SOUTHERN

BANCSHARES

2018 Consolidated Financial Statements

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES

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DIXON HUGHES GOODMAN LLP

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Southern BancShares (N.C.), Inc.
Mount Olive, North Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Southern BancShares (N.C.), Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

DIXON HUGHES GOODMAN LLP

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern BancShares (N.C.), Inc. and subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter
As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for certain equity investments as of January 1, 2018 due to the adoption of ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. Our opinion is not modified with respect to this matter.

Audit of Internal Control Over Financial Reporting

We also have audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 25, 2019 expressed an unmodified opinion thereon.

Dixon Hughes Goodman LLP

Raleigh, North Carolina
March 25, 2019

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands Except Share and Per Share Data)

	December 31, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 22,607	$ 19,848
Interest-bearing deposits with banks	128,239	157,604
Certificates of deposit with banks	19,979	31,782
Total cash and cash equivalents	170,825	209,234
Investment in marketable equity securities at fair value (cost of $15,864 in 2018)	79,868	-
Investment securities available for sale, at fair value (amortized cost of $604,213 and $598,869, respectively)	593,652	671,165
Loans held for sale	2,393	2,162
Loans and leases:		
Acquired loans	205,190	245,340
Non-acquired loans	1,499,117	1,385,315
Less allowance for loan and lease losses:		
Acquired loans	(1,734)	(1,661)
Non-acquired loans	(18,356)	(16,764)
Net loans and leases	1,684,217	1,612,230
Premises and equipment, net	60,295	59,933
Accrued interest receivable	9,853	8,591
Stock in Federal Home Loan Bank of Atlanta	2,322	2,510
Other real estate owned	354	783
Goodwill	26,649	26,649
Intangible assets	5,037	6,113
Bank owned life insurance	27,276	26,458
Other assets	21,351	29,480
Total assets	$ 2,684,092	$2,655,308
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 732,336	$ 695,830
Interest-bearing	1,567,291	1,550,200
Total deposits	2,299,627	2,246,030
Short-term borrowings	45,165	57,214
Long-term borrowings	23,711	30,836
Other liabilities	22,112	26,465
Total liabilities	2,390,615	2,360,545
SHAREHOLDERS' EQUITY		
Preferred stock	1,819	1,828
Common stock, $5 par value; 158,485 shares authorized; 81,201 and 81,223 shares issued and outstanding at December 31, 2018 and 2017, respectively	406	406
Surplus	48,487	69,862
Retained earnings	259,060	173,821
Accumulated other comprehensive (loss) income	(16,295)	48,846
Total shareholders' equity	293,477	294,763
Total liabilities and shareholders' equity	$ 2,684,092	$2,655,308

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Dollars in Thousands Except Share and Per Share Data)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Interest income:		
Loans and leases	$ 83,983	$ 81,676
Investment securities	16,405	14,550
Federal funds sold and deposits with banks	2,555	2,158
Total interest income	102,943	98,384
Interest expense:		
Deposits	4,665	2,738
Short-term borrowings	151	152
Long-term borrowings	2,179	2,866
Total interest expense	6,995	5,756
Net interest income	95,948	92,628
Provision for loan and lease losses	2,799	2,323
Net interest income after provision for loan and lease losses	93,149	90,305
Noninterest income:		
Service charges on deposit accounts	8,265	8,270
Other service charges and fees	5,347	4,711
Investment securities (losses) gains, net	(492)	3,205
Marketable equity securities losses, net	(2,877)	-
Gain on sale of loans	934	899
Amortization on FDIC receivable for loss share agreements	-	(293)
Other FDIC receivable for loss share agreements expense	-	(4,112)
Gain (loss) on sale and writedowns of other real estate owned	(200)	402
Investment services revenue	2,005	1,575
Other	2,991	2,945
Total noninterest income	15,973	17,602
Noninterest expense:		
Personnel	42,968	41,223
Data processing	7,719	7,278
Occupancy	6,327	6,458
Furniture and equipment	5,653	5,622
FDIC assessments	913	978
Professional fees	2,373	2,619
Amortization of intangibles and mortgage servicing rights	1,726	1,975
Other	5,062	6,591
Total noninterest expense	72,741	72,744
Income before income taxes	36,381	35,163
Income taxes	6,836	1,273
Net income	29,545	33,890
Other comprehensive (loss) income:		
Unrealized gains on investment securities available for sale:		
Unrealized (losses) gains arising during period on debt securities available for sale	(7,790)	12,712
Tax effect	1,765	(4,683)
Reclassification adjustment from security transactions	492	(3,205)
Tax effect	(120)	1,172
Net of tax amount	(5,653)	5,996
Pension obligation	(2,732)	3,255
Tax effect	617	(1,190)
Amortization of actuarial losses	986	1,036
Tax effect	(233)	(379)
Net of tax amount	(1,362)	2,722
Total other comprehensive (loss) income	(7,015)	8,718
Comprehensive income	$ 22,530	$ 42,608
Per share information:		
Net income available to common shareholders per common share, basic and diluted	$ 339.92	$ 389.54
Cash dividends declared on common shares	5.00	1.60
Weighted average common shares outstanding	81,220	81,394

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in Thousands Except Share and Per Share Data)

	Preferred Series B	Preferred Series C	Preferred Series D	Preferred Series E	Preferred Series F	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
BALANCE, DECEMBER 31, 2016	$ 1,350	$ 489	$ -	$ 1	$ -	$ 409	$ 69,862	$ 151,923	$ 31,370	$ 255,404
Net income	-	-	-	-	-	-	-	33,890		33,890
Purchase and retirement of stock	(12)	-	-	-	-	(3)	-	(920)		(935)
Cash dividends:										
Common stock	-	-	-	-	-	-	-	(130)		(130)
Preferred B	-	-	-	-	-	-	-	(241)		(241)
Preferred C	-	-	-	-	-	-	-	(33)		(33)
Preferred D	-	-	-	-	-	-	-	(736)		(736)
Preferred E	-	-	-	-	-	-	-	(79)		(79)
Preferred F	-	-	-	-	-	-	-	(1,095)		(1,095)
Revaluation of net deferred tax liabilities								(8,758)	8,758	-
Other comprehensive income	-	-	-	-	-	-	-		8,718	8,718
BALANCE, DECEMBER 31, 2017	1,338	489	-	1	-	406	69,862	173,821	48,846	294,763
Net income	-	-	-	-	-	-	-	29,545		29,545
Purchase and retirement of stock	(9)	-	-	-	-	-	(21,375)	(89)		(21,473)
Cash dividends:										
Common stock	-	-	-	-	-	-	-	(406)		(406)
Preferred B	-	-	-	-	-	-	-	(239)		(239)
Preferred C	-	-	-	-	-	-	-	(33)		(33)
Preferred D	-	-	-	-	-	-	-	(283)		(283)
Preferred E	-	-	-	-	-	-	-	(79)		(79)
Preferred F	-	-	-	-	-	-	-	(1,303)		(1,303)
Cumulative effect of adoption of ASU 2016-01								58,126	(58,126)	-
Other comprehensive loss	-	-	-	-	-	-	-	-	(7,015)	(7,015)
BALANCE, DECEMBER 31, 2018	$ 1,329	$ 489	$ -	$ 1	$ -	$ 406	$ 48,487	$ 259,060	$ (16,295)	$ 293,477

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands Except Share and Per Share Data)

	Year Ended December 31, 2018	Year Ended December 31, 2017
OPERATING ACTIVITIES:		
Net income	$ 29,545	$ 33,890
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan and lease losses	2,799	2,323
Deferred income tax (expense) benefit	(812)	403
Loss on marketable equity securities	2,877	-
Loss (gain) on sales and issuer calls of securities	492	(3,205)
Loss on disposal of premises and equipment	13	212
Loss on charitable contributions of property	-	28
Valuation adjustments on property held for sale	-	15
Loss (gain) on sale and writedowns of other real estate owned	200	(402)
Gain on sale of loans	(934)	(899)
Net amortization on investments	2,356	2,485
Amortization on FDIC receivable for loss share agreements	-	293
Accretion on acquired loans	(10,461)	(16,398)
Amortization of intangibles and mortgage servicing rights	1,726	1,975
Depreciation	4,177	4,181
Proceeds from sales of loans held for sale	76,163	71,024
Origination of loans held for sale	(75,460)	(67,708)
Net decrease in FDIC loss share receivable	-	4,112
Net increase in intangible assets	(650)	(648)
Net increase in accrued interest receivable	(1,262)	(675)
Net increase in cash surrender value of bank owned life insurance	(818)	(628)
Net decrease (increase) in other assets	8,451	(15,903)
Net decrease in other liabilities	(1,513)	(2,030)
NET CASH PROVIDED BY OPERATING ACTIVITIES	36,889	12,445
INVESTING ACTIVITIES:		
Proceeds from maturities, paydowns, and issuer calls of investment securities available for sale	63,308	69,888
Proceeds from sales of marketable equity securities	6,976	-
Proceeds from sales of investment securities available for sale	36,952	213,162
Purchases of investment securities available for sale	(124,681)	(167,966)
Net increase in loans and leases	(64,991)	(126,828)
Redemption (purchase) of FHLB stock	188	(326)
Purchases of premises and equipment	(4,723)	(5,685)
Proceeds from sale of premises and equipment	171	15
Proceeds from the sale of other real estate owned	895	2,353
Cash payment to FDIC to terminate loss share agreements	-	(17,260)
Purchase of bank owned life insurance	-	(20,000)
NET CASH USED BY INVESTING ACTIVITIES	(85,905)	(52,647)
FINANCING ACTIVITIES:		
Net increase in noninterest-bearing demand deposits	36,506	67,523
Net increase in interest-bearing deposits	17,091	57,804
Net repayments of short-term borrowed funds	(12,049)	(10,830)
Net repayments of long-term debt	(7,125)	-
Cash dividends paid	(2,343)	(2,314)
Purchase and retirement of stock	(21,473)	(935)
NET CASH PROVIDED BY FINANCING ACTIVITIES	10,607	111,248
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(38,409)	71,046
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF YEAR	209,234	138,188
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	$ 170,825	$ 209,234

SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Dollars in Thousands Except Share and Per Share Data)

	Year Ended December 31, 2018	Year Ended December 31, 2017
SUPPLEMENTAL DISCLOSURES OF CASH PAID DURING THE YEAR FOR:		
Interest	$ 6,935	$ 5,767
Income taxes	8,644	10,527
SUPPLEMENTAL DISCLOSURES OF NONCASH FINANCING AND INVESTING ACTIVITIES:		
Unrealized gains(losses) on available-for-sale securities, net of tax	$ (5,653)	$ 5,996
Change in pension obligation, net of tax	(1,362)	2,722
Investment securities available for sale transferred to marketable equity securities	91,789	-
Non-acquired foreclosed loans and leases transferred to other real estate	584	934
Acquired foreclosed loans and leases transferred to other real estate	82	-
Covered other real estate transferred to non-covered other real estate	-	95
Premises and equipment transferred to other assets	-	9
Reclassification from long-term borrowings to short-term borrowings	-	10,000

Note 1. Nature of Operations and Summary of Significant Accounting Policies

BancShares

Southern BancShares (N.C.), Inc. ("BancShares") is the holding company for Southern Bank and Trust Company ("Southern"), which operates 54 banking offices and 1 loan production office in eastern North Carolina and 10 banking offices in southeastern Virginia.

Southern Bank Community Development, LLC, is a wholly owned subsidiary of BancShares for the construction or rehabilitation of low-to-moderate income residential or commercial properties primarily in the rural Eastern North Carolina markets served by Southern. Southern, which began operations January 29, 1901, has a wholly-owned subsidiary, Goshen, Inc., whose primary operations include holding certain investments. Southern also has a wholly owned subsidiary, Tuscarora Properties, LLC, that was created to hold, manage and ultimately dispose of select other real estate owned ("OREO") properties. BancShares and Southern are headquartered in Mount Olive, North Carolina.

BancShares has no foreign operations and BancShares' customers are principally located in eastern North Carolina and southeastern Virginia.

BancShares and Southern are subject to extensive federal and state banking laws and regulations. These laws and regulations focus on the protection of depositors, federal deposit insurance funds, and the banking system as a whole rather than the protection of security holders. Federal and state banking regulators possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums, increased expenses, reductions in fee income and limitations on activities that could have a materially adverse effect on our results of operations.

Principles of Consolidation

The consolidated financial statements include the accounts of BancShares and other entities in which BancShares has a controlling interest. All significant intercompany balances have been eliminated in consolidation.

Basis of Financial Statement Presentation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates made by BancShares in the preparation of its consolidated financial statements are:

- Determination of the allowance for loan and lease losses
- Determination of other-than-temporary impairment for investment securities
- Determination of fair values of acquired assets and assumed liabilities
- Goodwill impairment
- Pension plan assumptions
- Mortgage servicing rights
- Income taxes

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation. Such reclassifications had no effect on net income or shareholders' equity as previously reported.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits with banks, and certificates of deposit with banks. Overnight and federal funds are purchased and sold for one day periods.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Equity Securities

Equity securities are recorded on a trade date basis and measured at fair value with all changes recorded through income. Realized and unrealized gains and losses are determined by specific identification and are included in noninterest income. Non-marketable equity securities are securities that do not have readily determinable fair values and are measured at cost. Equity securities with no recurring market value data available are reviewed periodically and any observable market value changes are adjusted through net income. BancShares evaluates its non-marketable equity securities for impairment and recoverability of the recorded investment by considering positive and negative evidence, including the profitability and asset quality of the issuer, dividend payment history and recent redemption experience. Impairment is assessed at each reporting period and if identified, is recognized in Noninterest Income. Non-marketable equity securities are recorded within Other Assets in the Consolidated Balance Sheets.

Debt Securities

BancShares classifies debt securities as available for sale and they are reported at estimated fair value, with unrealized gains and losses, net of income taxes, reported in Accumulated Other Comprehensive Income (“AOCI”). Amortization of premiums and accretion of discounts for debt securities are included in interest income. Realized gains and losses from the sale of debt securities are determined by specific identification on a trade date basis and are included in noninterest income. BancShares evaluates each available for sale security in a loss position for other-than-temporary impairment (“OTTI”) at least quarterly. BancShares considers such factors as the length of time and the extent to which the market value has been below amortized cost, long-term expectations and recent experience regarding principal and interest payments, BancShares' intent to sell, and whether it is more likely than not that it would be required to sell those securities before the anticipated recovery of the amortized cost. The credit component of an OTTI loss is recognized in earnings and the non-credit component is recognized in AOCI in situations where BancShares does not intend to sell the security, and it is more likely than not that BancShares will not be required to sell the security prior to recovery.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Estimated fair value is determined on the basis of existing forward commitments or the current market value of similar loans. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Loans held-for-sale are normally sold to investors with the best effort intent and ability to sell all loans as long as they meet the underwriting standards of the potential investor. We may also participate in a “mandatory” delivery program for mortgage loans. Under the mandatory delivery system, loans with interest rate locks are paired with the sale of a “to be announced” (“TBA”) mortgage-backed security bearing similar attributes. Under the mandatory delivery program, we commit to deliver loans to an investor at an agreed upon price prior to the close of such loans. This differs from a “best efforts” delivery, which sets the sale price with the investor on a loan-by-loan basis when each loan is locked.

Loans and Leases

Non-acquired loans that are held for investment purposes are carried at the principal amount outstanding reduced by unearned income and an allowance for loan losses.

Acquired loans are recorded at fair value at the date of acquisition. The fair values of acquired credit-impaired loans accounted for in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 310-30 are recorded net of a nonaccretable difference and, if appropriate, an accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is the nonaccretable difference which is included as a reduction to the carrying amount of acquired FASB ASC Topic 310-30 loans.

Subsequent decreases to expected cash flows will generally result in recognition of an allowance by a charge to provision for loan and lease losses. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation regarding the amount and timing of such cash flows. Subsequent increases in expected cash flows result in either a reversal of the provision for loan and lease losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on the accretable yield.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Loans and Leases (Continued)

Cash flow analyses are performed on acquired ASC 310-30 loans in order to determine the cash flows expected to be collected. Acquired credit-impaired loans that are accounted for in accordance with FASB ASC Topic 310-30, as well as acquired non-credit-impaired loans accounted for under ASC 310-20 are accruing interest under the accretion method and are thus not reported as nonaccrual. BancShares is accounting for substantially all acquired credit-impaired loans on a pool level basis with the exception of certain large or non-homogeneous loans.

Interest income on non-acquired loans is recognized in a manner that approximates the level yield method when related to the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes the borrower's financial condition is such that collection of principal or interest is doubtful. Loans are returned to the accrual status when the factors indicating doubtful collectability cease to exist and the loan has performed in accordance with its terms for a demonstrated period of time. The past due status of loans is based on the contractual terms of the loan.

Management considers a non-acquired loan to be impaired when, based on current information or events, it is probable that a borrower will be unable to pay all amounts due according to the contractual terms of the loan agreement. Impaired loans are valued using either the discounted expected cash flow method or the collateral value. When the ultimate collectability of the non-acquired impaired loan's principal is doubtful, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Future cash receipts are recorded as recoveries of any amounts previously charged-off.

Southern provides an allowance for loan losses ("ALLL") on non-acquired loans on a reserve basis and includes in operating expenses a provision for loan losses determined by management. The allowance is reduced by charge-offs and increased by subsequent recoveries. Management's periodic evaluation of the adequacy of the allowance is based on Southern's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect borrowers' experience, the estimated value of any underlying collateral, current economic conditions and other risk factors. Management believes it has established the allowance in accordance with accounting principles generally accepted in the United States of America and in consideration of the current economic environment. While management uses the best information available to make evaluations, future adjustments may be necessary.

The evaluation of the adequacy of the ALLL includes both loans evaluated collectively for impairment and loans evaluated individually for impairment. For loans evaluated collectively for impairment, loans are grouped based on common risk characteristics which include call report code and risk grade. Call report codes segregate loans based on loan type and collateral type and the use of call report codes provides consistent reporting across accounting principles generally accepted in the United States ("GAAP") and regulatory reports. Historical loss rates are calculated based on the historical probability of default ("PD") and loss given default ("LGD") for each loan grouping. PDs represent the likelihood that a loan will default within a one year period of time, and LGDs represent the estimated magnitude of loss the Company will incur if a loan defaults. A loan is considered to be in default if it becomes 90 days or more past due, meets the criteria for nonaccrual status, or incurs a charge-off. Historical loss rates are developed with five years of trailing default and loss data. These historical loss rates are then combined with certain qualitative factors to determine the ALLL reserve rates for each loan grouping. Qualitative factors include consideration of certain internal and external factors, such as loan delinquency levels and trends, loan growth, loan portfolio composition and concentrations, local and national economic conditions, the loan review function, and other factors management deems relevant to the ALLL calculation.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review Southern's allowance for loan losses and actual losses on OREO. Such agencies may require Southern to recognize adjustments to the allowance based on the examiners' judgments about information available to them at the time of their examinations.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Troubled Debt Restructurings ("TDRs")

Southern designates loan modifications as TDRs when, for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of modification are initially classified as accruing TDRs at the date of modification, if the note is reasonably assured of repayment and performance is in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the modification date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accruing status when there is economic substance to the restructuring, there is well documented credit evaluation of the borrower's financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated sustained repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months).

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated lives of the assets, ranging from 15 to 39 years for buildings and improvements and 3 to 10 years for furniture and equipment.

Stock in Federal Home Loan Bank of Atlanta

Stock in Federal Home Loan Bank of Atlanta ("FHLB") is acquired for regulatory purposes. This security does not have a readily determinable fair value because its ownership is restricted and lacks a market for trading. As a result, this security is carried at cost and is periodically evaluated for impairment.

OREO

OREO acquired through, or in lieu of, foreclosure is held for sale and is stated at estimated fair market value of the property, less estimated disposal costs at time of foreclosure then lower of cost or net realizable value throughout the remaining life. At least annually, current appraisals are obtained for all OREO and carrying values are adjusted, if required, with a charge to current expenses for adjustments to reflect the current appraised values less the estimated cost to sell.

BancShares estimates fair value at the asset's fair market value less disposal costs using management's assumptions which are based on current market trends and historical losses for similar assets. Any excess of cost over the estimated fair market value at the time of foreclosure is charged to the allowance for loan and lease losses.

Goodwill and Intangible Assets

Intangible assets are composed of goodwill, core deposit premiums and mortgage servicing rights. Core deposit premiums are generally amortized on an accelerated basis over a period of 5 to 10 years and the useful lives are periodically reviewed for reasonableness.

Mortgage servicing rights ("MSRs") represent the estimated value of the right to service mortgage loans for others. Capitalization of MSRs occurs when the underlying loans are sold with servicing retained by Southern. Capitalized MSRs are amortized into income over the projected servicing life of the underlying loans.

(Dollars in Thousands for Tabular Presentations)

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Goodwill and Intangible Assets (Continued)

As of December 31, 2018, BancShares had goodwill and intangible assets totaling $31.7 million. Management evaluated BancShares' existing intangible assets and goodwill for impairment as of September 30, 2018. BancShares will continue to amortize the intangible assets with finite lives, totaling $5.0 million at December 31, 2018, which relate to acquisitions of core deposit intangibles and mortgage servicing rights. The amortization expense associated with intangible assets was $1.7 million and $2.0 million for the years ended December 31, 2018 and 2017, respectively.

Goodwill arising from acquisitions is not amortized but is reviewed for potential impairment at least annually or if events or circumstances indicate a potential impairment. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. BancShares concluded that goodwill was not impaired as of December 31, 2018; however, future events impacting financial institutions could negatively impact BancShares' goodwill asset in the future.

The following is a summary of the gross carrying amounts, accumulated amortization and net carrying amounts of amortized intangible assets and the gross carrying amount of unamortized intangible assets as of December 31, 2018 and December 31, 2017:

	December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:			
Core deposits intangibles	$ 23,528	$ 22,151	$ 1,377
Mortgage servicing rights	10,417	6,757	3,660
Total	$ 33,945	$ 28,908	$ 5,037
Unamortized intangible assets:			
Goodwill	$ 26,649		

	December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:			
Core deposits intangibles	$ 23,528	$ 20,935	$ 2,593
Mortgage servicing rights	9,767	6,247	3,520
Total	$ 33,295	$ 27,182	$ 6,113
Unamortized intangible assets:			
Goodwill	$ 26,649		

Amortization for the core deposit intangibles in 2018 and 2017 was $1.2 million and $1.5 million, respectively.

At December 31, 2018, the scheduled amortization expense for intangible assets is as follows:

2019	$ 1,234
2020	796
2021	514
2022	342
2023	299
Thereafter	1,852
Total	$ 5,037

The actual amortization expense in future periods may be subject to change based on changes in the useful life of the assets, expectations for loan prepayments, future acquisitions and future loan sales.

(Dollars in Thousands for Tabular Presentations)

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain current and past key employees and directors where the insurance policy benefits and ownership are retained by the employer. These policies are recorded at their cash surrender value. Income from these policies and changes in the net cash surrender value are recorded in non-interest income as earnings on bank-owned life insurance. The cash value accumulation is permanently tax deferred if the policy is held to the insured person's death and certain other conditions are met.

Income Taxes

BancShares uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of BancShares' assets and liabilities at enacted rates expected to be in effect when such amounts are realized or settled.

Recognition of deferred tax assets is based on management's belief that it is "more likely than not" that the tax benefit associated with certain temporary differences will be realized. A valuation allowance is recorded for deferred tax assets when the "more likely than not" standard is not met.

Shareholders' Equity

Common shareholders are entitled to one vote per share and Series B and C preferred shareholders are entitled to one vote for each 38 shares owned of a class. Dividends on BancShares' common stock may be paid only after annual dividends of $.90 per share on both preferred series B and C shares have been paid, $1.36 per share on preferred series E shares, and after variable dividends, based on the current one month LIBOR rate plus a varying spread rate, not to exceed an annual rate of 12.24%, on series D and F preferred shares have been paid. Also see Note 14 – Related Parties. Holders of preferred series D and F shares have no right to vote, except with respect to such matters as to which voting by holders of preferred series D and F shares may be required by applicable law. When holders of preferred series D and F shares are entitled to vote, each such share will be entitled to one vote for each 38 shares held of record. Holders of preferred series E shares have no right to vote, except with respect to such matters as to which voting by holders of preferred series E shares may be required by applicable law. When holders of preferred series E shares are entitled to vote, each such share will be entitled to one vote for each share held of record.

Share activity and other information for each of the preferred and common stock issues is presented below:

	Non-cumulative Preferred Series B	Non-cumulative Preferred Series C	Non-cumulative Preferred Series D	Non-cumulative Preferred Series E	Non-cumulative Preferred Series F	Common
December 31, 2016	269,989	36,867	21,375	57,798	20,000	81,704
Purchase and retirement	(2,356)	-	-	-	-	(481)
December 31, 2017	267,633	36,867	21,375	57,798	20,000	81,223
Purchase and retirement	(1,893)	-	(21,375)	-	-	(22)
December 31, 2018	265,740	36,867	-	57,798	20,000	81,201
Shares authorized	408,728	43,631	39,750	79,680	20,000	158,485
Par value	None	None	$ 0.01	$ 0.01	$ 0.01	$ 5.00
Liquidation value						
December 31, 2017	$ 2,676	$ 369	$ 21,375	$ 1,445	$ 20,000	N/A
December 31, 2018	$ 2,657	$ 369	$ -	$ 1,445	$ 20,000	N/A

(Dollars in Thousands for Tabular Presentations)

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Shareholders' Equity (Continued)

Earnings per common share are computed by dividing income applicable to common shares by the weighted average number of common shares outstanding during the period. Income applicable to common shares represents net income reduced by dividends paid to preferred shareholders. BancShares has no potentially dilutive securities. BancShares redeemed $15.0 million and $6.3 million of the Preferred Series D on January 2, 2018 and December 26, 2018, respectively.

Earnings per common share are calculated based on the following amounts for the years ended December 31:

	2018	2017
Net income	$ 29,545	$ 33,890
Less: preferred dividends	(1,937)	(2,184)
Net income applicable to common shares	$ 27,608	$ 31,706
Weighted average common shares outstanding during the period	81,220	81,394

Other Comprehensive Income

Other comprehensive income is defined as the change in equity during a period for non-owner transactions and comprises net income and other comprehensive income. Other comprehensive income includes revenues, expenses, gains, and losses that are excluded from earnings under current accounting standards. Components of other comprehensive income for BancShares consist of the unrealized gains and losses, net of taxes, in BancShares' available-for-sale securities portfolio and changes in the defined benefit pension plan obligation.

Federally Assisted Acquisition of BOC

On September 23, 2011, Southern entered into an agreement with the FDIC, as Receiver, to purchase certain assets and assume certain liabilities of BOC of Norfolk, Virginia at a discount of $161.0 million with no deposit premium. BOC operated in Norfolk, Virginia, with 21 branch locations in southeastern Virginia and eastern North Carolina. The Purchase and Assumption Agreement with the FDIC included loss share agreements on the covered loans and OREO purchased by BancShares which provided protection against losses to Southern. Loss share agreements between the FDIC and Southern (one for single family residential loans and related OREO with a term of 10 years and the other for commercial loans and related OREO with a term of 5 years) provided significant loss protection to Southern for substantially all acquired non-consumer loans and acquired OREO. Effective March 7, 2017, the Company reached an agreement with the FDIC terminating the remaining loss-share agreements. Under the terms of the agreement, Southern made a net payment of $17.3 million to the FDIC as consideration for the early termination of the loss share agreements, and all rights and obligations of Southern and the FDIC under the loss share agreements, including the true-up liability provisions and the settlement of loss share and expense reimbursement claims, have been resolved and terminated. This transaction with the FDIC created a one-time accelerated amortization of the indemnification asset plus the negotiated settlement for the true-up liability, and resulted in a pre-tax loss of $4.1 million in the first quarter of 2017. This pre-tax loss is reflected in "Other FDIC receivable for loss share agreements expense" in the Consolidated Statements of Income.

Business Combinations and Method for Accounting for Loans Acquired

Southern accounts for its acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* exclusive of the loss share agreements with the FDIC. The fair value estimates associated with the loans include estimates related to expected prepayments and the amount and timing of expected principal, interest and other cash flows.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Business Combinations and Method for Accounting for Loans Acquired (Continued)

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality,* formerly American Institute of Certified Public Accountants ("AICPA") Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit-impaired. Evidence of credit quality deterioration as of purchase dates may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. Southern considers expected prepayments and estimates the amount and timing of expected principal, interest and other cash flows for each loan or pool of loans meeting the criteria above, and determines the excess of the loan's scheduled contractual principal and contractual interest payments over all cash flows expected to be collected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the loan's or pool's cash flows expected to be collected over the fair value for the loan or pool of loans, is accreted into interest income over the remaining life of the loan or pool (accretable yield). In accordance with FASB ASC Topic 310-30, Southern aggregated acquired loans that have common risk characteristics into pools.

Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable at least in part to credit quality are generally accounted for under this guidance. As a result, related discounts are recognized subsequently through accretion based on the expected cash flow of the acquired loans. Certain acquired loans, such as lines of credit (consumer and commercial) and loans with no significant credit related discount are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on contractual cash flows over the estimated life of the loan.

Subsequent to the acquisition date, increases in cash flows expected to be received in excess of Southern's initial estimates are reclassified from nonaccretable difference to accretable yield and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses.

Probable and significant increases in cash flows (in a loan pool where an allowance for acquired loan losses was previously recorded) reduces the remaining allowance for acquired loan losses before recalculating the amount of accretable yield percentage for the loan pool in accordance with ASC 310-30. For previously covered loan pools, the reduction of the remaining allowance for acquired loan losses was offset by the impact to the indemnification asset depending on the covered portfolio's loss share coverage.

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by BancShares.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). The core principle of the ASU is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard, which provides a five step model to determine when and how revenue is recognized, also results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements.

Accounting Standards Update No. 2015-14, *Deferral of the Effective Date* ("ASU 2015-14") established that ASU 2014-09 was to be effective for fiscal periods beginning December 15, 2017, including interim reporting periods within that reporting period. We adopted the guidance effective in the first quarter of 2018. Our revenue is comprised primarily of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in the scope of the guidance are primarily related to service charges on deposit accounts, other service charges and fees, interchange and debit card income. sales of other real estate, investment services income, merchant services income, check sales income and other income. Based on our overall assessment of revenue streams and review of related contracts affected by the ASU, the adoption of this guidance did not change the method in which we currently recognize revenue.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

We also completed an evaluation of the costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on this evaluation, we determined that the classification of expenses related to interchange and debit card income, merchant services and check sales should be netted against the respective revenue. We used the full retrospective method of adoption and restated the prior financial statements to net the expenses against the revenue for interchange income and check sale income. These classification changes resulted in changes to both Noninterest Income and Noninterest Expense; however, there was no change to previously reported net income. For the year ended December 31, 2017, expenses of $507,000 related to interchange and debit card income were reclassified from Other Noninterest Expense to Other Service Charges. Also for the year ended December 31, 2017, expenses of $251,000 related to check sales were reclassified from Other Noninterest Expense to Other Noninterest Income. Expenses in 2018 for interchange and debit card income and check sales income totaled $653,000 and $122,000 respectively and were categorized consistently with 2017 expenses. The revenue recognition standard requires disclosure of qualitative and quantitative information surrounding the amount, nature, timing and uncertainty of revenues and cash flows arising from contracts with customers. Descriptions of our noninterest revenue-generating activities that are within the scope of the new revenue ASU are broadly segregated as follows:

Service Charges on deposit accounts - These deposit account-related fees represent monthly account maintenance and transaction-based service fees such as overdraft fees, stop payment fees and charges for issuing cashier's checks and money orders. For account maintenance services, revenue is recognized at the end of the statement period when our performance obligation has been satisfied. All other revenues from transaction-based services are recognized at a point in time when the performance obligation has been completed.

Other service charges and fees - These include, but are not limited to, check cashing fees, internet banking fees, wire transfer fees and safe deposit fees. The performance obligation is fulfilled, and revenue is recognized, at the point in time the requested service is provided to the customer.

Interchange and debit card revenue - These represent interchange fees, included in Other Service Charges and Fees, from customer debit and credit card transactions that are earned at the time a cardholder engages in a transaction with a merchant. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the card transaction. Additionally, ASU 2014-09 requires costs associated with interchange and debit card revenue to be netted against the fee income from such transactions when an entity is acting as an agent in providing such services to a customer.

Sales of Other Real Estate (OREO) - OREO property consists of foreclosed real estate used as collateral for loans. Revenue is generally recognized on the date of sale where the performance obligation of providing access and transferring control of the specified OREO property to the buyer in good faith and good title is satisfied.

Investment Services - These primarily represent annuity fees, sales commissions, management fees, insurance sales, and advisory fees. The performance obligation for investment services is the provision of services to place annuity products issued by the counterparty to investors, and the provision of services to manage the client’s assets, including brokerage custodial and other management services. Revenue from investment services is recognized over the period in which services are performed, and is based on a percentage of the value of the assets under management/administration. This revenue is either fixed or variable based on account type, or transaction-based.

Merchant services- These represent fees charged to merchants, included in Other non-interest income, for providing them the ability to accept and process the debit and credit card transaction. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the card transaction. Additionally, ASU 2014-09 requires costs associated merchant services transactions to be netted against the fee income from such transactions when an entity is acting as an agent in providing services to a customer.

Check sales – These represent the fees, included in Other non-interest income, charged for checks sold to customers. A contract has been established with a third party vendor to provide the checks to the customer. The Company receives a commission based upon contractual terms with the third party vendor and the volume of sales that occur over a period of time. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the sale of the checks. Additionally, ASU 2014-09 requires costs associated check sales transactions to be netted against the fee income from such transactions when an entity is acting as an agent in providing services to a customer.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

Other - This consists of several forms of recurring revenue such as dividends on equity investments without a readily determinable fair value, Federal Home Loan Bank (FHLB) dividends, and income earned on changes in the cash surrender value of bank-owned life insurance, all of which are outside the scope of ASU 2014-09. The remaining miscellaneous income is the result of immaterial transactions where revenue is recognized when, or as, the performance obligation is satisfied.

In January 2016, the FASB issued Accounting Standards Update 2016-01: *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). The new guidance addresses certain aspects of recognition, measurement, presentation and disclosure. The amendments in this update (1) require equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without readily determinable fair value; (3) require public business entities to use exit prices, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (4) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (5) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (6) require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) state that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU only permits early adoption of the instrument-specific credit risk provision. We adopted the ASU during the first quarter of 2018. The change in accounting principle was accounted for as a cumulative-effect adjustment to the balance sheet resulting in a $58.1 million increase to retained earnings and a decrease to accumulated other comprehensive income on January 1, 2018. With the adoption of this ASU equity securities can no longer be classified as available for sale, as such marketable equity securities will be disclosed as a separate line item on the balance sheet with changes in the fair value of equity securities reflected in net income. If the ASU had been effective for the year ended December 31, 2017 BancShares pro-forma net income would have increased by $4.7 million.

For equity investments without a readily determinable fair value, BancShares has elected to measure the equity investments using the measurement alternative which requires BancShares to make a qualitative assessment of whether the investment is impaired at each reporting period. Under the measurement alternative these investments will be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. If a qualitative assessment indicates that the investment is impaired, BancShares will have to estimate the investment's fair value in accordance with ASC 820 and, if the fair value is less than the investment's carrying value, recognize an impairment loss in net income equal to the difference between carrying value and fair value. In January of 2018, BancShares recorded pre-tax income of $2.1 million related to recent observable price changes in orderly transactions related to one equity investment security without a readily determinable fair value. Equity investments without a readily determinable fair value are recorded within Other Assets in the Consolidated Balance Sheets at December 31, 2018 and 2017.

In February 2016, the FASB issued Accounting Standards Update 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). The ASU was issued in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. For public business entities the ASU is effective for interim and annual periods beginning after December 15, 2018. The Company will adopt the ASU in the first quarter of 2019. Adding these assets to our balance sheet will impact our total risk-weighted assets used to determine our regulatory capital levels. Our impact analysis estimates an increase to the Consolidated Balance Sheets of $4.5 to $5.5 million, as the initial gross up of both assets and liabilities. Regulatory capital is expected to be adversely impacted, however the impact is expected to be immaterial. These are preliminary estimates subject to change and will continue to be refined closer to adoption.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In June 2016, the FASB issued Accounting Standards Update 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-03"). This ASU eliminates the delayed recognition of the full amount of credit losses until the loss was probable of occurring and instead will reflect an entity's current estimate of all expected credit losses. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The ASU does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations of the credit loss estimate based on the entity's size, complexity and risk profile. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2020. The Company is currently evaluating the effect that implementation of the new standard will have on its consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update 2017-01, *Business Combinations, Clarifying the Definition of a Business (Topic 805)* ("ASU 2017-01"). This ASU provides a more robust framework to use in determining when a set of assets and activities is a business, including narrowing the definition of outputs and align it with how outputs are described in Topic 606. This ASU provides a screen to determine when an integrated set of assets and activities (collectively referred to as a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired or disposed of is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments in this ASU (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The framework includes two sets of criteria to consider that depend on whether a set has outputs. The amendments in this ASU are effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. We adopted the guidance during the first quarter of 2018 and there was no impact on our consolidated financial position or results of operations.

In January 2017, the FASB issued Accounting Standards Update 2017-04, *Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment (Topic 350)* ("ASU 2017-04"). This ASU eliminates Step 2 from the goodwill impairment test. Under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This ASU eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative test. This ASU will be effective for our annual or interim goodwill impairment tests for fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this standard is not expected to have an impact on our consolidated financial position or results of operation and we expect to adopt the guidance for our annual impairment test in fiscal year 2021.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In March of 2017, the FASB issued Accounting Standards Update 2017-07, *Compensation - Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (Topic 715) (“*ASU 2017-07”). This ASU requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers will present the other components separately from the line item that includes the service cost. In addition, only the service cost component of net benefit cost is eligible for capitalization. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We adopted the guidance effective in the first quarter of 2018. The ASU provides a practical expedient that allows employers to use the amounts disclosed in prior comparative period’s pension plan disclosure as the basis for the retrospective application of the new income statement presentation requirements. The Company adopted the practical expedient as the components that were disclosed in prior year’s for items not related to service cost were immaterial and appropriately estimate the expense related to the other components of net periodic pension cost for the year ended December 31, 2017. The adoption resulted in $1.0 million and $73,000 for the years ended December 31, 2018 and 2017, respectively, in other components of net periodic pension cost being reclassified from Personnel expense to Other Noninterest Expense in the Consolidated Statements of Income and Other Comprehensive Income.

In March 2017, the FASB issued ASU 2017-08 Receivables—*Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities* (“ASU2017-08”). The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. Early adoption is permitted. The Company is in the process of evaluating what effects the guidance may have on the consolidated statements of financial condition and results of operations.

In February 2018, the FASB issued Accounting Standards Update 2018-02, *Income Statement – Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220)* (“ASU 2018-02”*)*. This ASU requires a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate as a result of the Tax Cuts and Jobs Act. The amount of the reclassification is the difference between the historical corporate income tax rate and the newly enacted twenty-one percent corporate income tax rate. The new guidance was effective for the Company’s year ended December 31, 2018, however, the Company chose to early adopt the new standard for the year ended December 31, 2017, as allowed under the new standard. The amount of the reclassification for the Company was $8.8 million, as shown in the Consolidated Statement of Changes in Shareholder's Equity.

In July 2018, the FASB issued ASU 2018-09, *Codification Improvements* (“ASU 2018-09”). The amendments affect a wide variety of Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance. Those items generally are not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment.

In August 2018, the FASB issued ASU 2018-13 *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (“ASU 2018-13”). The amendments are part of the FASB’s disclosure framework project. The project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date. The Company will adopt the required disclosures effective with the 2020 Annual Report.

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In August 2018, the FASB issued ASU 2018-14 *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans* ("ASU 2018-14"). This ASU modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans by eliminating the requirement to disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year and adding a requirement to disclose an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments in this ASU are effective for public entities for fiscal years ending after December 15, 2020. Early adoption is permitted for all entities. BancShares will adopt all applicable amendments and update the disclosures as appropriate during the first quarter of 2021.

In August 2018, the FASB issued ASU 2018-15 *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* ("ASU 2018-15"). The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company is currently evaluating the effect that implementation of the new standard will have on its consolidated financial statements.

Although it is likely that further regulatory actions will arise as the Federal government attempts to address the economic situation, management is not aware of any further recommendations by regulatory authorities that, if implemented, would have or would be reasonably likely to have a material effect on liquidity, capital ratios or results of operations.

From time to time the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of BancShares and monitors the status of changes to and proposed effective dates of exposure drafts.

(Dollars in Thousands for Tabular Presentations)

Note 2. Investment Securities

The amortized cost and estimated fair values of investment securities at December 31 were as follows:

	2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Marketable equity securities	$ 15,864	$ 64,004	$ -	$ 79,868

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt*	$ 40,331	$ 179	$ (849)	$ 39,661
Corporate debt securities	4,059	504	(282)	4,281
Obligations of states and political subdivisions	86,758	487	(1,088)	86,157
Residential government-sponsored mortgage-backed securities	473,065	433	(9,945)	463,553
TOTAL	$ 604,213	$ 1,603	$ (12,164)	$ 593,652

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt*	$ 41,175	$ -	$ (860)	$ 40,315
Corporate debt securities	7,443	581	(150)	7,874
Marketable equity securities	16,232	75,557	-	91,789
Obligations of states and political subdivisions	48,732	811	(117)	49,426
Residential government-sponsored mortgage-backed securities	485,287	609	(4,135)	481,761
TOTAL	$ 598,869	$ 77,558	$ (5,262)	$ 671,165

* - Government-sponsored entities debt consists of debt securities offered by Federal Home Loan Mortgage Corporation, Federal National Mortgage Corporation, Federal Home Loan Bank, and Federal Farm Credit Banks.

The following table provides the realized and unrealized gains or losses on marketable equity securities for the year ended:

	December 31, 2018
Marketable equity securities losses, net	$ (2,877)
Less net gains recognized on marketable equity securities sold	553
Unrealized losses recognized on marketable equity securities held	$ (3,430)

Securities with a carrying value of $338.4 million and $60.5 million were pledged at December 31, 2018 to secure public deposits and short-term borrowings, respectively.

Included in the following tables are all investments with unrealized loss positions. Securities with unrealized losses in which other-than-temporary impairment has been recognized are further discussed below.

(Dollars in Thousands for Tabular Presentations)

Note 2. Investment Securities (Continued)

Temporarily impaired securities at December 31 were as follows:

	2018					
	Less Than 12 Months		12 Months or Longer		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt	$ -	$ -	$ 849	$ 29,066	849	$ 29,066
Corporate debt securities	-	-	282	3,742	282	3,742
Obligations of states and political subdivisions	711	37,887	377	6,771	1,088	44,658
Residential government-sponsored mortgage-backed securities	1,867	142,615	8,078	278,768	9,945	421,383
Total temporarily impaired securities	$ 2,578	$ 180,502	$ 9,586	$ 318,347	$ 12,164	$ 498,849

	2017					
	Less Than 12 Months		12 Months or Longer		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt	$ 134	$ 14,845	$ 726	$ 25,470	860	$ 40,315
Corporate debt securities	-	-	150	3,887	150	3,887
Obligations of states and political subdivisions	2	545	115	6,522	117	7,067
Residential government-sponsored mortgage-backed securities	702	121,350	3,433	216,446	4,135	337,796
Total temporarily impaired securities	$ 838	$ 136,740	$ 4,424	$ 252,325	$ 5,262	$ 389,065

The above securities' losses were considered temporary losses at December 31, 2018 principally resulting from the increase in rates toward the end of 2018 and 2017. There were one hundred eighty nine and one hundred eighteen securities in an unrealized loss position at December 31, 2018 and 2017, respectively including six and nine U.S. Treasuries and government-sponsored entities debt, two and two corporate debt securities, sixty-six and nine obligations of states and political subdivisions, one hundred fifteen and ninety-eight residential government-sponsored mortgage-backed securities, respectively. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased or until the security matures or is called by the issuer. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired. As of December 31, 2018, there was no intent to sell any of the securities classified as available-for-sale. Furthermore, it is not likely that BancShares will have to sell any such securities before a recovery of the carrying value.

(Dollars in Thousands for Tabular Presentations)

Note 2. Investment Securities (Continued)

The amortized cost and estimated fair value of debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Repayments of the residential government-sponsored mortgage-backed securities are dependent on the repayments of the underlying loan balances. Marketable equity securities do not have a stated maturity date.

	Amortized Cost	Fair Value
Securities available-for-sale:		
U.S. Treasuries and government-sponsored entities debt		
Due after one year through five years	$ 40,331	$ 39,661
	40,331	39,661
Corporate debt securities		
Due after one year through five years	1,032	1,012
Due after five years through ten years	3,027	2,773
Due after ten years	-	496
	4,059	4,281
Obligations of states and political subdivisions		
Due in one year or less	1,163	1,165
Due after one year through five years	3,128	3,132
Due after five years through ten years	7,449	7,412
Due after ten years	75,018	74,448
	86,758	86,157
Residential government-sponsored mortgage-backed securities	473,065	463,553
Total	$ 604,213	$ 593,652

Proceeds from the sale of marketable equity securities totaled $7.0 million which also equaled fair value. Sales of securities available-for-sale having a cost basis of $13.4 million and $105.7 million in 2018 and 2017, respectively, resulted in gross realized gains of $86,000 and $4.9 million for 2018 and 2017, respectively. The proceeds from such sales were $13.5 million and $110.6 million for the years ended December 31, 2018 and 2017, respectively. Sales of securities available-for-sale having a cost basis of $24.0 million and $104.3 million in 2018 and 2017, respectively, resulted in gross realized losses of $578,000 and $1.7 million in 2018 and 2017, respectively. The proceeds from such sales were $23.5 million and $102.6 million for the years ended December 31, 2018 and 2017, respectively.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses

The following is a summary of non-acquired loans:

	December 31, 2018	December 31, 2017
Commercial:		
Construction and land development	$ 91,277	$ 68,055
Agricultural	214,032	213,914
Commercial mortgage	592,795	560,136
Commercial and industrial	153,999	133,376
Other	14,558	12,969
Non-commercial:		
Residential mortgage	271,030	242,679
Revolving mortgage (HELOCS)	112,811	105,969
Construction and land development	24,943	25,256
Consumer	23,284	22,583
Demand overdrafts	388	378
Total non-acquired loans	$ 1,499,117	$ 1,385,315
Loans held for sale (excluded from total loans)	$ 2,393	$ 2,162
Loans serviced for others (excluded from total loans)	$ 510,891	$ 501,206

Net deferred fees and costs included within the respective balances for each loan type presented above total $447,000 and $364,000 at December 31, 2018 and 2017, respectively.

Total loans to directors, executive officers and related individuals and organizations were $3.1 million and $297,000 at December 31, 2018 and 2017, respectively. During 2018, there were $3.0 million of advances of these loans made to this group, and repayments totaling $160,000. There were no restructured or nonaccrual loans to directors, executive officers or related individuals and organizations. All extensions of credit to such persons have been made in the ordinary course of business.

Each portfolio segment and the classes within those segments are subject to risks that could have an adverse impact on the credit quality of the loan and lease portfolio. Management has identified the most significant risks as described below which are generally similar among the segments and classes. While the list is not exhaustive, it provides a description of the risks that management has determined are the most significant.

Commercial loans and leases
Each commercial loan or lease is underwritten based primarily upon the customer’s ability to generate the required cash flow to service the debt in accordance with the contractual terms and conditions of the loan agreement. A complete understanding of the borrower’s businesses including the experience and background of the principals is obtained prior to approval. To the extent that the loan or lease is secured by collateral, which is true for the majority of commercial loans and leases, the likely value of the collateral and what level of strength the collateral brings to the transaction is evaluated. To the extent that the principals or other parties provide personal guarantees, the relative financial strength and liquidity of each guarantor is assessed. Common risks to each class of commercial loans include general economic conditions within the markets BancShares serves, as well as risks that are specific to each transaction including demand for products and services, personal events such as disability or change in marital status, and reductions in the value of collateral.

Note 3. Loans and Allowance for Loan Losses (Continued)

In addition to these common risks for the majority of commercial loans and leases, additional risks are inherent in certain classes of commercial loans and leases, as follows:

Construction and land development
Construction and land development loans are highly dependent on the supply and demand for commercial real estate in the markets served by BancShares as well as the demand for newly constructed residential homes and lots that customers are developing. Continuing deterioration in demand could result in significant decreases in the underlying collateral values and make repayment of the outstanding loans more difficult for customers.

Agricultural, commercial mortgage, commercial and industrial, and commercial leases
Agricultural, commercial mortgage, commercial and industrial loans, and commercial leases are primarily dependent on the ability of borrowers to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a customer's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. The performance of agricultural loans is highly dependent on favorable weather, reasonable costs for seed and fertilizer, and the ability to successfully market the product at a profitable margin. The demand for these products is also dependent on macroeconomic conditions that are beyond the control of the borrower. While these loans and leases are generally secured by real property, personal property, or business assets such as inventory or accounts receivable, it is possible that the liquidation of the collateral will not fully satisfy the obligation.

Commercial other
Commercial other loans consist primarily of loans to municipalities and not for profit organizations, such as volunteer fire departments. Commercial other loans are dependent on the municipality or not for profit entity's ability to generate adequate cash flows to service the loan, primarily through tax revenues, fee revenues, federal and state grants, and donations by local citizens. As such, deterioration in the general economy could impact a borrower's ability to repay the loan due to declines in a municipality's tax base, available federal and state grants, and citizen's ability to provide donations. These loans are primarily secured by equipment used by the municipality or not for profit entity.

Non-commercial loans
Each non-commercial loan is underwritten based primarily upon the customer's ability to generate the required cash flow to service the debt in accordance with the contractual terms and conditions of the loan agreement. A complete understanding of the borrower's financial situation is obtained prior to loan approval. To the extent that the loan is secured by collateral we also evaluate the likely value of that collateral. Common risks to each class of non-commercial loans include risks that are not specific to individual transactions such as general economic conditions within the markets BancShares serves, particularly unemployment and potential declines in real estate values. Personal events such as disability or change in marital status also add risk to non-commercial loans.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

In addition to these common risks for the majority of non-commercial loans, additional risks are inherent in certain classes of non-commercial loans, as follows:

Revolving mortgage ("HELOCS")
HELOC loans are often secured by second liens on residential real estate, thereby making such loans particularly susceptible to declining collateral values. A substantial decline in collateral value could render a second lien position to be effectively unsecured. Additional risks include lien perfection inaccuracies and disputes with first lien holders that may further weaken the collateral position. Further, the open-end structure of these loans creates the risk that customers may draw on the lines in excess of the collateral value if there have been significant declines since origination.

Consumer
The consumer loan portfolio includes loans secured by personal property such as automobiles, marketable securities, other titled recreational vehicles including boats and motorcycles, as well as unsecured consumer debt. The value of underlying collateral within this class is especially volatile due to potential rapid depreciation in values since the date of loan origination in excess of principal repayment.

Residential mortgage and non-commercial construction and land development
Residential mortgage and non-commercial construction and land development loans are made to individuals and are typically secured by 1-4 family residential property, undeveloped land, and partially developed land in anticipation of pending construction of a personal residence. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral. Such a decline in values has led to unprecedented levels of foreclosures and losses within the banking industry. Non-commercial construction and land development projects can experience delays in completion and cost overruns that exceed the borrower's financial ability to complete the project. Such cost overruns can routinely result in foreclosure of partially completed and unmarketable collateral.

Acquired loans
The risks associated with acquired loans are generally consistent with the risks identified for commercial and non-commercial loans and the classes of loans within those segments. Further, these loans were underwritten by another institution with weaker lending standards. Therefore, there is a significant risk that the loans are not adequately supported by the paying capacity of the borrower or the values of underlying collateral at the time of origination.

During 2018 and 2017, provision (recovery) for loan and lease losses on acquired loans totaled $277,000 and ($336,000), respectively.

In accordance with FASB guidance on accounting for acquired loans with deteriorated credit quality, BancShares aggregated the majority of acquired loans that have common risk characteristics into pools of loan categories as described in the tables that follow. Certain loans with unique characteristics or larger balances that did not conform to the pools are accounted for individually. These loans are identified as "Loans individually accounted for under FASB ASC Topic 310-30" in the tables that follow. The collectability of these loans is influenced by the continued stabilization of the local real estate market combined with borrower strength. The carrying value which is net of specific reserves of $119,000 and $187,000 in 2018 and 2017, respectively and classification of these loans are as follows:

	December 31, 2018	December 31, 2017
Loans individually accounted for under FASB ASC Topic 310-30		
Non-farm, non-residential	$ 3,700	$ 4,367
1-4 family residential property	2,597	3,147
Commercial and industrial	1,259	1,433
1-4 family residential construction	28	30
Construction and land development	847	1,690
Other	27	41
Total loans individually accounted for under FASB ASC Topic 310-30	$ 8,458	$ 10,708

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

Southern's acquired loan portfolio is comprised of the following balances net of related discount:

	2018	2017
FASB ASC Topic 310-30 acquired loans:		
Commercial performing	$ 188	$ 754
Commercial non performing	71	95
Consumer performing	171	274
Consumer non performing	712	801
Construction & development performing	1,495	1,541
Construction & development non performing	1,398	1,692
Consumer real estate performing	8,685	9,929
Consumer real estate non performing	4,616	4,681
Commercial real estate performing short term amortizing	871	1,016
Commercial real estate non performing short term amortizing	1,456	1,266
Commercial real estate performing long term amortizing	5,753	6,108
Commercial real estate non performing long term amortizing	17,315	18,466
HELOCs	952	2,245
Loans individually accounted for under FASB ASC Topic 310-30	8,577	10,895
Total FASB ASC Topic 310-30 acquired loans	52,260	59,763
FASB ASC Topic 310-20 acquired loans	152,930	185,577
Total Acquired Loans:	$ 205,190	$ 245,340
Less allowance for loan losses	(1,734)	(1,661)
Acquired loans, net	$ 203,456	$ 243,679

The total contractual principal balance for acquired loans was $231.7 million at December 31, 2018 and $279.1 million at December 31, 2017.

The following are changes in the carrying value of acquired loans during the years ended December 31, 2018 and 2017.

	FASB ASC Topic 310-30
Balance at December 31, 2016	$ 66,739
Reductions for payments, foreclosures, and draws net of accretion	(8,282)
Change in the allowance for loan losses on loans	368
Balance at December 31, 2017	$ 58,825
Reductions for payments, foreclosures, and draws net of accretion	(7,504)
Change in the allowance for loan losses on loans	105
Balance at December 31, 2018	$ 51,426

The total outstanding balance, which includes contractual principal and interest owed at the end of the reporting period, for loans accounted for under FASB ASC Topic 310-30 was $79.8 million and $94.5 million at December 31, 2018 and 2017, respectively.

The table above excludes $152.9 million ($336.0 million in fair value of acquired loans at acquisition date and $183.1 million in net decreases for payments, draws, and accretion) in acquired loans at carrying value as of December 31, 2018 that are accounted for under FASB ASC Topic 310-20. The table above excludes $185.8 million ($336.0 million in fair value of acquired loans at acquisition date and $150.2 million in net decreases for payments, draws, and accretion) in acquired loans at carrying value as of December 31, 2017 that are accounted for under FASB ASC Topic 310-20. At December 31, 2018 and 2017 there was an allowance for loan loss in the amount of $900,000 and $722,000, respectively which related to FASB ASC Topic 310-20 loans.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following are changes in the carrying amount of accretable yield for loans accounted for under FASB ASC Topic 310-30:

	Years Ended December 31, 2018	Years Ended December 31, 2017
Balance at beginning of period	$ 49,667	$ 59,105
Accretion recorded in interest income	(10,461)	(16,398)
Reclass of nonaccretable difference due to improvement in expected cash flows	1,321	2,331
Other changes, net	1,376	4,629
Balance at end of period	$ 41,903	$ 49,667

Allowance for loan losses
The allowance for loan losses is based upon estimates made by management. We maintain an allowance for loan losses at a level that we believe is appropriate to cover estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of our loan portfolio. Arriving at the allowance involves a high degree of management judgment and results in a range of estimated losses. We regularly evaluate the adequacy of the allowance through our internal risk rating system, independent credit review, and regulatory agency examinations to assess the quality of the loan portfolio and identify problem loans. The evaluation process also includes our analysis of current economic conditions, composition of the loan portfolio, past due and nonaccrual loans, concentrations of credit, lending policies and procedures, and historical loan loss experience. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on, among other factors, changes in economic conditions in our markets. In addition, regulatory agencies, as an integral part of their examination process, periodically review our allowances for losses on loans. These agencies may require management to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these and other factors, it is possible that the allowances for losses on loans may change. The provision for loan losses is charged to expense in an amount necessary to maintain the allowance at an appropriate level.

The allowance for loan losses on non-acquired loans consists of general and specific reserves. The general reserves are determined by applying loss percentages to the portfolio that are based on the PD/LGD approach to calculating the historical loss rate for each call report code and risk grade. Additionally, the general economic and business conditions affecting key lending areas, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, the findings of internal and external credit reviews and results from external bank regulatory examinations are included in this evaluation. These adjustments are applied to the non-acquired loan portfolio when estimating the level of reserve required. The specific reserves are determined on a loan-by-loan basis based on management's evaluation of our exposure for each credit, given the current payment status of the loan and the value of any underlying collateral. These are loans classified by management as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. Loans that are determined to be impaired are provided a specific reserve, if necessary, and are excluded from the calculation of the general reserves.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

In determining the acquisition date fair value of purchased loans, and in subsequent accounting, Southern generally aggregates purchased loans into pools of loans with common risk characteristics. Expected cash flows at the acquisition date in excess of the fair value of loans are recorded as interest income over the life of the loans using a level yield method if the timing and amount of the future cash flows of the pool is reasonably estimable. Subsequent to the acquisition date, increases in cash flows over those expected at the acquisition date reduce previously recorded allowance for loan losses and any remaining portion are reclassified from the nonaccretable difference to accretable yield and recognized as interest income prospectively. Decreases in expected cash flows after the acquisition date are recognized by recording an allowance for loan losses. Management analyzes the acquired loan pools and loans not accounted for in pools using various assessments of risk to determine an expected loss. The expected loss is derived based upon a loss given default based upon the collateral type and/or detailed review by loan officers and the probability of default that is determined based upon historical data at the loan level. Trends are reviewed in terms of accrual status, past due status, and weighted-average grade of the loans within each of the accounting pools. In addition, the relationship between the change in the unpaid principal balance and change in the mark is assessed to correlate the directional consistency of the expected loss for each pool.

An aggregated analysis of changes in allowance for loan losses is as follows:

	Non-acquired Loans	Acquired Loans	Total
Balance at December 31, 2016	$ 14,803	$ 1,988	$ 16,791
Loans charged-off	(1,131)	(12)	(1,143)
Recoveries of loans previously charged off	433	21	454
Net charge-offs (recoveries)	(698)	9	(689)
Provision (recovery) for loan losses	2,659	(336)	2,323
Balance at December 31, 2017	16,764	1,661	18,425
Loans charged-off	(1,502)	(249)	(1,751)
Recoveries of loans previously charged off	572	45	617
Net charge-offs	(930)	(204)	(1,134)
Provision for loan losses	2,522	277	2,799
Balance at December 31, 2018	$ 18,356	$ 1,734	$ 20,090

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for non-acquired loans:

	As of and for the Year Ended December 31, 2018												
Allowances for loan losses:	Commercial Construction and Land Development	Agricultural	Commercial Mortgage	Commercial and Industrial	Lease Financing	Commercial Other	Residential Mortgage	Revolving Mortgage (HELOCS)	Non-Commercial Construction and Land Development	Consumer	Demand Overdrafts	Total
December 31, 2017	$ 890	$ 2,544	$ 6,290	$ 1,712	$ -	$ 153	$ 3,005	$ 1,296	$ 286	$ 414	$ 174	$ 16,764
Charge offs	(100)	(744)	-	(103)	-	-	(95)	(16)	-	(123)	(321)	(1,502)
Recoveries	-	-	216	30	-	-	156	61	-	26	83	572
Provision charged to operating expense	353	660	334	373	-	8	209	116	27	130	312	2,522
December 31, 2018	$ 1,143	$ 2,460	$ 6,840	$ 2,012	$ -	$ 161	$ 3,275	$ 1,457	$ 313	$ 447	$ 248	$ 18,356
Allowance for loans and leases individually evaluated for impairment	$ -	$ -	$ 26	$ -	$ -	$ -	$ 32	$ -	$ -	$ 21	$ -	$ 79
Allowance for loans and leases collectively evaluated for impairment	$ 1,143	$ 2,460	$ 6,814	$ 2,012	$ -	$ 161	$ 3,243	$ 1,457	$ 313	$ 426	$ 248	$ 18,277
Loans and leases:												
Ending balance:	$ 91,277	$ 214,032	$ 592,795	$ 153,999	$ -	$ 14,558	$ 271,030	$ 112,811	$ 24,943	$ 23,284	$ 388	$ 1,499,117
Ending balance: individually evaluated for impairment	$ 833	$ 3,229	$ 2,720	$ 173	$ -	$ -	$ 3,047	$ 195	$ -	$ 185	$ -	$ 10,382
Ending balance: collectively evaluated for impairment	$ 90,444	$ 210,803	$ 590,075	$ 153,826	$ -	$ 14,558	$ 267,983	$ 112,616	$ 24,943	$ 23,099	$ 388	$ 1,488,735

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

	As of and for the Year Ended December 31, 2017											
Allowances for loan losses:	Commercial Construction and Land Develop-ment	Agricultural	Commercial Mortgage	Commercial and Industrial	Lease Financing	Commercial Other	Residential Mortgage	Revolving Mortgage (HELOCS)	Commercial Construction and Land Develop-ment	Consumer	Demand Overdrafts	Total
December 31, 2016	$ 529	$ 2,149	$ 6,120	$ 1,475	$ 15	$ 168	$ 2,588	$ 1,018	$ 285	$ 263	$ 193	$ 14,803
Charge offs	-	(12)	(201)	(103)	-	-	(259)	(41)	(6)	(173)	(336)	(1,131)
Recoveries	-	5	90	8	-	-	190	24	-	30	86	433
Provision charged to operating expense	361	402	281	332	(15)	(15)	486	295	7	294	231	2,659
December 31, 2017	$ 890	$ 2,544	$ 6,290	$ 1,712	$ -	$ 153	$ 3,005	$ 1,296	$ 286	$ 414	$ 174	$ 16,764
Allowance for loans and leases individually evaluated for impairment	$ 102	$ 2	$ 34	$ -	$ -	$ -	$ 11	$ -	$ -	$ 22	$ -	$ 171
Allowance for loans and leases collectively evaluated for impairment	$ 788	$ 2,542	$ 6,256	$ 1,712	$ -	$ 153	$ 2,994	$ 1,296	$ 286	$ 392	$ 174	$ 16,593
Loans and leases:												
Ending balance:	$ 68,055	$ 213,914	$ 560,136	$ 133,376	$ -	$ 12,969	$ 242,679	$ 105,969	$ 25,256	$ 22,583	$ 378	$ 1,385,315
Ending balance: individually evaluated for impairment	$ 801	$ 472	$ 2,475	$ 149	$ -	$ -	$ 3,481	$ 221	$ 35	$ 189	$ -	$ 7,823
Ending balance: collectively evaluated for impairment	$ 67,254	$ 213,442	$ 557,661	$ 133,227	$ -	$ 12,969	$ 239,198	$ 105,748	$ 25,221	$ 22,394	$ 378	$ 1,377,492

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for acquired loans:
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Allowances for loan losses:	Commercial Performing	Commercial Non Performing	Consumer Performing	Consumer Non Performing	Construction and Development Performing	Construction and Development Non Performing	Consumer Real Estate Performing	Consumer Real Estate Non Performing	Commercial Real Estate Performing ST Amortizing
December 31, 2017	$ -	$ -	$ -	$ 588	$ -	$ -	$ 164	$ -	$ -
Charge offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision charged to operating expense	109	-	-	(26)	-	-	(120)	-	-
December 31, 2018	$ 109	$ -	$ -	$ 562	$ -	$ -	$ 44	$ -	$ -
Allowance for loans and leases individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Allowance for loans and leases collectively evaluated for impairment	$ 109	$ -	$ -	$ 562	$ -	$ -	$ 44	$ -	$ -
Loan and lease balances:									
Ending balance	$ 188	$ 71	$ 171	$ 712	$ 1,495	$ 1,398	$ 8,685	$ 4,616	$ 871
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance collectively evaluated for impairment	$ 188	$ 71	$ 171	$ 712	$ 1,495	$ 1,398	$ 8,685	$ 4,616	$ 871
December 31, 2016	$ -	$ -	$ -	$ 605	$ -	$ -	$ 319	$ -	$ -
Charge offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision charged to operating expense	-	-	-	(17)	-	-	(155)	-	-
December 31, 2017	$ -	$ -	$ -	$ 588	$ -	$ -	$ 164	$ -	$ -
Allowance for loans and leases individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Allowance for loans and leases collectively evaluated for impairment	$ -	$ -	$ -	$ 588	$ -	$ -	$ 164	$ -	$ -
Loan and lease balances:									
Ending balance	$ 754	$ 95	$ 274	$ 801	$ 1,541	$ 1,692	$ 9,929	$ 4,681	$ 1,016
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance collectively evaluated for impairment	$ 754	$ 95	$ 274	$ 801	$ 1,541	$ 1,692	$ 9,929	$ 4,681	$ 1,016

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

Allowances for loan losses:	Commercial Real Estate Non Performing ST Amortizing	Commercial Real Estate Performing LT Amortizing	Commercial Real Estate Non Performing LT Amortizing	HELOCS	Loans Individually Accounted For Under FASB ASC Topic 310-30	FASB ASC Topic 310-20 Loans	Total Loans
December 31, 2017	$ -	$ -	$ -	$ -	$ 187	$ 722	$ 1,661
Charge offs	-	-	-	-	(11)	(238)	(249)
Recoveries	-	-	-	-	-	45	45
Provision charged to operating expense	-	-	-	-	(57)	371	277
December 31, 2018	$ -	$ -	$ -	$ -	$ 119	$ 900	$ 1,734
Allowance for loans and leases individually evaluated for impairment	$ -	$ -	$ -	$ -	$ 119	$ 10	$ 129
Allowance for loans and leases collectively evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ 890	$ 1,604
Loan and lease balances:							
Ending balance	$ 1,456	$ 5,753	$ 17,315	$ 952	$ 8,577	$ 152,930	$ 205,190
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ 8,577	$ 756	$ 9,333
Ending balance collectively evaluated for impairment	$ 1,456	$ 5,753	$ 17,315	$ 952	$ -	$ 152,174	$ 195,857
December 31, 2016	$ -	$ -	$ -	$ -	$ 382	$ 682	$ 1,988
Charge offs	-	-	-	-	-	(12)	(12)
Recoveries	-	-	-	-	-	21	21
Provision charged to operating expense	-	-	-	-	(195)	31	(336)
December 31, 2017	$ -	$ -	$ -	$ -	$ 187	$ 722	$ 1,661
Allowance for loans and leases individually evaluated for impairment	$ -	$ -	$ -	$ -	$ 187	$ 12	$ 199
Allowance for loans and leases collectively evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ 710	$ 1,462
Loan and lease balances:							
Ending balance	$ 1,266	$ 6,108	$ 18,466	$ 2,245	$ 10,895	$ 185,577	$ 245,340
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ 10,895	$ 613	$ 11,508
Ending balance collectively evaluated for impairment	$ 1,266	$ 6,108	$ 18,466	$ 2,245	$ -	$ 184,964	$ 233,832

Note 3. Loans and Allowance for Loan Losses (Continued)

Loans and leases are closely monitored by management for changes in quality. This monitoring includes assessing the appropriateness of the credit quality indicator in relation to the risk of the loan or lease. Southern utilizes a risk rating matrix to assign a risk rating to each of its loans and leases. A description of the general characteristics of risk ratings is as follows:

- Superior - This grade includes loans to borrowers with excellent credit quality. These borrowers have exceptionally high net worth and cash flows to service existing debt and most have a significant or long term deposit relationship with Southern. If secured, the collateral for these loans is readily marketable and consists of savings accounts, life insurance assignments, etc.

- Above average - This grade includes loans to borrowers of adequate credit quality, adequate sufficient net worth and cash flows to service existing debt. Borrowers in this grade have an existing long term deposit relationship with Southern and have made a reasonable investment in the loan. If secured, collateral for these loans is reasonably marketable such as listed stocks and bonds.

- Average - This grade includes loans to borrowers of acceptable credit quality and risk. Such borrowers have maintained an existing deposit relationship with Southern, but not for the time periods of those included in the above grades of average and superior. These borrowers also have sufficient net worth and cash flows to service existing debt, but not to the level of those included in grades above average and superior. There has been reasonable investment in the loan by the borrower.

- Below average - This grade includes loans to borrowers with credit history that reflects delinquencies with justifiable explanation or no credit history. Typically these borrowers do not have a deposit relationship with Southern and/or have made an insignificant investment in the loan. Included in this grade are loans to borrowers with marginal cash flows and net worth or who reside outside of the trade area. Also, loans for which repayment is dependent upon sales in unproven or unstable markets fall into this grade.

- Special mention - This grade is for loans which are “especially mentioned” in accordance with regulatory guidelines. This grade includes loans on management’s “watchlist”. This grade includes loans for which repayment terms exceed policy or with no significant principal reduction in the past 12 months, are in an industry that is deteriorating, or that repayment is based upon the sale of collateral, guarantors, or government guarantees. Also included are real estate under construction for speculative purposes and the borrower does not have a long history of sales. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.

- Substandard - This grade includes loans on management’s “watchlist”. Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility that Southern will sustain some loss if the deficiency is not corrected.

- Doubtful - Loans classified as “doubtful” have all the weaknesses inherent in those classified as “substandard” with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable.

- Loss - Loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Included in this category are loans that are covered under loss share agreements with the FDIC which have been partial charge-offs based on the terms of the loss share agreements.

- Ungradable - This represents loans that are HELOC and other consumer type loans with relatively small balances for which risk ratings are not assigned.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following presents the credit risk profile by risk grade for non-acquired loans:

	As of December 31, 2018								
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Totals
Construction and land development	$ -	$ 38	$ 74,302	$ 16,188	$ 526	$ 223	$ -	$ -	$ 91,277
Agricultural	-	387	175,225	33,477	1,459	3,484	-	-	214,032
Commercial mortgage	-	16	469,847	119,054	969	2,909	-	-	592,795
Commercial and industrial	2	113	104,859	48,491	193	341	-	-	153,999
Commercial other	-	-	14,554	4	-	-	-	-	14,558
Non commercial residential mortgage	-	47	238,772	27,285	1,417	3,509	-	-	271,030
HELOC	-	701	102,787	8,658	130	535	-	-	112,811
Non-commercial construction and land development	-	-	24,173	712	-	58	-	-	24,943
Consumer	12	188	20,945	2,031	73	35	-	-	23,284
Demand overdrafts	-	-	-	388	-	-	-	-	388
Totals	$ 14	$ 1,490	$ 1,225,464	$ 256,288	$ 4,767	$ 11,094	$ -	$ -	$ 1,499,117

	As of December 31, 2017								
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Totals
Construction and land development	$ -	$ 60	$ 58,567	$ 8,775	$ 653	$ -	$ -	$ -	$ 68,055
Agricultural	-	611	171,236	39,113	2,253	701	-	-	213,914
Commercial mortgage	-	17	442,206	112,705	1,491	3,717	-	-	560,136
Commercial and industrial	-	102	95,571	37,243	241	219	-	-	133,376
Commercial other	-	-	12,940	29	-	-	-	-	12,969
Non commercial residential mortgage	-	219	212,140	24,820	1,541	3,959	-	-	242,679
HELOC	-	996	96,091	8,194	176	512	-	-	105,969
Non-commercial construction and land development	-	1	23,719	1,446	-	90	-	-	25,256
Consumer	4	53	20,167	2,234	91	34	-	-	22,583
Demand overdrafts	-	-	-	378	-	-	-	-	378
Totals	$ 4	$ 2,059	$ 1,132,637	$ 234,937	$ 6,446	$ 9,232	$ -	$ -	$ 1,385,315

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following table presents the credit risk profile by risk grade of acquired loans, net of the related discount.

	As of December 31, 2018									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Ungradable	Total
Commercial performing	$ -	$ -	$ -	$ 28	$ 84	$ 76	$ -	$ -	$ -	$ 188
Commercial non-performing	-	-	-	32	-	39	-	-	-	71
Consumer performing	-	-	171	-	-	-	-	-	-	171
Consumer non-performing	-	-	-	106	382	224	-	-	-	712
Construction and development performing	-	-	44	1,084	-	367	-	-	-	1,495
Construction and development non-performing	-	-	199	640	-	559	-	-	-	1,398
Consumer real estate performing	-	-	538	6,242	416	1,489	-	-	-	8,685
Consumer real estate non-performing	-	-	2,356	309	471	1,480	-	-	-	4,616
Commercial real estate performing ST amortization	-	-	-	867	4	-	-	-	-	871
Commercial real estate non-performing ST amortization	-	-	-	-	-	1,456	-	-	-	1,456
Commercial real estate performing LT amortization	-	-	1,767	3,040	613	333	-	-	-	5,753
Commercial real estate non-performing LT amortization	-	-	-	9,698	2,778	4,839	-	-	-	17,315
HELOCs	-	-	-	946	-	6	-	-	-	952
Loans individually accounted for under							-	-		
FASB ASC Topic 310-30	-	-	1,280	1,827	1,899	3,571			-	8,577
FASB ASC Topic 310-20 acquired loans	18	16	129,518	20,790	1,712	876	-	-	-	152,930
Total Loans	$ 18	$ 16	$ 135,873	$ 45,609	$ 8,359	$ 15,315	$ -	$ -	$ -	$ 205,190

	As of December 31, 2017									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Ungradable	Total
Commercial performing	$ -	$ -	$ 425	$ 246	$ 83	$ -	$ -	$ -	$ -	$ 754
Commercial non-performing	-	-	-	33	21	41	-	-	-	95
Consumer performing	-	-	220	54	-	-	-	-	-	274
Consumer non-performing	-	-	-	-	396	405	-	-	-	801
Construction and development performing	-	-	87	1,119	-	335	-	-	-	1,541
Construction and development non-performing	-	-	-	1,042	-	650	-	-	-	1,692
Consumer real estate performing	-	-	658	7,174	452	1,643	2	-	-	9,929
Consumer real estate non-performing	-	-	1,435	1,112	505	1,629	-	-	-	4,681
Commercial real estate performing ST amortization	-	-	-	978	38	-	-	-	-	1,016
Commercial real estate non-performing ST amortization	-	-	-	-	2	1,264	-	-	-	1,266
Commercial real estate performing LT amortization	-	-	1,958	3,191	622	337	-	-	-	6,108
Commercial real estate non-performing LT amortization	-	-	-	10,683	2,795	4,988	-	-	-	18,466
HELOCs	-	-	-	2,197	-	48	-	-	-	2,245
Loans individually accounted for under										
FASB ASC Topic 310-30	-	-	1,704	1,641	2,857	4,693	-	-	-	10,895
FASB ASC Topic 310-20 acquired loans	25	24	158,997	23,081	2,656	794	-	-	-	185,577
Total Loans	$ 25	$ 24	$ 165,484	$ 52,551	$10,427	$ 16,827	$ 2	$ -	$ -	$ 245,340

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The risk grading of acquired loans is determined utilizing a loan's contractual balance, while the amount recorded in the financial statements and reflected above is the carrying value. In an FDIC-assisted acquisition, covered acquired loans are initially recorded at their fair value, including a credit discount due to the high concentration of substandard and doubtful loans. In addition to the credit discount and the allowance for loan losses on covered acquired loans, Bancshares' risk of loss was mitigated by the FDIC loss share arrangement.

The following is a summary of information pertaining to impaired non-acquired and acquired loans accounted for under FASB ASC Topic 310-20:

	For the year ended December 31, 2018				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Non-Acquired:					
Commercial:					
Construction and land development loans	$ 940	$ 833	$ -	$ 833	$ -
Agricultural	3,883	3,229	-	3,229	-
Commercial mortgage	3,708	2,256	464	2,720	26
Commercial and industrial	195	173	-	173	-
Non-commercial:					
Residential mortgage	3,683	2,739	308	3,047	32
Revolving mortgage	201	195	-	195	-
Construction and land development	-	-	-	-	-
Consumer	185	-	185	185	21
Total Non-Acquired	12,795	9,425	957	10,382	79
Acquired:					
FASB ASC Topic 310-20 acquired loans	908	674	83	756	10
Total Acquired	908	674	83	756	10
Total Impaired loans	$ 13,703	$ 10,099	$ 1,040	$ 11,138	$ 89

	For the year ended December 31, 2017				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Non-Acquired:					
Commercial:					
Construction and land development loans	$ 801	$ -	$ 802	$ 802	$ 102
Agricultural	647	370	102	472	2
Commercial mortgage	3,393	1,928	548	2,476	34
Commercial and industrial	155	149	-	149	-
Non-commercial:					
Residential mortgage	4,295	3,101	384	3,485	11
Revolving mortgage	260	221	-	221	-
Construction and land development	49	35	-	35	-
Consumer	189	-	189	189	22
Total Non-Acquired	9,789	5,804	2,025	7,829	171
Acquired:					
FASB ASC Topic 310-20 acquired loans	716	523	90	613	12
Total Acquired	716	523	90	613	12
Total Impaired loans	$ 10,505	$ 6,327	$ 2,115	$ 8,442	$ 183

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following table summarizes the average investment in impaired loans, non-acquired and acquired loans accounted for under FASB ASC Topic 310-20, and interest income recognized on these loans:

	Years Ended December 31,			
	2018		2017	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
Non-Acquired:				
Commercial:				
Construction and land development	$ 836	$ 34	$ 874	$ 36
Agricultural	2,114	87	691	12
Commercial mortgage	2,967	67	2,122	45
Commercial and industrial	162	3	101	3
Non-commercial:				
Residential mortgage	3,157	59	3,845	86
Revolving mortgage (HELOCS)	162	4	149	3
Construction and land development	7	-	41	-
Consumer	187	4	196	5
Total Non-Acquired	9,592	258	8,019	190
Acquired:				
FASB ASC Topic 310-20 acquired loans	862	29	637	1
Total Acquired	862	29	637	1
Totals	$ 10,454	$ 287	$ 8,656	$ 191

The amount of foregone interest on non-acquired and acquired loans accounted for under FASB ASC Topic 310-20 at December 31, 2018 and 2017 was not material for the periods presented.

The following is a summary of information pertaining to non-acquired loans and acquired loans accounted for under FASB ASC Topic 310-20 that are on non-accrual, including restructured loans:

	December 31,	
	2018	2017
Non-Acquired:		
Commercial:		
Construction and land development	$ 47	$ -
Agricultural	3,135	370
Commercial mortgage	2,305	2,033
Commercial and industrial	173	149
Non-commercial:		
Residential mortgage	1,819	2,346
Revolving mortgage (HELOCS)	195	197
Construction and land development	-	35
Consumer	-	-
Total Non-Acquired	7,674	5,130
Acquired:		
FASB ASC Topic 310-20 acquired loans	757	613
Total Acquired	757	613
Totals	$ 8,431	$ 5,743

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

An aging analysis of past due loans, segregated by class for non-acquired loans, was as follows:

	As of December 31, 2018						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment Greater Than 90 Days and Accruing
Commercial:							
Construction and land development	$ 2	$ 28	$ -	$ 30	$ 91,247	$ 91,277	$ -
Agriculture	825	386	2,203	3,414	210,618	214,032	-
Commercial mortgage	1,427	50	896	2,373	590,422	592,795	-
Commercial and industrial	776	53	-	829	153,170	153,999	-
Other	21	-	-	21	14,537	14,558	-
Non-commercial:							
Residential mortgage	2,626	139	540	3,305	267,725	271,030	55
Revolving mortgage (HELOCS)	668	22	87	777	112,034	112,811	-
Construction and land development	-	7	-	7	24,936	24,943	-
Consumer	55	12	-	67	23,217	23,284	-
Demand overdrafts	-	-	-	-	388	388	-
Totals	$ 6,400	$ 697	$ 3,726	$ 10,823	$ 1,488,294	$ 1,499,117	$ 55

	As of December 31, 2017						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment Greater Than 90 Days and Accruing
Commercial:							
Construction and land development	$ 225	$ -	$ -	$ 225	$ 67,830	$ 68,055	$ -
Agriculture	279	53	92	424	213,490	213,914	-
Commercial mortgage	2,473	1,483	233	4,189	555,947	560,136	-
Commercial and industrial	205	16	132	353	133,023	133,376	-
Other	-	-	-	-	12,969	12,969	-
Non-commercial:							
Residential mortgage	763	76	606	1,445	241,234	242,679	-
Revolving mortgage (HELOCS)	331	21	108	460	105,509	105,969	-
Construction and land development	-	-	25	25	25,231	25,256	-
Consumer	141	10	-	151	22,432	22,583	-
Demand overdrafts	-	-	-	-	378	378	-
Totals	$ 4,417	$ 1,659	$ 1,196	$ 7,272	$ 1,378,043	$ 1,385,315	$ -

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

An aging analysis of past due loans, segregated by class for acquired loans, was as follows:

	As of December 31, 2018					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Past Due	Current	Total Loans
FASB ASC Topic 310-30 acquired loans:						
Commercial performing	$ -	$ -	$ 78	$ 78	$ 110	$ 188
Commercial non-performing	-	-	-	-	71	71
Consumer performing	-	-	-	-	171	171
Consumer non-performing	-	-	-	-	712	712
Construction and development performing	-	-	368	368	1,127	1,495
Construction and development non-performing	-	-	-	-	1,398	1,398
Consumer real estate performing	86	-	64	150	8,535	8,685
Consumer real estate non-performing	32	-	-	32	4,584	4,616
Commercial real estate performing ST amortizing	-	-	-	-	871	871
Commercial real estate non-performing ST amortizing	-	1,299	-	1,299	157	1,456
Commercial real estate performing LT amortizing	-	-	-	-	5,753	5,753
Commercial real estate non-performing LT amortizing	340	-	2,333	2,673	14,642	17,315
HELOCs	-	2	-	2	950	952
Loans individually accounted for under FASB ASC Topic 310-30	-	-	-	-	8,577	8,577
Total FASB ASC Topic 310-30 acquired loans	458	1,301	2,843	4,602	47,658	52,260
FASB ASC Topic 310-20 acquired loans	67	198	476	741	152,189	152,930
Totals	$ 525	$ 1,499	$ 3,319	$ 5,343	$199,847	$205,190

	As of December 31, 2017					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Past Due	Current	Total Loans
FASB ASC Topic 310-30 acquired loans:						
Commercial performing	$ 136	$ -	$ -	$ 136	$ 618	$ 754
Commercial non-performing	3	-	-	3	92	95
Consumer performing	-	-	-	-	274	274
Consumer non-performing	-	-	-	-	801	801
Construction and development performing	-	-	335	335	1,206	1,541
Construction and development non-performing	-	-	-	-	1,692	1,692
Consumer real estate performing	32	-	62	94	9,835	9,929
Consumer real estate non-performing	-	-	-	-	4,681	4,681
Commercial real estate performing ST amortizing	-	-	-	-	1,016	1,016
Commercial real estate non-performing ST amortizing	1,044	-	68	1,112	154	1,266
Commercial real estate performing LT amortizing	-	-	-	-	6,108	6,108
Commercial real estate non-performing LT amortizing	324	-	2,361	2,685	15,781	18,466
HELOCs	52	27	-	79	2,166	2,245
Loans individually accounted for under FASB ASC Topic 310-30	-	7	-	7	10,888	10,895
Total FASB ASC Topic 310-30 acquired loans	1,591	34	2,826	4,451	55,312	59,763
FASB ASC Topic 310-20 acquired loans	395	39	205	639	184,938	185,577
Totals	$ 1,986	$ 73	$ 3,031	$ 5,090	$240,250	$245,340

In the course of resolving delinquent loans, the Bank may choose to restructure the contractual terms of certain loans. A troubled debt restructuring is a restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty. A loan is accounted for as a troubled debt restructured loan ("TDR") if BancShares, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise grant. A TDR typically involves a modification of terms such as a reduction of the interest rate below the current market rate for a loan with similar risk characteristics or the waiving of certain financial loan covenants without corresponding offsetting compensation or additional support. BancShares measures the impairment loss of a TDR using the methodology for individually impaired loans. In accordance with FASB ASC Topic 310-30, a loan is not considered a TDR at the date of acquisition but may be classified as such if a modification is made subsequent to the acquisition.

(Dollars in Thousands for Tabular Presentations)

Note 3. Loans and Allowance for Loan Losses (Continued)

The following table presents a breakdown of the types of concessions made by loan class for the non-acquired loans that were modified as TDR's during 2018 and 2017. For the twelve month period ended December 31, 2018 and 2017, the recorded investment in TDR's prior to modification was not materially impacted by the modification. Commitments to lend additional funds to TDR borrowers at December 31, 2018 and 2017 were not considered material.

	Years Ended December 31,					
	2018			2017		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Extended payment terms:						
Commercial:						
Agricultural	-	$ -	$ -	2	$ 171	$ 171
Commercial mortgage	-	-	-	1	52	52
Non-commercial:						
Residential mortgage	1	275	274	2	202	201
Construction and land development	-	-	-	1	16	16
Total term modifications	1	$ 275	$ 274	6	$ 441	$ 440
Total restructured loans	1	$ 275	$ 274	6	$ 441	$ 440

Southern had $3.7 million and $4.2 million of non-acquired loans considered TDR's at December 31, 2018 and 2017, respectively. Included in TDR's are non-acquired loans totaling $1.0 million and $1.5 million at December 31, 2018 and 2017, respectively, which were also classified as nonaccrual loans. These loans were modified to extend maturity dates or permit interest only terms for a defined period of time with no material effect on interest income recognition.

These troubled debt restructurings are evaluated on an individual basis along with all other troubled debt restructurings based on underlying collateral value if asset dependent or the present value of future cash flows. In the event that there is a shortfall in the value of the collateral securing these loans or the present value of future cash flows the calculated impairment is reserved for in the allowance for loan losses.

The following table presents non-acquired loans that were modified as troubled debt restructurings during the 12 months indicated for which there was a payment default. A payment default is defined as a loan that is past due more than 30 days.

	December 31, 2018		December 31, 2017	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Non-commercial:				
Residential mortgage	-	$ -	1	$ 43
Construction and land development	-	-	1	18
Total term modifications	-	$ -	2	$ 61
Total restructured loans	-	$ -	2	$ 61

These troubled debt restructurings are evaluated on an individual basis along with all other troubled debt restructurings based on underlying collateral value. In the event that there is a shortfall in the value of the collateral securing these loans, the calculated impairment is included in the allowance for loan losses.

At December 31, 2018 and 2017, BancShares had $0 and $562,000, respectively, of foreclosed residential real estate property in OREO. The recorded investment in consumer mortgage loans collateralized by residential real estate property in the process of foreclosure totaled $136,000 and $85,000 at December 31, 2018 and December 31, 2017, respectively.

(Dollars in Thousands for Tabular Presentations)

Note 4. FDIC True-up Liability for Loss Share Agreements

The following table provides changes in the net FDIC true-up liability for loss share agreements:

	December 31, 2017
Balance at beginning of period	$ (12,855)
Amortization of discounts and premiums, net	(293)
Termination of FDIC loss share agreements	13,148
Balance at end of period	$ -

Effective March 7, 2017, the Company reached an agreement with the FDIC terminating the remaining loss-share agreements. Under the terms of the agreement, Southern made a net payment of $17.3 million to the FDIC as consideration for the early termination of the loss share agreements, and all rights and obligations of Southern and the FDIC under the loss share agreements, including the true-up liability provisions and the settlement of loss share and expense reimbursement claims, have been resolved and terminated. This transaction with the FDIC created a one-time accelerated amortization of the indemnification asset plus the negotiated settlement for the true-up liability, and resulted in a pre-tax loss of $4.1 million in 2017.

Note 5. Premises and Equipment

The components of premises and equipment were as follows:

	December 31, 2018	December 31, 2017
Land	$ 18,044	$ 17,803
Buildings and improvements	62,888	62,244
Furniture and equipment	22,947	22,192
Construction in progress	1,951	136
	105,830	102,375
Less: accumulated depreciation	(45,535)	(42,442)
Balance at the end of the year	$ 60,295	$ 59,933

Depreciation and amortization amounts of $4.2 million and $4.2 million in 2018 and 2017, respectively, are included in occupancy and furniture and equipment expenses. Construction-in-progress represents facilities currently undergoing renovations.

Premises and Equipment Lease Commitments

BancShares leases certain premises and equipment under various lease agreements that provide for payment of property taxes, insurance and maintenance costs. Operating leases frequently provide for one or more renewal options on the same basis as current rental terms. However, certain leases require increased rents under cost of living escalation clauses. Some leases also provide purchase options.

Future minimum rental commitments for non-cancellable operating leases with initial or remaining terms of one or more years consisted of the following at December 31, 2018:

For the Year Ending December 31:	
2019	$ 634
2020	524
2021	493
2022	325
2023	293
Thereafter	646
Total future minimum payments	$ 2,915

In January of 2019 the Company entered into a lease commitment which resulted in a non-cancellable rental commitment of $1.7 million.

Rent expense for all operating leases totaled $757,000 and $1.0 million for the years ended December 31, 2018 and 2017, respectively.

(Dollars in Thousands for Tabular Presentations)

Note 5. Premises and Equipment (Continued)

Premises and Equipment Lease Commitments (Continued)

In 2015 Southern disposed of a facility for a net gain of $223,000 and leased it back until construction of a new building could be completed. The net gain was deferred and was amortized over the two year lease term of the building sold. The amount included in other income was $18,000 in 2017. The Bank had several former bank branch facilities which were being marketed and were written down to the lower of cost or estimated net realizable value resulting in a write-down of approximately $15,000 in 2017. The remaining carrying value of those facilities in the amount of $704,000 was reclassified out of Property and Equipment and is included in Other Assets as of December 31, 2017. The facilities were sold in 2018 for $993,000 resulting in a net gain of $289,000 which is included in Other Noninterest Income.

Note 6. Income Taxes

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the "2017 Tax Act"). The 2017 Tax Act includes a number of changes to existing U.S. tax laws that impact the Company, most notably a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017.

The Company recognized the income tax effects of the 2017 Tax Act in its 2017 consolidated financial statements in accordance with Staff Accounting Bulletin No. 118, which provides guidance for the application of ASC Topic 740, *Income Taxes*, in the reporting period in which the 2017 Tax Act was signed into law. While the Company is not registered with the Securities and Exchange Commission ("the SEC") and therefore Staff Accounting Bulletins issued by the SEC are not authoritative guidance for non-registered companies, FASB has indicated that it will not object to similar treatment by such companies. As such, the Company's financial results reflect the income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 was complete and provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 was incomplete but a reasonable estimate could be determined. The Company did not identify material items for which the income tax effects of the 2017 Tax Act have not been completed and a reasonable estimate could not be determined as of December 31, 2017 and no adjustments were made in 2018 to our 2017 estimates.

Allocation of federal and state income taxes between current and deferred portions for the years ended December 31 is as follows:

	2018	2017
Current:		
Federal	$ 6,731	$ 743
State	917	127
Total	$ 7,648	$ 870
Deferred:		
Federal	$ (777)	$ (298)
State	(35)	701
Total	$ (812)	$ 403
Total tax expense	$ 6,836	$ 1,273

A reconciliation of income tax expense computed at the statutory federal income tax rate to income tax expense included in net income is as follows:

	2018	2017
Tax at statutory federal rate	$ 7,640	$ 12,307
State income tax, net of federal benefit	697	539
Tax exempt income	(714)	(595)
Tax rate impact	-	(10,272)
Dividends received deduction	(46)	(104)
Other	(741)	(602)
Total	$ 6,836	$ 1,273

(Dollars in Thousands for Tabular Presentations)

Note 6. Income Taxes (Continued)

The components of the net deferred tax liability, included in other liabilities, are as follows:

	December 31, 2018	December 31, 2017
Deferred tax assets:		
Allowance for loan losses	$ 4,364	$ 3,995
Pension liability	2,368	1,984
Unrealized loss on available for sale securities	2,391	-
Deferred compensation	686	729
Gain on FDIC-assisted transaction, deferred for tax purposes	513	943
Other	1,581	1,261
Total deferred tax assets	11,903	8,912
Deferred tax liabilities:		
Depreciation	(1,290)	(749)
Intangibles	(1,997)	(2,214)
Pension funding commitment	(4,949)	(5,178)
Unrealized gains on marketable equity securities	(15,120)	-
Unrealized gains on available for sale securities	-	(16,687)
Other	(1,350)	(1,134)
Total deferred tax liabilities	(24,706)	(25,962)
Net deferred tax liability	$ (12,803)	$ (17,050)

The Company measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid. Accordingly, the Company's deferred tax assets and liabilities were re-measured to reflect the reduction in the U.S. corporate income tax rate from 35 percent to 21 percent, resulting in a $10.3 million decrease in income tax expense and net deferred tax liabilities for the year ended December 31, 2017. There was no impact on the consolidated financial statements for the year ended December 31, 2018.

BancShares has invested in Qualified Affordable Housing Projects in the amount of $4.5 million. The current investment balance net of amortized tax benefits is $4.5 million and is shown on the Consolidated Balance Sheet in Other Assets. BancShares also has commitments, which are shown in Other Liabilities on the Consolidated Balance Sheet, to provide additional capital calls in the amount of $2.2 million. It is anticipated that these additional commitment amounts will be paid within the next four years.

Tax positions must meet a recognition threshold of more-likely-than-not in order for the benefit of those tax positions to be recognized in BancShares' consolidated financial statements. BancShares has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2018. Interest and penalties related to income tax assessments, if any, are reflected in income tax expense in the accompanying Consolidated Statements of Income and Comprehensive Income. Fiscal years ending on or after December 31, 2015 remain subject to examination by federal and state tax authorities.

Note 7. Deposits

Deposits at December 31 are summarized as follows:

	2018	2017
Demand	$ 732,336	$ 695,830
Time	275,711	304,806
Money market accounts	743,118	705,203
Checking with interest	372,844	368,938
Savings	175,618	171,253
Total deposits	$ 2,299,627	$ 2,246,030

Total time deposits with a denomination of $250,000 or more were $36.7 million and $40.5 million at December 31, 2018 and 2017, respectively.

(Dollars in Thousands for Tabular Presentations)

Note 7. Deposits (Continued)

At December 31, 2018, the scheduled maturities of all time deposits were:

2019	$	185,659
2020		56,109
2021		7,815
2022		4,807
2023		4,968
Thereafter		16,353
Total time deposits	$	275,711

Note 8. Short and Long-Term Borrowings

Short-term Borrowings

	2018		2017	
Other borrowing	$	-	$	10,000
Notes payable to Federal Home Loan Bank		-		7,000
Repurchase agreements		45,165		40,214
Total short-term borrowings	$	45,165	$	57,214

For the years ended December 31, 2018 and 2017, average short-term borrowings outstanding totaled $53.3 million and $68.8 million, respectively, with weighted average rates of 0.87% and 0.53% as of December 31, 2018 and 2017, respectively.

We utilize securities sold under agreements to repurchase to facilitate the needs of our customers. Repurchase agreements are transactions whereby we offer to sell to a counterparty an undivided interest in an eligible security at an agreed upon purchase price, and which obligates BancShares to repurchase the security on an agreed upon date at an agreed upon repurchase price plus interest at an agreed upon rate. Securities sold under agreements to repurchase are recorded at the amount of cash received in connection with the transaction and are reflected as short-term borrowings on the Consolidated Balance Sheets.

We monitor collateral levels on a continuous basis and maintain records of each transaction specifically describing the applicable security and the counterparty's fractional interest in that security, and we segregate the security from its general assets in accordance with regulations governing custodial holdings of securities. The primary risk with our repurchase agreements is market risk associated with the investments securing the transactions, as we may be required to provide additional collateral based on fair value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

At December 31, 2018 and 2017, investment securities with a carrying value of $60.5 million and $57.8 million, respectively were pledged for repurchase agreements. The securities collateralizing the repurchase agreements have been delivered to a third party custodian for safekeeping. In addition, loans and Federal Home Loan Bank stock totaling $313.3 million are pledged as collateral for notes payable to the Federal Home Loan Bank at December 31, 2017.

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in short-term borrowings as of December 31, 2018 and 2017 is as follows:

	Overnight and Continuous			
	2018		2017	
U.S. Treasuries and government-sponsored entities debt	$	4,041	$	-
Residential government-sponsored mortgage-backed securities		56,493		57,821
Total	$	60,534	$	57,821

The other borrowing of $10.0 million from a commercial bank pays interest at the annual rate, reset quarterly, at the 1 month LIBOR plus 112.50 basis points. The credit line was repaid in December 2018 and renewed for an additional three years. It is secured by a first priority secured interest in marketable equity securities with a December 31, 2018 market value of $50.8.

(Dollars in Thousands for Tabular Presentations)

Note 8. Short and Long-Term Borrowings (Continued)

Long-term Borrowings

Long-term borrowings at December 31 were:

	2018		2017	
Junior subordinated debentures	$	23,711	$	23,711
Subordinated debt		-		7,125
Total long-term borrowings	$	23,711	$	30,836

The $23.7 million junior subordinated debentures payable to Southern Capital Trust II (the "Trust"), qualify as Tier 1 Capital for BancShares, bear interest at 6.95% and mature in 2035. The Trust is a grantor trust established by BancShares for the purpose of issuing trust preferred securities. The obligations of the Company with respect to the issuance of the capital securities constitute a full and unconditional guarantee by the Company of the Trusts' obligations with respect to the capital securities. BancShares may, at any time, redeem the junior subordinated debentures long-term borrowings in whole or in part. The Trust is not consolidated with BancShares. Accordingly, BancShares does not report the securities issued by Southern Capital Trust II as liabilities, and instead reports as liabilities the junior subordinated debentures issued by BancShares and held by the Trust. However, BancShares has fully and unconditionally guaranteed the repayment of the trust preferred securities. These trust preferred securities currently qualify as Tier 1 capital for regulatory capital requirements of BancShares.

Subordinated debt in the amount of $8.8 million was issued September 21, 2011 to assist in the acquisition of BOC. The subordinated debt pays interest quarterly at the annual rate, reset monthly, equal to 3 month LIBOR plus 1035.33 basis points not to exceed 15.72%. The interest rate at December 31, 2017 was 11.94%. The subordinated debt matures on September 21, 2026 and can be prepaid any time after September 30, 2012. BancShares repaid $5.0 million of the outstanding subordinated debt on January 2, 2018 and the remaining $2.1 million on December 26, 2018. See also Note 14 Related Parties regarding the issuance of the subordinated debt.

Total long-term borrowing averaged $25.8 million for 2018 and 2017 and the average cost was 7.22% and 6.48% for 2018 and 2017, respectively.

Note 9. Retirement Plans

Southern has a noncontributory, defined benefit pension plan which covers a substantial number of full-time employees. Southern discontinued offering benefits under the defined benefit plan to employees hired after June 30, 2012. Employees hired who met eligibility requirements on or before June 30, 2012 were allowed the option of continued participation in the defined benefit plan and the existing 401(k) plan or enrollment in an enhanced 401(k) plan, discussed further below. Employees who elected to enroll in the enhanced plan discontinued the accrual of additional years of service under the defined benefit plan. Under the plan, retirement benefits are based on years of service and average earnings. The plan's assets consist primarily of investments in listed common stocks and fixed income securities. It is Southern's policy to determine the service cost and projected benefit obligation using the Projected Unit Credit Cost method.

Effective June 30, 2017, the plan was amended to allow active employees participating in the plan, who were not receiving long-term disability payments, the option to voluntarily elect not to accrue additional benefits under the plan after December 31, 2017, and to become a participant in an enhanced 401(k) plan for the employees of Southern Bank and Trust Company effective January 1, 2018. Active participants making such an election shall receive no credit for years of service completed after December 31, 2017, or for compensation received after December 31, 2017, for purposes of benefit accrual under the plan. Also effective June 30, 2017, the plan was amended to allow terminated vested participants not receiving payments from the plan, and who satisfied certain requirements of the plan, the option to voluntarily elect to receive a lump sum payment of the vested accrued benefit. Payments totaling $4.0 million were made in 2017 to terminated vested participants who elected to receive payment of the vested accrued benefit.

(Dollars in Thousands for Tabular Presentations)

Note 9. Retirement Plans (Continued)

The following sets forth pertinent information regarding the projected benefit obligation of the pension plan for the periods indicated:

	2018	2017
Projected benefit obligation, beginning of year	$ 77,002	$ 76,042
Service cost	1,900	1,979
Interest cost	2,820	3,149
Actuarial (gain) loss	(7,189)	3,215
Benefits paid	(3,028)	(6,881)
Curtailments	-	(502)
Projected benefit obligation, end of year	$ 71,505	$ 77,002

The accumulated benefit obligation for the pension plan at the end of 2018 and 2017 was $63.4 million and $67.4 million, respectively. Southern uses a measurement date of December 31 for its pension plan.

The weighted average assumptions used to determine benefit obligations, at the end of the year were as follows:

	2018	2017
Discount rate	4.30%	3.65%
Rate of compensation increase	4.00%	4.00%

The change in pension plan assets is as follows:

	2018	2017
Fair value of plan assets, beginning of year	$ 90,100	$ 77,850
Actual return on plan assets	(5,091)	10,225
Employer contribution	930	8,906
Benefits paid	(3,028)	(6,881)
Fair value of plan assets, end of year	$ 82,911	$ 90,100

Employer contributions and benefits paid in the above table include only those amounts contributed directly to, or paid directly from, plan assets.

	2018	2017
Funded status, end of year		
Fair value of plan assets	$ 82,911	$ 90,100
Projected benefit obligation	(71,505)	(77,002)
Funded status	11,406	13,098
Amounts not yet recognized:		
Unrecognized net loss	-	-
Net amount recognized	$ 11,406	$ 13,098

	2018	2017
Amounts recognized in the statement of financial position consist of:		
Noncurrent asset	$ 11,406	$ 13,098
Noncurrent liability	$ -	$ -
Amounts recognized in accumulated other comprehensive income, excluding income taxes, consist of:		
Net actuarial loss	$ 10,493	$ 8,747
Prior service cost	-	-
Accumulated other comprehensive income	$ 10,493	$ 8,747

(Dollars in Thousands for Tabular Presentations)

Note 9. Retirement Plans (Continued)

The following table discloses the components of periodic benefit cost related to the pension plan for the years ended December 31, 2018 and 2017:

	2018	2017
Service cost	$ 1,900	$ 1,979
Interest cost	2,820	3,149
Expected return on plan assets	(4,829)	(4,258)
Amortization of net actuarial loss	986	1,036
Net periodic benefit cost	$ 877	$ 1,906

Investment decisions regarding the plan's assets seek to achieve a favorable annual return through a diversified portfolio that will provide needed capital appreciation and cash flow to allow both current and future benefit obligations to be paid. The target asset mix may change if the objectives for the plan's assets or risk tolerance change or if a major shift occurs in the expected long-term risk and reward characteristics of one or more asset classes.

The asset allocation for Southern's pension plan at the end of 2018 and 2017, and the target allocation for 2018, by asset category, follows:

Asset category	Target Allocation for 2019	Percentage of Plan Assets at December 31, 2018	2017
Equity securities	60%	58%	52%
Debt securities	36%	37%	34%
Other investments	3%	3%	4%
Cash and cash equivalents	1%	2%	10%
Total	100%	100%	100%

The expected long term rate of return on the plan assets was 6.00% in 2018 and 2017. Southern's investment strategy calls for earning an adequate return on assets while not exposing the assets to unnecessary risk. The plan's assets are primarily invested in marketable, fixed rate U. S. Government and corporate securities and marketable equity securities. The plan's target allocation was changed slightly from the prior year increasing the exposure to equity and debt securities and increasing other satellite investments while decreasing cash and cash equivalents.

(Dollars in Thousands for Tabular Presentations)

Note 9. Retirement Plans (Continued)

The fair values of pension plan assets at December 31, 2018 and 2017, by asset category are as follows:

Asset Category	Market Value as of December 31,	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Target Allocation	Actual % of Plan Assets
2018						
Money market fund	$ 1,447	$ 1,447	$ -	$ -	1%	2%
Other investments	2,408	2,408	-	-	5%	3%
Equity securities:					57%	58%
Individual equities	9,592	9,592	-	-		
Mutual funds	23,710	23,710	-	-		
Exchange traded funds	14,529	14,529	-	-		
Debt securities:					37%	37%
Bonds	29,511	10,633	18,878	-		
Exchange traded funds	1,714	1,714	-	-		
Total pension assets	$ 82,911	$ 64,033	$ 18,878	$ -	100%	100%
2017						
Money market fund	$ 8,883	$ -	$ 8,883	$ -	1%	10%
Other investments	3,937	3,937	-	-	5%	4%
Equity securities:					57%	52%
Individual equities	6,348	6,348	-	-		
Mutual funds	26,511	24,529	1,982	-		
Exchange traded funds	13,959	13,959	-	-		
Debt securities:					37%	34%
Bonds	28,223	9,100	19,123	-		
Exchange traded funds	2,239	2,239	-	-		
Total pension assets	$ 90,100	$ 60,112	$ 29,988	$ -	100%	100%

Following are estimated payments to pension plan participants in the indicated periods:

Employer Contributions	
2019 (expected) to plan trust	$ -
Expected Benefit Payments	
2019	$ 3,201
2020	3,304
2021	3,418
2022	3,528
2023	3,650
2024 - 2027	20,658

(Dollars in Thousands for Tabular Presentations)

Note 9. Retirement Plans (Continued)

The weighted-average assumptions used to determine the net periodic benefit cost for the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
Discount rate	3.65%	4.15%
Rate of compensation increase	4.00%	4.00%
Expected return on plan assets	6.00%	6.00%

The discount rate above reflects the discount in effect at January 1 of the plan year. The estimated actuarial loss that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2018 is $985,000. There is no prior service cost expected to be amortized into the net periodic benefit cost in 2019.

Employees hired before July 1, 2012 are also eligible to participate in a 401(k) plan through deferral of portions of their salary. Based on the employee's contribution, BancShares will match up to 100% of the first 3% of the participant's contributions and 50% of the next 3%. In addition BancShares also offers an enhanced 401(k) plan for certain employees. BancShares will match 100% of the first 6% of the participant's contributions. In addition BancShares may make discretionary contributions. BancShares made participating contributions of $1.4 million and $1.6 million during 2018 and 2017, respectively.

Note 10. Regulatory Requirements and Restrictions

BancShares is subject to regulations with respect to certain risk-based capital ratios. These risk-based capital ratios measure the relationship of capital to a combination of balance sheet and off-balance sheet risks. The values of both balance sheet and off-balance sheet items are adjusted based on the rules to reflect categorical credit risk. In addition to the risk-based capital ratios, the regulatory agencies have also established a leverage ratio for assessing capital adequacy. The leverage ratio is equal to Tier 1 capital divided by total consolidated on-balance sheet assets (minus amounts deducted from Tier 1 capital). The leverage ratio does not involve assigning risk weights to assets.

In July 2013, the Federal Reserve announced its approval of a final rule to implement the regulatory capital reforms developed by the Basel Committee on Banking Supervision ("Basel III"), among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new rules became effective January 1, 2015, subject to a phase-in period for certain aspects of the new rules.

As applied to BancShares and Southern, the new rules include a new minimum ratio of common equity Tier 1 capital ("CET1") to risk-weighted assets of 4.5%. The new rules also raise the minimum required ratio of Tier 1 capital to risk-weighted assets from 4% to 6%. The minimum required leverage ratio under the new rules is 4%. The minimum required total capital to risk-weighted assets ratio remains at 8% under the new rules.

In order to avoid restrictions on capital distributions and discretionary bonus payments to executives, under the new rules a covered banking organization will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of common equity Tier 1, and the buffer will apply to all three risk-based measurements (CET1, Tier 1 capital and total capital). The capital conservation buffer, which is 1.875% at December 31, 2018, is being phased in incrementally over time and is fully effective on January 1, 2019, and ultimately consists of an additional amount of Tier 1 common equity equal to 2.5% of risk-weighted assets.

Southern is also subject to the regulatory framework for prompt corrective action, which identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and is based on specified thresholds for each of the three risk-based regulatory capital ratios (CET1, Tier 1 capital and total capital) and for the leverage ratio.

Note 10. Regulatory Requirements and Restrictions (Continued)

The following table presents actual and required capital ratios as of December 31, 2018 and 2017 for BancShares and Southern under the Basel III capital rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2018 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum capital required - Basel III phase-in schedule		Minimum capital required - Basel III fully phased-in		Required to be considered well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)					
December 31, 2018:								
Common equity Tier 1 to risk-weighted assets:								
BancShares	$ 226,814	10.254%	$ 141,011	6.375%	$ 154,835	7.000%	$ 143,776	6.500%
Southern	250,688	12.278%	130,162	6.375%	142,922	7.000%	132,714	6.500%
Tier 1 capital to risk-weighted assets								
BancShares	273,076	12.346%	174,189	7.875%	188,014	8.500%	176,954	8.000%
Southern	250,688	12.278%	160,788	7.875%	173,549	8.500%	163,340	8.000%
Total capital to risk-weighted assets								
BancShares	293,166	13.254%	218,429	9.875%	232,254	10.500%	221,194	10.000%
Southern	270,778	13.262%	201,622	9.875%	214,383	10.500%	204,174	10.000%
Tier 1 capital to average assets (leverage ratio):								
BancShares	273,076	10.164%	107,469	4.000%	107,469	4.000%	134,336	5.000%
Southern	250,688	9.586%	104,602	4.000%	104,602	4.000%	130,752	5.000%

	Actual		Minimum capital required - Basel III phase-in schedule		Minimum capital required - Basel III fully phased-in		Required to be considered well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)					
December 31, 2017:								
Common equity Tier 1 to risk-weighted assets:								
BancShares	$ 174,669	8.541%	$ 117,591	5.750%	$ 143,155	7.000%	$ 132,929	6.500%
Southern	237,903	12.294%	111,269	5.750%	135,458	7.000%	125,782	6.500%
Tier 1 capital to risk-weighted assets								
BancShares	242,316	11.849%	148,265	7.250%	173,828	8.500%	163,603	8.000%
Southern	237,903	12.294%	140,296	7.250%	164,485	8.500%	154,809	8.000%
Total capital to risk-weighted assets								
BancShares	301,869	14.761%	189,167	9.250%	214,730	10.500%	204,504	10.000%
Southern	264,225	13.654%	179,001	9.250%	203,190	10.500%	193,515	10.000%
Tier 1 capital to average assets (leverage ratio):								
BancShares	242,316	9.487%	102,168	4.000%	102,168	4.000%	127,709	5.000%
Southern	237,903	9.331%	101,984	4.000%	101,984	4.000%	127,480	5.000%

Note 10. Regulatory Requirements and Restrictions (Continued)

The primary source of funds for the dividends paid by BancShares to its shareholders is dividends received from its banking subsidiary. Southern is restricted as to dividend payout by state laws applicable to banks and may pay dividends only out of retained earnings. Should at any time its surplus be less than 50% of its paid-in capital stock, Southern may not declare a dividend until it has transferred from retained earnings to surplus 25% of its undivided profits or any lesser percentage that may be required to restore its surplus to an amount equal to 50% of its paid-in capital stock. Additionally, dividends paid by Southern may be limited by the need to retain sufficient earnings to satisfy minimum capital requirements imposed by the FDIC. Dividends on BancShares' common shares may be paid only after dividends on preferred series B, C, D, E and F shares have been paid. Common share dividends are based upon BancShares' profitability and are paid at the discretion of the Board of Directors.

Management does not expect any of the foregoing restrictions to materially limit its ability to pay dividends comparable to those paid in the past. At December 31, 2018, BancShares' investment in Southern was restricted to an amount equal to the level of regulatory capital that could be transferred from Southern without obtaining prior regulatory approval.

Note 11. Commitments, Contingencies and Concentration of Credit Risk

In the normal course of business there are various commitments and contingent liabilities outstanding, such as guarantees, commitments to extend credit, etc., which are not reflected in the accompanying financial statements. Southern is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and undisbursed advances on customer lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

Southern is exposed to credit loss for the contractual notional amount of commitments to extend credit and standby letters of credit in the event of nonperformance by the other party to the financial instrument. Southern uses the same credit policies in making these commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit and undisbursed advances on customer lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments expire without being drawn, the total commitment amounts do not necessarily represent future cash requirements. Southern evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Southern, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include trade accounts receivable, property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are commitments issued by Southern 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 to customers. The maximum potential amount of undiscounted future payments related to standby letters of credit at December 31, 2018 is $4.5 million. At December 31, 2018, BancShares considered this amount to be immaterial and has recorded no liability for the current carrying amount of the obligation to perform as a guarantor and no liability is considered necessary. Substantially all standby letters of credit are secured by real estate and/or guaranteed by third parties in the event BancShares had to advance funds to fulfill the guarantee.

Outstanding commitments to lend at December 31, 2018 and December 31, 2017 were $472.5 million and $436.9 million and include undisbursed advances on customer lines of credit of $147.9 million and $140.2 million, respectively. Outstanding standby letters of credit and commitments to lend at December 31, 2018 generally expire within one year, whereas commitments associated with undisbursed advances on customer lines of credit at December 31, 2018 generally expire within one to five years.

Non-recourse commitments to sell loans amounted to $9.5 million and $7.0 million at December 31, 2018 and 2017, respectively. BancShares utilized investor commitments to protect its mortgage loans held for sale from interest rate risk from the time of origination to the time of sale. These commitments are accounted for at fair market value. Unfunded residential mortgage loan commitments for loans to be sold are also accounted for at fair market value. These fair market value adjustments were insignificant as of and for the years ended December 31, 2018 and 2017.

Southern is also committed to leases for banking facilities. See Note 5 – Premises and Equipment for lease commitments at December 31, 2018.

BancShares does not have any special purpose entities or other similar forms of off-balance sheet financing arrangements other than the trust preferred securities discussed in Note 8.

(Dollars in Thousands for Tabular Presentations)

Note 11. Commitments, Contingencies and Concentration of Credit Risk (Continued)

Southern grants agribusiness, commercial and consumer loans to customers primarily in eastern North Carolina and southeastern Virginia.

BancShares is also involved in various legal actions arising in the normal course of business. Management is of the opinion that the outcome of such actions will not have a material adverse effect on the consolidated financial condition of BancShares.

Note 12. Parent Company Financial Statements

Presented below are the condensed balance sheets (parent company only) of Southern BancShares (N.C.), Inc. as of December 31, 2018 and 2017 and condensed statements of income and cash flows for the years then ended.

CONDENSED BALANCE SHEETS

	December 31, 2018	December 31, 2017
ASSETS		
Cash	$ 10,550	$ 8,845
Investment in marketable equity securities	58,327	-
Investment securities available-for-sale	-	68,767
Other assets	2,133	5,590
Investment in subsidiaries	261,030	269,426
Total assets	$ 332,040	$ 352,628
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued liabilites	$ 12,452	$ 13,182
Notes payable	26,111	44,683
Total liabilities	38,563	57,865
Shareholders' equity	293,477	294,763
Total liabilities and shareholders' equity	$ 332,040	$ 352,628

CONDENSED STATEMENTS OF INCOME

	Year Ended December 31, 2018	Year Ended December 31, 2017
Interest and dividend income	$ 387	$ 497
Dividends from bank subsidiary	33,259	4,944
Marketable equity securites losses, net	(3,464)	-
Gain on investments without a readily determinable market value	2,069	-
Total income	32,251	5,441
Interest expense	2,233	2,886
Other expense	301	318
Total expense	2,534	3,204
Income before income tax benefit	29,717	2,237
Income tax benefit	(1,209)	(8,870)
Net income before equity in undistributed earnings of subsidiaries	30,926	11,107
Equity in undistributed income of subsidiaries	(1,381)	22,783
Net income	29,545	33,890
Dividends on preferred stock	(1,937)	(2,184)
Net income available to common shareholders	$ 27,608	$ 31,706

(Dollars in Thousands for Tabular Presentations)

Note 12. Parent Company Financial Statements (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2018	2017
OPERATING ACTIVITIES:		
Net income	$ 29,545	$ 33,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed net income of subsidiaries	1,381	(22,783)
Loss on marketable equity securities	3,464	-
Gain on equity investments without a readily determinable market value	(2,069)	-
Decrease in other assets	5,526	684
Decrease in accrued liabilities	(730)	(7,838)
NET CASH PROVIDED BY OPERATING ACTIVITIES	37,117	3,953
INVESTING ACTIVITIES:		
Proceeds from sales of marketable equity securities	6,976	-
NET CASH PROVIDED BY INVESTING ACTIVITIES	6,976	-
FINANCING ACTIVITIES:		
Repayment of borrowed funds	(18,572)	(15,300)
Dividends paid	(2,343)	(2,314)
Purchase and retirement or redemption of stock	(21,473)	(935)
NET CASH USED BY FINANCING ACTIVITIES	(42,388)	(18,549)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,705	(14,596)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF YEAR	8,845	23,441
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	$ 10,550	$ 8,845
SUPPLEMENTAL DISCLOSURES OF CASH PAID DURING THE YEAR FOR:		
Interest	$ 2,232	$ 2,886
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING ACTIVITIES:		
Unrealized gains on available-for-sale securities, net of tax	$ -	$ 5,546
Transfer of investment securities available for sale to investment in marketable equity securities	68,767	-

Note 13. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Due from Banks, Interest–bearing Deposits with Banks, Certificates of Deposit with Banks and Accrued Interest Receivable

The carrying amounts for cash and due from banks, interest-bearing deposits with banks, certificates of deposits with banks and accrued interest receivable are equal to their fair values due to the short term nature of these financial instruments.

Marketable Equity Securities

Equity securities are measured at fair value using observable closing prices.

Investment Securities Available for Sale

Fair values of investment securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans Held for Sale

Fair value for loans held for sale is generally based on market prices for loans with similar characteristics or external valuations.

Loans

Fair value is estimated based on discounted future cash flows using the current interest rates at which loans with similar terms would be made to borrowers of similar credit quality. The inputs used in the fair value measurements for loans and leases are considered Level 3 inputs.

Stock in FHLB

The carrying amount for FHLB stock is equal to the fair value due to the redemption provisions of the FHLB and no ready market for such stock.

Deposits

The fair value of demand deposits, savings accounts and money market deposits is the amount payable on demand at year end. The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates paid for similar deposits.

Short-term Borrowings and Accrued Interest Payable

The carrying amounts for short-term borrowings and accrued interest payable are equal to the fair values due to the short-term nature of these financial instruments.

Long-term Borrowings

The fair value of long-term borrowings reflects discounting future cash flows using the current interest rates for similar maturities.

Commitments

Southern's commitments to extend credit have no carrying value and are generally at variable rates and/or have relatively short terms to expiration. Accordingly, these financial instruments are deemed to have no material fair value.

(Dollars in Thousands for Tabular Presentations)

Note 13. Fair Value of Financial Instruments (Continued)

The estimated fair values of BancShares' financial instruments at December 31 are as follows:

	2018		2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 22,607	$ 22,607	$ 19,848	$ 19,848
Interest-bearing deposits with banks	128,239	128,239	157,604	157,604
Certificates of deposits with banks	19,979	19,979	31,782	31,782
Investment securities available-for-sale	593,652	593,652	671,165	671,165
Loans held for sale	2,393	2,393	2,162	2,162
Loans and leases, net of allowance	1,684,217	1,671,112	1,612,230	1,570,430
Stock in FHLB	2,322	2,322	2,510	2,510
Accrued interest receivable	9,853	9,853	8,591	8,591
Financial liabilities:				
Deposits	$ 2,299,627	$ 2,295,951	$ 2,246,030	$ 2,113,306
Short-term borrowings	45,165	45,165	57,214	57,214
Long-term borrowings	23,711	25,989	30,836	31,236
Accrued interest payable	162	162	102	102

Limitations on Fair Value Assumptions

Fair value estimates are made by management at specific points in time based on relevant information about the financial instrument and the market. These estimates do not reflect any premium or discount that could result from offering for sale at one time BancShares' entire holdings of a particular financial instrument nor are potential taxes and other expenses that would be incurred in an actual sale considered. Because no market exists for a significant portion of BancShares' financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and/or the methodology used could significantly affect the estimates disclosed. Similarly, the fair values disclosed could vary significantly from amounts realized in actual transactions.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, BancShares has premises and equipment which are not considered financial instruments. Accordingly, the value of these assets has not been incorporated into the fair value estimates. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

BancShares reports fair value on a recurring basis for certain financial instruments, most notably for available-for-sale investment securities and certain derivative instruments. BancShares may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value which was below cost at the end of the period. Assets subject to nonrecurring use of fair value measurements could include impaired loans, loans held for sale, goodwill, and OREO.

(Dollars in Thousands for Tabular Presentations)

Note 13. Fair Value of Financial Instruments (Continued)

BancShares groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party services for similar or comparable assets or liabilities.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or brokered traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Marketable equity securities are measured at fair value using observable closing prices. The valuation also considers the amount of market activity by examining the trade volume of each security. Equity securities are classified as Level 1 since they are traded in an active market.

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or U.S. Treasury securities and mortgage backed securities by government sponsored entities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include obligations of states and political subdivisions and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets given that there is an absence of observable inputs for these and similar securities in the debt markets. For these securities, a present value approach that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs provides representative fair values, and therefore, has been used rather than a market valuation approach. This income valuation approach requires numerous steps in determining fair value. These steps include estimating credit quality of the collateral, generating asset defaults, forecasting cash flows for underlying collateral, and determining losses given default assumptions.

BancShares is allowed to make an irrevocable election to measure certain financial instruments at fair value. The changes in fair value from one reporting period to the next period must be reported in the income statement with additional disclosures to identify the effect on net income. BancShares continued to account for securities available-for-sale at fair value as reported in prior years. BancShares has no derivative activity. Securities available-for-sale are reported on a recurring basis.

Fair Value Measurements at December 31:

	Market Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2018				
Marketable equity securities	$ 79,868	$ 79,868	$ -	$ -
U.S. Treasuries and government sponsored entities debt	$ 39,661	$ 39,661	$ -	$ -
Corporate debt securities	4,281	-	3,742	539
Obligations of states and political subdivisions	86,157	-	82,244	3,913
Residential government-sponsored mortgage-backed securities	463,553	-	463,553	-
Total debt securities	$ 593,652	$ 39,661	$ 549,539	$ 4,452

(Dollars in Thousands for Tabular Presentations)

Note 13. Fair Value of Financial Instruments (Continued)

	Market Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2017				
U.S. Treasuries and government sponsored entities debt	$ 40,315	$ 40,315	$ -	$ -
Corporate debt securities	7,874	-	7,316	558
Marketable equity securities	91,789	91,789	-	-
Obligations of states and political subdivisions	49,426	-	45,178	4,248
Residential government-sponsored mortgage-backed securities	481,761	-	481,761	-
Total	$ 671,165	$ 132,104	$ 534,255	$ 4,806

For those investment securities available-for-sale with fair values that are determined by reliance on significant unobservable inputs, the following table identifies the factors causing the change in fair values for the years ended December 31, 2018 and 2017:

Description	Investment Securities Available-For-Sale With Fair Values Based on Significant Unobservable Inputs
Beginning balance, January 1, 2017	$ 5,559
Total gains (losses) realized or unrealized:	
Included in earnings	(1)
Included in other comprehensive income	69
Maturies and calls, net	(821)
Ending balance, December 31, 2017	4,806
Total gains (losses) realized or unrealized:	
Included in other comprehensive income	(19)
Maturies and calls, net	(335)
Ending balance, December 31, 2018	$ 4,452

As previously discussed, loans are considered impaired when it is determined to be probable that all amounts due under the contractual terms of the loan will not be collected when due. Loans considered individually impaired are evaluated and a specific allowance is established, if required, based on the most appropriate of the three measurement methods: present value of expected future cash flows, fair value of collateral, or the observable market price of a loan method. A specific allowance is required if the fair value of the expected repayments or the collateral is less than the recorded investment in the loan. At December 31, 2018, $1.0 million of impaired loans required a specific allowance of $89,000 and $3.8 million of impaired loans had partial charge-offs for a total of $4.7 million of impaired loans measured at fair value. At December 31, 2017, $2.2 million of impaired loans required a specific allowance of $183,000 and $1.6 million of impaired loans had partial charge-offs for a total of $3.6 million of impaired loans measured at fair value. The methods used to determine the fair value of these loans were considered Level 3.

(Dollars in Thousands for Tabular Presentations)

Note 13. Fair Value of Financial Instruments (Continued)

OREO is measured and reported at fair value using Level 3 inputs for valuations based on non-observable criteria. At December 31, 2018 and 2017, OREO totaled $354,000 and $783,000, respectively all of which was valued using Level 3 inputs.

At December 31, 2018, BancShares had certain non-marketable equity securities with no recurring market value data available which were reviewed periodically and valued using Level 3 inputs. At December 31, 2018 and December 31, 2017, BancShares had certain impaired loans and OREO that are measured at fair value on a nonrecurring basis. The significant unobservable input used in the fair value measurement of BancShares' impaired loans and OREO range between 6 - 15% discount from appraisals for expected liquidation and sales costs.

The tables below present the balances of assets and liabilities measured at fair value on a nonrecurring basis.

	Market Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2018				
Non-marketable equity securities	$ 2,086	$ -	$ -	$ 2,086
Impaired loans	4,727	-	-	4,727
OREO	354	-	-	354
2017				
Impaired loans	$ 3,629	$ -	$ -	$ 3,629
OREO	783	-	-	783

Certain assets are carried at fair value on a nonrecurring basis. Loans held for sale are carried at the lower of aggregate cost or fair value and are therefore carried at fair value only when fair value is less than the asset cost. The values of loans held for sale are based on prices observed for similar pools of loans. There have been no fair value adjustments recorded for loans held for sale at December 31, 2018 and 2017. No financial liabilities were carried at fair value on a nonrecurring basis as of December 31, 2018 or December 31, 2017.

Note 14. Related Parties

First Citizens BancShares, Inc. has an executive officer who is also a significant shareholder and director of BancShares. At December 31, 2018 the officer beneficially owned 8,732 shares, or 10.76%, of BancShares' outstanding common stock and 2,000 shares, or 0.76%, of BancShares' outstanding Series B preferred stock. Another director who is related to the aforementioned director beneficially owns 5,990 shares, or 7.38%, of BancShares' outstanding common stock. In addition, a limited liability company owned by the same two directors plus other family members owns the Series D and Series F preferred stock and the subordinated debt securities.

BancShares has entered into various service contracts with First Citizens BancShares, Inc. and its subsidiary, First-Citizens Bank and Trust Company (collectively "First Citizens"). The following table lists the various charges paid to and income received from First Citizens during the years ended December 31:

	2018	2017
Income from credit cards	$ 153	$ 145
Miscellaneous services	$ 195	$ 210
Trustee for employee benefit plans	406	397
Total expenses	$ 601	$ 607

Miscellaneous services include primarily courier services. BancShares also has a correspondent relationship with First Citizens. Correspondent account balances with First Citizens included in cash and due from banks totaled $589,000 and $872,000 at December 31, 2018 and 2017, respectively. In addition, at December 31, 2017 BancShares had $373,000 of loan participations bought from First Citizens and loan participations sold of $13.0 million and $5.2 million as of December 31, 2018 and 2017, respectively.

Note 14. Related Parties (Continued)

BancShares also owns stock in First Citizens as follows:

	2018			2017		
	Number of shares	Amortized Cost	Fair Value	Number of shares	Amortized Cost	Fair Value
			($ in thousands)			
First Citizens						
Class A	191,963	$ 15,322	$ 72,380	204,463	$ 15,322	$ 82,399
Class B	22,619	532	7,464	22,619	532	7,985
Total	214,582	$ 15,854	$ 79,844	227,082	$ 15,854	$ 90,384

BancShares is also related through common ownership with Fidelity BancShares (N.C.), Inc., ("Fidelity") in that the aforementioned significant shareholder of BancShares and certain of their related parties are also significant shareholders of Fidelity. At December 31, 2018 and 2017 BancShares had $11.9 million and $8.6 million, respectively in loan participations sold to Fidelity. Fidelity has also contracted with BancShares for BancShares to service, on Fidelity's behalf, $51,000 and $62,000 of Fidelity's mortgage loans at December 31, 2018 and 2017, respectively.

Note 15. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) included the following as of December 31:

	2018			2017		
	Accumulated other comprehensive income (loss)	Deferred tax benefit (expense)	Accumulated other comprehensive loss net of tax	Accumulated other comprehensive income (loss)	Deferred tax benefit (expense)	Accumulated other comprehensive income (loss) net of tax
Unrealized gains on investment securities available for sale	$ (10,561)	$ 2,391	$ (8,170)	$ 72,296	$ (16,687)	$ 55,609
Funded status of defined benefit plan	(10,493)	2,368	$ (8,125)	(8,747)	1,984	$ (6,763)
Total	$ (21,054)	$ 4,759	$ (16,295)	$ 63,549	$ (14,703)	$ 48,846

	Unrealized gains and losses on available-for-sale securities	Defined benefit pension plan	Total
Balance at January 1, 2017	$ 39,646	$ (8,276)	$ 31,370
Other comprehensive income (loss) before reclassifications	8,029	2,065	10,094
Amounts reclassified from accumulated other comprehensive income (loss)	(2,033)	657	(1,376)
Net current period other comprehensive income (loss)	5,996	2,722	8,718
Revaluation of deferred tax liabilities (assets)	9,967	(1,209)	8,758
Balance at December 31, 2017	55,609	(6,763)	48,846
Other comprehensive income before reclassifications	(6,025)	(2,115)	(8,140)
Amounts reclassified from accumulated other comprehensive income (loss)	372	753	1,125
Net current period other comprehensive income	(5,653)	(1,362)	(7,015)
Cumulative effect of adoption of ASU 2016-01	(58,126)	-	(58,126)
Balance at December 31, 2018	$ (8,170)	$ (8,125)	$ (16,295)

(Dollars in Thousands for Tabular Presentations)

Note 15. Accumulated Other Comprehensive Income (Continued)

The following table represents the amounts reclassified from accumulated other comprehensive income and the line items affected in the statement where net income is presented for the twelve months ended December 31, 2018 and December 31, 2017:

	Year ended December 31, 2018	
Details about accumulated other comprehensive income	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Unrealized gains and losses on available-for-sale debt securities	$ 492	Investment securities gains, net
	(120)	Income taxes
	$ 372	Net income
Amortization of defined benefit plan actuarial losses	$ 986	Other noninterest expense
	(233)	Income taxes
	$ 753	Net income
Total reclassifications for the period	$ 1,125	

	Year ended December 31, 2017	
Details about accumulated other comprehensive income	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Unrealized gains and losses on available-for-sale securities	$ (3,205)	Investment securities gains, net
	1,172	Income taxes
	$ (2,033)	Net income
Amortization of defined benefit plan Actuarial losses	$ 1,036	Other noninterest expense
	(379)	Income taxes
	$ 657	Net income
Total reclassifications for the period	$ (1,376)	

Note 16. Subsequent Events

Management has evaluated subsequent events through March 25, 2019, the date the consolidated statements were available to be issued. During the first quarter of 2019 BancShares retired $1.4 million of the Series E Preferred stock.