifically affecting our operations, markets and services. Forward-looking statements are subject to significant risks and uncertainties. Investors are cautioned against placing undue reliance on such statements. Without limiting the foregoing, the words “believes,” “expects,” “anticipates,” “estimates,” “projects,” “intends,” “plans,” “targets,” “initiatives,” “p “outlook,” or similar expressions or future conditional verbs such as “may,” “will,” “should,” “would,” and “could” are intended to identify forward-looking statements. Such statements are not based on fact but instead based upon the current beliefs and expectations of management and on information currently available to management based upon assumptions that management believes are reasonable and may relate to, among other things, the difficult economic conditions and the economy’s impact on operating results, credit quality, liquidity, capital, the adequacy of the allowance for loan losses, changes in interest rates, and litigation results. Actual results could differ materially from those projected for many reasons, including without limitation, changing events and trends that have influenced our assumptions.

These trends and events include: (1) events adversely affecting our loan portfolio, such as potential difficulties maintaining quality loan growth, the risk of credit losses and an insufficient allowance for loan losses, maintaining and servicing relationships with customers and other counterparties, the ability to rely upon information from customers and other counterparties, and managing changes in our lending operations; (2) events adversely affecting our investment portfolio, resulting in potential impairments or losses that may adversely affect earnings and capital; (3) potential adverse economic conditions at the national, regional, and local levels where we conduct business, and the resulting impact on the quality of our loan portfolio, earnings, and business operations; (4) expectations of and actual timing and amount of interest rate movements, and the slope and shape of the yield curve; (5) extensive regulation, new or enhanced enforcement of laws and regulations, increased compliance costs, potential failure to comply with laws and regulations, and the possibility of claims or litigation from customers or other parties; (6) maintaining adequate liquidity, the failure or which would adversely impact our growth and ability to meet our current or future funding obligations; (7) our ability to maintain sufficient capital and to raise additional capital when needed; (8) events affecting our business operations, such as the effectiveness of our risk management framework and internal controls and procedures, our reliance on financial models and the accuracy of such financial models, our reliance on third party vendors, the risk of security breaches and potential fraud, including cyber-fraud, ability to maintain sufficient investment in technological improvements, and potential adverse weather events in the geographic markets in which we operate; (9) events affecting our ability to compete effectively and achieve our strategies, such as greater competitive pressures among financial institutions in our market areas, the risk of failure to achieve the revenue increases expected to result from our acquisitions, branch additions and in our transaction deposit, trust and lending businesses, and our ability to attract and retain skilled people; (10) events that adversely affect our reputation, and the resulting potential adverse impact on our operations in the event of negative public opinion; and (11) risks arising from owning our common stock, such as the volatility and trading volume of our common stock, our ability to pay dividends, the impact of dilution on our common stock, the lack of FDIC insurance with respect to our common stock, regulatory limitations on stock ownership, and provisions in our bylaws that may make it more difficult for another party to obtain control of us.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included herein and are not intended to represent a complete list of all risks and uncertainties in our business. We assume no obligation to update or revise, whether as a result of new information, future events, or otherwise, any forward-looking statements that are made in this report or in any other statements, release, report or filing from time to time. Investors are encouraged to read the related section in our 2017 Annual Report on Form 10-K, including the “Risk Factors” set forth therein. Additional information and other factors that could affect future financial results may be included, from time to time, in our filings with the Securities and Exchange Commission (“SEC”).

Selected Financial Data
The following table contains selected financial data and should be read in conjunction with “Management's Discussion and Analysis of Financial Condition and Results of Operations” and unaudited consolidated financial statements and accompanying notes included in Item 1 of this Quarterly Report on Form 10-Q.

	As of or for the Three Months Ended			As of or for the Nine Months Ended	
($ in thousands, except per share data)	September 30, 2018	June 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
INCOME STATEMENT DATA:					
Interest income	$46,872	$44,740	$ 39,105	$133,174	$116,325
Interest expense	8,125	8,268	5,711	23,187	16,951
Net interest income	38,747	36,472	33,394	109,987	99,374
Provision for loan losses	360	2,286	1,425	4,776	4,275
Noninterest income	33,662	36,977	33,638	107,772	106,064
Noninterest expense	55,585	58,852	52,837	169,179	157,960
Net income before income taxes	16,464	12,311	12,770	43,804	43,203
Income tax expense	3,722	2,921	4,836	9,905	15,850
Net income	12,742	9,390	7,934	33,899	27,353
PERFORMANCE:					
Earnings per common share - basic	$0.47	$0.35	$ 0.30	$1.25	$1.03
Earnings per common share - diluted	0.47	0.34	0.30	1.25	1.03
Total revenues	72,409	73,449	67,032	217,759	205,438
Book value per common share	15.85	15.48	14.47	15.85	14.47
Tangible book value per common share (1)	15.43	15.05	14.00	15.43	14.00
Cash dividends paid per common share	0.12	0.12	0.12	0.36	0.36
Dividend payout ratio	25.53 %	34.29 %	40.00 %	28.80 %	34.95 %
Return on average assets	1.05 %	0.77 %	0.70 %	0.95 %	0.81 %
Return on average shareholders' equity	11.87 %	9.06 %	8.28 %	10.92 %	9.66 %
Equity to assets ratio	8.98 %	8.60 %	8.61 %	8.98 %	8.61 %
Net interest margin	3.45 %	3.22 %	3.20 %	3.32 %	3.20 %
END OF PERIOD BALANCE SHEET SUMMARY:					
Total assets	$4,812,056	$4,892,369	4,505,423	$4,812,056	$4,505,423
Earning assets	4,448,875	4,549,315	4,167,549	4,448,875	4,167,549
Loans, excluding loans held-for-sale	3,706,953	3,792,886	3,409,707	3,706,953	3,409,707
Total loans	4,078,272	4,237,572	3,750,036	4,078,272	3,750,036
Total deposits	4,049,969	4,069,630	3,938,360	4,049,969	3,938,360
Shareholders' equity	432,098	420,962	388,068	432,098	388,068
Assets serviced for others (2)	10,882,832	10,632,607	10,109,466	10,882,832	10,109,466
ASSET QUALITY RATIOS:					
Net charge-offs, annualized to average loans	0.09 %	0.17 %	0.13 %	0.12 %	0.13 %
Allowance to period-end loans	0.84 %	0.83 %	0.90 %	0.84 %	0.90 %
Adjusted allowance to adjusted period-end loans (1)	1.14 %	1.16 %	1.29 %	1.14 %	1.29 %
Nonperforming assets to total loans, ORE and repossessions	1.92 %	1.96 %	1.71 %	1.92 %	1.71 %
Adjusted nonperforming assets to loans, ORE and repossessions (1)	0.92 %	0.99 %	1.05 %	0.92 %	1.05 %

Allowance to nonperforming loans, ORE and repossessions	0.44x	0.42x	0.52x	0.44x	0.52x
SELECTED RATIOS:					
Loans to total deposits	91.53 %	93.20 %	86.58 %	91.53 %	86.58 %
Average total loans to average earning assets	92.29 %	92.90 %	89.85 %	92.63 %	89.61 %
Noninterest income to total revenue	46.49 %	50.34 %	50.18 %	49.49 %	51.63 %
Leverage ratio	8.96 %	8.43 %	8.81 %	8.96 %	8.81 %
Common equity tier 1 capital	9.15 %	8.45 %	8.81 %	9.15 %	8.81 %
Tier 1 risk-based capital	10.24 %	9.50 %	9.96 %	10.24 %	9.96 %
Total risk-based capital	12.78 %	11.99 %	12.68 %	12.78 %	12.68 %
LOAN PRODUCTION AND SALES VOLUME:					
Mortgage loan production	$748,044	$908,754	$ 752,854	$2,270,112	$2,106,277
Total mortgage loan sales	771,058	800,084	731,595	2,067,626	1,986,671
Indirect automobile loan production	86,801	183,675	256,084	529,036	822,341
Total indirect automobile loan sales	18,614	29,275	27,115	113,889	371,546

(1)Non-GAAP financial measure. See non-GAAP reconciliation table for the comparable GAAP

(2)Balances for September 30, 2018 include approximately $1.1 billion of sub-serviced loans as a result of the August 30, 2018 MSRs sale. Servicing on these loans transferred to the Purchaser on October 1, 2018 and October 16, 2018.

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Overview

Fidelity Southern Corporation (“FSC” or “Fidelity”) is a bank holding company headquartered in Atlanta, Georgia. We conduct operations primarily through Fidelity Bank, a state chartered wholly-owned subsidiary bank (the “Bank”). The Bank was organized as a national banking corporation in 1973 and converted to a Georgia chartered state bank in 2003. LionMark Insurance Company (“LionMark”) is a wholly-owned subsidiary of FSC and is an insurance agency offering consumer credit related insurance products. FSC also owns three subsidiaries established to issue trust preferred securities. The “Company,” “we,” or “our,” as used herein, includes FSC and its subsidiaries, unless the context otherwise requires.

Since our inception in 1973, we have pursued managed, profitable growth through providing quality financial services. Our overall focus is on building shareholder value. Our mission is to continue growth, improve earnings and increase shareholder value; to treat customers, employees, community and shareholders according to the "Golden Rule"; and to operate within a culture of strong internal controls.

Our franchise primarily spans the metropolitan Atlanta, Jacksonville, Orlando, Tallahassee and Sarasota-Bradenton, Florida markets. We also conduct indirect automobile lending in Georgia and Florida and residential mortgage lending throughout the South. SBA lending has a nation-wide footprint.

We have continued to focus on organic growth and building meaningful presence and relationships in Georgia and northern, eastern and central Florida. During 2018, the market pressures in indirect auto required us to exit all remaining states outside of our existing branch footprint in Georgia and Florida. We continue to emphasize investing in systems and infrastructure to create efficiencies to provide support for our continued growth. We currently have 69 total retail branches with 50 branches in Georgia and 19 in Florida. We believe our retail branch network positions us to generate new customers and business opportunities. We are also continuing to focus on asset quality, revenue growth, deposit growth, and quality loan growth at a well-maintained capital level.

Wealth Management began operations in July 2014 when we began offering trust services. The Wealth Management division provides trust administration, investment management, financial and estate planning, specialized lending and banking for affluent and high net worth individuals. We expanded our services and team in 2017 with the addition of client advisors. Our investment in the Wealth Management business began to contribute to earnings in 2017.

Our lending activities are significantly influenced by the local economic environments in the markets we serve. We have grown our mortgage, construction, commercial, and consumer installment loan portfolios organically and through acquisitions as the economy continues to improve. The commercial loan production momentum that began in the fourth quarter of 2017 continues to be strong while we implement strategies to grow our commercial bank. Our loan portfolio is well diversified among consumer, business, and real estate lending. The credit quality of the loans we have originated continues to be strong.

A portion of our profitability, as with other financial institutions, is dependent upon net interest income, which is the difference between the interest we receive on interest-earning assets, such as loans and securities, and the interest we pay on interest-bearing liabilities, principally deposits and borrowings. Our net interest margin is affected by prevailing interest rates, nonperforming assets and competition among financial institutions and nonbank entities for loans and deposits.

We derive approximately half of our revenues from noninterest income sources such as service charges on loan and deposit accounts, fees on other products and services and income from mortgage banking, indirect automobile, and SBA activities. The majority of the noninterest income earned from these sources is generated from gains on sales of loans including recognition of gain on loan servicing on the majority of loans sold. The retained servicing obligation generates servicing revenue over the life of the loans sold. The revenue generated from gains on sales of loans and related servicing is partially offset by amortization and possible impairment of the related servicing rights. Servicing rights are amortized in proportion to the estimated future servicing income on the underlying loans sold. Impairment on servicing rights is recorded based on changes in the estimated and actual prepayment speeds and default rates and losses on the underlying loans sold. During the three and nine months ended September 30, 2018, (impairment) and impairment recovery on mortgage servicing rights ("MSRs") of $(605,000) and $4.6 million was recorded as part of noninterest income from mortgage banking activities. During the three and nine months ended September 30, 2017, (impairment) and impairment recovery on MSRs was $(544,000) and $809,000. The impairment recovery occurred in

2018 as estimated future prepayment speeds stabilized during the period, partially the result of higher interest rates, and subsequently, the estimated remaining life of the servicing income on the underlying loans serviced for others extended slightly.

We continue to attract new customer relationships, and talented and experienced bankers to support our growth. During the nine months ended September 30, 2018, we made significant progress in integrating and leveraging our acquisitions from previous years and continuing expansion. We are also continuing to focus on asset quality, revenue growth, deposit growth and quality loan growth at a well-maintained capital level.

Financial Performance

We recorded net income for the three months ended September 30, 2018 of $12.7 million compared to $7.9 million for the same period in 2017, an increase of $4.8 million, or 60.6%. For the nine months ended September 30, 2018, we recorded net income of $33.9 million compared to $27.4 million for the same period in 2017, an increase of $6.5 million, or 23.9%.

Basic and diluted earnings per common share for the three months ended September 30, 2018 was $0.47, compared to $0.30 for each of the basic and diluted earnings per common share for the same period last year. For the nine months ended September 30, 2018, each of the basic and diluted earnings per common share was $1.25, compared to $1.03 for each of the basic and diluted earnings per common share for the same period last year.

Non-GAAP Financial Measures

In addition to traditional measures, management provides non-GAAP financial information and performance indicators it considers useful to investors in understanding the Company's operating performance and trends, and to facilitate comparisons with the performance of its peers and better comparability with prior periods. Management also uses these measures internally to assess and better understand the Company's underlying business performance and trends related to core business activities. The non-GAAP financial measures and key performance indicators used by the Company may differ from the non-GAAP financial measures and performance indicators used by other financial institutions to assess their performance and trends.

In particular, management uses tangible shareholders' equity, adjusted allowance for loan losses, adjusted nonperforming assets, adjusted nonperforming loans, adjusted total loans, and related ratios, each of which is a non-GAAP financial measure. Management uses (i) tangible shareholders' equity (which excludes goodwill and other intangibles from equity) and related ratios to evaluate the adequacy of shareholders' equity and to facilitate comparisons with peers; and (ii) adjusted allowance for loan losses (which includes adjustments related to acquired loans and indirect auto loans), adjusted nonperforming assets and adjusted loans (which includes adjustments for repurchased government-guaranteed loans, SBA guaranteed loans and acquired loans) as supplemental information to evaluate both asset quality and asset quality trends, and to facilitate comparisons with peers. A reconciliation of these non-GAAP financial measures to their nearest GAAP measure appears in the table below.

Non-GAAP financial measures should be viewed in addition to, and not as an alternative for, the Company's reported results prepared in accordance with GAAP. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. Although these non-GAAP financial measures frequently are used by shareholders in the evaluation of a company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of results as reported under GAAP. We encourage readers to consider the unaudited consolidated financial statements in their entirety and not to rely on any single financial measure.

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($ in thousands)	As of or for the quarter ended September 30, 2018	June 30, 2018	December 31, 2017	September 30, 2017
Reconciliation of nonperforming assets to adjusted nonperforming assets:				
Nonperforming assets (GAAP)	$71,333	$74,442	$63,338	$58,606
Less: GNMA repurchased government-guaranteed loans included in nonaccrual loans	(27,218)	(27,220)	(19,478)	(15,450)
Less: SBA guaranteed loans included in nonaccrual loans	(4,049)	(3,639)	(1,652)	(2,145)
Less: Nonaccrual acquired loans	(7,388)	(7,648)	(6,242)	(7,366)
Adjusted nonperforming assets, excluding government-guaranteed and acquired loans (non-GAAP)	$32,678	$35,935	$35,966	$33,645
Reconciliation of loans, ORE and repossessions to adjusted loans, ORE and repossessions, less acquired loans:				
Loans, excluding loans held-for-sale	$3,706,953	$3,792,886	$3,580,966	$3,409,707
Add: ORE	8,031	6,834	7,621	8,624
Add: repossessions	1,271	1,303	2,392	2,040
Total loans, ORE, and repossessions (GAAP)	3,716,255	3,801,023	3,590,979	3,420,371
Less: acquired loans	(150,763)	(165,303)	(196,567)	(216,994)
Adjusted loans, ORE, and repossessions, excluding acquired loans (non-GAAP)	$3,565,492	$3,635,720	$3,394,412	$3,203,377
Nonperforming assets to loans, ORE, and repossessions (GAAP)	1.92%	1.96%	1.76%	1.71%
Adjusted nonperforming assets to adjusted loans, ORE, and repossessions (non-GAAP)	0.92%	0.99%	1.06%	1.05%
Nonperforming assets to total assets (GAAP)	1.48%	1.52%	1.38%	1.30%
Adjusted nonperforming assets to total assets (non-GAAP)	0.68%	0.73%	0.79%	0.75%
Reconciliation of allowance to adjusted allowance:				
Allowance for loan losses (GAAP)	$31,157	$31,623	$29,772	$30,703
Less: allowance allocated to indirect auto loans	(8,556)	(9,210)	(10,258)	(10,116)
Less: allowance allocated to acquired loans	(134)	(134)	(209)	(159)
Adjusted allowance for loan losses (non-GAAP)	$22,467	$22,279	$19,305	$20,428
Reconciliation of period end loans to adjusted period end loans:				
Loans, excluding loans held-for-sale	$3,706,953	$3,792,886	$3,580,966	$3,409,707
Less: indirect auto loans	(1,588,419)	(1,698,879)	(1,716,156)	(1,609,678)
Less: acquired loans	(150,763)	(165,303)	(196,567)	(216,994)
Adjusted period end loans (non-GAAP)	$1,967,771	$1,928,704	$1,668,243	$1,583,035
Allowance to total loans (GAAP)	0.84%	0.83%	0.83%	0.90%
Adjusted allowance to adjusted period end loans (non-GAAP)	1.14%	1.16%	1.16%	1.29%
Reconciliation of book value per common share to tangible book value per common share:				
Shareholders' equity	$432,098	$420,962	$401,632	$388,068
Less: intangibles	(11,474)	(11,751)	(12,306)	(12,625)
Tangible shareholders' equity	$420,624	$409,211	$389,326	$375,443
End of period shares	27,260,681	27,191,787	27,019,201	26,815,287
Book value per common share (GAAP)	$15.85	$15.48	$14.86	$14.47
Tangible book value per common share (non-GAAP)	15.43	15.05	14.41	14.00

Results of Operations

Net Income

Net income for the quarter was $12.7 million compared to $7.9 million for the same period in 2017, an increase of $4.8 million, or 60.6%. This increase was due to multiple factors. Net interest income increased by $5.4 million as the result of an increase of 34 basis points in the yield on total loans and growth in average loans of $384.6 million. Income tax expense decrease by $1.1 million primarily due to the change in the federal tax rate as discussed in Note 1. Significant Accounting Policies to the unaudited

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consolidated financial statements. Pre-tax income was $3.7 million higher compared to the same quarter last year. Provision for loan losses decreased by $1.1 million compared to the same period last year. These favorable factors were offset by $2.7 million in higher noninterest expense primarily salaries and employee benefits.

Net income for the nine months ended September 30, 2018 was $33.9 million compared to $27.4 million for the same period in 2017, an increase of $6.5 million, or 23.9%. This increase is primarily due to a decrease of $5.9 million in income tax expense from the change in the federal tax rate as discussed in Note 1. Significant Accounting Policies to the unaudited consolidated financial statements. Pre-tax income was $601,000 higher compared to the same period last year. Higher net interest income of $10.6 million was the result of an increase of 17 basis points in loan yields and growth in average loans of $375.9 million, which was offset by $11.2 million in higher noninterest expense, primarily salaries and employee benefits and commissions expense.

On a linked-quarter basis, net income was $3.4 million higher than the previous quarter, as net interest income increased by $2.3 million and noninterest expense decreased by $3.3 million, primarily due to a $1.7 million decrease in commissions as a 17.7% decrease in mortgage loan production during the quarter drove lower mortgage commissions. A decrease of $1.9 million in the provision for loan losses also contributed to the increase in net income. Offsetting these changes was a decrease in noninterest income of $3.3 million, primarily due to a $5.9 million decrease in mortgage banking income, offset by a $2.8 million increase in other noninterest income mainly due to a $2.6 million death benefit received from cash surrender value life insurance policies during the quarter.

Interest Income

Interest income for the quarter was $46.9 million, an increase of $7.8 million, or 19.9%, compared to the same period in 2017 as average loans increased by $384.6 million, or 10.3%, and the yield on total average interest-earning assets increased by 43 basis points, as market interest rates were higher in 2018 compared to 2017.

Interest income for the nine months ended September 30, 2018 was $133.2 million, an increase of $16.8 million, or 14.5%, compared to the same period in 2017 as average loans for the period increased by $375.9 million, or 10.1%, and the yield on total average interest-bearing assets increased by 27 basis points, as market interest rates increased year-over-year.

On a linked-quarter basis, interest income increased by $2.1 million, or 4.8%, primarily driven by an increase of 25 basis points in the yield on total loans. Interest income on loans for the quarter included a $1.1 million interest recovery from one nonaccrual commercial loan, which contributed 11 basis points to this increase. Although average loans decreased by $111.7 million for the quarter, $98.7 million of this was due to a decrease in lower yielding indirect loans, which were partially replaced in the portfolio mix with higher yielding commercial and SBA loans. An increase in average investment securities of $26.4 million also contributed to higher interest income. The yield on total average interest-bearing assets increased 23 basis points from the previous quarter.

Interest Expense

Interest expense for the quarter of $8.1 million reflects an increase of $2.4 million, or 42.3%, as compared to the same quarter a year ago, primarily due to rising market rates paid on money market and time deposits that drove the increase, as well as increased volume and rates for short term borrowings.

Interest expense for the nine months ended September 30, 2018 of $23.2 million reflects an increase of $6.2 million, or 36.8%, as compared to the same period a year ago, primarily due to rising market rates paid on money market and time deposits that drove the increase, as well as increased volume and rates for short term borrowings.

On a linked-quarter basis, interest expense decreased by $143,000, or 1.7%, as average FHLB borrowings decreased by $226.1 million.

Net Interest Margin

As compared to the same quarter a year ago, net interest margin (tax equivalent) increased by 25 basis points, from 3.20% to 3.45%, primarily due to a 43 basis point increase in the yield on total average interest-earning assets of $4.5 billion, offset by an increase of 27 basis points in the yield on total average interest-bearing liabilities of $3.1 billion. Average earning assets increased by $307.0 million, primarily due to an increase in average loans over the year. Average interest-bearing liabilities increased by $136.1 million, primarily driven by an increase in average borrowings of $148.2 million, offset by a decrease in average interest-bearing deposits of $12.3 million.

As compared to the same nine months a year ago, net interest margin (tax equivalent) increased by 12 basis points, from 3.20% to 3.32%, primarily due to a 17 basis point increase in the yield on average loans.

As compared to the same quarter a year ago, average earning assets increased by $307.0 million, primarily due to the increase in average loans over the year. Average interest-bearing liabilities increased by $136.1 million primarily driven by an increase in average borrowings of $148.2 million offset by a decrease in average interest-bearing deposits of $12.3 million. Year over year, the deposit marketing campaigns in Florida have successfully increased average deposits and new commercial deposit relationships.

As compared to the same nine months a year ago, average earning assets increased by $270.0 million, primarily due to the increase in average loans over the year. Average interest-bearing liabilities increased by $89.7 million primarily driven by an

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increase in average borrowings of $97.2 million. Year over year, the deposit marketing campaigns in Florida and new commercial deposit relationships have successfully increased average deposits

On a linked-quarter basis, the net interest margin increased from 3.22% to 3.45% an increase of 23 basis points. Adjusting the net interest margin for the $1.1 million interest recovery, the net interest margin percentage was 3.36% for the quarter. Loan coupon yields, excluding fees, SBA discount accretion, and accretable yields, increased faster than deposit and borrowing costs during the quarter.

The yield on total interest bearing liabilities increased by only 2 basis points while the yield on average earning assets increased by 23 basis points from 3.95% to 4.18%. The previously mentioned interest recovery of $1.1 million contributed 11 basis points to this increase. Average loans decreased by $111.7 million, of which $98.7 million was a decrease in lower yielding indirect auto loans. Higher yielding commercial and SBA loans increased by $40.8 million as the Bank's strategy to reposition its balance sheet continues to occur.

Taxable-equivalent Interest Income

The interest income earned on certain loans and investments is completely or partially exempt from federal income and state taxes. As such, these tax-exempt instruments typically yield lower returns than taxable instruments. To provide more meaningful comparisons of yields and margins for all earning assets, we also provide revenue on a taxable-equivalent basis by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable instruments. This adjustment is not permitted under GAAP in the Consolidated Statements of Comprehensive Income.

The following is a reconciliation of interest income as reported in the Consolidated Statements of Comprehensive Income to interest income on a taxable-equivalent basis:

Reconciliation of Non-GAAP Measure:	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Interest income, GAAP basis	$46,872	$39,105	$133,174	$116,325
Taxable-equivalent adjustment	30	57	102	179
Interest income, taxable-equivalent basis	$46,902	$39,162	$133,276	$116,504

Average Balances, Interest and Yields (Unaudited)

	For the Three Months Ended					
	September 30, 2018			September 30, 2017		
($ in thousands)	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets						
Interest-earning assets:						
Loans:						
Commercial	$949,747	$12,615	5.27%	$802,318	$9,397	4.65%
SBA	166,467	3,384	8.07%	150,733	2,966	7.81%
Construction	255,302	4,252	6.61%	238,437	3,911	6.51%
Indirect automobile	1,673,014	12,987	3.08%	1,645,641	12,127	2.92%
Installment loans and personal lines of credit	36,764	329	3.55%	39,477	353	3.55%
Residential mortgage	877,080	9,153	4.14%	704,937	6,766	3.81%
Home equity lines of credit	152,231	2,028	5.29%	144,433	1,813	4.98%
Total loans, net of unearned income [(1)]	4,110,605	44,748	4.32%	3,725,976	37,333	3.98%
Investment securities [(1)]	201,696	1,674	3.29%	147,572	1,026	2.76%
Other earning assets	141,748	480	1.34%	273,505	803	1.16%
Total interest-earning assets	4,454,049	46,902	4.18%	4,147,053	39,162	3.75%
Noninterest-earning assets:						
Cash and due from banks	39,508			41,590		
Allowance for loan losses	(31,581)			(30,518)		

Premises and equipment, net	91,232			87,679		
Other real estate	7,221			9,111		
Other assets	242,360			224,730		
Total noninterest-earning assets	348,740			332,592		
Total assets	$4,802,789			$4,479,645		
Liabilities and shareholders' equity						
Interest-bearing liabilities:						
Demand deposits	$463,292	$149	0.13%	$447,348	$134	0.12%
Money market and savings deposits	1,415,868	2,493	0.70%	1,341,189	1,661	0.49%
Time deposits	918,668	3,013	1.30%	1,021,563	2,368	0.92%
Total interest-bearing deposits	2,797,828	5,655	0.80%	2,810,100	4,163	0.59%
Short-term borrowings	169,128	818	1.92%	20,899	17	0.32%
Subordinated debt	120,667	1,652	5.43%	120,538	1,532	5.04%
Total interest-bearing liabilities	3,087,623	8,125	1.04%	2,951,537	5,712	0.77%
Noninterest-bearing liabilities and shareholders' equity:						
Demand deposits	1,244,640			1,103,414		
Other liabilities	44,538			44,732		
Shareholders' equity	425,988			379,962		
Total noninterest-bearing liabilities and shareholders' equity	1,715,166			1,528,108		
Total liabilities and shareholders' equity	$4,802,789			$4,479,645		
Net interest income/spread		$38,777	3.14%		$33,450	2.98%
Net interest margin			3.45%			3.20%

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($ in thousands)	For the Nine Months Ended September 30, 2018 Average Balance	Income/ Expense	Yield/ Rate	September 30, 2017 Average Balance	Income/ Expense	Yield/ Rate
Assets						
Interest-earning assets:						
Loans:						
Commercial	$912,532	$33,735	4.94%	$803,366	$29,260	4.87%
SBA	158,246	9,204	7.78%	155,496	9,266	7.97%
Construction	260,131	12,748	6.55%	239,663	11,196	6.25%
Indirect automobile	1,742,810	39,443	3.03%	1,692,218	36,451	2.88%
Installment loans and personal lines of credit	40,738	925	3.04%	42,124	1,129	3.58%
Residential mortgage	837,427	25,726	4.11%	654,014	19,020	3.89%
Home equity lines of credit	151,019	5,695	5.04%	140,099	4,732	4.52%
Total loans, net of unearned income [1]	4,102,903	127,476	4.15%	3,726,980	111,054	3.98%
Investment securities [1]	177,811	4,241	3.19%	161,064	3,448	2.86%
Other earning assets	148,580	1,559	1.40%	271,218	2,002	0.99%
Total interest-earning assets	4,429,294	133,276	4.02%	4,159,262	116,504	3.75%
Noninterest-earning assets:						
Cash and due from banks	37,343			41,443		
Allowance for loan losses	(30,925)			(30,143)		
Premises and equipment, net	90,007			87,599		
Other real estate	7,402			11,365		
Other assets	240,722			227,733		
Total noninterest-earning assets	344,549			337,997		
Total assets	$4,773,843			$4,497,259		
Liabilities and shareholders’ equity						
Interest-bearing liabilities:						
Demand deposits	$468,055	$484	0.14%	$436,028	$363	0.11%
Money market and savings deposits	1,370,663	6,374	0.62%	1,278,689	4,270	0.45%
Time deposits	908,795	7,933	1.17%	1,040,445	6,870	0.88%
Total interest-bearing deposits	2,747,513	14,791	0.72%	2,755,162	11,503	0.56%
Short-term borrowings	266,377	3,540	1.78%	169,193	910	0.72%
Subordinated debt	120,637	4,856	5.38%	120,505	4,538	5.03%
Total interest-bearing liabilities	3,134,527	23,187	0.99%	3,044,860	16,951	0.74%
Noninterest-bearing liabilities and shareholders’ equity:						
Demand deposits	1,182,892			1,031,516		
Other liabilities	41,306			42,369		
Shareholders’ equity	415,118			378,514		
Total noninterest-bearing liabilities and stockholders' equity	1,639,316			1,452,399		
Total liabilities and shareholders’ equity	$4,773,843			$4,497,259		
Net interest income/spread		$110,089	3.03%		$99,553	3.01%
Net interest margin			3.32%			3.20%

[1]Interest income includes the effect of taxable equivalent adjustment on nontaxable interest income using a 21% tax rate in 2018 and a 35% tax rate in 2017.

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Provision for Loan Losses

Management’s policy is to maintain the allowance for loan losses at a level sufficient to absorb probable incurred losses inherent in the loan portfolio as of the balance sheet date. The allowance is increased by the provision for loan losses and decreased by charge-offs, net of recoveries, net of amounts due from the FDIC under the loss sharing agreements for our past FDIC-assisted transactions. The provision for loan losses is subject to a quarterly review process which incorporates trends in factors such as historical credit losses, delinquencies, level of nonperforming loans, loan growth, composition of the loan portfolio, etc., combined with management's view on qualitative factors such as economic conditions, loan concentrations, etc.

The provision for loan losses was $360,000 for the three months ended September 30, 2018, a decrease of $1.1 million compared to the same period in 2017. For the nine months ended September 30, 2018, provision for loan losses was $4.8 million, an increase of $501,000 compared to the same period in 2017. The primary reason for the increase was the growth of our commercial, SBA and mortgage loan portfolio and charge-offs of several non performing asset-related specific reserves. Credit quality trend performance remains consistent and strong.

The following schedule summarizes the changes in the allowance for loan losses for the periods indicated:

	As of or for the Nine Months Ended September 30,		Year Ended December 31,
($ in thousands)	2018	2017	2017
Balance at beginning of period	$29,772	$29,831	$29,831
Net (charge-offs) / recoveries:			
Commercial	(143)	(19)	(237)
SBA	(204)	(109)	(160)
Construction	623	793	898
Consumer	(3,071)	(3,915)	(4,736)
Mortgage	(596)	2	56
Total net charge-offs	(3,391)	(3,248)	(4,179)
Decrease in FDIC indemnification asset	—	(155)	(155)
Provision for loan losses (1)	4,776	4,275	4,275
Balance at end of period	$31,157	$30,703	$29,772
Allowance for loan losses as a percentage of loans	0.84 %	0.90 %	0.83 %
Adjusted allowance as a percentage of adjusted loans (non-GAAP) (2)	1.14 %	1.29 %	1.16 %
Ratio of net charge-offs to average loans outstanding, net	0.12 %	0.13 %	0.12 %

(1)Net of benefit attributable to FDIC indemnification asset for periods prior to 2018.

(2)Excludes indirect and acquired loans. See non-GAAP reconciliation table for a reconciliation to the comparable GAAP measure.

Management believes the allowance for loan losses is adequate to provide for losses inherent in the loan portfolio at September 30, 2018.

Noninterest Income

The categories of noninterest income, and the dollar and percentage change between periods, are as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
($ in thousands)	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Service charges on deposit accounts	$1,690	$1,553	$ 137	8.8 %	$4,630	$4,489	$141	3.1 %
Other fees and charges	2,464	2,197	267	12.2	7,148	6,060	1,088	18.0
Mortgage banking activities	23,520	25,040	(1,520)	(6.1)	81,465	77,865	3,600	4.6
Indirect lending activities	1,120	1,901	(781)	(41.1)	4,538	9,967	(5,429)	(54.5)
SBA lending activities	914	1,460	(546)	(37.4)	3,288	3,959	(671)	(16.9)

Trust and wealth management fees	588	325	263	80.9	1,694	853	841	98.6
Other	3,366	1,162	2,204	189.7	5,009	2,871	2,138	74.5
Total noninterest income	$33,662	$33,638	$ 24	0.1	$107,772	$106,064	$1,708	1.6

Noninterest income was $33.7 million for the three months ended September 30, 2018, a marginal increase of $24,000, or 0.1%, primarily driven by an increase in other noninterest income of $2.2 million (mainly due to the aforementioned $2.6 million death benefit received from cash surrender value life insurance policies), offset by a decrease in mortgage banking income of $1.5 million, and other categories primarily indirect lending and SBA lending activities.

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Noninterest income was $107.8 million for the nine months ended September 30, 2018, an increase of $1.7 million, or 1.6%, primarily due to an increase in mortgage banking income of $3.6 million, an increase in other noninterest income of $2.1 million, primarily due to the $2.6 million death benefit received from life insurance policies, an increase in other fees and charges of $1.1 million, offset by a decrease in income from indirect lending activities of $5.4 million, as investor demand for loan sales declined.

On a linked-quarter basis, noninterest income decreased by $3.3 million, or 9.0%, largely due to a net decrease in income from mortgage banking activities of $5.9 million, or 20.0%. Gross mortgage revenue decreased by $4.5 million and the mortgage MSR valuation impairment resulted in a decrease in related income of $1.3 million. Mortgage production also decreased during the quarter by $160.7 million. Offsetting this decrease, other noninterest income increased by $2.8 million, primarily due to the $2.6 million death benefit received from life insurance policies during the quarter.

The majority of our noninterest income is derived from mortgage banking activities. The various components of noninterest income from mortgage banking activities are further detailed below:

(in thousands)	For the Three Months Ended September 30, 2018	For the Three Months Ended September 30, 2017	For the Nine Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017
Marketing gain, net	$16,427	$ 19,713	$54,332	$ 59,745
Origination points and fees	4,707	3,815	13,849	11,025
Loan servicing revenue	6,360	5,616	18,788	16,336
Gross mortgage revenue	$27,494	$ 29,144	$86,969	$ 87,106
Less: MSR amortization	(3,369)	(3,560)	(10,127)	(10,050)
MSR recovery/(impairment), net	(605)	(544)	4,623	809
Total income from mortgage banking activities	$23,520	$ 25,040	$81,465	$ 77,865

Noninterest Expense

The categories of noninterest expense, and the dollar and percentage change between periods, are as follows:

($ in thousands)	Three Months Ended September 30, 2018	2017	$ Change	% Change	Nine Months Ended September 30, 2018	2017	$ Change	% Change
Salaries and employee benefits	$28,805	$26,331	$2,474	9.4 %	$84,581	$77,621	$6,960	9.0 %

Commissions	9,523	9,244	279	3.0	28,271	26,126	2,145	8.2
Occupancy and equipment, net	4,654	4,508	146	3.2	14,127	13,371	756	5.7
Professional and other services	4,243	4,604	(361)	(7.8)	13,676	13,723	(47)	(0.3)
Other	8,360	8,150	210	2.6	28,524	27,119	1,405	5.2
Total noninterest expense	$55,585	$52,837	$2,748	5.2	$169,179	$157,960	$11,219	7.1

For the three months ended September 30, 2018, noninterest expense of $55.6 million increased by $2.7 million, or 5.2%, mostly due to increased expenses associated with organic growth, especially in the mortgage and retail divisions. Salaries, commissions and employee benefits expense increased by $2.8 million, or 7.7%, due primarily to an increase in headcount of 63 in the mortgage and retail divisions and branches.
For the nine months ended September 30, 2018, noninterest expense of $169.2 million increased by $11.2 million, or 7.1%, mostly due to increased salaries, commissions, and employee benefits expenses, which increased by $9.1 million, or 8.8%, mainly due to the same reasons listed in the paragraph above, as four new branches were added over the year and 14 new mortgage offices.
On a linked-quarter basis, noninterest expense decreased by $3.3 million, or 5.6%, primarily due to an decrease in commissions expense of $1.7 million from lower mortgage loan originations and a net decrease in all other noninterest expenses of $1.5 million. These were primarily due to projects related to debit card and ATM fraud loss, outside service fees, utilities, and other liabilities, offset by increased incentives related to the balance sheet strategies implemented earlier in the year.

Income Tax Expense

Income tax expense was $3.7 million and $9.9 million for the three and nine months ended September 30, 2018, respectively, a decrease of $1.1 million, or 23.0%, and $5.9 million, or 37.51%, respectively, as compared to the same periods in 2017. The Tax Cuts and Jobs Act enacted into law on December 22, 2017, included, among other things, a reduction in the federal corporate income tax rate from 35% to 21%. The decrease in our income tax expense was almost entirely driven by the change in the federal tax rate. The effective tax rate for both of the three and nine months ended September 30, 2018 was 22.6%, as compared to 37.9%

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and 36.7%, respectively, for the same periods in 2017.

On a linked quarter basis, income tax expense was $3.7 million, an increase of $801,000 compared to $2.9 million in the prior quarter primarily due to the increase in pre-tax income for the quarter.

Financial Condition

Total assets grew to $4.8 billion at September 30, 2018, an increase of $235.2 million, or 5.1%, compared to December 31, 2017, primarily driven by loan growth of $139.6 million, or 3.5%, mainly in the commercial, SBA and mortgage loan portfolios, an increase in available-for-sale investment securities of 89.1 million,or 74.1%, and other assets that increased by $6.0 million, or 10.2%. The other assets increase includes a $2.9 million increase in accounts receivable, which includes $1.3 million related to the previously mentioned MSRs sale and $1.7 million from death benefits owed to the Bank from life insurance policies. A $1.2 million increase in FHLB stock due to an increased level of FHLB borrowings during the period also contributed to the increase in other assets.

Asset growth during the nine months ended September 30, 2018 was funded by $197.8 million in core deposit growth, an $13.0 million increase in short-term borrowings, primarily FHLB borrowings, offset by a $15.0 million decrease in time deposits, mainly brokered deposits.

Loans

Total loans of $4.1 billion at September 30, 2018, increased by $139.6 million, or 3.5%, as compared to December 31, 2017, primarily driven by increases of $151.2 million in commercial and SBA loans, $85.6 million in mortgage loans, $13.7 million in construction loans, and $13.6 million in loans held-for-sale, offset by a planned decrease of $127.7 million in indirect auto loans. The commercial loan production momentum that began in the 4th quarter of 2017 continues as we further implement strategies to grow the commercial bank and replace lower yielding indirect auto loans with higher yielding commercial and mortgage loans.

The increase in loans held for sale of $13.6 million, or 3.8%, during the nine month period, was primarily due to increases in mortgage loans held-for-sale of $59.0 million and SBA loans held-for-sale of $4.6 million, offset by a decrease of $50.0 million in indirect automobile loans held-for-sale. The mortgage loans held-for-sale increase is primarily the result of higher seasonal volume.

Fair Value Adjustments

Loan servicing rights increased by $4.4 million, or 3.9%, to $117.0 million at September 30, 2018, compared to December 31, 2017. MSRs, the primary component of loan servicing rights, contributed the majority of the change, increasing by $6.2 million or 6.2%, to $106.9 million, offset by decreasing indirect auto servicing rights of $1.5 million at September 30, 2018. For the year, MSRs have increased primarily due to cumulative mortgage loan sales with servicing retained of $1.8 billion, offset by a decrease from the sale of MSRs related to $1.1 billion unpaid principal balance. The current estimated fair market value of MSRs was $111.6 million at September 30, 2018.

At September 30, 2018, fair value adjustments recorded on the balance sheet for loans held-for-sale, interest rate lock commitments ("IRLCs"), and hedge items were $11.8 million, a $1.5 million or 14.5% increase from December 31, 2017. On a linked quarter basis, fair market value adjustments for loans held-for-sale, IRLCs, and hedge items decreased by $3.0 million, or 20.1%, from the previous quarter.

At September 30, 2018, gross pipeline of interest rate lock commitments was $289.1 million, an $85.2 million or 41.8% increase from December 31, 2017. On a linked quarter basis, the gross pipeline of interest rate lock commitments was $65.7 million lower compared to the previous quarter, due to slower seasonal production.

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Asset Quality

The following schedule summarizes our asset quality as of or for the three months ended for the dates indicated:

($ in thousands)	September 30, 2018		December 31, 2017		September 30, 2017	
NONPERFORMING ASSETS						
Nonaccrual loans [(2) (6)]	$ 53,173		$ 47,012		$ 41,408	
Loans past due 90 days or more and still accruing	8,858		6,313		6,534	
Repossessions	1,271		2,392		2,040	
Other real estate (ORE)	8,031		7,621		8,624	
Nonperforming assets	$ 71,333		$ 63,338		$ 58,606	
ASSET QUALITY RATIOS						
Loans 30-89 days past due	$ 6,858		$ 22,079		$ 10,193	
Loans 30-89 days past due to loans	0.19	%	0.62	%	0.30	%
Loans past due 90 days or more and still accruing to loans	0.24	%	0.18	%	0.19	%
Nonperforming loans as a % of loans	1.67	%	1.49	%	1.41	%
Nonperforming assets to loans, ORE, and repossessions	1.92	%	1.76	%	1.71	%
Adjusted nonperforming assets to adjusted loans, ORE and repossessions (non-GAAP)[(7)]	0.92	%	1.06	%	1.05	%
Nonperforming assets to total assets	1.48	%	1.38	%	1.30	%
Adjusted non performing assets to total assets (non-GAAP) [(7)]	0.68	%	0.79	%	0.75	%
Classified Asset Ratio [(4)]	19.60	%	20.70	%	20.59	%
ALL to nonperforming loans	50.23	%	55.83	%	64.04	%
Net charge-offs, annualized to average loans	0.09	%	0.11	%	0.13	%
ALL as a % of loans	0.84	%	0.83	%	0.90	%
Adjusted ALL as a % of adjusted loans (non-GAAP) [(8)]	1.14	%	1.16	%	1.29	%
ALL as a % of loans, excluding acquired loans [(5)]	0.88	%	0.88	%	0.96	%
CLASSIFIED ASSETS						
Classified loans [(1)]	$ 80,176		$ 77,679		$ 75,033	
ORE and repossessions	9,302		10,013		10,664	
Total classified assets [(3)]	$ 89,478		$ 87,692		$ 85,697	
[(1)]Amount of SBA guarantee included in classified loans.	$ 5,254		$ 2,930		$ 2,755	
[(2)]Amount of repurchased government-guaranteed loans, primarily residential mortgage loans, included in nonaccrual loans.	$ 27,218		$ 19,478		$ 15,450	

[(3)]Classified assets include loans having a risk rating of substandard or worse, both accrual and nonaccrual, repossessions and ORE, net of loss share and purchase discounts.

[(4)]Classified asset ratio is defined as classified assets as a percentage of the sum of Tier 1 capital plus allowance for loan losses.

[(5)]Allowance calculation excludes the recorded investment of acquired loans, due to valuation calculated at acquisition.

[(6)]Excludes purchased credit impaired (PCI) loans which are not removed from their accounting pool.

[(7)]Excludes acquired loans and net of government guarantees. See non-GAAP reconciliation table for a reconciliation to the comparable GAAP measure.

[(8)]Excludes indirect and acquired loans. See non-GAAP reconciliation table for a reconciliation to the comparable GAAP measure.

The Bank had $23.2 million in troubled debt restructured loans ("TDRs") at September 30, 2018, compared to $20.7 million at December 31, 2017, of which $14.6 million were accruing loans and $8.6 million were on nonaccrual (including $4.8 million in real estate mortgage loans modified in accordance with government programs) and included in nonperforming assets in the table above. Prior to permanently modifying a loan, we may enter into trial modifications with certain borrowers under both government and proprietary programs. Trial modifications generally represent a three- to four-month period during which the borrower makes monthly payments under the anticipated modified payment terms. Upon successful completion of the trial period, the Bank and the borrower enter into a permanent modification. Binding trial modifications are classified as TDRs when the trial offer is made and continue to be classified as TDRs, regardless of whether the borrower enters into a permanent modification.

Nonperforming assets increased from December 31, 2017 to September 30, 2018, primarily due to an increase in nonaccrual loans of $6.2 million. The majority of the increase in nonaccrual loans was due to growth of $7.7 million in the portfolio of repurchased GNMA government-guaranteed mortgage loans, as well as two large SBA loans added to nonaccrual during the year. Our loss exposure on the government-guaranteed loans is mitigated by the government guarantee in whole or in part.

Qualifying residential mortgage loans guaranteed by U.S. governmental agencies have been sold into GNMA pools since

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2012. Under certain performance conditions specified in government programs, the Company may have the right, but not the obligation to repurchase certain loans from the GNMA pools. These loans are recognized as residential mortgage loans in the Consolidated Balance Sheets at the time of repurchase and are classified according to delinquency status. The principal balance of the repurchased government-guaranteed loans is guaranteed in whole or in part. As the average age of the GNMA servicing portfolio increases, normal activity includes buying out delinquent loans which are covered by applicable government guarantees and reimbursements. Real estate property obtained upon foreclosure of delinquent repurchased loans repurchased is later classified as a separate receivable for the amount expected to be received under the guarantee as management intends to convey the property to the respective government agency and collect any unpaid mortgage principal balance on the loan from the government upon conveyance.

Management believes it has been proactive in charging down and charging-off its nonperforming assets as appropriate. Management's assessment of the overall loan portfolio is that loan quality and performance have improved in recent years. Management believes it is being aggressive in evaluating credit relationships and proactive in addressing problems.

When a loan is classified as nonaccrual, to the extent collection is in question, previously accrued interest is reversed, reducing interest income in the current year. If such nonaccrual loans had been on a full accrual basis, interest income on these loans for the nine months ended September 30, 2018, and 2017 would have been $1.5 million and $1.1 million, respectively.

Other Assets

Other assets were $65.2 million at September 30, 2018 compared to $59.2 million at December 31, 2017, an increase of $6.0 million. This increase was partially due to an increase in accounts receivable of $2.9 million (previously discussed in the Financial Condition section above) and FHLB stock of $1.2 million.

Deposits

Total deposits at September 30, 2018 were $4.0 billion, an increase of $182.8 million, or 4.7%, compared to December 31, 2017, primarily due to growth in core deposits, which are comprised of noninterest-bearing and interest-bearing demand accounts, including money market accounts and savings deposits, of $197.8 million, or 6.7%, offset by a decrease in time deposits of $15.0 million, or 1.6%, primarily in brokered deposits. Money market account promotions continued and new deposit accounts from commercial loan relationships began to fund. Three new branches recently opened in Georgia and Florida also contributed to deposit growth during the nine months ended September 30, 2018.

The following table summarizes average deposit composition and average rate paid for the periods presented:

	For the Three Months Ended								
	September 30, 2018			June 30, 2018			September 30, 2017		
($ in millions)	Average Balance	Rate	Percent of Total Deposits	Average Balance	Rate	Percent of Total Deposits	Average Balance	Rate	Percent of Total Deposits
Noninterest-bearing demand deposits	$1,245	— %	30.8 %	$1,172	— %	29.9 %	$1,103	— %	28.2 %
Interest-bearing deposits:									
Demand deposits	463	0.13%	11.5 %	489	0.14%	12.5 %	447	0.12%	11.4 %
Money market and savings	1,416	0.70%	35.0 %	1,350	0.61%	34.5 %	1,341	0.49%	34.3 %
Time deposits	919	1.30%	22.7 %	906	1.16%	23.1 %	1,022	0.92%	26.1 %
Total average deposits	$4,043	0.55%	100.0 %	$3,917	0.49%	100.0 %	$3,913	0.42%	100.0 %

	For the Nine Months Ended					
	September 30, 2018			September 30, 2017		
($ in millions)	Average Balance	Rate	Percent of Total Deposits	Average Balance	Rate	Percent of Total Deposits
Noninterest-bearing demand deposits	$1,183	— %	30.1 %	$1,032	— %	27.2 %
Interest-bearing deposits:						

Demand deposits	468	0.14	%	11.9	%	436	0.11	%	11.5	%
Money market and savings	1,371	0.62	%	34.9	%	1,279	0.45	%	33.8	%
Time deposits	909	1.17	%	23.1	%	1,040	0.88	%	27.5	%
Total average deposits	$3,931	0.50	%	100.0	%	$3,787	0.41	%	100.0	%

Average core deposits (excluding time deposits), grew by $231.9 million, or 8.0%, compared to the same quarter in 2017, mainly due to growth in noninterest-bearing and interest-bearing demand deposit and money market accounts, as money market account promotions continued over the year, and deposits from new commercial loan relationships began to fund. Compared to the prior linked quarter, average core deposits grew by $113.0 million, or 3.8%, mainly due to growth in noninterest-bearing and interest-bearing money market accounts. Average time deposits decreased by $102.8 million, or 10.1%, compared to the same quarter in 2017, partially due to run-off of brokered deposits, and increased by $12.6 million, or 1.4%, compared to the prior linked quarter.

Time deposits that met or exceeded the FDIC insurance limit of $250,000 were $185.3 million, and $178.5 million at September 30, 2018, and December 31, 2017, respectively.

Borrowings

Short-term borrowings increased by $13.0 million, or 8.6%, compared to December 31, 2017, as FHLB borrowings increased by $25.0 million, to finance higher loan production during the nine months ended September 30, 2018, offset by a decrease in repurchase agreements of $12.0 million.

Liquidity and Capital Resources

Market and public confidence in our financial strength and that of financial institutions in general largely determines the access to appropriate levels of liquidity. This confidence is significantly dependent on our ability to maintain sound credit quality and the ability to maintain appropriate levels of capital resources.

We define liquidity as the ability to generate sufficient cash flows to support our operations and to meet our financial obligations at a reasonable cost and on a timely basis including repayment of borrowings, anticipated customer demands for funds under credit commitments and deposit withdrawals by customers. Liquidity risk is the risk to earnings or capital if we are unable to fulfill our obligations as they become due. Liquidity risk can also develop if we fail to timely recognize or address changes in market conditions that affect our ability to obtain adequate funding to continue to operate on a profitable basis.

Management measures our liquidity position by giving consideration to both on-balance sheet and off-balance sheet sources of and demands for funds on a daily and weekly basis. As of September 30, 2018, and December 31, 2017, our cash and liquid securities totaled 8.6% and 7.2% of assets, respectively, providing ample liquidity to support our existing operations. In addition, due to FSC being a separate entity and apart from the Bank, it must provide for its own liquidity. FSC is responsible for the payment of dividends declared for its common and preferred shareholders, and interest and principal on any outstanding debt or trust preferred securities. As of September 30, 2018 and December 31, 2017, FSC had available cash balances of $11.1 million and $9.1 million, respectively. This cash is available for general corporate purposes, including FSC's debt service obligations, providing capital support to the Bank and potential future acquisitions.

Sources of the Bank’s liquidity include cash and cash equivalents, net of federal requirements to maintain reserves against deposit liabilities; investment securities eligible for sale or pledging to secure borrowings from dealers and customers pursuant to securities sold under agreements to repurchase; loan repayments; loan sales; etc. Our liabilities also provide liquidity on a day-to-day basis. Daily liquidity needs are met from deposits and certain interest-sensitive deposits; brokered deposits; securities sold under agreements to repurchase; a collateralized line of credit at the Federal Reserve Bank of Atlanta (“FRB”) Discount Window; a collateralized line of credit from the Federal Home Loan Bank of Atlanta (“FHLB”); and, to a lesser extent, borrowings under unsecured overnight Federal funds lines available from correspondent banks. The principal demands for liquidity are new loans, anticipated fundings under unfunded credit commitments to customers and deposit withdrawals. Substantially all of FSC’s liquidity is obtained from capital raises and dividends from its wholly-owned subsidiaries, LionMark Insurance Company and the Bank, which are limited by applicable law.

Management seeks to maintain a stable net liquidity position while optimizing operating results, as reflected in net interest income, the net yield spread on interest-earning assets and the cost of interest-bearing liabilities in particular. We deploy our funds in a manner to provide liquidity from both assets and liabilities sufficient to meet our cash needs. Our Asset Liability Management Committee (“ALCO”), which includes the CEO and senior management representatives, manages our liquidity risk. ALCO meets monthly to review the current and projected net liquidity positions and to review actions taken by management to achieve this liquidity objective. One of the primary goals of ALCO is to maintain a sufficient level of liquidity in both normal operating conditions and in periods of internal or industry stress. The Board of Directors also reviews performance against internal liquidity benchmarks on at least a quarterly basis.

Managing the levels of total liquidity, short-term liquidity, and short-term liquidity sources continues to be an important and complex exercise because of the coordination of the projected mortgage, SBA and indirect automobile loan production and sales, loans held-for-sale balances, and individual loans and pools of loans sold anticipated to fluctuate during the year. We also have fluctuating obligations related to our portfolio of loans serviced for others such as advances we are obligated to make to investors to fund scheduled principal, interest, tax and insurance payments that mortgage loan borrowers have failed to make, to cover foreclosure costs and various other items that are required to preserve the assets being serviced. These servicer advance obligations require capital and liquidity to fund these advances until we are contractually obligated to be reimbursed from the loan investors.

Our loans held for sale are considered highly liquid. The majority of commitments to purchase mortgage loans held-for-sale will be funded within sixty days of the loan closing. The majority of these loans are conforming residential mortgage loans sold to GNMA, Federal National Mortgage Association (“FNMA”), and Federal Home Loan Mortgage Corporation (“FHLMC”). Other categories of loans held for sale include indirect automobile loans purchased from motor vehicle dealers and the government-guaranteed portion of SBA and USDA loans. The portfolio of indirect auto loans held for sale fluctuates based on the demand for loan sales from investors, mainly other financial institutions, which has declined in recent years. Government-guaranteed SBA and USDA loans held for sale are sold upon completion of the disbursement period.

Our investment securities portfolio increased by $87.8 million, or 61.9% compared to the balance at December 31, 2017. Our recent strategy has been to increase the investment portfolio as a percentage of total assets as we identify securities that meet our strategy and objectives.

Shareholders’ Equity

Shareholders’ equity was $432.1 million at September 30, 2018, and $401.6 million at December 31, 2017. The increase of $30.5 million in shareholders’ equity during the nine months ended September 30, 2018 was attributable to net income earned during the period of $33.9 million, partially offset by cash dividends declared on common shares of $9.8 million. The remainder of the increase is primarily attributable to stock issued through employee programs.

On May 5, 2017, we filed a shelf registration statement with the SEC for up to $100 million of common stock, preferred stock, warrants, or debt securities, to be issued from time to time for general corporate purposes which may include funding bank and non-bank subsidiaries, financing business expansion, or refinancing or extending the maturity of debt obligations and investments at the holding company level. The amount was available to be issued as of June 15, 2017, which was the date that the SEC issued a Notice of Effectiveness. As of September 30, 2018, we have not issued any securities under the shelf registration statement.

On May 4, 2018, we filed a registration statement with the SEC to issue up to 1,250,000 shares of common stock, pursuant to awards granted or exercised under the Fidelity Southern Corporation 2018 Omnibus Incentive Plan (the "Plan") reduced by grants under the Fidelity Southern Equity 2006 Incentive Plan, as amended (the "Prior Plan") after December 31, 2017, plus an indeterminate number of additional shares of underlying awards outstanding as of March 8, 2018 under the Prior Plan that thereafter terminate or expire unexercised, or are canceled, forfeited or lapse for any reason and may become issuable under the Plan, plus such indeterminate number of additional securities as may become issuable under the Plan as the result of any future stock splits, stock dividends or similar adjustments of the Common Stock. No further awards will be granted under the Prior Plan and the Prior Plan will remain in effect only for so long as awards granted thereunder remain outstanding. As of September 30, 2018, we have not granted any awards under the Plan.

On May 8, 2018, we filed a registration statement with the SEC to issue up to 1,224,616 shares of common stock to be issued to shareholders and first-time investor participation in our Direct Stock Purchase and Dividend Investment Plan (the "DRIP Plan"). As of September 30, 2018, there were 1,148,438 shares remaining to be granted under the DRIP Plan.

Capital Ratios

FSC is subject to certain regulations with respect to certain risk-based capital ratios. We are regulated by the Board of Governors of the Federal Reserve Board and is subject to the securities registration and public reporting regulations of the SEC. The Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Georgia Department of Banking and Finance.

The Bank must comply with regulatory capital requirements established by its regulators. Failure to meet minimum regulatory capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific regulatory capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. These regulatory capital standards require us to maintain minimum ratios of “Tier 1” capital to total risk-weighted assets and total capital to risk-weighted assets of 6.00% and 8.00%, respectively. Tier 1 capital is comprised of total shareholders’ equity calculated in accordance with generally accepted accounting principles, excluding accumulated other comprehensive income, less intangible assets and excess loan servicing rights.

As part of our capital management strategy, we carefully monitor the impact of the loan servicing rights on our capital ratios. As part of our analysis, we consider current and proposed regulatory capital guidelines surrounding MSRs. On August 30, 2018, the Bank sold MSRs relating to certain single-family mortgage loans serviced for the Fannie Mae and the Freddie Mac, with an aggregate unpaid principal balance of approximately $1.1 billion, effective as of August 31, 2018. Approximately $13.0 million in deposit balances representing custodial funds and advances related to the MSRs were transferred to the buyer after the sale date. The sale represented approximately 12% of the Bank's total single-family mortgage servicing portfolio as of August 31, 2018. This was the first sale of MSRs executed by the Bank as part of the Company's capital management strategy. The Bank anticipates executing other MSRs sales from time to time in the future as part of its ordinary course of business.

Total capital is comprised of Tier 1 capital plus certain adjustments, the largest of which is our qualifying subordinated debt, as well as the allowable portion of the allowance for loan losses. Risk-weighted assets refer to our on- and off-balance sheet exposures, adjusted for their related risk levels using formulas set forth in FDIC regulations.

In addition to the risk-based capital requirements described above, we are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 capital to quarterly average total assets of 4.00%. The Tier 1 leverage ratio does not assign risk weights to assets. The Bank is also subject to a Common Equity Tier 1 (“CET1”) capital to total risk-weighted assets ratio of 4.50%. CET1 is comprised of Tier 1 capital less amounts attributable to qualifying non-cumulative perpetual preferred stock and minority interests in consolidated subsidiaries.

Basel III

On July 2, 2013, the Federal Reserve Bank (“FRB”) and the FDIC each approved rules implementing new capital guidelines for U.S. banking organizations in accordance with the Basel Committee on Banking Supervision ("BCBS") framework for capital("Basel III"). Under these rules, minimum requirements increase for both the quantity and quality of capital we maintain.

The rules include a new "Common Equity Tier 1" or "CET1" capital to risk-weighted assets ratio of 4.50% and a CET1 capital conservation buffer of 2.50% of risk-weighted assets. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers. The capital conservation buffer began phasing in on January 1, 2016 at 0.625% of risk-weighted assets and continues to increase at the same rate each subsequent year until reaching its final level of 2.5% of risk-weighted assets on January 1, 2019. As of January 1, 2017, the capital conservation buffer was 1.25% of risk-weighted assets.

The rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.00% to 6.00%, and require a minimum leverage ratio of 4.00%. The rules implement strict eligibility criteria for regulatory capital instruments, including limitations on MSRs and DTAs, requiring us to deduct a much larger portion of the value of our mortgage servicing rights from our Tier 1 capital. Basel III limits the amount of MSRs and DTAs to 10 percent of CET1, individually, and 15 percent of CET1, in the aggregate.

The Basel III final rules became effective for us on January 1, 2015, with full compliance with all of the final rule's requirements originally required to be phased in over a three year period ending January 1, 2018. However, the banking regulators released a final rule on November 21, 2017 which effectively freezes the currently applicable phase of the transition provisions for these capital requirements until a separate rulemaking is finalized. This ruling delays the last phase of the Basel III capital rules’ transition provisions relating to certain deductions from capital and limitations on the recognition of minority interests, which were scheduled to become effective January 1, 2018.

Prompt Corrective Action

In July 2013, the final rules implementing the BCBS's Basel III capital guidelines increased regulatory capital requirements of U.S. banking organizations in a manner that more closely reflected risk exposures, and brought the regulatory capital framework into compliance with Basel III. The final rules revised the level at which the Bank becomes subject to corrective action. The federal banking agencies have broad powers with which to require companies to take prompt corrective action to resolve problems of insured depository institutions that do not meet minimum capital requirements. The law establishes five capital categories for this purpose: (i) well-capitalized; (ii) adequately capitalized; (iii) undercapitalized; (iv) significantly undercapitalized; and (v) critically undercapitalized. The final rules amended the thresholds in the prompt corrective action framework to reflect the higher capital ratios required.

Under the final rules, to be considered “adequately capitalized,” or “well-capitalized”, an institution generally must meet the capital measures as laid out on the table below:

	Adequately Capitalized			Well Capitalized
	(minimum)	(with buffer for 2018)	(with buffer fully phased in 2019)	(minimum)
Total risk-based capital	8.000%	9.875%	10.500%	10.000%
Tier 1 risk-based capital	6.000%	7.875%	8.500%	8.000%
CET 1 capital	4.500%	6.375%	7.000%	6.500%
Leverage ratio	4.000%	N/A	N/A	5.000%

While the prompt corrective action rules apply to banks and not bank holding companies, the FRB is authorized to take actions at the holding company level. Failure to meet applicable capital standards could subject the bank holding company or financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on the ability to pay dividends, the issuance by the regulatory authorities of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. FSC is not subject to the provisions

of prompt corrective action.
To continue to conduct our business as currently conducted, we must maintain capital levels well above the minimum regulatory requirements. At September 30, 2018, the Bank’s capital ratios exceeded the well capitalized and regulatory minimum ratios discussed above.

The following tables sets forth the minimum regulatory capital requirements for the Bank under FDIC regulations and the Bank’s regulatory capital ratios at September 30, 2018, and December 31, 2017:

Fidelity Bank	September 30, 2018		December 31, 2017	
($ in thousands)	Amount	Percent	Amount	Percent
Common Equity Tier 1 Capital:				
Actual	$387,819	9.33 %	$355,580	8.78 %
Minimum	187,051	4.50 %	182,245	4.50 %
Tier 1 Capital:				
Actual	$403,819	9.71 %	$371,407	9.17 %
Minimum	249,528	6.00 %	243,014	6.00 %
Total Risk-Based Capital:				
Actual	$521,031	12.53%	$487,149	12.03%
Minimum	332,661	8.00 %	323,956	8.00 %
Tier 1 Capital Leverage Ratio:				
Actual		8.50 %		8.34 %
Minimum		4.00 %		4.00 %

The FRB, as the primary regulator of FSC, has established minimum regulatory capital requirements as a function of its oversight of bank holding companies. The following tables depict FSC’s regulatory capital ratios at September 30, 2018, and December 31, 2017, in relation to the minimum capital ratios established by the regulations of the FRB:

Fidelity Southern Corporation	September 30, 2018		December 31, 2017	
($ in thousands)	Amount	Percent	Amount	Percent
Common Equity Tier 1 Capital:				
Actual	$380,456	9.15 %	$349,133	8.86 %
Minimum	187,110	4.50 %	177,225	4.50 %
Tier 1 Capital:				
Actual	$425,456	10.24%	$393,818	10.00%
Minimum	249,291	6.00 %	236,291	6.00 %
Total Risk-Based Capital:				
Actual	$531,275	12.78%	$498,166	12.65%
Minimum	332,567	8.00 %	315,071	8.00 %
Tier 1 Capital Leverage Ratio:				
Actual		8.96 %		8.85 %
Minimum		4.00 %		4.00 %

Our regulatory capital ratios are currently well in excess of the minimum standards and continue to be in the "well capitalized" regulatory classification.

Dividends

On October 18, 2018, we declared a cash dividend of $0.12 per share, payable on November 14, 2018, to common shareholders of record as of November 2, 2018.

Future dividends require a quarterly review of current and projected earnings for the remainder of 2018 in relation to capital requirements prior to the determination of the dividend, and be subject to regulatory restrictions under applicable law. The Board of Directors for both the Bank and the Company will review on a quarterly basis whether to declare and pay dividends for the remainder of the fiscal year 2018, with the declared and paid dividend consistent with current regulatory limitations, earnings, capital requirements, and forecasts of future earnings.

Market Risk

Market risk is defined as the sensitivity of income, fair value measurements and capital to changes in market rates or prices. Our primary market risk exposure is credit risk and, to a lesser extent, interest rate risk and liquidity risk. We have little or no risk related to trading accounts, commodities, or foreign exchange. Our real estate loan portfolio is subject to risks associated with the local economies of our various markets and, in particular, the regional economy of the South. Interest rate risk, which encompasses price risk, is the exposure of our financial condition and earnings ability to withstand adverse movements in interest rates. Price and interest rate risks arise from the financial instruments and positions we hold including loans, mortgage servicing rights, investment securities, deposits, borrowings, and derivative financial instruments. Accepting this risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk can pose a significant threat to assets, earnings, and capital. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our success.

ALCO monitors and considers methods of managing the rate and sensitivity repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of changes in portfolio values and net interest income with changes in interest rates. The primary purposes of ALCO are to manage our interest rate risk consistent with earnings and liquidity, to effectively invest our capital, and to preserve the value created by our core business operations. In addition, our exposure to interest rate risk is compared to established tolerances on at least a quarterly basis by our Board of Directors.

Evaluating our exposure to changes in interest rates includes assessing both the adequacy of the process we use to control interest rate risk and our quantitative levels of exposure. When assessing the interest rate risk management process, we seek to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. Evaluating the quantitative level of interest rate risk exposure requires us to assess the existing and potential future effects of changes in interest rates on our consolidated financial condition, including capital adequacy, earnings, liquidity, and, where appropriate, asset quality.

Interest Rate Sensitivity

Economic value of equity (“EVE”) sensitivity analysis measures the estimated changes in the net present value of our cash flows from assets, liabilities and off-balance sheet items to changes in market interest rates. This analysis assesses the risk of balance sheet value decline in the event of a sudden and sustained 100, 200, 300, and 400 basis point increase or decrease in market interest rates. In addition, management reviews the impact of various yield curve scenarios on earnings and cash flows.

The most recent rate shock analysis indicated that the effects of an immediate and sustained change in rates would fall within policy parameters and approved tolerances for net interest income. If large downward shocks did occur from today's already low rates, increased modeled impairment may breach net income and equity at risk internal benchmarks.

Rate shock analysis provides only a limited, point in time view of interest rate sensitivity. The actual impact of interest rate changes upon earnings and net present value may differ from that implied by any static rate shock. In addition, net interest income and net present value under various future interest rate scenarios are affected by multiple other factors not embodied in a static rate shock, including competition, changes in the shape of the Treasury yield curve, divergent movement among various interest rate indices, and the speed with which interest rates change. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities that are not reflected in the interest rate sensitivity analysis.

Visa Class B Stock

As of September 30, 2018, we owned 46,436 shares of Class B common stock of Visa, Inc. We received these Class B shares in 2008 as part of Visa’s initial public offering. These shares are transferable only under limited circumstances until they can be converted into the publicly traded Class A shares. This conversion will not occur until the settlement of certain litigation which is indemnified by Visa members. Visa funded an escrow account from its initial public offering to settle these litigation claims. Should this escrow account not be sufficient to cover these litigation claims, Visa is entitled to fund additional amounts to the escrow account by reducing each member bank’s Class B conversion ratio to unrestricted Class A shares. Effective June 28, 2018, the conversion rate for each Class B common share decreased to 1.6298 shares of Class A common stock. Based on the existing transfer restriction and the uncertainty of the covered litigation, the Visa Class B shares (75,681 Class A equivalent shares) that we own are carried at a zero cost basis as of September 30, 2018.

Loss Share Agreement Termination with FDIC

On June 27, 2018, the Bank entered into an agreement with the FDIC to terminate the remaining loss share agreements entered into with the FDIC in regard to the Bank's past FDIC-assisted acquisitions of Decatur First Bank (“DFB”) and Security Exchange Bank (“SEB”). The DFB non-single family loss share agreement between the Bank and the FDIC expired on December 31, 2016 and losses on non-single family loans and other real estate assets covered under the agreement were no longer eligible to be claimed after filing the fourth quarter of 2016 loss share certificate with the FDIC. Similarly, the SEB non-single family loss share agreement between the Bank and the FDIC expired on

June 30, 2017 and losses on non-single family loans and other real estate assets covered under the agreement were no longer eligible to be claimed after filing the second quarter of 2017 loss share certificate with the FDIC. There were no single-family loans included in the loss share agreement for SEB.
Claims for losses on covered DFB single-family loans were eligible for reimbursement under the single-family loss share agreement between the Bank and the FDIC until 2021 and were ended by the termination agreement. As a result, Fidelity made a cash payment of approximately $632,000 to the FDIC as consideration for the early termination of the agreements, which was accrued at December 31, 2017 pursuant to the clawback provision within the loss share agreements.
Off-Balance Sheet Arrangements
We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers, and to reduce our own exposure to fluctuations in interest rates. These financial instruments, which include commitments to extend credit and letters of credit, involve to varying degrees elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. The contract or notional amounts of these instruments reflect the extent of involvement we have in particular classes of financial instruments.

Our exposure to credit loss, in the event of nonperformance by customers for commitments to extend credit and letters of credit, is represented by the contractual or notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for recorded loans. Loan commitments and other off-balance sheet exposures are evaluated by the Credit Review department quarterly and reserves are provided for risk as deemed appropriate.

Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the agreement. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Thus, we will deny funding a commitment if the borrower’s financial condition deteriorates during the commitment period, such that the customer no longer meets the pre-established conditions of lending. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby and import letters of credit are commitments issued by us to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans or lines of credit to customers. We hold collateral supporting those commitments as deemed necessary.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See “Market Risk” and “Interest Rate Sensitivity” contained in Item 2 of Part I of this report for quantitative and qualitative discussion about our market risk.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, the Company's management supervised and participated in an evaluation, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on, and as of the date of, that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There has been no change in the Company’s internal control over financial reporting during the three months ended September 30, 2018, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are a party to various legal proceedings such as claims and lawsuits arising in the course of our normal business activities. Although the ultimate outcome of all claims and lawsuits outstanding as of September 30, 2018 cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on our business, results of operations or financial condition.

Item 1A. Risk Factors

While the Company attempts to identify, manage, and mitigate risks and uncertainties associated with its business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our cash flows, results of operations, and financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

	(a)	(b)	(c)	(d)
Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
July 2018	—	$ —	—	$ 10,000,000
August 2018	—	—	—	10,000,000
September 2018	—	—	—	10,000,000
Total	—	$ —	—	$ 10,000,000

The repurchase plan announced April 3, 2014, authorizing the repurchase of up to $10.0 million of our outstanding common stock, has no expiration date for the authorized share repurchases under such plan.

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

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Item 6. Exhibits
The following exhibits are filed or furnished as part of this Report:

		Incorporated by Reference			
Exhibit Number	Description of Document	Form	Filing Date	Exhibit Number	SEC File No.
3(a)	Amended and Restated Articles of Incorporation of Fidelity Southern Corporation, as amended effective December 16, 2008	10-K	03/17/2009	3(a)	001-34981
3(b)	Articles of Amendment to the Articles of Incorporation of Fidelity Southern Corporation	8-K	11/23/2010	3.1	001-34981
3(c)	By-Laws of Fidelity Southern Corporation, as amended	10-Q	11/08/2007	3(b)	001-34981
3(d)	Amendment to By-Laws of Fidelity Southern Corporation	8-K	11/23/2010	3.2	001-34981
4(a)	See Exhibits 3(a) through 3(d) for provisions of the Amended and Restated Articles of Incorporation, as amended, and By-laws of Fidelity Southern Corporation, which define the rights of the shareholders.	See 3(a) through 3(d) above			001-34981
4(b)	Form of Global Note representing the Fixed/Floating Rate Subordinated Notes due 2030 of Fidelity Bank	8-K	06/03/2015	4.1	001-34981
31.1+	Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2+	Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1#	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				
32.2#	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				
101	Financial Statements submitted in XBRL format				

+ Filed herewith
# Furnished herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIDELITY SOUTHERN CORPORATION
(Registrant)

Date:	November 2, 2018	BY:	/s/ JAMES B. MILLER, JR. James B. Miller, Jr. Chief Executive Officer
Date:	November 2, 2018	BY:	/s/ CHARLES D. CHRISTY Charles D. Christy Chief Financial Officer