

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549**

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2019
or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission File Number: 001-36522



Investar Holding Corporation

(Exact name of registrant as specified in its charter)

Louisiana
(State or other jurisdiction of
incorporation or organization)

27-1560715
(I.R.S. Employer
Identification No.)

10500 Coursey Boulevard, Baton Rouge, Louisiana 70808
(Address of principal executive offices, including zip code)
(225) 227-2222
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$1.00 par value per share	ISTR	The Nasdaq Global Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

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

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

The number of shares outstanding of the issuer's class of common stock, as of the latest practicable date, is as follows: Common stock, \$1.00 par value, 9,940,260 shares outstanding as of August 7, 2019.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

INVESTAR HOLDING CORPORATION
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share data)

	June 30, 2019	December 31, 2018
	(Unaudited)	
ASSETS		
Cash and due from banks	\$ 30,400	\$ 15,922
Interest-bearing balances due from other banks	33,519	1,212
Federal funds sold	—	6
Cash and cash equivalents	63,919	17,140
Available for sale securities at fair value (amortized cost of \$252,554 and \$253,504, respectively)	253,985	248,981
Held to maturity securities at amortized cost (estimated fair value of \$15,480 and \$15,805, respectively)	15,473	16,066
Loans, net of allowance for loan losses of \$9,924 and \$9,454, respectively	1,533,384	1,391,371
Equity securities	14,537	13,562
Bank premises and equipment, net of accumulated depreciation of \$11,078 and \$9,898, respectively	46,097	40,229
Other real estate owned, net	1,529	3,611
Accrued interest receivable	6,880	5,553
Deferred tax asset	—	1,145
Goodwill and other intangible assets, net	26,409	19,787
Bank owned life insurance	29,204	23,859
Other assets	5,224	5,165
Total assets	\$ 1,996,641	\$ 1,786,469
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 289,481	\$ 217,457
Interest-bearing	1,262,736	1,144,274
Total deposits	1,552,217	1,361,731
Advances from Federal Home Loan Bank	196,600	206,490
Repurchase agreements	1,876	1,999
Subordinated debt, net of unamortized issuance costs	18,238	18,215
Junior subordinated debt	5,871	5,845
Accrued taxes and other liabilities	16,340	9,927
Total liabilities	1,791,142	1,604,207
STOCKHOLDERS' EQUITY		
Preferred stock, no par value per share; 5,000,000 shares authorized	—	—
Common stock, \$1.00 par value per share; 40,000,000 shares authorized; 9,937,752 and 9,484,219 shares issued and outstanding, respectively	9,938	9,484
Surplus	140,856	130,133
Retained earnings	53,492	45,721
Accumulated other comprehensive income (loss)	1,213	(3,076)
Total stockholders' equity	205,499	182,262
Total liabilities and stockholders' equity	\$ 1,996,641	\$ 1,786,469

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
INTEREST INCOME				
Interest and fees on loans	\$ 20,233	\$ 16,223	\$ 38,777	\$ 31,849
Interest on investment securities	1,923	1,644	3,849	3,103
Other interest income	232	142	448	235
Total interest income	22,388	18,009	43,074	35,187
INTEREST EXPENSE				
Interest on deposits	4,684	2,426	8,790	4,679
Interest on borrowings	1,373	1,263	2,797	2,330
Total interest expense	6,057	3,689	11,587	7,009
Net interest income	16,331	14,320	31,487	28,178
Provision for loan losses	369	567	634	1,192
Net interest income after provision for loan losses	15,962	13,753	30,853	26,986
NONINTEREST INCOME				
Service charges on deposit accounts	434	327	834	686
Gain on sale of investment securities, net	227	22	229	22
(Loss) gain on sale of fixed assets, net	(11)	(1)	(11)	89
Gain (loss) on sale of other real estate owned, net	13	(4)	18	(4)
Servicing fees and fee income on serviced loans	150	253	330	541
Interchange fees	291	255	531	446
Income from bank owned life insurance	170	161	322	312
Change in the fair value of equity securities	57	3	229	3
Other operating income	411	177	541	170
Total noninterest income	1,742	1,193	3,023	2,265
Income before noninterest expense	17,704	14,946	33,876	29,251
NONINTEREST EXPENSE				
Depreciation and amortization	873	629	1,637	1,227
Salaries and employee benefits	7,077	6,495	13,492	12,543
Occupancy	454	335	868	715
Data processing	644	565	1,180	1,107
Marketing	68	44	119	82
Professional fees	309	228	614	483
Acquisition expense	—	—	905	1,104
Other operating expenses	2,129	1,864	4,042	3,461
Total noninterest expense	11,554	10,160	22,857	20,722
Income before income tax expense	6,150	4,786	11,019	8,529
Income tax expense	1,216	966	2,168	2,307
Net income	\$ 4,934	\$ 3,820	\$ 8,851	\$ 6,222
EARNINGS PER SHARE				
Basic earnings per share	\$ 0.49	\$ 0.39	\$ 0.89	\$ 0.64
Diluted earnings per share	0.48	0.39	0.88	0.64
Cash dividends declared per common share	0.06	0.04	0.11	0.08

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Net income	\$ 4,934	\$ 3,820	\$ 8,851	\$ 6,222
Other comprehensive income (loss):				
Unrealized gain (loss) on investment securities:				
Unrealized gain (loss), available for sale, net of tax expense (benefit) of \$710, (\$195), \$1,298, and (\$671), respectively	2,672	(734)	4,884	(2,523)
Reclassification of realized gain, net of tax expense of \$48, \$4, \$48, and \$4, respectively	(179)	(17)	(181)	(17)
Unrealized loss, transfer from available for sale to held to maturity, net of tax benefit of \$0 for all respective periods	—	(1)	—	(1)
Fair value of derivative financial instruments:				
Change in fair value of interest rate swap designated as a cash flow hedge, net of tax (benefit) expense of (\$66), \$19, (\$110), and \$90, respectively	(247)	72	(414)	337
Total other comprehensive income (loss)	2,246	(680)	4,289	(2,204)
Total comprehensive income	\$ 7,180	\$ 3,140	\$ 13,140	\$ 4,018

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts in thousands, except share data)
(Unaudited)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Three months ended:					
June 30, 2018					
Balance at beginning of period	\$ 9,517	\$ 131,179	\$ 35,829	\$ (3,095)	\$ 173,430
Surrendered shares	—	(39)	—	—	(39)
Options and warrants exercised	60	746	—	—	806
Dividends declared, \$0.04 per share	—	—	(391)	—	(391)
Stock-based compensation and other activity	4	280	—	—	284
Net income	—	—	3,820	—	3,820
Other comprehensive loss, net	—	—	—	(680)	(680)
Balance at end of period	<u>\$ 9,581</u>	<u>\$ 132,166</u>	<u>\$ 39,258</u>	<u>\$ (3,775)</u>	<u>\$ 177,230</u>
June 30, 2019					
Balance at beginning of period	10,130	144,813	49,104	(1,033)	203,014
Surrendered shares	(2)	(39)	—	—	(41)
Options exercised	2	26	—	—	28
Dividends declared, \$0.551 per share	—	—	(546)	—	(546)
Stock-based compensation	5	388	—	—	393
Shares repurchased	(197)	(4,332)	—	—	(4,529)
Net income	—	—	4,934	—	4,934
Other comprehensive income, net	\$ —	\$ —	\$ —	\$ 2,246	\$ 2,246
Balance at end of period	<u>\$ 9,938</u>	<u>\$ 140,856</u>	<u>\$ 53,492</u>	<u>\$ 1,213</u>	<u>\$ 205,499</u>

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Six months ended:					
June 30, 2018					
Balance at beginning of period	\$ 9,515	\$ 131,582	\$ 33,203	\$ (1,571)	\$ 172,729
Surrendered shares	(7)	(171)	—	—	(178)
Shares repurchased	(28)	(646)	—	—	(674)
Options and warrants exercised	73	905	—	—	978
Dividends declared, \$0.075 per share	—	—	(719)	—	(719)
Stock-based compensation and other activity	28	496	—	—	524
Reclassification of tax effects of the Tax Cuts and Jobs Act ⁽¹⁾	—	—	557	—	557
Net income	—	—	6,222	—	6,222
Other comprehensive loss, net	—	—	—	(2,204)	(2,204)
Impact of adoption of new accounting standards ⁽²⁾	—	—	(5)	—	(5)
Balance at end of period	\$ 9,581	\$ 132,166	\$ 39,258	\$ (3,775)	\$ 177,230
June 30, 2019					
Balance at beginning of period	\$ 9,484	\$ 130,133	\$ 45,721	\$ (3,076)	\$ 182,262
Common stock issued in acquisition	764	17,873	—	—	18,637
Surrendered shares	(11)	(262)	—	—	(273)
Options exercised	2	26	—	—	28
Dividends declared, \$0.1076 per share	—	—	(1,080)	—	(1,080)
Stock-based compensation	40	642	—	—	682
Shares repurchased	(341)	(7,556)	—	—	(7,897)
Net income	—	—	8,851	—	8,851
Other comprehensive income, net	—	—	—	4,289	4,289
Balance at end of period	\$ 9,938	\$ 140,856	\$ 53,492	\$ 1,213	\$ 205,499

⁽¹⁾ The Tax Cuts and Jobs Act, enacted on December 22, 2017, required the revaluation of the Company's deferred tax assets and liabilities as of December 31, 2017 as a result of the lower corporate tax rates to be realized beginning January 1, 2018. The \$0.6 million adjustment to retained earnings for the period ended June 30, 2018 represents a reclassification of the tax effects of the Tax Cuts and Jobs Act.

⁽²⁾ Represents the impact of adopting Accounting Standards Update ("ASU") No. 2016-01, *Financial Instruments - Overall (Topic 825)*, which requires equity investments, other than equity method investments, to be measured at fair value with changes in fair value recognized in net income. Upon adoption on January 1, 2018, the ASU required a cumulative-effect adjustment to retained earnings to reclassify the cumulative change in the fair value of equity securities previously recognized in accumulated other comprehensive income.

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(Unaudited)

	Six months ended June 30,	
	2019	2018
Net income	\$ 8,851	\$ 6,222
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,637	1,227
Provision for loan losses	634	1,192
Amortization of purchase accounting adjustments	(791)	(1,281)
Net amortization of securities	(21)	334
Gain on sale of investment securities, net	(229)	(22)
Loss (gain) on sale of fixed assets, net	11	(89)
Gain on sale of other real estate owned, net	(18)	4
FHLB stock dividend	(172)	(97)
Stock-based compensation	682	524
Deferred taxes	281	1,236
Net change in value of bank owned life insurance	(322)	(312)
Amortization of subordinated debt issuance costs	23	23
Change in the fair value of equity securities	(229)	14
Net change in:		
Accrued interest receivable	(1,081)	(154)
Other assets	(489)	407
Accrued taxes and other liabilities	3,064	(1,011)
Net cash provided by operating activities	11,831	8,217
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	62,564	—
Purchases of securities available for sale	(80,170)	(41,723)
Proceeds from maturities, prepayments and calls of investment securities available for sale	18,825	13,327
Proceeds from maturities, prepayments and calls of investment securities held to maturity	572	671
Proceeds from redemption or sale of equity securities	—	521
Purchase of equity securities	—	(2,870)
Net increase in loans	(59,420)	(41,472)
Proceeds from sales of other real estate owned	3,507	37
Proceeds from the sales of fixed assets	—	9
Purchases of other real estate owned	—	(225)
Purchases of fixed assets	(3,510)	(2,771)
Purchase of bank owned life insurance	(5,023)	—
Purchase of other investments	(95)	—
Distributions from investments	51	13
Cash acquired from acquisition of Mainland Bank	38,365	—
Net cash used in investing activities	(24,334)	(74,483)

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(Amounts in thousands)
(Unaudited)

Cash flows from financing activities:

Net increase in customer deposits	82,872	5,796
Net decrease in repurchase agreements	(4,808)	(5,183)
Net increase in short-term FHLB advances	2,100	41,500
Proceeds from long-term FHLB advances	—	45,000
Repayment of long-term FHLB advances	(12,000)	(16,100)
Cash dividends paid on common stock	(1,013)	(642)
Proceeds from stock options and warrants exercised	28	979
Payments to repurchase common stock	(7,897)	(674)
Net cash provided by financing activities	59,282	70,676
Net change in cash and cash equivalents	46,779	4,410
Cash and cash equivalents, beginning of period	17,140	30,421
Cash and cash equivalents, end of period	<u>\$ 63,919</u>	<u>\$ 34,831</u>

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of Investar Holding Corporation (the “Company”) have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include information or footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with GAAP. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial statements have been included. The results of operations for the three and six month periods ended June 30, 2019 is not necessarily indicative of the results that may be expected for the entire fiscal year. These statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2018, including the notes thereto, which were included as part of the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on March 15, 2019.

Nature of Operations

Investar Holding Corporation, headquartered in Baton Rouge, Louisiana, provides full banking services, excluding trust services, through its wholly-owned banking subsidiary, Investar Bank, National Association (the “Bank”), a national bank. The Company’s primary markets are southeast Louisiana and southeast Texas. At June 30, 2019, the Company operated 21 full service branches located in Louisiana and 3 full service branches located in Texas, and had 283 employees.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences could be material.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Other estimates that are susceptible to significant change in the near term relate to the determination of other-than-temporary impairments of securities and the fair value of financial instruments.

Investment Securities

The Company’s investments in securities are accounted for in accordance with applicable guidance contained in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), which requires the classification of securities into one of the following categories:

- Securities to be held to maturity (“HTM”): bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.
- Securities available for sale (“AFS”): available for sale securities consist of bonds, notes, and debentures that are available to meet the Company’s operating needs. These securities are reported at fair value.

INVESTAR HOLDING CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Unrealized holding gains and losses, net of tax, on AFS debt securities are reported as a net amount in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses on the sale of debt securities are determined using the specific-identification method.

The Company follows FASB guidance related to the recognition and presentation of other-than-temporary impairment. The guidance specifies that if an entity does not have the intent to sell a debt security and it is not more likely than not that the Company will be required to sell the security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Loans

The Company's loan portfolio categories include real estate, commercial and consumer loans. Real estate loans are further categorized into construction and development, 1-4 family residential, multifamily, farmland and commercial real estate loans. The consumer loan category includes loans originated through indirect lending. Indirect lending, which is lending initiated through third-party business partners, is largely comprised of loans made through automotive dealerships.

Loans for which management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off are stated at unpaid principal balances, adjusted by an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Loans are ordinarily placed on nonaccrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more; however, management may elect to continue the accrual when the estimated net realizable value of collateral is sufficient to cover the principal balance and the accrued interest. Any unpaid interest previously accrued on nonaccrual loans is reversed from income. Interest income, generally, is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period of repayment performance by the borrower.

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Company's impaired loans include troubled debt restructurings and performing and non-performing loans for which full payment of principal or interest is not expected. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. The Company calculates an allowance required for impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of its collateral. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is required as a component of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the provision for loan losses.

The Company follows the FASB accounting guidance on sales of financial assets, which includes participating interests in loans. For loan participations that are structured in accordance with this guidance, the sold portions are recorded as a reduction of the loan portfolio. Loan participations that do not meet the criteria are accounted for as secured borrowings.

Allowance for Loan Losses

The adequacy of the allowance for loan losses is determined in accordance with GAAP. The allowance for loan losses is estimated through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan balance is uncollectable. Subsequent recoveries, if any, are credited to the allowance.

INVESTAR HOLDING CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The allowance is an amount that management believes will be adequate to absorb probable losses inherent in the loan portfolio as of the balance sheet date based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Credits deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance. Past due status is determined based on contractual terms.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For loans that are 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. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. Based on management's review and observations made through qualitative review, management may apply qualitative adjustments to determine loss estimates at a group and/or portfolio segment level as deemed appropriate. Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in its portfolio and portfolio segments. The Company utilizes an internally developed model that requires judgment to determine the estimation method that fits the credit risk characteristics of the loans in its portfolio and portfolio segments. Qualitative and environmental factors that may not be directly reflected in quantitative estimates include: asset quality trends, changes in loan concentrations, new products and process changes, changes and pressures from competition, changes in lending policies and underwriting practices, trends in the nature and volume of the loan portfolio, changes in experience and depth of lending staff and management and national and regional economic trends. Changes in these factors are considered in determining changes in the allowance for loan losses. The impact of these factors on the Company's qualitative assessment of the allowance for loan losses can change from period to period based on management's assessment of the extent to which these factors are already reflected in historic loss rates. The uncertainty inherent in the estimation process is also considered in evaluating the allowance for loan losses.

In the ordinary course of business, the Bank enters into commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded lending commitments is included in accrued taxes and other liabilities in the consolidated balance sheet. At June 30, 2019 and December 31, 2018 the reserve for unfunded loan commitments was \$143,000 and \$66,000, respectively.

Acquisition Accounting

Acquisitions are accounted for under the purchase method of accounting. Purchased assets and assumed liabilities are recorded at their respective acquisition date fair values, and identifiable intangible assets are recorded at fair value. If the consideration given exceeds the fair value of the net assets received, goodwill is recognized. If the fair value of the net assets received exceeds the consideration given, a bargain purchase gain is recognized. Fair values are subject to refinement for up to one year after the closing date of an acquisition as information relative to closing date fair values becomes available.

Purchased loans acquired in a business combination are recorded at their estimated fair value as of the acquisition date. The fair value of loans acquired is determined using a discounted cash flow model based on assumptions regarding the amount and timing of principal and interest prepayments, estimated payments, estimated default rates, estimated loss severity in the event of defaults, and current market rates. Estimated credit losses are included in the determination of fair value; therefore, an allowance for loan losses is not recorded on the acquisition date. The fair value adjustment is amortized over the life of the loan using the effective interest method, except for those loans accounted for under ASC Topic 310-30, discussed below.

The Company accounts for acquired impaired loans under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ("ASC 310-30"). An acquired loan is considered impaired when there is evidence of credit deterioration since origination and it is probable, at the date of acquisition, that we will be unable to collect all contractually required payments. ASC 310-30 prohibits the carryover of an allowance for loan losses for acquired impaired loans. Over the life of the acquired loans, we continually estimate the cash flows expected to be collected on individual loans or on pools of loans sharing common risk characteristics. As of the end of each fiscal quarter, we evaluate the present value of the acquired loans using the effective interest rates. For any increases in cash flows expected to be collected, we adjust the amount of accretable yield recognized on a prospective basis over the loan's or pool's remaining life, while we recognize a provision for loan loss in the consolidated statement of operations if the cash flows expected to be collected have decreased.

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Servicing Rights

Primary servicing rights represent the Company's right to service consumer automobile loans for third-party whole-loan sales and loans sold as participations. Primary servicing involves the collection of payments from individual borrowers and the distribution of these payments to the investors.

The Company capitalizes the value expected to be realized from performing specified automobile servicing activities for others as automobile servicing rights ("ASRs") when the expected future cash flows from servicing are projected to be more than adequate compensation for such activities. These capitalized servicing rights are purchased or retained upon sale of consumer automobile loans.

The Company measures all consumer automobile servicing assets and liabilities at fair value. The Company defines servicing rights based on both the availability of market inputs and the manner in which the Company manages the risks of servicing assets and liabilities. The Company leverages all available relevant market data to determine the fair value of recognized servicing assets and liabilities.

The Company calculates the fair value of ASRs using various assumptions including future cash flows, market discount rates, expected prepayments, servicing costs and other factors. A significant change in prepayments of loans in the servicing portfolio could result in significant changes in the valuation adjustments, thus creating potential volatility in the carrying amount of ASRs.

For the six months ended June 30, 2019 and 2018, expected future cash flows from ASRs approximated adequate compensation for such activities. Accordingly, the Company has not recorded an asset or liability. There were no loan sales during the six months ended June 30, 2019 or 2018.

Reclassifications

Certain reclassifications have been made to the 2018 financial statements to be consistent with the 2019 presentation, if applicable.

Concentrations of Credit Risk

The Company's loan portfolio consists of the various types of loans described in Note 5. Loans and Allowance for Loan Losses. Real estate or other assets secure most loans. The majority of loans have been made to individuals and businesses in the Company's market of southeast Louisiana. Customers are dependent on the condition of the local economy for their livelihoods and servicing their loan obligations. The Company does not have any significant concentrations in any one industry or individual customer.

Tax Cuts and Jobs Act

Public law No. 115-97, known as the Tax Cuts and Jobs Act (the "Tax Act"), enacted on December 22, 2017, reduced the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. Also on December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on accounting for tax effects of the Tax Act. SAB 118 provided a measurement period of up to one year from the enactment date to complete the accounting. Any adjustments during the measurement period were included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments were determined. Based on the information available and interpretation of the rules, the Company recorded the impact of the reduction in the corporate tax rate and remeasurement of certain deferred tax assets and liabilities in the fourth quarter of 2017. An additional \$0.6 million was expensed in the first quarter of 2018 due to the remeasurement of the Company's deferred tax balance, resulting in an effective tax rate of 27.0% for the six months ended June 30, 2018. No additional adjustments were recorded during the measurement period, which ended December 31, 2018.

Accounting Standards Adopted in 2019

In June 2018, the FASB issued ASU 2018-07, *Compensation - Stock Compensation (Topic 718)*, which expands the scope of Topic 718 to include share-based payments issued to nonemployees for goods or services and supersedes Subtopic 505-50, "Equity – Equity-Based Payments to Non-Employees." The Company adopted ASU 2018-07 on January 1, 2019. The adoption of ASU 2018-07 did not have a material impact on the Company's consolidated financial statements.

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In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which amends the hedge accounting model in Topic 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments expand an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest rate risk. The guidance eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The guidance also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. This amended guidance was adopted on January 1, 2019, and, given the current level of derivatives designated as hedges, did not have a material impact on our consolidated financial statements.

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*. The amendments in the ASU shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The Company adopted ASU 2017-08 on January 1, 2019. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The ASU intends to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities and disclosing key information about leasing arrangements. The ASU requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, *Revenue from Contracts with Customers*. The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) may apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may also elect to apply the amendments in the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company adopted the ASU on January 1, 2019, using the modified retrospective approach, and recognized a right-of-use asset and related lease liability of \$1.2 million. The Company historically has owned all property and equipment and had entered an operating lease for a future branch location on December 31, 2018. Therefore, the adoption of this ASU did not have a significant impact on the Company's consolidated financial statements.

Recent Accounting Pronouncements

FASB ASC Topic 250 "Intangibles - Goodwill and Other - Internal Use Software (Subtopic 250-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" Update No. 2018-15. In August 2018, the FASB issued ASU 2018-15. This ASU requires an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service. ASU 2018-15 is effective for the Company on January 1, 2020. Early adoption is permitted, including adoption in any interim period. The adoption of ASU 2018-15 is not expected to have a material impact on the Company's consolidated financial statements.

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FASB ASC Topic 820 “Fair Value Measurement: Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement” Update No. 2018-13. In August 2018, the FASB issued ASU 2018-13, which modifies the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. ASU 2018-13 removes the disclosure requirement detailing the amount of and reasons for transfers between Level 1 and Level 2 and the valuation processes for Level 3 fair value measurements will be removed. In addition, this ASU modifies the disclosure requirement for investments in certain entities that calculate net asset value. Lastly, ASU 2018-13 adds a disclosure requirement for changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. ASU 2018-13 is effective for the Company on January 1, 2020. Early adoption is permitted upon the issuance of ASU 2018-13. The removed and modified disclosures will be adopted on a retrospective basis, and the new disclosures will be adopted on a prospective basis. The adoption of ASU 2018-13 is not expected to have a material impact on the Company’s consolidated financial statements.

FASB ASC Topic 350 “Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment” Update No. 2017-04. The FASB issued ASU No. 2017-04 in January 2017. The ASU simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Therefore, any carrying amount which exceeds the reporting unit’s fair value, up to the amount of goodwill recorded, will be recognized as an impairment loss. ASU 2017-04 will be effective for the Company on January 1, 2020. The amendments will be applied prospectively on or after the effective date. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Based on recent goodwill impairments tests, which did not require the application of Step 2, the Company does not expect the adoption of this ASU to have an immediate impact.

FASB ASC Topic 326 “Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments” Update No. 2016-13. The FASB issued ASU No. 2016-13 in June 2016. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company on January 1, 2020. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements. In that regard, we have formed a cross-functional working group, under the direction of our Chief Financial Officer and our Chief Risk Officer. The working group is comprised of individuals from various functional areas including credit, risk management, finance and information technology. We have developed an implementation plan to include assessment of processes, portfolio segmentation, model development, system requirements and the identification of data and resource needs, among other things. We have also selected a third-party vendor solution to assist us in the application of ASU 2016-13. The adoption of ASU 2016-13 is likely to result in an increase in the allowance for loan losses as a result of changing from an “incurred loss” model, which encompasses allowances for current known and inherent losses within the portfolio, to an “expected loss” model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses on debt securities. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios, as well as the prevailing economic conditions and forecasts, as of the adoption date.

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NOTE 2. BUSINESS COMBINATIONS

Mainland Bank

On March 1, 2019, the Company completed the acquisition of Mainland Bank (“Mainland”) located in Texas City, Texas. The Company acquired 100% of Mainland’s outstanding common shares for an aggregate merger consideration of 763,849 shares of the Company’s common stock, for a total of approximately \$18.6 million. The acquisition of Mainland expanded the Company’s branch footprint into the greater Houston, Texas market. After fair value adjustments, including total adjustments of \$(31,000) and \$(0.5) million to other assets and other liabilities, respectively, recorded in the three months ended June 30, 2019, the acquisition added \$128.4 million in total assets, \$82.4 million in loans, and \$107.6 million in deposits. As consideration paid was in excess of the net fair value of acquired assets, the Company recorded \$4.6 million of goodwill. Goodwill resulted from a combination of synergies and cost savings, expansion into Texas with the addition of three branch locations, enhanced products and services, and a lower cost of funds. The change in goodwill and other intangibles at June 30, 2019 compared to December 31, 2018 is primarily attributable to the goodwill and core deposit intangible recorded as a result of the Mainland acquisition.

The table below shows the allocation of the consideration paid for Mainland’s common equity to the acquired identifiable assets and liabilities assumed and the goodwill generated from the transaction (dollars in thousands). The fair values listed below, primarily related to loans and deferred tax assets and liabilities, are subject to refinement for up to one year after the closing date of the acquisition as additional information becomes available.

Purchase price:		
Stock issued	\$	18,637
Fair value of assets acquired:		
Cash and cash equivalents		38,365
Loans		82,431
Other real estate owned		1,408
Bank premises and equipment		2,550
Core deposit intangible asset		2,439
Other assets		1,179
Total assets acquired		<u>128,372</u>
Fair value of liabilities acquired:		
Deposits		107,646
Repurchase agreements		4,684
Other liabilities		1,959
Total liabilities assumed		<u>114,289</u>
Fair value of net assets acquired		<u>14,083</u>
Goodwill	\$	<u>4,554</u>

Fair value adjustments to assets acquired and liabilities assumed are generally amortized using the effective yield method over periods consistent with the average life, useful life and/or contractual term of the related assets and liabilities.

The fair value of net assets acquired includes a fair value adjustment to loans as of the acquisition date. The adjustment for the acquired loan portfolio is based on current market interest rates, and the Company’s initial evaluation of credit losses identified. No loans acquired from Mainland were considered to be purchased credit impaired loans. The contractually required principal and interest payments of the loans acquired from Mainland is \$91.9 million, of which \$1.3 million is not expected to be collected.

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Supplemental Unaudited Pro Forma Information

The following unaudited supplemental pro forma information is presented to show estimated results assuming Mainland was acquired as of January 1, 2018. These unaudited pro forma results are not necessarily indicative of the operating results that the Company would have achieved had it completed the acquisition as of January 1, 2018 and should not be considered representative of future operating results. The pro forma net income for the six months ended June 30, 2019 excludes the tax-affected amount of \$1.6 million of acquisition expenses recorded in noninterest expense by the Company and Mainland.

<i>(dollars in thousands)</i>	Unaudited pro forma for the			
	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Interest income	\$ 22,388	\$ 19,465	\$ 44,016	\$ 38,069
Noninterest income	1,742	1,277	3,170	2,427
Net income	4,934	4,227	8,809	6,937

For the three months ended June 30, 2019, Mainland added approximately \$1.5 million, \$79,000, and \$0.7 million to interest income, noninterest income, and net income, respectively. For the six months ended June 30, 2019, Mainland added approximately \$2.1 million, \$0.1 million, and \$1.0 million to interest income, noninterest income, and net income, respectively.

Acquisition Expense

Acquisition related costs of \$0.9 million are included in acquisition expenses in the accompanying consolidated statements of income for the six months ended June 30, 2019. These costs include system conversion and integrating operations charges as well as legal and consulting expenses.

NOTE 3. EARNINGS PER SHARE

The following is a summary of the information used in the computation of basic and diluted earnings per share for the three and six months ended June 30, 2019 and 2018 (in thousands, except share data).

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Earnings per common share - basic				
Net income allocated to common shareholders	\$ 4,888	\$ 3,764	\$ 8,758	\$ 6,136
Weighted-average basic shares outstanding	10,008,882	9,558,873	9,843,052	9,536,229
Basic earnings per common share	<u>\$ 0.49</u>	<u>\$ 0.39</u>	<u>\$ 0.89</u>	<u>\$ 0.64</u>
Earnings per common share - diluted				
Net income allocated to common shareholders	\$ 4,888	\$ 3,764	\$ 8,758	\$ 6,135
Weighted-average basic shares outstanding	10,008,882	9,558,873	9,843,052	9,536,229
Dilutive effect of securities	95,364	89,148	95,076	81,184
Total weighted average diluted shares outstanding	10,104,246	9,648,021	9,938,128	9,617,413
Diluted earnings per common share	<u>\$ 0.48</u>	<u>\$ 0.39</u>	<u>\$ 0.88</u>	<u>\$ 0.64</u>

The weighted average shares that have an antidilutive effect in the calculation of diluted earnings per common share and have been excluded from the computations above are shown below.

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Stock options	—	5,070	—	7,222
Restricted stock awards	519	313	4	12,139
Restricted stock units	868	—	21,915	—

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NOTE 4. INVESTMENT SECURITIES

The amortized cost and approximate fair value of investment securities classified as AFS are summarized below as of the dates presented (dollars in thousands).

June 30, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government agencies and corporations	\$ 24,084	\$ 158	\$ (46)	\$ 24,196
Obligations of state and political subdivisions	33,624	404	(143)	33,885
Corporate bonds	18,752	145	(397)	18,500
Residential mortgage-backed securities	106,667	1,026	(167)	107,526
Commercial mortgage-backed securities	69,427	693	(242)	69,878
Total	<u>\$ 252,554</u>	<u>\$ 2,426</u>	<u>\$ (995)</u>	<u>\$ 253,985</u>

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government agencies and corporations	\$ 7,946	\$ 14	\$ (90)	\$ 7,870
Obligations of state and political subdivisions	34,875	6	(895)	33,986
Corporate bonds	16,166	53	(710)	15,509
Residential mortgage-backed securities	136,768	336	(2,177)	134,927
Commercial mortgage-backed securities	57,749	108	(1,168)	56,689
Total	<u>\$ 253,504</u>	<u>\$ 517</u>	<u>\$ (5,040)</u>	<u>\$ 248,981</u>

Proceeds from sales of investment securities AFS and gross gains and losses are summarized below for the periods presented (dollars in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Proceeds from sale	\$ 62,171	\$ —	\$ 62,564	\$ —
Gross gains	\$ 573	\$ —	\$ 575	\$ —
Gross losses	\$ 346	\$ —	\$ 346	\$ —

The amortized cost and approximate fair value of investment securities classified as HTM are summarized below as of the dates presented (dollars in thousands).

June 30, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of state and political subdivisions	\$ 10,472	\$ 2	\$ (2)	\$ 10,472
Residential mortgage-backed securities	5,001	14	(7)	5,008
Total	<u>\$ 15,473</u>	<u>\$ 16</u>	<u>\$ (9)</u>	<u>\$ 15,480</u>

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of state and political subdivisions	\$ 10,699	\$ 2	\$ (111)	\$ 10,590
Residential mortgage-backed securities	5,367	—	(152)	5,215
Total	<u>\$ 16,066</u>	<u>\$ 2</u>	<u>\$ (263)</u>	<u>\$ 15,805</u>

Securities are classified in the consolidated balance sheets according to management's intent. The Company had no securities classified as trading as of June 30, 2019 or December 31, 2018.

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The aggregate fair values and aggregate unrealized losses on securities whose fair values are below book values are summarized in the tables below. Unrealized losses are generally due to changes in interest rates. The Company has the intent to hold these securities either until maturity or a forecasted recovery, and it is more likely than not that the Company will not have to sell the securities before the recovery of their cost basis. Due to the nature of the investment, current market prices, and the current interest rate environment, these unrealized losses are considered a temporary impairment of the securities.

The number of AFS securities, fair value, and unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized below as of the dates presented (dollars in thousands).

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2019							
Obligations of U.S. government agencies and corporations	8	\$ 6,458	\$ (36)	\$ 1,219	\$ (9)	\$ 7,677	\$ (45)
Obligations of state and political subdivisions	22	9,576	(138)	721	(5)	10,297	(143)
Corporate bonds	23	1,958	(42)	8,785	(354)	10,743	(396)
Residential mortgage-backed securities	51	—	—	29,726	(167)	29,726	(167)
Commercial mortgage-backed securities	48	11,300	(151)	13,930	(92)	25,230	(243)
Total	152	\$ 29,292	\$ (367)	\$ 54,381	\$ (627)	\$ 83,673	\$ (994)

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018							
Obligations of U.S. government agencies and corporations	15	\$ 469	\$ —	\$ 5,304	\$ (90)	\$ 5,773	\$ (90)
Obligations of state and political subdivisions	63	13,716	(330)	19,270	(565)	32,986	(895)
Corporate bonds	27	6,793	(225)	5,763	(485)	12,556	(710)
Residential mortgage-backed securities	193	24,868	(245)	79,517	(1,932)	104,385	(2,177)
Commercial mortgage-backed securities	94	5,156	(42)	39,560	(1,126)	44,716	(1,168)
Total	392	\$ 51,002	\$ (842)	\$ 149,414	\$ (4,198)	\$ 200,416	\$ (5,040)

The number of HTM securities, fair value, and unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized below as of the dates presented (dollars in thousands).

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2019							
Obligations of state and political subdivisions	1	\$ 5,350	\$ (2)	\$ —	\$ —	\$ 5,350	\$ (2)
Residential mortgage-backed securities	4	—	—	2,219	(7)	2,219	(7)
Total	5	\$ 5,350	\$ (2)	\$ 2,219	\$ (7)	\$ 7,569	\$ (9)

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018							
Obligations of state and political subdivisions	1	\$ —	\$ —	\$ 5,468	\$ (111)	\$ 5,468	\$ (111)
Residential mortgage-backed securities	9	1,761	(35)	3,454	(117)	5,215	(152)
Total	10	\$ 1,761	\$ (35)	\$ 8,922	\$ (228)	\$ 10,683	\$ (263)

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The unrealized losses in the Company's investment portfolio, caused by interest rate increases, are not credit issues and the Company does not intend to sell the securities. Furthermore, it is not more likely than not that the Company will be required to sell the securities before recovery of their amortized cost bases. The Company does not consider these securities to be other-than-temporarily impaired at June 30, 2019 or December 31, 2018.

The amortized cost and approximate fair value of debt securities, by contractual maturity (including mortgage-backed securities), are shown below as of the dates presented (dollars in thousands). Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available For Sale		Securities Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
June 30, 2019				
Due within one year	\$ 2,467	\$ 2,469	\$ 755	\$ 755
Due after one year through five years	12,693	12,794	3,405	3,406
Due after five years through ten years	57,363	57,236	6,312	6,310
Due after ten years	180,031	181,486	5,001	5,009
Total debt securities	\$ 252,554	\$ 253,985	\$ 15,473	\$ 15,480

	Securities Available For Sale		Securities Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2018				
Due within one year	\$ 3,734	\$ 3,730	\$ 755	\$ 755
Due after one year through five years	10,681	10,600	3,405	3,406
Due after five years through ten years	44,255	43,460	960	961
Due after ten years	194,834	191,191	10,946	10,683
Total debt securities	\$ 253,504	\$ 248,981	\$ 16,066	\$ 15,805

At June 30, 2019, securities with a carrying value of \$85.7 million were pledged to secure certain deposits, borrowings, and other liabilities, compared to \$77.6 million in pledged securities at December 31, 2018.

NOTE 5. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company's loan portfolio consists of the following categories of loans as of the dates presented (dollars in thousands).

	June 30, 2019	December 31, 2018
Construction and development	\$ 167,232	\$ 157,946
1-4 Family	305,512	287,137
Multifamily	56,081	50,501
Farmland	25,203	21,356
Commercial real estate	677,556	627,004
Total mortgage loans on real estate	1,231,584	1,143,944
Commercial and industrial	276,902	210,924
Consumer	34,822	45,957
Total loans	\$ 1,543,308	\$ 1,400,825

Unamortized premiums and discounts on loans, included in the total loans balances above, were \$2.2 million and \$1.4 million at June 30, 2019 and December 31, 2018, respectively.

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Nonaccrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, we consider the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regard to our collateral position. Regulatory provisions would typically require the placement of a loan on nonaccrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on nonaccrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

The table below provides an analysis of the aging of loans as of the dates presented (dollars in thousands).

June 30, 2019								
Accruing								
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Nonaccrual	Total Past Due & Nonaccrual	Acquired Impaired Loans	Total Loans
Construction and development	\$ 166,349	\$ 27	\$ 450	\$ —	\$ 406	\$ 883	\$ —	\$ 167,232
1-4 Family	302,408	566	559	—	1,507	2,632	472	305,512
Multifamily	56,081	—	—	—	—	—	—	56,081
Farmland	22,939	—	—	—	—	—	2,264	25,203
Commercial real estate	674,289	44	870	—	803	1,717	1,550	677,556
Total mortgage loans on real estate	1,222,066	637	1,879	—	2,716	5,232	4,286	1,231,584
Commercial and industrial	276,616	247	21	—	18	286	—	276,902
Consumer	33,734	278	71	—	697	1,046	42	34,822
Total loans	<u>\$ 1,532,416</u>	<u>\$ 1,162</u>	<u>\$ 1,971</u>	<u>\$ —</u>	<u>\$ 3,431</u>	<u>\$ 6,564</u>	<u>\$ 4,328</u>	<u>\$ 1,543,308</u>

December 31, 2018								
Accruing								
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Nonaccrual	Total Past Due & Nonaccrual	Acquired Impaired Loans	Total Loans
Construction and development	\$ 157,202	\$ 175	\$ —	\$ —	\$ 556	\$ 731	\$ 13	\$ 157,946
1-4 Family	284,205	1,101	41	—	1,300	2,442	490	287,137
Multifamily	50,392	109	—	—	—	109	—	50,501
Farmland	19,092	—	—	—	—	—	2,264	21,356
Commercial real estate	624,244	66	—	—	683	749	2,011	627,004
Total mortgage loans on real estate	1,135,135	1,451	41	—	2,539	4,031	4,778	1,143,944
Commercial and industrial	209,399	221	45	—	64	330	1,195	210,924
Consumer	44,493	375	51	—	994	1,420	44	45,957
Total loans	<u>\$ 1,389,027</u>	<u>\$ 2,047</u>	<u>\$ 137</u>	<u>\$ —</u>	<u>\$ 3,597</u>	<u>\$ 5,781</u>	<u>\$ 6,017</u>	<u>\$ 1,400,825</u>

Portfolio Segment Risk Factors

The following describes the risk characteristics relevant to each of the Company's loan portfolio segments.

Construction and Development - Construction and development loans are generally made for the purpose of acquisition and development of land to be improved through the construction of commercial and residential buildings. The successful repayment of these types of loans is generally dependent upon a commitment for permanent financing from the Company, or from the sale of the constructed property. These loans carry more risk than commercial or residential real estate loans due to the dynamics of construction projects, changes in interest rates, the long-term financing market, and state and local government regulations. One such risk is that loan funds are advanced upon the security of the property under construction, which is of uncertain value prior to the completion of construction. Thus, it is more difficult to evaluate accurately the total loan funds required to complete a project and to calculate related loan-to-value ratios. The Company attempts to minimize the risks associated with construction lending by limiting loan-to-value ratios as described above. In addition, as to speculative development loans, the Company generally makes such loans only to borrowers that have a positive pre-existing relationship with us. The Company manages risk by using specific underwriting policies and procedures for these types of loans and by avoiding excessive concentrations in any one business or industry.

1-4 Family - The 1-4 family portfolio mainly consists of residential mortgage loans to consumers to finance a primary residence. The majority of these loans are secured by properties located in the Company's market areas and carry risks associated with the creditworthiness of the borrower and changes in the value of the collateral and loan-to-value ratios. The Company manages these risks through policies and procedures such as limiting loan-to-value ratios at origination, employing experienced underwriting personnel, requiring standards for appraisers, and not making subprime loans.

Multifamily - Multifamily loans are normally made to real estate investors to support permanent financing for multifamily residential income producing properties that rely on the successful operation of the property for repayment. This management mainly involves property maintenance and collection of rents due from tenants. This type of lending carries a lower level of risk, as compared to other commercial lending. In addition, underwriting requirements for multifamily properties are stricter than for other non-owner-occupied property types. The Company manages this risk by avoiding concentrations with any particular customer.

Farmland - Farmland loans are often for land improvements related to agricultural endeavors and may include construction of new specialized facilities. These loans are usually repaid through the conversion to permanent financing, or if scheduled loan amortization begins, for the long-term benefit of the borrower's ongoing operations. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies.

Commercial Real Estate - Commercial real estate loans are extensions of credit secured by owner occupied and non-owner occupied collateral. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies. Repayment is commonly derived from the successful ongoing operations of the property. General market conditions and economic activity may impact the performance of these types of loans, including fluctuations in the value of real estate, new job creation trends, and tenant vacancy rates. The Company attempts to limit risk by analyzing a borrower's cash flow and collateral value on an ongoing basis. The Company also typically requires personal guarantees from the principal owners of the property, supported by a review of their personal financial statements, as an additional means of mitigating our risk. The Company manages risk by avoiding concentrations in any one business or industry.

Commercial and Industrial - Commercial and industrial loans receive similar underwriting treatment as commercial real estate loans in that the repayment source is analyzed to determine its ability to meet cash flow coverage requirements as set forth by Bank policies. Repayment of these loans generally comes from the generation of cash flow as the result of the borrower's business operations. Commercial lending generally involves different risks from those associated with commercial real estate lending or construction lending. Although commercial loans may be collateralized by equipment or other business assets (including real estate, if available as collateral), the repayment of these types of loans depends primarily on the creditworthiness and projected cash flow of the borrower (and any guarantors). Thus, the general business conditions of the local economy and the borrower's ability to sell its products and services, thereby generating sufficient operating revenue to repay us under the agreed upon terms and conditions, are the chief considerations when assessing the risk of a commercial loan. The liquidation of collateral, if any, is considered a secondary source of repayment because equipment and other business assets may, among other things, be obsolete or of limited resale value. The Company actively monitors certain financial measures of the borrower, including advance rate, cash flow, collateral value and other appropriate credit factors.

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Consumer - Consumer loans are offered by the Company in order to provide a full range of retail financial services to its customers and include auto loans, credit cards, and other consumer installment loans. Typically, the Company evaluates the borrower's repayment ability through a review of credit scores and an evaluation of debt to income ratios. Repayment of consumer loans depends upon key consumer economic measures and upon the borrower's financial stability, and is more likely to be adversely affected by divorce, job loss, illness and personal hardships than repayment of other loans. A shortfall in the value of any collateral also may pose a risk of loss to the Company for these types of loans. Indirect auto loans comprised the largest component of our consumer loans, representing 62% of our total consumer loans at June 30, 2019. At June 30, 2019, the weighted average remaining term of the indirect auto loan portfolio was 2.4 years. We exited the indirect auto lending business at the end of 2015.

Credit Quality Indicators

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The following definitions are utilized for risk ratings, which are consistent with the definitions used in supervisory guidance:

Pass - Loans not meeting the criteria below are considered pass. These loans have high credit characteristics and financial strength. The borrowers at least generate profits and cash flow that are in line with peer and industry standards and have debt service coverage ratios above loan covenants and our policy guidelines. For some of these loans, a guaranty from a financially capable party mitigates characteristics of the borrower that might otherwise result in a lower grade.

Special Mention - Loans classified as special mention possess some credit deficiencies that need to be corrected to avoid a greater risk of default in the future. For example, financial ratios relating to the borrower may have deteriorated. Often, a special mention categorization is temporary while certain factors are analyzed or matters addressed before the loan is re-categorized as either pass or substandard.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower or the liquidation value of any collateral. If deficiencies are not addressed, it is likely that this category of loan will result in the Bank incurring a loss. Where a borrower has been unable to adjust to industry or general economic conditions, the borrower's loan is often categorized as substandard.

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 existing facts, conditions, and values, highly questionable and improbable.

Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as recorded assets is not warranted. This classification does not mean that the assets have absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these assets.

The table below presents the Company's loan portfolio by category and credit quality indicator as of the dates presented (dollars in thousands).

	June 30, 2019				
	Pass	Special Mention	Substandard	Doubtful	Total
Construction and development	\$ 166,713	\$ —	\$ 439	\$ 80	\$ 167,232
1-4 Family	303,700	—	1,740	72	305,512
Multifamily	56,081	—	—	—	56,081
Farmland	22,939	—	2,264	—	25,203
Commercial real estate	676,753	—	803	—	677,556
Total mortgage loans on real estate	1,226,186	—	5,246	152	1,231,584
Commercial and industrial	273,905	—	2,997	—	276,902
Consumer	34,544	221	57	—	34,822
Total loans	\$ 1,534,635	\$ 221	\$ 8,300	\$ 152	\$ 1,543,308

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	Pass	Special Mention	Substandard	Doubtful	Total
Construction and development	\$ 157,360	\$ —	\$ 586	\$ —	\$ 157,946
1-4 Family	285,692	69	1,303	73	287,137
Multifamily	50,501	—	—	—	50,501
Farmland	19,092	—	2,264	—	21,356
Commercial real estate	625,670	—	1,334	—	627,004
Total mortgage loans on real estate	1,138,315	69	5,487	73	1,143,944
Commercial and industrial	207,941	—	2,983	—	210,924
Consumer	44,798	167	992	—	45,957
Total loans	\$ 1,391,054	\$ 236	\$ 9,462	\$ 73	\$ 1,400,825

The Company had no loans that were classified as loss at June 30, 2019 or December 31, 2018.

Loan participations and whole loans sold to and serviced for others are not included in the accompanying consolidated balance sheets. The balance of loans serviced for others was \$114.9 million and \$135.4 million as of June 30, 2019 and December 31, 2018, respectively. The unpaid principal balance of these loans was approximately \$203.6 million and \$187.6 million as of June 30, 2019 and December 31, 2018, respectively.

In the ordinary course of business, the Company makes loans to related parties including its executive officers, principal stockholders, directors and their immediate family members, as well as companies in which these individuals are principal owners. Loans outstanding to such related party borrowers amounted to approximately \$89.3 million and \$93.0 million as of June 30, 2019 and December 31, 2018, respectively.

The table below shows the aggregate principal balance of loans to such related parties as of the dates presented (dollars in thousands).

	June 30, 2019	December 31, 2018
Balance, beginning of period	\$ 93,021	\$ 31,153
New loans	3,981	79,639
Repayments and changes in relationship	(7,745)	(17,771)
Balance, end of period	\$ 89,257	\$ 93,021

Loans Acquired with Deteriorated Credit Quality

The Company accounts for certain loans acquired as acquired impaired loans under ASC 310-30 due to evidence of credit deterioration at acquisition and the probability that the Company will be unable to collect all contractually required payments. The acquired impaired loans had no accretable yield recorded for the three and six months ended June 30, 2019 and 2018.

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Allowance for Loan Losses

The table below shows a summary of the activity in the allowance for loan losses for the three and six months ended June 30, 2019 and 2018 (dollars in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Balance, beginning of period	\$ 9,642	\$ 8,130	\$ 9,454	\$ 7,891
Provision for loan losses	369	567	634	1,192
Loans charged off	(120)	(291)	(224)	(737)
Recoveries	33	45	60	105
Balance, end of period	\$ 9,924	\$ 8,451	\$ 9,924	\$ 8,451

The following tables outline the activity in the allowance for loan losses by collateral type for the three and six months ended June 30, 2019 and 2018, and show both the allowances and portfolio balances for loans individually and collectively evaluated for impairment as of June 30, 2019 and 2018 (dollars in thousands).

	Three months ended June 30, 2019							
	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 1,094	\$ 101	\$ 1,511	\$ 380	\$ 4,226	\$ 1,673	\$ 657	\$ 9,642
Provision	34	(4)	(77)	(9)	53	424	(52)	369
Charge-offs	(51)	—	—	—	—	—	(69)	(120)
Recoveries	15	—	5	—	—	1	12	33
Ending balance	\$ 1,092	\$ 97	\$ 1,439	\$ 371	\$ 4,279	\$ 2,098	\$ 548	\$ 9,924

	Three months ended June 30, 2018							
	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 974	\$ 63	\$ 1,283	\$ 359	\$ 3,608	\$ 935	\$ 908	\$ 8,130
Provision	58	3	81	(40)	209	246	10	567
Charge-offs	(16)	—	(28)	—	—	(141)	(106)	(291)
Recoveries	2	—	3	—	—	8	32	45
Ending balance	\$ 1,018	\$ 66	\$ 1,339	\$ 319	\$ 3,817	\$ 1,048	\$ 844	\$ 8,451

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	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 1,038	\$ 81	\$ 1,465	\$ 331	\$ 4,182	\$ 1,641	\$ 716	\$ 9,454
Provision	89	16	(33)	40	97	445	(20)	634
Charge-offs	(51)	—	—	—	—	—	(173)	(224)
Recoveries	16	—	7	—	—	12	25	60
Ending balance	<u>\$ 1,092</u>	<u>\$ 97</u>	<u>\$ 1,439</u>	<u>\$ 371</u>	<u>\$ 4,279</u>	<u>\$ 2,098</u>	<u>\$ 548</u>	<u>\$ 9,924</u>
Ending allowance balance for loans individually evaluated for impairment	\$ 66	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 185	\$ 251
Ending allowance balance for loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—
Ending allowance balance for loans collectively evaluated for impairment	\$ 1,026	\$ 97	\$ 1,439	\$ 371	\$ 4,279	\$ 2,098	\$ 363	\$ 9,673
Loans receivable:								
Balance of loans individually evaluated for impairment	\$ 346	\$ —	\$ 1,312	\$ —	\$ 878	\$ 6	\$ 658	\$ 3,200
Balance of loans acquired with deteriorated credit quality	—	2,264	472	—	1,550	—	42	4,328
Balance of loans collectively evaluated for impairment	166,886	22,939	303,728	56,081	675,128	276,896	34,122	1,535,780
Total period-end balance	<u>\$ 167,232</u>	<u>\$ 25,203</u>	<u>\$ 305,512</u>	<u>\$ 56,081</u>	<u>\$ 677,556</u>	<u>\$ 276,902</u>	<u>\$ 34,822</u>	<u>\$ 1,543,308</u>

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	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 945	\$ 60	\$ 1,287	\$ 332	\$ 3,599	\$ 693	\$ 975	\$ 7,891
Provision	81	6	81	(13)	218	765	54	1,192
Charge-offs	(16)	—	(35)	—	—	(451)	(235)	(737)
Recoveries	8	—	6	—	—	41	50	105
Ending balance	<u>\$ 1,018</u>	<u>\$ 66</u>	<u>\$ 1,339</u>	<u>\$ 319</u>	<u>\$ 3,817</u>	<u>\$ 1,048</u>	<u>\$ 844</u>	<u>\$ 8,451</u>
Ending allowance balance for loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 296	\$ 296
Ending allowance balance for loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—
Ending allowance balance for loans collectively evaluated for impairment	\$ 1,018	\$ 66	\$ 1,339	\$ 319	\$ 3,817	\$ 1,048	\$ 548	\$ 8,155
Loans receivable:								
Balance of loans individually evaluated for impairment	\$ 230	\$ —	\$ 1,248	\$ —	\$ 711	\$ 89	\$ 1,010	\$ 3,288
Balance of loans acquired with deteriorated credit quality	52	2,264	1,194	820	2,057	1,217	—	7,604
Balance of loans collectively evaluated for impairment	165,113	17,880	277,893	48,018	577,498	144,248	58,769	1,289,419
Total period-end balance	<u>\$ 165,395</u>	<u>\$ 20,144</u>	<u>\$ 280,335</u>	<u>\$ 48,838</u>	<u>\$ 580,266</u>	<u>\$ 145,554</u>	<u>\$ 59,779</u>	<u>\$ 1,300,311</u>

Impaired Loans

The Company considers a loan to be impaired when, based on current information and events, the Company determines that it will not be able to collect all amounts due according to the loan agreement, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When the Company identifies a loan as impaired, it measures the impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loans is the operation or liquidation of the collateral. In these cases when foreclosure is probable, the Company uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If the Company determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), the Company recognizes impairment through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual, contractual interest is credited to interest income when received, under the cash basis method.

The following tables contain information on the Company's impaired loans, which include troubled debt restructurings ("TDRs"), discussed in more detail below, and nonaccrual loans individually evaluated for impairment for purposes of determining the allowance for loan losses. The average balances are calculated based on the month-end balances of the loans during the period reported (dollars in thousands).

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	Recorded Investment	Unpaid Principal Balance	Related Allowance
<u>With no related allowance recorded:</u>			
Construction and development	\$ 266	\$ 285	\$ —
1-4 Family	1,312	1,315	—
Commercial real estate	878	908	—
Total mortgage loans on real estate	2,456	2,508	—
Commercial and industrial	6	7	—
Consumer	164	199	—
Total	2,626	2,714	—
<u>With related allowance recorded:</u>			
Construction and development	80	136	66
Total mortgage loans on real estate	80	136	66
Consumer	494	538	185
Total	574	674	251
<u>Total loans:</u>			
Construction and development	346	421	66
1-4 Family	1,312	1,315	—
Commercial real estate	878	908	—
Total mortgage loans on real estate	2,536	2,644	66
Commercial and industrial	6	7	—
Consumer	658	737	185
Total	\$ 3,200	\$ 3,388	\$ 251

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	December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
<u>With no related allowance recorded:</u>			
Construction and development	\$ 339	\$ 359	\$ —
1-4 Family	1,177	1,180	—
Commercial real estate	761	777	—
Total mortgage loans on real estate	2,277	2,316	—
Commercial and industrial	76	77	
Consumer	215	237	—
Total	2,568	2,630	—
<u>With related allowance recorded:</u>			
Consumer	701	738	236
Total	701	738	236
<u>Total loans:</u>			
Construction and development	339	359	—
1-4 Family	1,177	1,180	—
Commercial real estate	761	777	—
Total mortgage loans on real estate	2,277	2,316	—
Commercial and industrial	76	77	—
Consumer	916	975	236
Total	\$ 3,269	\$ 3,368	\$ 236

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Presented in the tables below is the average recorded investment of the impaired loans and the related amount of interest income recognized during the time within the period that the loans were impaired. The average balances are calculated based on the month-end balances of the loans during the periods reported (dollars in thousands).

	Three months ended June 30,			
	2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<u>With no related allowance recorded:</u>				
Construction and development	\$ 265	\$ 3	\$ 182	\$ 2
1-4 Family	1,281	7	1,209	10
Multifamily	36	—	—	—
Commercial real estate	1,198	2	869	8
Total mortgage loans on real estate	2,780	12	2,260	20
Commercial and industrial	7	—	215	—
Consumer	188	—	241	—
Total	2,975	12	2,716	20
<u>With related allowance recorded:</u>				
Construction and development	114	—	—	—
Total mortgage loans on real estate	114	—	—	—
Commercial and industrial	—	—	—	—
Consumer	479	—	785	—
Total	593	—	785	—
<u>Total loans:</u>				
Construction and development	379	3	182	2
1-4 Family	1,281	7	1,209	10
Multifamily	36	—	—	—
Commercial real estate	1,198	2	869	8
Total mortgage loans on real estate	2,894	12	2,260	20
Commercial and industrial	7	—	215	—
Consumer	667	—	1,026	—
Total	\$ 3,568	\$ 12	\$ 3,501	\$ 20

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	Six months ended June 30,			
	2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<u>With no related allowance recorded:</u>				
Construction and development	\$ 264	\$ 8	\$ 171	\$ 4
1-4 Family	1,257	17	1,210	21
Multifamily	72	—	—	—
Commercial real estate	1,079	4	1,029	16
Total mortgage loans on real estate	2,672	29	2,410	41
Commercial and industrial	14	—	480	—
Consumer	258	—	296	—
Total	2,944	29	3,186	41
<u>With related allowance recorded:</u>				
Construction and development	124	—	—	—
Total mortgage loans on real estate	124	—	—	—
Commercial and industrial	—	—	—	—
Consumer	489	—	785	—
Total	613	—	785	—
<u>Total loans:</u>				
Construction and development	388	8	171	4
Multifamily	72	—	—	—
1-4 Family	1,257	17	1,210	21
Commercial real estate	1,079	4	1,029	16
Total mortgage loans on real estate	2,796	29	2,410	41
Commercial and industrial	14	—	480	—
Consumer	747	—	1,081	—
Total	3,557	29	3,971	41

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a TDR. The Company strives to identify borrowers in financial difficulty early and work with them to modify their loans to more affordable terms before such loans reach nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases in which the Company grants the borrower new terms that provide for a reduction of either interest or principal, or otherwise include a concession, the Company identifies the loan as a TDR and measures any impairment on the restructuring as previously noted for impaired loans.

Loans classified as TDRs, consisting of 19 credits, totaled \$1.6 million at June 30, 2019, compared to 24 credits totaling \$2.2 million at December 31, 2018. At June 30, 2019, 11 of the restructured loans were considered TDRs due to modification of terms through adjustments to maturity, seven of the restructured loans were considered TDRs due to a reduction in the interest rate to a rate lower than the current market rate, and one restructured loan was considered a TDR due to forgiveness of interest due on the loan. As of June 30, 2019, two of the TDRs, consisting of one \$0.3 million construction and development loan and one \$0.2 million 1-4 family loan, were in default of their modified terms and are included in nonaccrual loans. At December 31, 2018, three of the TDRs, consisting of one \$0.5 million commercial real estate loan, one \$0.3 million construction and development loan, and one \$0.2 million 1-4 family loan, were in default of their modified terms and are included in nonaccrual loans. The Company individually evaluates each TDR for allowance purposes, primarily based on collateral value, and excludes these loans from the loan population that is collectively evaluated for impairment.

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At June 30, 2019 and December 31, 2018, there were no available balances on loans classified as TDRs that the Company was committed to lend.

There were no loans modified under TDRs during the three and six month periods ended June 30, 2019 and there were two loans, one commercial and industrial loan and one 1-4 family loan, modified under TDRs during the three and six month periods ended June 30, 2018. There were two loans modified under TDRs during the previous twelve month period that subsequently defaulted during the six months ended June 30, 2018. No TDRs defaulted on their modified terms during the three and six months ended June 30, 2019.

NOTE 6. STOCKHOLDERS' EQUITY

Accumulated Other Comprehensive Income (Loss)

Activity within the balances in accumulated other comprehensive income (loss) is shown in the tables below (dollars in thousands).

	Three months ended June 30,					
	2019			2018		
	Beginning of Period	Net Change	End of Period	Beginning of Period	Net Change	End of Period
Unrealized (loss) gain, available for sale, net	\$ 565	\$ 2,672	\$ 3,237	\$ (1,860)	\$ (734)	\$ (2,594)
Reclassification of realized gain, net	(1,927)	(179)	(2,106)	(1,914)	(17)	(1,931)
Unrealized loss, transfer from available for sale to held to maturity, net	5	—	5	7	(1)	6
Change in fair value of interest rate swap designated as a cash flow hedge, net	324	(247)	77	672	72	744
Accumulated other comprehensive (loss) income	<u>\$ (1,033)</u>	<u>\$ 2,246</u>	<u>\$ 1,213</u>	<u>\$ (3,095)</u>	<u>\$ (680)</u>	<u>\$ (3,775)</u>

	Six months ended June 30,					
	2019			2018		
	Beginning of Period	Net Change	End of Period	Beginning of Period	Net Change	End of Period
Unrealized gain (loss), available for sale, net	\$ (1,647)	\$ 4,884	\$ 3,237	\$ (71)	\$ (2,523)	\$ (2,594)
Reclassification of realized gain, net	(1,925)	(181)	(2,106)	(1,914)	(17)	(1,931)
Unrealized loss, transfer from available for sale to held to maturity, net	5	—	5	7	(1)	6
Change in fair value of interest rate swap designated as a cash flow hedge, net	491	(414)	77	407	337	744
Accumulated other comprehensive (loss) income	<u>\$ (3,076)</u>	<u>\$ 4,289</u>	<u>\$ 1,213</u>	<u>\$ (1,571)</u>	<u>\$ (2,204)</u>	<u>\$ (3,775)</u>

NOTE 7. STOCK-BASED COMPENSATION

Equity Incentive Plan. The Company's 2017 Long-Term Incentive Compensation Plan (the "Plan") authorizes the grant of various types of equity grants and awards, such as restricted stock, restricted stock units, stock options and stock appreciation rights, to eligible participants, which include all of the Company's employees, non-employee directors, and consultants. The Plan has reserved 600,000 shares of common stock for grant, award or issuance to eligible participants, including shares underlying granted options. As of June 30, 2019, 399,041 shares were available for future grants under the Plan. Shares covered by awards that expire or terminate will again be available for the grant of awards under the Plan.

Stock Options

The Company uses a Black-Scholes option pricing model to estimate the fair value of share-based awards. The Black-Scholes option pricing model incorporates various highly subjective assumptions, including expected term and expected volatility. The assumptions presented below were used for the options granted during the six months ended June 30, 2019.

Expected dividends	0.82%
Expected volatility	27.26%
Risk-free interest rate	2.63%
Expected term (in years)	6.5
Weighted-average grant date fair value	\$ 7.30

Stock option expense in the accompanying consolidated statements of income for the three and six months ended June 30, 2019 was \$86,000 and 146,000, respectively, and \$66,000 and \$127,000 for the three and six months ended June 30, 2018, respectively. At June 30, 2019, there was \$0.7 million of unrecognized compensation cost related to stock options that is expected to be recognized over a weighted-average period of 3.17 years.

The table below summarizes stock option activity for the periods presented.

Six months ended June 30,

	2019		2018	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of period	340,646	\$ 15.98	322,917	\$ 15.09
Granted	36,984	24.40	31,788	24.30
Forfeited	—	—	—	—
Exercised	1,916	14.60	(8,501)	14.10
Outstanding at end of period	379,546	\$ 16.82	346,204	\$ 15.96
Exercisable at end of period	196,111	\$ 15.27	135,831	\$ 14.86

At June 30, 2019, the shares underlying outstanding stock options and exercisable stock options had aggregate intrinsic values of \$2.7 million and \$1.7 million, respectively.

Restricted Stock and Restricted Stock Units

Under the Plan, the Company may grant restricted stock, restricted stock units, and other stock-based awards to Plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant's award agreement. While restricted stock is subject to forfeiture, restricted stock participants may exercise full voting rights and will receive all dividends paid with respect to the restricted shares. Restricted stock units do not have voting rights and do not receive dividends or dividend equivalents. The restricted stock granted under the Plan is typically subject to a vesting period. Compensation expense for restricted stock is recognized over the requisite service period of generally five years for employees and two years for non-employee directors for the entire award on a straight-line basis. Upon vesting of restricted stock and restricted stock units, the benefit of tax deductions in excess of recognized compensation expense is reflected as an income tax benefit in the unaudited Consolidated Statements of Income.

Historically, the Company has issued restricted stock awards to Plan participants. Beginning in 2019, the Company issued time vested restricted stock units to its non-employee directors and certain officers of the Company with vesting terms ranging from 2 to 5 years. The total share-based compensation expense to be recognized for these awards is determined based on the market price of the Company's common stock at the grant date applied to the total number of units awarded and is amortized over the vesting period.

Stock compensation expense related to time vested restricted stock and restricted stock units in the accompanying consolidated statements of income was \$0.3 million and \$0.5 million for the three and six months ended June 30, 2019, respectively, and \$0.2 million and \$0.4 million for the three and six months ended June 30, 2018, respectively. At June 30, 2019, there was \$3.3 million of unrecognized compensation cost related to time vested restricted stock and restricted stock units that is expected to be recognized over a weighted average period of 3.62 years.

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The restricted stock and restricted stock unit activity is shown below for the periods presented.

	Six months ended June 30,			
	2019		2018	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Balance at beginning of period	135,848	\$ 20.47	112,688	\$ 17.28
Granted	76,809	24.45	60,260	24.35
Forfeited	(5,828)	23.70	(1,583)	20.10
Earned and issued	(39,861)	19.84	(28,187)	17.24
Balance at end of period	166,968	\$ 22.33	143,178	\$ 20.24

NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS

The Company currently holds interest rate swap contracts to manage exposure against the variability in the expected future cash flows (future interest payments) attributable to changes in the 1-month LIBOR associated with the forecasted issuances of 1-month fixed rate debt arising from a rollover strategy. The maximum length of time over which the Company is currently hedging its exposure to the variability in future cash flows for forecasted transactions is approximately 1.1 years. The total notional amount of the derivative contracts is \$50.0 million. These derivative contracts are currently between the Company and a single counterparty. To mitigate credit risk, securities are pledged to the Company by the counterparty in an amount greater than or equal to the gain position of the derivative contracts.

For the three and six months ended June 30, 2019, losses of \$0.2 million and \$0.4 million, respectively, have been recognized in “Other comprehensive income (loss)” in the accompanying consolidated statements of comprehensive income for the change in fair value of the interest rate swaps compared to gains of \$72,000 and \$0.3 million recognized for the three and six months ended June 30, 2018, respectively. The swap contracts had a fair value of \$0.1 million at June 30, 2019 and have been recorded in “Other assets” in the accompanying consolidated balance sheet. The accumulated gain of \$77,000 included in “Accumulated other comprehensive income (loss)” in the accompanying consolidated balance sheet would be reclassified to current earnings if the hedge transactions become probable of not occurring. The Company expects the hedges to remain fully effective during the remaining term of the swap contracts.

NOTE 9. FAIR VALUES OF FINANCIAL INSTRUMENTS

In accordance with FASB ASC Topic 820, *Fair Value Measurement and Disclosure* (“ASC 820”), disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, is required. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. Fair value is best determined based upon quoted market prices, or exit prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows, and the fair value estimates may not be realized in an immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with ASC 820, the Company groups its 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.

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Level 1 – Valuation is based upon quoted prices for identical assets or liabilities traded in active markets.

Level 2 – Valuation is based upon observable inputs other than quoted prices included in level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Valuation is based upon unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Due from Banks – For these short-term instruments, fair value is the carrying value. Cash and due from banks is classified in level 1 of the fair value hierarchy.

Federal Funds Sold – The fair value is the carrying value. The Company classifies these assets in level 1 of the fair value hierarchy.

Investment Securities and Equity Securities – Where quoted prices are available in an active market, the Company classifies the securities within level 1 of the valuation hierarchy. Securities are defined as both long and short positions. Level 1 securities include exchange-traded equity securities.

If quoted market prices are not available, the Company estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy if observable inputs are available, include obligations of U.S. government agencies and corporations, obligations of state and political subdivisions, corporate bonds, residential mortgage-backed securities, commercial mortgage-backed securities, and other equity securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Company classifies those securities in level 3. At June 30, 2019 and 2018, the majority of our level 3 investments was obligations of state and political subdivisions. The Company estimated the fair value of these level 3 investments using an option-adjusted discounted cash flow model which is based on readily traded comparable municipal credits and current spreads to the yield curves, adjusted for illiquidity of the local municipal market and sinking funds, if applicable.

Loans – The fair value of portfolio loans, net is determined using an exit price methodology. The exit price methodology continues to be based on a discounted cash flow analysis, in which projected cash flows are based on contractual cash flows adjusted for prepayments for certain loan types (e.g. residential mortgage loans and multifamily loans) and the use of a discount rate based on expected relative risk of the cash flows. The discount rate selected considers loan type, maturity date, a liquidity premium, cost to service, and cost of capital, which is a level 3 fair value estimate.

Deposit Liabilities – The fair values disclosed for noninterest-bearing demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). These noninterest-bearing deposits are classified in level 2 of the fair value hierarchy. All interest-bearing deposits are classified in level 3 of the fair value hierarchy. The carrying amounts of variable-rate (for example interest-bearing checking, savings, and money market accounts), fixed-term money market accounts, and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings – The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings approximate their fair values. The Company classifies these borrowings in level 2 of the fair value hierarchy.

Long-Term Borrowings, including Junior Subordinated Debt Securities – The fair values of long-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the Company's long-term debt is therefore classified in level 3 in the fair value hierarchy.

Subordinated Debt Securities – The fair value of subordinated debt is estimated based on current market rates on similar debt in the market. The Company classifies this debt in level 2 of the fair value hierarchy.

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Derivative Financial Instruments – The fair value for interest rate swap agreements is based upon the amounts required to settle the contracts. These derivative instruments are classified in level 2 of the fair value hierarchy.

Fair Value of Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized in the table below as of the dates indicated (dollars in thousands).

	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2019				
Assets:				
Obligations of U.S. government agencies and corporations	\$ 24,196	\$ —	\$ 24,196	\$ —
Obligations of state and political subdivisions	33,885	—	14,594	19,291
Corporate bonds	18,500	—	17,178	1,322
Residential mortgage-backed securities	107,526	—	107,526	—
Commercial mortgage-backed securities	69,878	—	69,878	—
Equity securities	1,929	1,929	—	—
Derivative financial instruments	98	—	98	—
Total assets	<u>\$ 256,012</u>	<u>\$ 1,929</u>	<u>\$ 233,470</u>	<u>\$ 20,613</u>
December 31, 2018				
Assets:				
Obligations of U.S. government agencies and corporations	\$ 7,870	\$ —	\$ 7,870	\$ —
Obligations of state and political subdivisions	33,986	—	15,178	18,808
Corporate bonds	15,509	—	14,174	1,335
Residential mortgage-backed securities	134,927	—	134,927	—
Commercial mortgage-backed securities	56,689	—	56,689	—
Equity securities	1,699	1,699	—	—
Derivative financial instruments	622	—	622	—
Total assets	<u>\$ 251,302</u>	<u>\$ 1,699</u>	<u>\$ 229,460</u>	<u>\$ 20,143</u>

The Company reviews fair value hierarchy classifications on a quarterly basis. Changes in the Company's ability to observe inputs to the valuation may cause reclassification of certain assets or liabilities within the fair value hierarchy. The tables below provide a reconciliation for assets measured at fair value on a recurring basis using significant unobservable inputs, or level 3 inputs, for the six months ended June 30, 2019 and June 30, 2018 (dollars in thousands).

	Obligations of State and Political Subdivisions	Corporate Bonds	Total
Balance at December 31, 2018	\$ 18,808	\$ 1,335	\$ 20,143
Realized gains (losses) included in earnings	—	—	—
Unrealized gains (losses) included in other comprehensive income	506	(13)	493
Purchases	—	—	—
Sales	—	—	—
Maturities, prepayments, and calls	(23)	—	(23)
Transfers into level 3	—	—	—
Transfers out of level 3	—	—	—
Balance at June 30, 2019	<u>\$ 19,291</u>	<u>\$ 1,322</u>	<u>\$ 20,613</u>

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	Obligations of State and Political Subdivisions	Corporate Bonds	Total
Balance at December 31, 2017	\$ 19,543	\$ 1,325	\$ 20,868
Realized gains (losses) included in earnings	—	—	—
Unrealized (losses) gains included in other comprehensive income	(375)	16	(359)
Purchases	—	—	—
Sales	—	—	—
Transfers into level 3	—	—	—
Transfers out of level 3	—	—	—
Balance at June 30, 2018	<u>\$ 19,168</u>	<u>\$ 1,341</u>	<u>\$ 20,509</u>

There were no liabilities measured at fair value on a recurring basis using level 3 inputs at June 30, 2019 and December 31, 2018. For the three and six months ended June 30, 2019 and 2018, there were no gains or losses included in earnings related to the change in fair value of the assets measured on a recurring basis using significant unobservable inputs held at the end of the period.

Fair Value of Assets and Liabilities Measured on a Nonrecurring Basis

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Quantitative information about assets measured at fair value on a nonrecurring basis based on significant unobservable inputs (level 3) is summarized below as of the dates indicated; there were no liabilities measured on a nonrecurring basis at June 30, 2019 or December 31, 2018 (dollars in thousands).

	Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Discounts	Weighted Average Discount
<u>June 30, 2019</u>					
Impaired loans	\$ 76	Discounted cash flows, Underlying collateral value	Collateral discounts and estimated costs to sell	0% - 100%	40%
<u>December 31, 2018</u>					
Impaired loans	\$ 383	Discounted cash flows, Underlying collateral value	Collateral discounts and estimated costs to sell	0% - 100%	15%
Other real estate owned	3,270	Underlying collateral value, Third party appraisals	Collateral discounts and discount rates	15%	15%

The estimated fair values of the Company's financial instruments are summarized in the table below as of the dates indicated (dollars in thousands).

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June 30, 2019

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 63,919	\$ 63,919	\$ 63,919	\$ —	\$ —
Federal funds sold	—	—	—	—	—
Investment securities	269,458	269,465	—	238,380	31,085
Equity securities	14,537	14,537	1,929	12,608	—
Loans, net of allowance	1,533,384	1,536,871	—	—	1,536,871
Derivative financial instruments	98	98	—	98	—
Financial liabilities:					
Deposits, noninterest-bearing	\$ 289,481	\$ 289,481	\$ —	\$ 289,481	\$ —
Deposits, interest-bearing	1,262,736	1,268,654	—	—	1,268,654
FHLB short-term advances and repurchase agreements	140,376	140,376	—	140,376	—
FHLB long-term advances	58,100	58,022	—	—	58,022
Junior subordinated debt	5,871	7,710	—	—	7,710
Subordinated debt	18,600	23,727	—	23,727	—

December 31, 2018

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 17,134	\$ 17,134	\$ 17,134	\$ —	\$ —
Federal funds sold	6	6	6	—	—
Investment securities	265,047	264,786	—	234,053	30,733
Equity securities	13,562	13,562	1,699	11,863	—
Loans, net of allowance	1,391,371	1,374,292	—	—	1,374,292
Derivative financial instruments	622	622	—	622	—
Financial liabilities:					
Deposits, noninterest-bearing	\$ 217,457	\$ 217,457	\$ —	\$ 217,457	\$ —
Deposits, interest-bearing	1,144,274	1,095,639	—	—	1,095,639
FHLB short-term advances and repurchase agreements	205,399	205,399	—	205,399	—
FHLB long-term advances	3,090	2,712	—	—	2,712
Junior subordinated debt	5,845	7,420	—	—	7,420
Subordinated debt	18,600	19,187	—	19,187	—

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NOTE 10. INCOME TAXES

The expense for income taxes and the effective tax rate included in the consolidated statements of income are shown in the table below for the periods presented (dollars in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Income tax expense	\$ 1,216	\$ 966	\$ 2,168	\$ 2,307
Effective tax rate	19.8%	20.2%	19.7%	27.0%

For the three and six months ended June 30, 2019, the effective tax rate differs from the statutory tax rate of 21%, effective January 1, 2018, due to tax exempt interest income earned on certain investment securities. The Company's income tax expense for the six months ended June 30, 2018 includes a \$0.6 million charge directly related to the revaluation of its deferred tax assets and liabilities as a result of the Tax Act, which is the primary reason the effective tax rate differs from the statutory rate of 21%.

NOTE 11. COMMITMENTS AND CONTINGENCIES

Unfunded Commitments

The Company is a party to financial instruments with off-balance-sheet risk entered into in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit consisting of loan commitments and standby letters of credit, which are not included in the accompanying financial statements. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded loan commitments is included in other liabilities in the consolidated balance sheets and was \$143,000 and \$66,000 at June 30, 2019 and December 31, 2018, respectively.

Commitments to extend credit are agreements to lend money with fixed expiration dates or termination clauses. The Company applies the same credit standards used in the lending process when extending these commitments, and periodically reassesses the customer's creditworthiness through ongoing credit reviews. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Collateral is obtained based on the Company's assessment of the transaction. Essentially all standby letters of credit issued have expiration dates within one year.

The table below shows the approximate amounts of the Company's commitments to extend credit as of the dates presented (dollars in thousands).

	June 30, 2019	December 31, 2018
Commitments to extend credit		
Loan commitments	\$ 306,697	\$ 263,002
Standby letters of credit	14,082	11,114

Additionally, at June 30, 2019, the Company had unfunded commitments of \$38,000 for its investment in Small Business Investment Company qualified funds.

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NOTE 12. LEASES

On January 1, 2019, the Company adopted ASU 2016-02, Leases, as further explained in Note 1, Summary of Significant Accounting Policies. The Company's primary leasing activities relate to certain real estate leases entered into in support of the Company's branch operations. Prior to the Mainland acquisition on March 1, 2019, the Company leased only one of its properties, a future branch location expected to be opened in 2019. With the Mainland acquisition, the Company increased its branch network by three branches, of which two are operated under lease agreements. The Company's branch locations operated under lease agreements have all been designated as operating leases. The Company does not lease equipment under operating leases, nor does it have leases designated as finance leases.

The Company determines if an arrangement is a lease at inception. Operating leases, with the exception of short-term leases, are included in operating lease right-of-use ("ROU") assets and operating lease liabilities in Bank premises and equipment, net and Accrued taxes and other liabilities, respectively, in the consolidated balance sheets. ROU assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The operating lease ROU asset also includes any lease pre-payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease. When it is reasonably certain that the Company will exercise an option to extend a lease, the extension is included in the lease term when calculating the present value of lease payments.

Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components, which the Company has elected to account for separately, as the non-lease component amounts are readily determinable. No operating lease expense was recorded in the three and six months ended June 30, 2018 as the Company had no operating leases until December 31, 2018.

Quantitative information regarding the Company's operating leases is presented below as of and for six months ended June 30, 2019 (dollars in thousands).

Total operating lease cost	\$	127.0
Weighted-average remaining lease term (in years)		11.1
Weighted-average discount rate		3.5%

As of June 30, 2019, the Company's lease ROU assets and related lease liabilities were \$2.4 million and \$2.5 million, respectively, and have remaining terms ranging from 5 to 12 years, including extension options if the Company is reasonably certain they will be exercised.

Future minimum lease payments due under non-cancelable operating leases at June 30, 2019 are presented below (dollars in thousands).

2019	\$	143
2020		289
2021		294
2022		298
2023		297
Thereafter		1,672
Total	\$	2,993

At June 30, 2019, the Company had not entered into any material leases that have not yet commenced.

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NOTE 13. SUBSEQUENT EVENTS

On July 30, 2019, the Company and the Bank entered into an Agreement and Plan of Reorganization (the “Merger Agreement”) to acquire Bank of York in York, Alabama (“Bank of York”). The Merger Agreement provides for the merger of Bank of York with and into the Bank, with the Bank as the entity surviving the merger. Following the merger, the Bank will continue as a wholly-owned subsidiary of the Company.

Under the terms of the Merger Agreement, all of the issued and outstanding shares of Bank of York common stock will be converted into and represent the right to receive aggregate merger consideration of \$15.0 million. Bank of York will also be permitted under the Merger Agreement to make regular and special pre-closing cash distributions to its shareholders in an aggregate amount of approximately \$1.0 million.

At June 30, 2019, Bank of York had approximately \$99.5 million in assets, \$46.0 million in net loans, \$82.3 million in deposits and \$11.2 million in stockholders’ equity. Bank of York offers a full range of banking products and services to the residents of Sumter and Tuscaloosa Counties through its two branch locations in York and Livingston, Alabama and a loan production office in Tuscaloosa, Alabama.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Note Regarding Forward-Looking Statements

When included in this Quarterly Report on Form 10-Q, or in other documents that Investar Holding Corporation (the “Company,” “we,” “our,” or “us”) files with the Securities and Exchange Commission (“SEC”) or in statements made by or on behalf of the Company, words like “may,” “should,” “could,” “predict,” “potential,” “believe,” “think,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would,” “outlook” and similar expressions or the negative version of those words are intended to identify forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve a variety of risks and uncertainties that could cause actual results to differ materially from those described therein. The Company’s forward-looking statements are based on assumptions and estimates that management believes to be reasonable in light of the information available at the time such statements are made. However, many of the matters addressed by these statements are inherently uncertain and could be affected by many factors beyond management’s control. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements. These factors include, but are not limited to, the following, any one or more of which could materially affect the outcome of future events:

- business and economic conditions generally and in the financial services industry in particular, whether nationally, regionally or in the markets in which we operate;
- our ability to achieve organic loan and deposit growth, and the composition of that growth;
- our ability to identify and enter into agreements to combine with attractive acquisition candidates, finance acquisitions, complete acquisitions after definitive agreements are entered into, and successfully integrate acquired operations;
- our ability to successfully enter new markets and capitalize on growth opportunities, including receipt of required regulatory approvals;
- changes (or the lack of changes) in interest rates, yield curves and interest rate spread relationships that affect our loan and deposit pricing;
- possible cessation or market replacement of LIBOR and the related effect on our LIBOR-based financial products and contracts, including, but not limited to, hedging products, debt obligations, investments, and loans;
- the extent of continuing client demand for the high level of personalized service that is a key element of our banking approach as well as our ability to execute our strategy generally;
- our dependence on our management team, and our ability to attract and retain qualified personnel;
- changes in the quality or composition of our loan or investment portfolios, including adverse developments in borrower industries or in the repayment ability of individual borrowers;
- inaccuracy of the assumptions and estimates we make in establishing reserves for probable loan losses and other estimates;
- the concentration of our business within our geographic areas of operation in Louisiana and Texas, and, upon completion of our acquisition of Bank of York, Alabama; and
- concentration of credit exposure.

These factors should not be construed as exhaustive. Additional information on these and other risk factors can be found in Item 1A. “Risk Factors” and Item 7. “Special Note Regarding Forward-Looking Statements” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC.

Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, you should not rely on any forward-looking statement as a prediction of future events. We expressly disclaim any obligation or undertaking to update our forward-looking statements, and we do not intend to release publicly any updates or changes in our expectations concerning the forward-looking statements or any changes in events, conditions or circumstances upon which any forward-looking statement may be based, except as required by law.

Overview

This section presents management's perspective on the consolidated financial condition and results of operations of the Company and its wholly-owned subsidiary, Investar Bank, National Association (the "Bank"). The following discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and related notes thereto included herein, and the audited consolidated financial statements for the year ended December 31, 2018, including the notes thereto, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report on Form 10-K that the Company filed with the SEC on March 15, 2019.

Through our wholly-owned subsidiary, Investar Bank, National Association, we provide full banking services, excluding trust services, tailored primarily to meet the needs of individuals and small to medium-sized businesses in our primary areas of operation in southeast Louisiana including Baton Rouge, New Orleans, Lafayette, and their surrounding metropolitan areas, and in southeast Texas, including Houston and its surrounding metropolitan areas. Our Bank commenced operations in 2006 and we completed our initial public offering in July 2014. Our strategy includes organic growth through high quality loans and growth through acquisitions. We currently operate 21 full service branches in Louisiana and 3 full service branches in Texas. We completed acquisitions in 2011, 2013, 2017 and 2019 and regularly review acquisition opportunities. On July 30, 2019, we announced that we had entered into a definitive agreement to acquire Bank of York, with two branches in York and Livingston, Alabama and a loan production office in Tuscaloosa, Alabama. For additional information, see Note 13.

On July 1, 2019, the Bank changed from a Louisiana state bank charter to a national bank charter and its name changed to Investar Bank, National Association.

Our principal business is lending to and accepting deposits from individuals and small to medium-sized businesses in our areas of operation. We generate our income principally from interest on loans and, to a lesser extent, our securities investments, as well as from fees charged in connection with our various loan and deposit services and gains on the sale securities. Our principal expenses are interest expense on interest-bearing customer deposits and borrowings, salaries, employee benefits, occupancy costs, data processing and other operating expenses and, depending on our level of acquisition activity in a period, may also include acquisition expense. We measure our performance through our net interest margin, return on average assets, and return on average equity, among other metrics, while seeking to maintain appropriate regulatory leverage and risk-based capital ratios.

Certain Events That Affect Year-over-Year Comparability

Change in Tax Laws. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. The Tax Act made broad and complex changes to the U.S. tax code that affected the Company's income tax rate in 2017, including requiring the revaluation of the Company's deferred tax assets and liabilities at December 31, 2017 as a result of the lower corporate tax rates to be realized beginning January 1, 2018. The Tax Act reduces the U.S. federal corporate income tax rate from 35% to 21% and establishes new tax laws that affect 2018 and beyond.

ASC 740, *Income Taxes*, requires a company to record the effects of a tax law change in the period of enactment; however, shortly after the enactment of the Tax Act, the SEC staff issued Staff Accounting Bulletin ("SAB") 118, which allows a company to record a provisional amount when it does not have the necessary information available, prepared, or analyzed in reasonable detail to complete its accounting for the change in the tax law. The measurement period ends when the company has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. The Company recorded a revaluation of its deferred tax assets and liabilities based on the information available to management at the time, resulting in a \$0.3 million charge to income tax expense in the year ended December 31, 2017 and a \$0.6 million charge to income tax in the first quarter of 2018.

Acquisitions. On March 1, 2019, the Company completed the acquisition of Mainland Bank (“Mainland”), a Texas state bank located in Texas City, Texas. The Company acquired 100% of Mainland’s outstanding common shares for approximately \$18.6 million in the form of 763,849 shares of the Company’s common stock. The acquisition of Mainland expanded the Company’s branch footprint into Texas and increased the core deposit base. On the date of acquisition, Mainland had total assets with a fair value of approximately \$128.4 million, \$82.4 million in loans, and \$107.6 million in deposits, and served the residents of Harris and Galveston counties through its three branch locations. The Company recorded a core deposit intangible and goodwill of \$2.4 million and \$4.6 million, respectively, related to the acquisition of Mainland.

Discussion and Analysis of Financial Condition

For the six months ended June 30, 2019, net income was \$8.9 million, or \$0.89 and \$0.88 per basic and diluted common share, respectively, compared to net income of \$6.2 million, or \$0.64 per basic and diluted common share, for the six months ended June 30, 2018. For the six months ended June 30, 2019, our net interest margin was 3.56%, return on average assets was 0.94%, and return on average equity was 9.06%. From December 31, 2018 to June 30, 2019, total loans increased \$142.5 million, or 10.2%, and total deposits increased \$190.5 million, or 14.0%. At June 30, 2019, the Company and Bank each were in compliance with all regulatory capital requirements, and the Bank was considered “well-capitalized” under the FDIC’s prompt corrective action regulations.

Loans

General. Loans constitute our most significant asset, comprising 77.3% and 78.4% of our total assets at June 30, 2019 and December 31, 2018, respectively. Total loans increased \$142.5 million, or 10.2%, to \$1.54 billion at June 30, 2019 compared to \$1.40 billion at December 31, 2018 primarily due to the acquisition of Mainland on March 1, 2019. Excluding acquired loans with a total balance of \$77.5 million, total loans at June 30, 2019 increased \$64.9 million, or 4.6%, compared to December 31, 2018.

The table below sets forth the composition of the Company’s loan portfolio as of the dates indicated (dollars in thousands).

	June 30, 2019		December 31, 2018	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans
Construction and development	\$ 167,232	10.9%	\$ 157,946	11.3%
1-4 Family	305,512	19.8	287,137	20.5
Multifamily	56,081	3.6	50,501	3.6
Farmland	25,203	1.6	21,356	1.5
Commercial real estate				
Owner-occupied	339,130	22.0	298,222	21.3
Nonowner-occupied	338,426	21.9	328,782	23.5
Total mortgage loans on real estate	1,231,584	79.8	1,143,944	81.7
Commercial and industrial	276,902	17.9	210,924	15.0
Consumer	34,822	2.3	45,957	3.3
Total loans	\$ 1,543,308	100.0%	\$ 1,400,825	100.0%

At June 30, 2019, the Company’s business lending portfolio, which consists of loans secured by owner-occupied commercial real estate properties and commercial and industrial loans, was \$616.0 million, an increase of \$106.9 million, or 21.0%, compared to \$509.1 million at December 31, 2018. The increase in the business lending portfolio is primarily attributable to the increased production of our Commercial and Industrial Division. The commercial real estate and commercial and industrial loans acquired from Mainland totaled \$49.6 million at June 30, 2019.

Consumer loans totaled \$34.8 million at June 30, 2019, a decrease of \$11.2 million, or 24.2%, compared to \$46.0 million at December 31, 2018. The decrease in consumer loans is attributable to the scheduled paydowns of the consumer loans, most of which relate to our former indirect auto loan business.

The following table sets forth loans outstanding at June 30, 2019, which, based on remaining scheduled repayments of principal, are due in the periods indicated. Loans with balloon payments and longer amortizations are often repriced and extended beyond the initial maturity when credit conditions remain satisfactory. Demand loans, loans having no stated schedule of repayments and no stated maturity and overdrafts are reported below as due in one year or less (dollars in thousands).

	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years Through Fifteen Years	After Fifteen Years	Total
Construction and development	\$ 127,578	\$ 24,787	\$ 10,786	\$ 3,895	\$ 186	\$ 167,232
1-4 Family	46,969	86,124	46,668	26,548	99,203	305,512
Multifamily	940	27,709	25,980	—	1,452	56,081
Farmland	5,601	11,444	7,394	650	114	25,203
Commercial real estate						
Owner-occupied	38,873	145,050	86,460	56,445	12,302	339,130
Nonowner-occupied	27,146	151,833	133,056	26,391	—	338,426
Total mortgage loans on real estate	247,107	446,947	310,344	113,929	113,257	1,231,584
Commercial and industrial	145,175	84,977	32,189	6,168	8,393	276,902
Consumer	4,330	26,934	3,368	185	5	34,822
Total loans	\$ 396,612	\$ 558,858	\$ 345,901	\$ 120,282	\$ 121,655	\$ 1,543,308

Loan Concentrations. Loan concentrations are considered to exist when there are amounts loaned to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. At June 30, 2019 and December 31, 2018, we had no concentrations of loans exceeding 10% of total loans other than loans in the categories listed in the table above.

Investment Securities

We purchase investment securities primarily to provide a source for meeting liquidity needs, with return on investment a secondary consideration. We also use investment securities as collateral for certain deposits and other types of borrowing. Investment securities represented 13.5% of our total assets and totaled \$269.5 million at June 30, 2019, an increase of \$4.4 million, or 1.7%, from \$265.0 million at December 31, 2018. The increase in investment securities at June 30, 2019 compared to December 31, 2018 primarily resulted from purchases of obligations of U.S. government agencies and corporations and commercial mortgage-backed securities offset by the sales of residential mortgage-backed securities as we sought to better position the balance sheet for potential reductions in short term interest rates. On July 31, 2019, the Federal Reserve lowered the target range for the federal funds rate by 25 basis points to 2.00 to 2.25%.

The table below shows the carrying value of our investment securities portfolio by investment type and the percentage that such investment type comprises of our entire portfolio as of the dates indicated (dollars in thousands).

	June 30, 2019		December 31, 2018	
	Balance	Percentage of Portfolio	Balance	Percentage of Portfolio
Obligations of U.S. government agencies and corporations	\$ 24,196	9.0%	\$ 7,870	3.0%
Obligations of state and political subdivisions	44,357	16.5	44,685	16.9
Corporate bonds	18,500	6.9	15,509	5.8
Residential mortgage-backed securities	112,527	41.7	140,294	52.9
Commercial mortgage-backed securities	69,878	25.9	56,689	21.4
Total	\$ 269,458	100.0%	\$ 265,047	100.0%

The investment portfolio consists of AFS and HTM securities. We classify debt securities as HTM if management has the positive intent and ability to hold the securities to maturity. HTM debt securities are stated at amortized cost. Securities not classified as HTM are classified as AFS. The carrying values of the Company's AFS securities are adjusted for unrealized gains or losses as valuation allowances, and any gains or losses are reported on an after-tax basis as a component of other comprehensive income. Any expected credit loss due to the inability to collect all amounts due according to the security's contractual terms is recognized as a charge against earnings. Any remaining unrealized loss related to other factors would be recognized in other comprehensive income, net of taxes.

The table below sets forth the stated maturities and weighted average yields of our investment debt securities based on the amortized cost of our investment portfolio at June 30, 2019 (dollars in thousands).

	One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Held to maturity:								
Obligations of state and political subdivisions	\$ 755	5.88%	\$ 3,405	5.88%	\$ 6,312	3.94%	\$ —	—%
Residential mortgage-backed securities	—	—	—	—	—	—	5,001	2.83
Available for sale:								
Obligations of U.S. government agencies and corporations	—	—	2,465	2.03	13,807	3.56	7,812	3.60
Obligations of state and political subdivisions	2,467	1.85	4,887	2.36	13,856	2.63	12,414	4.18
Corporate bonds	—	—	3,288	3.47	15,464	3.94	—	—
Residential mortgage-backed securities	—	—	344	3.16	336	2.91	105,987	2.49
Commercial mortgage-backed securities	—	—	1,709	2.59	13,900	2.73	53,818	2.95
	<u>\$ 3,222</u>		<u>\$ 16,098</u>		<u>\$ 63,675</u>		<u>\$ 185,032</u>	

The maturity of mortgage-backed securities reflects scheduled repayments based upon the contractual maturities of the securities. Weighted average yields on tax-exempt obligations have been computed on a fully tax equivalent basis assuming a federal tax rate of 21%.

Deposits

The following table sets forth the composition of our deposits and the percentage of each deposit type to total deposits at June 30, 2019 and December 31, 2018 (dollars in thousands).

	June 30, 2019		December 31, 2018	
	Amount	Percentage of Total Deposits	Amount	Percentage of Total Deposits
Noninterest-bearing demand deposits	\$ 289,481	18.6%	\$ 217,457	16.0%
NOW accounts	332,754	21.5	295,212	21.7
Money market deposit accounts	177,209	11.4	179,340	13.2
Savings accounts	111,222	7.2	104,146	7.6
Time deposits	641,551	41.3	565,576	41.5
Total deposits	<u>\$ 1,552,217</u>	<u>100.0%</u>	<u>\$ 1,361,731</u>	<u>100.0%</u>

Total deposits were \$1.6 billion at June 30, 2019, an increase of \$190.5 million, or 14.0%, compared to December 31, 2018. Deposits acquired from Mainland totaled \$107.6 million at March 1, 2019.

The following table shows the contractual maturities of certificates of deposit and other time deposits greater than \$100,000 at June 30, 2019 and December 31, 2018 (dollars in thousands).

	June 30, 2019		December 31, 2018	
	Certificates of Deposit	Other Time Deposits	Certificates of Deposit	Other Time Deposits
Time remaining until maturity:				
Three months or less	\$ 69,782	\$ 905	\$ 76,435	\$ 1,488
Over three months through six months	66,778	1,164	72,177	220
Over six months through twelve months	140,029	2,905	100,215	1,840
Over one year through three years	125,094	3,443	67,820	4,704
Over three years	15,103	2,036	9,737	1,835
	<u>\$ 416,786</u>	<u>\$ 10,453</u>	<u>\$ 326,384</u>	<u>\$ 10,087</u>

Borrowings

Total borrowings include securities sold under agreements to repurchase, advances from the Federal Home Loan Bank (“FHLB”), unsecured lines of credit with First National Bankers Bank (“FNBB”) and The Independent Bankers Bank (“TIB”), junior subordinated debentures assumed through acquisitions, and subordinated debt issued in 2017.

Securities sold under agreements to repurchase decreased \$0.1 million to \$1.9 million at June 30, 2019 from \$2.0 million at December 31, 2018. Our advances from the FHLB were \$196.6 million at June 30, 2019, a decrease of \$9.9 million, or 4.8%, from FHLB advances of \$206.5 million at December 31, 2018. We had no outstanding balances drawn on unsecured lines of credit at June 30, 2019 or December 31, 2018. The carrying value of the subordinated debt was \$18.2 million at June 30, 2019 and December 31, 2018. The \$5.9 million and \$5.8 million in junior subordinated debt at June 30, 2019 and December 31, 2018, respectively, represent the junior subordinated debentures that we assumed through acquisition.

The average balances and cost of funds of short-term borrowings for the six months ended June 30, 2019 and 2018 are summarized in the table below (dollars in thousands).

	Average Balances		Cost of Funds	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Federal funds purchased and other short-term borrowings	\$ 128,675	\$ 121,444	2.19%	1.67%
Securities sold under agreements to repurchase	2,846	20,668	2.01	0.79
Total short-term borrowings	\$ 131,521	\$ 142,112	2.17%	1.54%

The main source of our short-term borrowings are advances from the FHLB. The rate charged for these advances is directly tied to the Federal Reserve Bank’s federal funds rate. The Federal Reserve increased the target range for the federal funds rate by a total of 75 basis points during 2017 and 100 basis points during 2018. On July 31, 2019, the Federal Reserve decreased the target range by 25 basis points to 2.00 to 2.25% in light of the implications of global developments for the economic outlook as well as muted inflation pressure.

Results of Operations

Performance Summary

Three months ended June 30, 2019 vs. three months ended June 30, 2018. For the three months ended June 30, 2019, net income was \$4.9 million, or \$0.49 per basic common share and \$0.48 per diluted common share, compared to net income of \$3.8 million, or \$0.39 per basic common share and diluted common share, for the three months ended June 30, 2018. Return on average assets increased to 1.01% for the three months ended June 30, 2019 compared to 0.93% for the three months ended June 30, 2018. Return on average equity was 9.70% for the three months ended June 30, 2019 compared to 8.72% for the three months ended June 30, 2018.

Six months ended June 30, 2019 vs. six months ended June 30, 2018. For the six months ended June 30, 2019, net income was \$8.9 million, or \$0.89 per basic common share and \$0.88 per diluted common share, compared to net income of \$6.2 million, or \$0.64 per basic common share and diluted common share, for the six months ended June 30, 2018. Return on average assets increased to 0.94% for the six months ended June 30, 2019 compared to 0.76% for the six months ended June 30, 2018. Return on average equity was 9.06% for the six months ended June 30, 2019 compared to 7.18% for the six months ended June 30, 2018.

Net Interest Income

Net interest income, which is the largest component of our earnings, is the difference between interest earned on assets, such as loans and investments, and the cost of interest-bearing liabilities, such as deposits and borrowings. The primary factors affecting net interest income are the volume, yield and mix of our rate-sensitive assets and liabilities, as well as the amount of our nonperforming loans and the interest rate environment.

Three months ended June 30, 2019 vs. three months ended June 30, 2018. Net interest income increased 14.0% to \$16.3 million for the three months ended June 30, 2019 compared to \$14.3 million for the same period in 2018. This increase is due primarily to the \$253.1 million and \$11.5 million increases in average loans and average investment securities, respectively, compared to the same period in 2018, resulting in a \$4.4 million increase in interest income, discussed in more detail below. Average interest-bearing deposits increased approximately \$235.3 million and average short- and long-term borrowings decreased \$27.4 million for the three months ended June 30, 2019 compared to the same period in 2018, resulting in a \$2.4 million increase in interest expense, also discussed in more detail below. The increases in both average interest-earning assets and interest-bearing liabilities are results of both organic growth of the Company and the acquisition of Mainland on March 1, 2019.

Interest income was \$22.4 million for the three months ended June 30, 2019 compared to \$18.0 million for the same period in 2018. Loan interest income made up substantially all of our interest income for the three months ended June 30, 2019 and 2018. An increase in interest income of \$3.3 million can be attributed to an increase in the volume of interest-earning assets and an increase of \$1.1 million can be attributed to an increase in the yield earned on those assets. The overall yield on interest-earning assets was 4.93% and 4.65% for the three months ended June 30, 2019 and 2018, respectively. The loan portfolio yielded 5.33% for the three months ended June 30, 2019 compared to 5.12% for the three months ended June 30, 2018, while the yield on the investment portfolio was 2.86% for the three months ended June 30, 2019 compared to 2.55% for the three months ended June 30, 2018.

Interest expense was \$6.1 million for the three months ended June 30, 2019, an increase of \$2.4 million compared to interest expense of \$3.7 million for the three months ended June 30, 2018, as a result of an increase of \$0.4 million attributed to the increase in volume and \$1.9 million attributed to the increase in the cost of interest-bearing liabilities. Average interest-bearing liabilities increased approximately \$207.9 million for the three months ended June 30, 2019 compared to the same period in 2018 mainly as a result of a \$235.3 million increase in interest-bearing deposits, as average short- and long-term borrowings decreased \$27.4 million. The cost of deposits increased 55 basis points to 1.52% for the three months ended June 30, 2019 compared to 0.97% for the three months ended June 30, 2018 as a result of the increase in the rates offered for our interest-bearing demand accounts and time deposits. The cost of interest-bearing liabilities increased 48 basis points to 1.67% for the three months ended June 30, 2019 compared to 1.19% for the same period in 2018, due to the increase in the cost of deposits, as well as the increased cost of short-term borrowings, or 51 basis points, which is primarily driven by the Federal Reserve Bank's federal funds rate.

Net interest margin was 3.59% for the three months ended June 30, 2019, a decrease of 11 basis points from 3.70% for the three months ended June 30, 2018. The decrease in net interest margin was primarily driven by an increase in the cost of funds required to fund the increase in assets.

Average Balances and Yields. The following table sets forth average balance sheet data, including all major categories of interest-earning assets and interest-bearing liabilities, together with the interest earned or paid and the average yield or rate paid on each such category for the three months ended June 30, 2019 and 2018. Averages presented in the table below are daily averages (dollars in thousands).

	Three months ended June 30,					
	2019			2018		
	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾
Assets						
Interest-earning assets:						
Loans	\$ 1,523,004	\$ 20,233	5.33%	\$ 1,269,894	\$ 16,223	5.12%
Securities:						
Taxable	238,150	1,726	2.94	224,263	1,441	2.58
Tax-exempt	31,554	197	2.51	33,936	203	2.40
Interest-earning balances with banks	30,488	232	3.05	25,720	142	2.20
Total interest-earning assets	1,823,196	22,388	4.93	1,553,813	18,009	4.65
Cash and due from banks	23,154			16,690		
Intangible assets	26,501			20,064		
Other assets	88,486			73,312		
Allowance for loan losses	(9,778)			(8,170)		
Total assets	\$ 1,951,559			\$ 1,655,709		
Liabilities and stockholders' equity						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand deposits	\$ 504,541	\$ 1,333	1.06%	\$ 372,824	\$ 641	0.69%
Savings deposits	113,179	126	0.45	121,174	138	0.46
Time deposits	618,604	3,225	2.09	507,039	1,647	1.30
Total interest-bearing deposits	1,236,324	4,684	1.52	1,001,037	2,426	0.97
Short-term borrowings	127,196	685	2.16	140,595	579	1.65
Long-term debt	92,103	688	2.99	106,063	684	2.59
Total interest-bearing liabilities	1,455,623	6,057	1.67	1,247,695	3,689	1.19
Noninterest-bearing deposits	277,822			222,404		
Other liabilities	14,203			9,809		
Stockholders' equity	203,911			175,801		
Total liabilities and stockholders' equity	\$ 1,951,559			\$ 1,655,709		
Net interest income/net interest margin		\$ 16,331	3.59%		\$ 14,320	3.70%

⁽¹⁾ Interest income and net interest margin are expressed as a percentage of average interest-earning assets outstanding for the indicated periods. Interest expense is expressed as a percentage of average interest-bearing liabilities for the indicated periods.

Volume/Rate Analysis. The following table sets forth a summary of the changes in interest earned and interest paid resulting from changes in volume and rates for the three months ended June 30, 2019 compared to the same period in 2018 (dollars in thousands).

	Three months ended June 30, 2019 vs. three months ended June 30, 2018		
	Volume	Rate	Net⁽¹⁾
Interest income:			
Loans	\$ 3,234	\$ 776	\$ 4,010
Securities:			
Taxable	89	196	285
Tax-exempt	(14)	8	(6)
Interest-earning balances with banks	26	64	90
Total interest-earning assets	<u>3,335</u>	<u>1,044</u>	<u>4,379</u>
Interest expense:			
Interest-bearing demand deposits	226	466	692
Savings deposits	(9)	(3)	(12)
Time deposits	363	1,215	1,578
Short-term borrowings	(55)	161	106
Long-term debt	(90)	94	4
Total interest-bearing liabilities	<u>435</u>	<u>1,933</u>	<u>2,368</u>
Change in net interest income	<u>\$ 2,900</u>	<u>\$ (889)</u>	<u>\$ 2,011</u>

⁽¹⁾ Changes in interest due to both volume and rate have been allocated on a pro-rata basis using the absolute ratio value of amounts calculated.

Six months ended June 30, 2019 vs. six months ended June 30, 2018. Net interest income increased 11.7% to \$31.5 million for the six months ended June 30, 2019 compared to \$28.2 million for the same period in 2018. This increase is due primarily to the \$214.6 million and \$22.7 million increases in average loans and average investment securities, respectively, compared to the same period in 2018, resulting in a \$7.9 million increase in interest income, discussed in more detail below. Average interest-bearing deposits increased approximately \$208.3 million and average short- and long-term borrowings decreased \$11.9 million for the six months ended June 30, 2019 compared to the same period in 2018, resulting in a \$3.3 million increase in interest expense, also discussed in more detail below. The increases in both average interest-earning assets and interest-bearing liabilities are results of both organic growth of the Company and the acquisition of Mainland on March 1, 2019.

Interest income was \$43.1 million for the six months ended June 30, 2019 compared to \$35.2 million for the same period in 2018. Loan interest income made up substantially all of our interest income for the six months ended June 30, 2019 and 2018. An increase in interest income of \$5.7 million can be attributed to an increase in the volume of interest-earning assets and an increase of \$2.1 million can be attributed to an increase in the yield earned on those assets. The overall yield on interest-earning assets was 4.87% and 4.61% for the six months ended June 30, 2019 and 2018, respectively. The loan portfolio yielded 5.28% for the six months ended June 30, 2019 compared to 5.08% for the six months ended June 30, 2018, while the yield on the investment portfolio was 2.85% for the six months ended June 30, 2019 compared to 2.50% for the six months ended June 30, 2018.

Interest expense was \$11.6 million for the six months ended June 30, 2019, an increase of \$4.5 million compared to interest expense of \$7.0 million for the six months ended June 30, 2018, as a result of an increase of \$0.8 million attributed to the increase in volume and \$3.7 million attributed to the increase in the cost of interest-bearing liabilities. Average interest-bearing liabilities increased approximately \$196.4 million for the six months ended June 30, 2019 compared to the same period in 2018 mainly as a result of a \$208.3 million increase in interest-bearing deposits, as average short- and long-term borrowings decreased \$11.9 million. The cost of deposits increased 52 basis points to 1.46% for the six months ended June 30, 2019 compared to 0.94% for the six months ended June 30, 2018 as a result of the increase in the rates offered for our interest-bearing demand accounts and time deposits. The cost of interest-bearing liabilities increased 49 basis points to 1.63% for the six months ended June 30, 2019 compared to 1.14% for the same period in 2018, due to the increase in the cost of deposits, as well as the increased cost of short-term borrowings, or 63 basis points, which is primarily driven by the Federal Reserve Bank's federal funds rate.

Net interest margin was 3.56% for the six months ended June 30, 2019, a decrease of 13 basis points from 3.69% for the six months ended June 30, 2018. The decrease in net interest margin was primarily driven by an increase in the cost of funds required to fund the increase in assets.

Average Balances and Yields. The following table sets forth average balance sheet data, including all major categories of interest-earning assets and interest-bearing liabilities, together with the interest earned or paid and the average yield or rate paid on each such category for the six months ended June 30, 2019 and 2018. Averages presented in the table below are daily averages (dollars in thousands).

	Six months ended June 30,					
	2019			2018		
	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾
Assets						
Interest-earning assets:						
Loans	\$ 1,480,139	\$ 38,777	5.28%	\$ 1,265,495	\$ 31,849	5.08%
Securities:						
Taxable	240,594	3,455	2.90	215,541	2,694	2.52
Tax-exempt	31,937	394	2.49	34,310	409	2.41
Interest-earning balances with banks	30,867	448	2.96	25,118	235	1.88
Total interest-earning assets	1,783,537	43,074	4.87	1,540,464	35,187	4.61
Cash and due from banks	21,660			16,837		
Intangible assets	24,413			19,973		
Other assets	83,206			73,374		
Allowance for loan losses	(9,672)			(8,082)		
Total assets	\$ 1,903,144			\$ 1,642,566		
Liabilities and stockholders' equity						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand deposits	\$ 504,333	\$ 2,687	1.07%	\$ 366,896	\$ 1,220	0.67%
Savings deposits	108,865	245	0.45	121,018	276	0.46
Time deposits	596,894	5,858	1.98	513,927	3,183	1.25
Total interest-bearing deposits	1,210,092	8,790	1.46	1,001,841	4,679	0.94
Short-term borrowings	131,521	1,418	2.17	142,112	1,086	1.54
Long-term debt	93,126	1,379	2.99	94,417	1,244	2.66
Total interest-bearing liabilities	1,434,739	11,587	1.63	1,238,370	7,009	1.14
Noninterest-bearing deposits	258,550			219,631		
Other liabilities	12,950			9,924		
Stockholders' equity	196,905			174,641		
Total liabilities and stockholders' equity	\$ 1,903,144			\$ 1,642,566		
Net interest income/net interest margin		\$ 31,487	3.56%		\$ 28,178	3.69%

⁽¹⁾ Interest income and net interest margin are expressed as a percentage of average interest-earning assets outstanding for the indicated periods. Interest expense is expressed as a percentage of average interest-bearing liabilities for the indicated periods.

Volume/Rate Analysis. The following table sets forth a summary of the changes in interest earned and interest paid resulting from changes in volume and rates for the six months ended June 30, 2019 compared to the same period in 2018 (dollars in thousands).

	Six months ended June 30, 2019 vs. six months ended June 30, 2018		
	Volume	Rate	Net⁽¹⁾
Interest income:			
Loans	\$ 5,402	\$ 1,526	\$ 6,928
Securities:			
Taxable	313	448	761
Tax-exempt	(28)	13	(15)
Interest-earning balances with banks	54	159	213
Total interest-earning assets	<u>5,741</u>	<u>2,146</u>	<u>7,887</u>
Interest expense:			
Interest-bearing demand deposits	458	1,009	1,467
Savings deposits	(28)	(3)	(31)
Time deposits	514	2,161	2,675
Short-term borrowings	(81)	413	332
Long-term debt	(17)	152	135
Total interest-bearing liabilities	<u>846</u>	<u>3,732</u>	<u>4,578</u>
Change in net interest income	<u>\$ 4,895</u>	<u>\$ (1,586)</u>	<u>\$ 3,309</u>

⁽¹⁾ Changes in interest due to both volume and rate have been allocated on a pro-rata basis using the absolute ratio value of amounts calculated.

Noninterest Income

Noninterest income includes, among other things, fees generated from our deposit services, gain on sale of investment securities, fixed assets and other real estate owned, servicing fees and fee income on serviced loans, interchange fees and income from bank owned life insurance. We expect to continue to develop new products that generate noninterest income, and enhance our existing products, in order to diversify our revenue sources.

Three months ended June 30, 2019 vs. three months ended June 30, 2018. Total noninterest income increased \$0.5 million, or 46.0%, to \$1.7 million for the three months ended June 30, 2019 compared to \$1.2 million for the three months ended June 30, 2018. The increase in noninterest income is mainly attributable to the \$0.1 million and \$0.2 million increases in service charges on deposit accounts and other operating income, respectively, as well as a \$0.2 million increase in the gain on sale of investment securities. During the three months ended June 30, 2019, we recognized \$0.2 million in net gains on the sales of approximately \$61.9 million of investment securities as we seek to better position the balance sheet for potential reductions in short term interest rates.

The \$0.2 million increase in other operating income is primarily due to a \$0.1 million increase in income recorded on an equity method investment during the three months June 30, 2019 compared to same period in 2018, as well as other increases due to organic growth and growth through acquisition. The increase in service charges on deposit accounts is a result of increased volume of deposit accounts.

Servicing fees and fee income on serviced loans, which are fees collected for servicing loans which have been sold and are held in our servicing portfolio, decreased \$0.1 million, or 40.7%, to \$0.2 million for the three months ended June 30, 2019 compared to \$0.3 million for the same period in 2018. The Bank's servicing portfolio primarily consists of indirect auto loans. As this portfolio of loans ages, and consequently decreases in principal value, the servicing fees and fee income on serviced loans earned will continue to decrease.

Six months ended June 30, 2019 vs. six months ended June 30, 2018. Total noninterest income increased \$0.7 million, or 33.5%, to \$3.0 million for the six months ended June 30, 2019 compared to \$2.3 million for the six months ended June 30, 2018. The increase in noninterest income is mainly attributable to the \$0.4 million increase in other operating income and the \$0.2 million increases in both the fair value of equity securities and gain on sale of investment securities, partially offset by a \$0.2 million decrease in servicing fees and fee income on serviced loans.

The \$0.4 million increase in other operating income is primarily due to a \$0.2 million increase in income recorded on an equity method investment during the six months June 30, 2019 compared to same period in 2018, in which a loss was recorded on the equity investment. There were also other increases in other operating income due to organic growth and growth through acquisition, including ATM and credit card fees.

The \$0.2 million increase in the fair value of equity securities compared to the six months ended June 30, 2018 is attributable to closing prices and mix of equity securities held by the Company at June 30, 2019 and fluctuates with market activity. The \$0.2 million increase in the gain on sale of investment securities is due to the sales activity discussed above.

Servicing fees and fee income on serviced loans decreased \$0.2 million, or 39.0%, to \$0.3 million for the six months ended June 30, 2019 compared to \$0.5 million for the same period in 2018. The Bank's servicing portfolio primarily consists of indirect auto loans. As this portfolio of loans ages, and consequently decreases in principal value, the servicing fees and fee income on serviced loans earned will continue to decrease.

Noninterest Expense

Three months ended June 30, 2019 vs. three months ended June 30, 2018. Total noninterest expense was \$11.6 million for the three months ended June 30, 2019, an increase of \$1.4 million, or 13.7%, compared to the same period in 2018. The increase is primarily attributable to increases in depreciation and amortization, salaries and employee benefits, and other operating expenses. The \$0.2 million increase in depreciation and amortization compared to the three months ended June 30, 2018 resulted from various projects, including equipment upgrades at acquired branches and the launch of the Company's first interactive teller machine, as well the acquisition of Mainland, which added fixed assets of approximately \$2.6 million. The \$0.6 million increase in salaries and employee benefits compared to the three months ended June 30, 2018 is mainly attributable to the staffing mix throughout the year, including the addition of our new Commercial and Industrial Division, which includes five new lenders and related support staff hired in the second quarter of 2018, as well as the additional staff from the Mainland acquisition. The \$0.3 million increase in other operating expenses compared to the three months ended June 30, 2018 is primarily driven by increased software expense and debit and credit card activity.

Six months ended June 30, 2019 vs. six months ended June 30, 2018. Total noninterest expense was \$22.9 million for the six months ended June 30, 2019, an increase of \$2.1 million, or 10.3%, compared to the same period in 2018. The increase is primarily attributable to increases in depreciation and amortization, salaries and employee benefits, and other operating expenses, partially offset by a decrease in acquisition expense. The \$0.4 million increase in depreciation and amortization compared to the six months ended June 30, 2018 resulted from various projects, discussed above, and the acquisition of Mainland. The \$0.9 million increase in salaries and employee benefits compared to the six months ended June 30, 2018 is mainly attributable to the staffing mix throughout the year, discussed above, as well as the additional staff from the Mainland acquisition. The \$0.6 million increase in other operating expenses compared to the six months ended June 30, 2018 is primarily attributable to increased software expense, debit and credit card activity, and provision for unfunded loan commitments. These increases in noninterest expense were partially offset by a \$0.2 million decrease in acquisition expense.

Income Tax Expense

Income tax expense for the three months ended June 30, 2019 was \$1.2 million, an increase of \$0.2 million compared to \$1.0 million for the three months ended June 30, 2018. The effective tax rate for the three months ended June 30, 2019 and 2018 was 19.8% and 20.2%, respectively.

Income tax expense for the six months ended June 30, 2019 was \$2.2 million, a decrease of \$0.1 million compared to \$2.3 million for the six months ended June 30, 2018. The effective tax rate for the six months ended June 30, 2019 and 2018 was 19.7% and 27.0%, respectively. Income tax expense for the six months ended June 30, 2018 includes a charge of \$0.6 million as a result of the revaluation of the Company's deferred tax assets and liabilities required following the enactment of the Tax Act.

Risk Management

The primary risks associated with our operations are credit, interest rate and liquidity risk. Credit and interest rate risk are discussed below, while liquidity risk is discussed in this section under the heading *Liquidity and Capital Resources* below.

Credit Risk and the Allowance for Loan Losses

General. The risk of loss should a borrower default on a loan is inherent in any lending activity. Our portfolio and related credit risk are monitored and managed on an ongoing basis by our risk management department, the board of directors' loan committee and the full board of directors. We utilize a ten point risk-rating system, which assigns a risk grade to each borrower based on a number of quantitative and qualitative factors associated with a loan transaction. The risk grade categorizes the loan into one of five risk categories, based on information about the ability of borrowers to service the debt. The information includes, among other factors, current financial information about the borrower, historical payment experience, credit documentation, public information and current economic trends. These categories assist management in monitoring our credit quality. The following describes each of the risk categories, which are consistent with the definitions used in guidance promulgated by federal banking regulators.

- *Pass (grades 1-6)* – Loans not falling into one of the categories below are considered pass. These loans have high credit characteristics and financial strength. The borrowers at least generate profits and cash flow that are in line with peer and industry standards and have debt service coverage ratios above loan covenants and our policy guidelines. For some of these loans, a guaranty from a financially capable party mitigates characteristics of the borrower that might otherwise result in a lower grade.
- *Special Mention (grade 7)* – Loans classified as special mention possess some credit deficiencies that need to be corrected to avoid a greater risk of default in the future. For example, financial ratios relating to the borrower may have deteriorated. Often, a special mention categorization is temporary while certain factors are analyzed or matters addressed before the loan is re-categorized as either pass or substandard.
- *Substandard (grade 8)* – Loans rated as substandard are inadequately protected by the current net worth and paying capacity of the borrower or the liquidation value of any collateral. If deficiencies are not addressed, it is likely that this category of loan will result in the Bank incurring a loss. Where a borrower has been unable to adjust to industry or general economic conditions, the borrower's loan is often categorized as substandard.
- *Doubtful (grade 9)* – Doubtful loans are substandard loans with one or more additional negative factors that makes full collection of amounts outstanding, either through repayment or liquidation of collateral, highly questionable and improbable.
- *Loss (grade 10)* – Loans classified as loss have deteriorated to such a point that it is not practicable to defer writing off the loan. For these loans, all efforts to remediate the loan's negative characteristics have failed and the value of the collateral, if any, has severely deteriorated relative to the amount outstanding. Although some value may be recovered on such a loan, it is not significant in relation to the amount borrowed.

At June 30, 2019 and December 31, 2018, there were no loans classified as loss. At June 30, 2019, there were \$0.2 million of loans classified as doubtful compared to \$0.1 million at December 31, 2018. At June 30, 2019 and December 31, 2018, there were \$8.3 million and \$9.5 million, respectively, of loans classified as substandard, and \$0.2 million of loans classified as special mention.

An external loan review consultant is engaged annually to review approximately 60% of commercial loans, utilizing a risk-based approach designed to maximize the effectiveness of the review. In addition, credit analysts periodically review smaller dollar commercial loans to identify negative financial trends related to any one borrower, any related groups of borrowers or an industry. All loans not categorized as pass are put on an internal watch list, with quarterly reports to the board of directors. In addition, a written status report is maintained by our special assets division for all commercial loans categorized as substandard or worse. We use this information in connection with our collection efforts.

If our collection efforts are unsuccessful, collateral securing loans may be repossessed and sold or, for loans secured by real estate, foreclosure proceedings initiated. The collateral is generally sold at public auction for fair market value, with fees associated with the foreclosure being deducted from the sales price. The purchase price is applied to the outstanding loan balance. If the loan balance is greater than the sales proceeds, the deficient balance is charged-off.

Allowance for Loan Losses. The allowance for loan losses is an amount that management believes will be adequate to absorb probable losses inherent in the entire loan portfolio. The appropriate level of the allowance is based on an ongoing analysis of the loan portfolio and represents an amount that management deems adequate to provide for inherent losses, including collective impairment as recognized under ASC 450, *Contingencies*. Collective impairment is calculated based on loans grouped by type. Another component of the allowance is losses on loans assessed as impaired under ASC 310, *Receivables*. The balance of these loans and their related allowance is included in management's estimation and analysis of the allowance for loan losses. Other considerations in establishing the allowance for loan losses include the nature and volume of the loan portfolio, overall portfolio quality, historical loan loss, review of specific problem loans and current economic conditions that may affect our borrowers' ability to pay, as well as trends within each of these factors. The allowance for loan losses is established after input from management as well as our risk management department and our special assets committee. We evaluate the adequacy of the allowance for loan losses on a quarterly basis. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses was \$9.9 million at June 30, 2019, an increase from \$9.5 million at December 31, 2018.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Determination of impairment is treated the same across all classes of loans. Impairment is measured on a loan-by-loan basis for, among others, all loans of \$500,000 or greater and nonaccrual loans. When we identify a loan as impaired, we measure the extent of the impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loans is the operation or liquidation of the collateral. In these cases when foreclosure is probable, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. For real estate collateral, the fair value of the collateral is based upon a recent appraisal by a qualified and licensed appraiser. If we determine that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), we recognize impairment through an allowance estimate or a charge-off recorded against the allowance. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual, contractual interest is credited to interest income when received, under the cash basis method.

Impaired loans at June 30, 2019, which include TDRs and nonaccrual loans individually evaluated for impairment for purposes of determining the allowance for loan losses, were \$3.2 million compared to \$3.3 million at December 31, 2018. At June 30, 2019 and December 31, 2018, \$0.3 million of the allowance for loan losses was specifically allocated to impaired loans.

The provision for loan losses is a charge to expense in an amount that management believes is necessary to maintain an adequate allowance for loan losses. The provision is based on management's regular evaluation of current economic conditions in our specific markets as well as regionally and nationally, changes in the character and size of the loan portfolio, underlying collateral values securing loans, and other factors which deserve recognition in estimating loan losses. For the three months ended June 30, 2019 and 2018, the provision for loan losses was \$0.4 million and \$0.6 million, respectively. The decrease in the provision for loan losses is primarily attributable to the changes in incremental loan growth, excluding acquired loan balances, as credit quality and other factors impacting our allowance and related provision were relatively unchanged period over period.

For the six months ended June 30, 2019 and 2018, the provision for loan losses was \$0.6 million and \$1.2 million, respectively. The decrease in the provision for loan losses is primarily attributable to \$0.4 million of charge-offs recorded on a commercial and industrial borrower during the six months ended June 30, 2018 and the subsequent need to increase the allowance for loan losses.

Acquired loans that are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"), were marked to market on the date we acquired the loans to values which, in management's opinion, reflected the estimated future cash flows, based on the facts and circumstances surrounding each respective loan at the date of acquisition. We continually monitor these loans as part of our normal credit review and monitoring procedures for changes in the estimated future cash flows. Because ASC 310-30 does not permit carry over or recognition of an allowance for loan losses, we may be required to reserve for these loans in the allowance for loan losses through future provision for loan losses if future cash flows deteriorate below initial projections.

The following table presents the allocation of the allowance for loan losses by loan category as of the dates indicated (dollars in thousands).

	June 30, 2019	December 31, 2018
Construction and development	\$ 1,092	\$ 1,038
1-4 Family	1,439	1,465
Multifamily	371	331
Farmland	97	81
Commercial real estate	4,279	4,182
Total mortgage loans on real estate	7,278	7,097
Commercial and industrial	2,098	1,641
Consumer	548	716
Total	\$ 9,924	\$ 9,454

As discussed above, the balance in the allowance for loan losses is principally influenced by the provision for loan losses and by net loan loss experience. Additions to the allowance are charged to the provision for loan losses. Losses are charged to the allowance as incurred and recoveries on losses previously charged to the allowance are credited to the allowance at the time recovery is collected. The table below reflects the activity in the allowance for loan losses for the periods indicated (dollars in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Allowance at beginning of period	\$ 9,642	\$ 8,130	\$ 9,454	\$ 7,891
Provision for loan losses	369	567	634	1,192
Charge-offs:				
Mortgage loans on real estate:				
1-4 Family	—	(28)	—	(35)
Commercial and industrial	—	(141)	—	(451)
Consumer	(69)	(106)	(173)	(235)
Total charge-offs	(120)	(291)	(224)	(737)
Recoveries				
Mortgage loans on real estate:				
Construction and development	15	2	16	8
1-4 Family	5	3	7	6
Commercial and industrial	1	8	12	41
Consumer	12	32	25	50
Total recoveries	33	45	60	105
Net charge-offs	(87)	(246)	(164)	(632)
Balance at end of period	\$ 9,924	\$ 8,451	\$ 9,924	\$ 8,451
Net charge-offs to:				
Loans - average	0.01%	0.02%	0.01%	0.05%
Allowance for loan losses	0.88%	2.91%	1.65%	7.48%
Allowance for loan losses to:				
Total loans	0.64%	0.65%	0.64%	0.65%
Nonperforming loans	173.43%	199.04%	173.43%	199.04%

The allowance for loan losses to total loans was 0.64% at June 30, 2019 and 2018. The allowance for loan losses to nonperforming loans decreased to 173.43% at June 30, 2019 compared to 199.04% at June 30, 2018. The decrease in the allowance for loan losses to nonperforming loans at June 30, 2019 is due to the \$1.5 million increase in nonperforming loans compared to June 30, 2018. Nonperforming loans increased to \$5.7 million at June 30, 2019 compared to \$4.2 million at June 30, 2018.

Charge-offs reflect the realization of losses in the portfolio that were recognized previously through the provision for loan losses. Net charge-offs, which include recoveries of amounts previously charged off, for the three and six months ended June 30, 2019 were \$0.1 million and \$0.2 million, respectively, equal to 0.01% of the average loan balance for each period. Net charge-offs for the three and six months ended June 30, 2018 were \$0.2 million and \$0.6 million, respectively, equal to 0.02% and 0.05%, respectively, of the average loan balance for the period.

Management believes the allowance for loan losses at June 30, 2019 is sufficient to provide adequate protection against losses in our portfolio. Although the allowance for loan losses is considered adequate by management, there can be no assurance that this allowance will prove to be adequate over time to cover ultimate losses in connection with our loans. This allowance may prove to be inadequate due to unanticipated adverse changes in the economy or discrete events adversely affecting specific customers or industries. Our results of operations and financial condition could be materially adversely affected to the extent that the allowance is insufficient to cover such changes or events.

Nonperforming Assets and Restructured Loans. Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans are those on which the accrual of interest has stopped or loans which are contractually 90 days past due on which interest continues to accrue. Loans are ordinarily placed on nonaccrual when a loan is specifically determined to be impaired or when principal and interest is delinquent for 90 days or more. However, management may elect to continue the accrual when the estimated net available value of collateral is sufficient to cover the principal balance and accrued interest. It is our policy to discontinue the accrual of interest income on any loan for which we have reasonable doubt as to the payment of interest or principal. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period of repayment performance by the borrower.

Another category of assets which contributes to our credit risk is troubled debt restructurings (“TDR”), or restructured loans. A restructured loan is a loan for which a concession that is not insignificant has been granted to the borrower due to a deterioration of the borrower’s financial condition and which is performing in accordance with the new terms. Such concessions may include reduction in interest rates, deferral of interest or principal payments, principal forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. We strive to identify borrowers in financial difficulty early and work with them to modify their loans to more affordable terms before such loan reaches nonaccrual status. In evaluating whether to restructure a loan, management analyzes the long-term financial condition of the borrower, including guarantor and collateral support, to determine whether the proposed concessions will increase the likelihood of repayment of principal and interest. Restructured loans that are not performing in accordance with their restructured terms that are either contractually 90 days past due or placed on nonaccrual status are reported as nonperforming loans.

There were 19 loans classified as TDRs at June 30, 2019 that totaled \$1.6 million, compared to 24 loans totaling \$2.2 million at December 31, 2018. At June 30, 2019, 11 restructured loans were considered TDRs due to a modification of terms through adjustments to maturity, seven restructured loans were considered TDRs due to a reduction in the interest rate to a rate lower than the current market rate, and one restructured loan was considered a TDR due to forgiveness of interest due on the loan. As of June 30, 2019 and December 31, 2018, two of the TDRs were in default of their modified terms and are included in nonaccrual loans. The Company individually evaluates each TDR for allowance purposes, primarily based on collateral value, and excludes these loans from the loan population that is collectively evaluated for impairment.

The following table shows the principal amounts of nonperforming and restructured loans as of the dates indicated. All loans for which information exists about possible credit problems that would cause us to have serious doubts about the borrower’s ability to comply with the current repayment terms of the loan have been reflected in the table below (dollars in thousands).

	June 30, 2019	December 31, 2018
Nonaccrual loans	\$ 5,722	\$ 5,891
Accruing loans past due 90 days or more	—	58
Total nonperforming loans	5,722	5,949
TDRs	1,118	1,248
Total nonperforming loans and TDRs	\$ 6,840	\$ 7,197
Interest income recognized on nonperforming loans and TDRs	\$ 39	\$ 315
Interest income foregone on nonperforming loans and TDRs	\$ 167	\$ 164

Nonperforming loans are comprised of accruing loans past due 90 days or more and nonaccrual loans. Nonperforming loans outstanding represented 0.37% and 0.42% of total loans at June 30, 2019 and December 31, 2018, respectively.

Other Real Estate Owned. Other real estate owned consists of properties acquired through foreclosure or acceptance of a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair market value based on appraised value less estimated selling costs. Losses arising at the time of foreclosure of properties are charged to the allowance for loan losses. Other real estate owned with a cost basis of \$0.2 million and \$3.5 million was sold during the three and six months ended June 30, 2019, respectively, resulting in a gain of \$13,000 and \$18,000 for the respective periods. Other real estate owned with a cost basis of \$42,000 was sold during the three and six months ended June 30, 2018 resulting in a net loss of \$4,000 for the respective periods. At June 30, 2019, approximately \$1.7 million of loans secured by real estate were in the process of foreclosure, \$0.9 million of which were consumer mortgage loans secured by residential real estate property.

The table below provides details of our other real estate owned as of the dates indicated (dollars in thousands).

	June 30, 2019	December 31, 2018
Construction and development	\$ 122	\$ 122
1-4 Family	—	15
Farmland	—	204
Commercial real estate	1,407	3,270
Total other real estate owned	\$ 1,529	\$ 3,611

Changes in our other real estate owned are summarized in the table below for the periods indicated (dollars in thousands).

	Six months ended June 30,	
	2019	2018
Balance, beginning of period	\$ 3,611	\$ 3,837
Additions	—	225
Transfers from acquired loans	—	205
Acquired other real estate owned	1,407	(42)
Sales of other real estate owned	(3,489)	—
Balance, end of period	\$ 1,529	\$ 4,225

Interest Rate Risk

Market risk is the risk of loss from adverse changes in market prices and rates. Since the majority of our assets and liabilities are monetary in nature, our market risk arises primarily from interest rate risk inherent in our lending and deposit activities. A sudden and substantial change in interest rates may adversely impact our earnings and profitability because the interest rates borne by assets and liabilities do not change at the same speed, to the same extent or on the same basis. Accordingly, our ability to proactively structure the volume and mix of our assets and liabilities to address anticipated changes in interest rates, as well as to react quickly to such fluctuations, can significantly impact our financial results. To that end, management actively monitors and manages our interest rate risk exposure.

The Asset Liability Committee (“ALCO”) has been authorized by the board of directors to implement our asset/liability management policy, which establishes guidelines with respect to our exposure to interest rate fluctuations, liquidity, loan limits as a percentage of funding sources, exposure to correspondent banks and brokers and reliance on non-core deposits. The goal of the policy is to enable us to maximize our interest income and maintain our net interest margin without exposing the Bank to excessive interest rate risk, credit risk and liquidity risk. Within that framework, the ALCO monitors our interest rate sensitivity and makes decisions relating to our asset/liability composition.

We monitor the impact of changes in interest rates on our net interest income using gap analysis. The gap represents the net position of our assets and liabilities subject to repricing in specified time periods. During any given time period, if the amount of rate-sensitive liabilities exceeds the amount of rate-sensitive assets, a financial institution would generally be considered to have a negative gap position and would benefit from falling rates over that period of time. Conversely, a financial institution with a positive gap position would generally benefit from rising rates.

Within the gap position that management directs, we attempt to structure our assets and liabilities to minimize the risk of either a rising or falling interest rate environment. We manage our gap position for time horizons of one month, two months, three months, 4-6 months, 7-12 months, 13-24 months, 25-36 months, 37-60 months and more than 60 months. The goal of our asset/liability management is for the Bank to maintain a net interest income at risk in an up or down 100 basis point environment at less than (5)%. At June 30, 2019, the Bank was within the policy guidelines for asset/liability management.

The table below depicts the estimated impact on net interest income of immediate changes in interest rates at the specified levels.

As of June 30, 2019	
Changes in Interest Rates (in basis points)	Estimated Increase/Decrease in Net Interest Income ⁽¹⁾
+300	(3.1)%
+200	(2.1)%
+100	(0.8)%
-100	(0.4)%
-200	(3.9)%

⁽¹⁾ The percentage change in this column represents the projected net interest income for 12 months on a flat balance sheet in a stable interest rate environment versus the projected net interest income in the various rate scenarios.

The computation of the prospective effects of hypothetical interest rate changes requires numerous assumptions regarding characteristics of new business and the behavior of existing positions. These business assumptions are based upon our experience, business plans and published industry experience. Key assumptions include asset prepayment speeds, competitive factors, the relative price sensitivity of certain assets and liabilities and the expected life of non-maturity deposits. However, there are a number of factors that influence the effect of interest rate fluctuations on us which are difficult to measure and predict. For example, a rapid drop in interest rates might cause our loans to repay at a more rapid pace and certain mortgage-related investments to prepay more quickly than projected. Conversely, a rapid rise in rates could give us an opportunity to increase our margins and stifle the rate of repayment on our mortgage-related loans which would increase our returns. As a result, because these assumptions are inherently uncertain, actual results will differ from simulated results.

Liquidity and Capital Resources

Liquidity. Liquidity is a measure of the ability to fund loan commitments and meet deposit maturities and withdrawals in a timely and cost-effective way. Cash flow requirements can be met by generating net income, attracting new deposits, converting assets to cash or borrowing funds. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows, loan prepayments, loan sales and borrowings are greatly influenced by general interest rates, economic conditions and the competitive environment in which we operate. To minimize funding risks, we closely monitor our liquidity position through periodic reviews of maturity profiles, yield and rate behaviors, and loan and deposit forecasts. Excess short-term liquidity is usually invested in overnight federal funds sold.

Our core deposits, which are deposits excluding time deposits greater than \$250,000 and deposits of municipalities and other political entities, are our most stable source of liquidity to meet our cash flow needs due to the nature of the long-term relationships generally established with our customers. Maintaining the ability to acquire these funds as needed in a variety of markets, and within ALCO compliance targets, is essential to ensuring our liquidity. At June 30, 2019 and December 31, 2018, 66% of our total assets, respectively, were funded by core deposits.

Our investment portfolio is another alternative for meeting our cash flow requirements. Investment securities generate cash flow through principal payments and maturities, and generally have readily available markets that allow for their conversion to cash. Some securities are pledged to secure certain deposit types or short-term borrowings, such as FHLB advances, which impacts their liquidity. At June 30, 2019, securities with a carrying value of \$85.7 million were pledged to secure certain deposits, borrowings, and other liabilities, compared to \$77.6 million in pledged securities at December 31, 2018.

Other sources available for meeting liquidity needs include advances from the FHLB, repurchase agreements and other borrowings. FHLB advances are primarily used to match-fund fixed rate loans in order to minimize interest rate risk and also may be used to meet day to day liquidity needs, particularly if the prevailing interest rate on an FHLB advance compares favorably to the rates that we would be required to pay to attract deposits. At June 30, 2019, the balance of our outstanding advances with the FHLB was \$196.6 million, a decrease from \$206.5 million at December 31, 2018. The total amount of the remaining credit available to us from the FHLB at June 30, 2019 was \$518.4 million. Repurchase agreements are contracts for the sale of securities which we own with a corresponding agreement to repurchase those securities at an agreed upon price and date. Our policies limit the use of repurchase agreements to those collateralized by investment securities. We had \$1.9 million of repurchase agreements outstanding at June 30, 2019 compared to \$2.0 million of repurchase agreements outstanding at December 31, 2018. We maintain unsecured lines of credit with other commercial banks totaling \$60.0 million. The lines of credit mature at various times within the next year. We had no outstanding balances on our unsecured lines of credit at June 30, 2019 and December 31, 2018.

Our liquidity strategy is focused on using the least costly funds available to us in the context of our balance sheet composition and interest rate risk position. Accordingly, we target growth of noninterest-bearing deposits. Although we cannot directly control the types of deposit instruments our customers choose, we can influence those choices with the interest rates and deposit specials we offer. We hold brokered deposits, as defined for federal regulatory purposes, included in our interest-bearing demand deposit balance, as well as QwickRate® deposits, included in our time deposit balance, which we obtain through a qualified network to address liquidity needs when rates on such deposits compare favorably with deposit rates in our markets. At June 30, 2019 and December 31, 2018, we held \$15.2 million and \$15.0 million, respectively, of brokered deposits. At June 30, 2019, we held \$85.2 million of QwickRate® deposits, an increase compared to \$56.7 million at December 31, 2018.

The following table presents, by type, our funding sources, which consist of total average deposits and borrowed funds, as a percentage of total funds and the total cost of each funding source for the three and six month periods ended June 30, 2019 and 2018.

	Percentage of Total				Cost of Funds			
	Three months ended June 30,		Six months ended June 30,		Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018	2019	2018	2019	2018
Noninterest-bearing demand deposits	15%	15%	14%	15%	—%	—%	—%	—%
Interest-bearing demand deposits	30	25	31	25	1.06	0.69	1.07	0.67
Savings accounts	6	8	6	8	0.45	0.46	0.45	0.46
Time deposits	35	35	35	35	2.09	1.30	1.98	1.25
Short-term borrowings	8	10	8	10	2.16	1.65	2.17	1.54
Long-term borrowed funds	6	7	6	7	2.99	2.59	2.99	2.66
Total deposits and borrowed funds	100%	100%	100%	100%	1.40%	1.01%	1.38%	0.97%

Capital. Our primary sources of capital include retained earnings, capital obtained through acquisitions, and proceeds from the sale of our capital stock and subordinated debt. During the six months ended June 30, 2019, the Company paid \$1.0 million in dividends, compared to \$0.6 million during the six months ended June 30, 2018. The Company declared dividends on its common stock of \$0.0551 and \$0.1076 per share during the three and six months ended June 30, 2019 compared to dividends of \$0.04 and \$0.075 per share during the three and six months ended June 30, 2018. Our board of directors has authorized a share repurchase program and, at June 30, 2019, the Company had 345,051 shares of its common stock remaining authorized for repurchase under the program. During the six months ended June 30, 2019, the Company paid \$7.9 million to repurchase its shares, compared to \$0.7 million during the six months ended June 30, 2018. During the six months ended June 30, 2019, the Company repurchased 341,199 shares of its common stock, compared to 27,933 shares during the six months ended June 30, 2018.

We are subject to various regulatory capital requirements administered by the Federal Reserve and the FDIC which specify capital tiers, including the following classifications.

Capital Tiers	Common Equity Tier 1			
	Tier 1 Leverage Ratio	Capital Ratio	Tier 1 Capital Ratio	Total Capital Ratio
Well capitalized	5% or above	6.5% or above	8% or above	10% or above
Adequately capitalized	4% or above	4.5% or above	6% or above	8% or above
Undercapitalized	Less than 4%	Less than 4.5%	Less than 6%	Less than 8%
Significantly undercapitalized	Less than 3%	Less than 3%	Less than 4%	Less than 6%
Critically undercapitalized			2% or less	

The Company and the Bank each were in compliance with all regulatory capital requirements at June 30, 2019 and December 31, 2018. The Bank also was considered “well-capitalized” under the FDIC’s prompt corrective action regulations as of these dates. The following table presents the actual capital amounts and regulatory capital ratios for the Company and the Bank as of the dates presented (dollars in thousands).

	Actual		Minimum Capital Requirement to be Well Capitalized	
	Amount	Ratio	Amount	Ratio
June 30, 2019				
Investar Holding Corporation:				
Tier 1 leverage capital	\$ 184,377	9.59%	\$ —	—%
Common equity tier 1 capital	177,877	10.51	—	—
Tier 1 capital	184,377	10.89	—	—
Total capital	212,682	12.56	—	—
Investar Bank:				
Tier 1 leverage capital	202,784	10.53	96,264	5.00
Common equity tier 1 capital	202,784	11.95	110,258	6.50
Tier 1 capital	202,784	11.95	135,702	8.00
Total capital	212,851	12.55	169,627	10.00
December 31, 2018				
Investar Holding Corporation:				
Tier 1 leverage capital	\$ 172,050	9.81%	\$ —	—%
Common equity tier 1 capital	165,550	11.15	—	—
Tier 1 capital	172,050	11.59	—	—
Total capital	199,786	13.46	—	—
Investar Bank:				
Tier 1 leverage capital	187,735	10.72	87,570	5.00
Common equity tier 1 capital	187,735	12.67	96,349	6.50
Tier 1 capital	187,735	12.67	118,583	8.00
Total capital	197,256	13.31	148,229	10.00

Off-Balance Sheet Transactions

The Company currently holds interest rate swap contracts to manage exposure against the variability in the expected future cash flows (future interest payments) attributable to changes in the 1-month LIBOR associated with the forecasted issuances of 1-month fixed rate debt arising from a rollover strategy. An interest rate swap is an agreement whereby one party agrees to pay a fixed rate of interest on a notional principal amount in exchange for receiving a floating rate of interest on the same notional amount for a predetermined period of time, from a second party. The maximum length of time over which the Bank is currently hedging its exposure to the variability in future cash flows for forecasted transactions is approximately 1.1 years. The total notional amount of the derivative contracts is \$50.0 million.

The Bank enters into loan commitments and standby letters of credit in the normal course of its business. Loan commitments are made to meet the financing needs of our customers, while standby letters of credit commit the Bank to make payments on behalf of customers when certain specified future events occur. The credit risks associated with loan commitments and standby letters of credit are essentially the same as those involved in making loans to our customers. Accordingly, our normal credit policies apply to these arrangements. Collateral (e.g., securities, receivables, inventory, equipment, etc.) is obtained based on management's credit assessment of the customer. Loan commitments are also evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded loan commitments is included in other liabilities in the consolidated balance sheets and was \$143,000 and \$66,000 at June 30, 2019 and December 31, 2018, respectively.

Loan commitments and standby letters of credit do not necessarily represent future cash requirements, in that while the customer typically has the ability to draw upon these commitments at any time, these commitments often expire without being drawn upon in full or at all. Virtually all of our standby letters of credit expire within one year. Our unfunded loan commitments and standby letters of credit outstanding are summarized below as of the dates indicated (dollars in thousands):

	June 30, 2019	December 31, 2018
Commitments to extend credit:		
Loan commitments	\$ 306,697	\$ 263,002
Standby letters of credit	14,082	11,114

The Company closely monitors the amount of remaining future commitments to borrowers in light of prevailing economic conditions and adjusts these commitments as necessary. The Company intends to continue this process as new commitments are entered into or existing commitments are renewed.

Additionally, at June 30, 2019, the Company had unfunded commitments of \$38,000 for its investment in Small Business Investment Company qualified funds.

For the six months ended June 30, 2019 and for the year ended December 31, 2018, except as disclosed herein and in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, we engaged in no off-balance sheet transactions that we believe are reasonably likely to have a material effect on our financial condition, results of operations, or cash flows.

Contractual Obligations

The following table presents, at June 30, 2019, contractual obligations to third parties by payment date (dollars in thousands).

	Payments Due In:				
	Less than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity ⁽¹⁾	\$ 910,666	\$ —	\$ —	\$ —	\$ 910,666
Time Deposits ^{(1) (2)}	416,868	200,289	24,333	—	641,490
Securities sold under agreements to repurchase ⁽¹⁾	1,876	—	—	—	1,876
Federal Home Loan Bank advances ⁽²⁾	141,600	—	—	55,000	196,600
Subordinated debt ⁽²⁾	—	—	—	18,600	18,600
Junior subordinated debt ⁽²⁾	—	—	—	6,702	6,702
Operating lease commitment	287	890	687	1,129	2,993
Total contractual obligations	<u>\$ 1,471,297</u>	<u>\$ 201,179</u>	<u>\$ 25,020</u>	<u>\$ 81,431</u>	<u>\$ 1,778,927</u>

⁽¹⁾ Excludes interest.

⁽²⁾ Excludes unamortized premiums and discounts.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Quantitative and qualitative disclosures about market risk as of December 31, 2018 are set forth in the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2019 in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations – Risk Management." There have been no material changes in the Company's market risk since December 31, 2018. Please refer to the information in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the heading "Risk Management" in this report for additional information about the Company's market risk for the six months ended June 30, 2019.

Item 4. Controls and Procedures

Based on their evaluation as of the end of the period covered by this quarterly report on Form 10-Q, the Company's Principal Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) are effective for ensuring that information the Company is required to disclose in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

There were no changes in the Company's internal control over financial reporting during the fiscal quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

For information regarding risk factors that could affect Investar Holding Corporation's (the "Company") results of operations, financial condition and liquidity, see the risk factors disclosed in the Annual Report on Form 10-K for the year ended December 31, 2018 filed by the Company with the Securities and Exchange Commission ("SEC") on March 15, 2019.

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

Unregistered Sales of Equity Securities and Use of Proceeds

None.

Issuer Purchases of Equity Securities

The table below provides the information with respect to purchases made by the Company of shares of its common stock during each of the months during the three month period ended June 30, 2019.

Period	(a) Total Number of Shares (or Units) Purchased⁽¹⁾	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs⁽²⁾	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Be Purchased Under the Plans or Programs⁽²⁾
April 1, 2019 to April 30, 2019	103,037	\$ 22.27	101,512	140,954
May 1, 2019 to May 31, 2019	7,248	23.86	7,084	133,870
June 1, 2019 to June 30, 2019	88,862	23.55	88,829	345,041
	<u>199,147</u>	<u>\$ 22.90</u>	<u>197,425</u>	<u>345,041</u>

⁽¹⁾ Includes 1,722 shares surrendered to cover the payroll taxes due upon the vesting of restricted stock.

⁽²⁾ On February 5, 2019, the Company announced that its board of directors authorized the repurchase of an additional 300,000 shares of the Company's common stock under its stock repurchase plan, in addition to the 86,240 shares that were remaining as authorized for repurchase at December 31, 2018. On June 26, 2019, the Company announced that its board of directors authorized the repurchase of an additional 300,000 shares of the Company's common stock.

The Company's ability to pay dividends to its shareholders may be limited by the junior subordinated debentures that the Company assumed in connection with its acquisition of First Community Bank, which are senior to shares of the Company's common stock. The Company must make payments on the junior subordinated debentures before any dividends can be paid on its common stock.

In addition, the Company's status as a bank holding company affects its ability to pay dividends, in two ways:

- As a holding company with no material business activities, the Company's ability to pay dividends is substantially dependent upon the ability of the Bank to transfer funds to the Company in the form of dividends, loans and advances. The Bank's ability to pay dividends and make other distributions and payments is itself subject to various legal, regulatory and other restrictions.
- As a holding company of a bank, the Company's payment of dividends must comply with the policies and enforcement powers of the Federal Reserve. Under Federal Reserve policies, in general a bank holding company should pay dividends only when (1) its net income available to shareholders over the last four quarters (net of dividends paid) has been sufficient to fully fund the dividends, (2) the prospective rate of earnings retention appears to be consistent with the capital needs and overall current and prospective financial condition of the bank holding company and its subsidiaries, and (3) the bank holding company will continue to meet minimum regulatory capital adequacy ratios.

Item 6. Exhibits

Exhibit No.	Description of Exhibit
2.1	Agreement and Plan of Reorganization, dated July 30, 2019, by and among Investar Holding Corporation, Investar Bank, and Bank of York ⁽¹⁾
3.1	Restated Articles of Incorporation of Investar Holding Corporation ⁽²⁾
3.2	Amended and Restated By-laws of Investar Holding Corporation ⁽³⁾
4.1	Specimen Common Stock Certificate ⁽⁴⁾
4.2	Indenture, dated March 24, 2017, by and between Investar Holding Corporation and Wilmington Trust, National Association, as Trustee ⁽⁵⁾
4.3	Supplemental Indenture, dated March 24, 2017, by and between Investar Holding Corporation and Wilmington Trust, National Association, as Trustee ⁽⁶⁾
10.1	Supplemental Salary Continuation Agreement, dated May 22, 2019, by and between Investar Bank and John D'Angelo ⁽⁷⁾
10.2	Supplemental Salary Continuation Agreement, dated May 22, 2019, by and between Investar Bank and Christopher Hufft ⁽⁸⁾
10.3	Form of First Amendment to Split Dollar Agreement by and between Investar Bank and each executive entering into a Supplemental Salary Continuation Agreement ⁽⁹⁾
31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Principal Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Principal Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

⁽¹⁾ Filed as exhibit 2.1 to the Current Report on Form 8-K of the Company filed with the SEC on July 31, 2019 and incorporated herein by reference.

⁽²⁾ Filed as exhibit 3.1 to the Registration Statement on Form S-1 of the Company filed with the SEC on May 16, 2014 and incorporated herein by reference.

⁽³⁾ Filed as exhibit 3.2 to the Registration Statement on Form S-4 of the Company filed with the SEC on October 10, 2017 and incorporated herein by reference.

⁽⁴⁾ Filed as exhibit 4.1 to the Registration Statement on Form S-1 of the Company filed with the SEC on May 16, 2014 and incorporated herein by reference.

⁽⁵⁾ Filed as exhibit 4.1 to the Current Report on Form 8-K filed with the SEC on March 24, 2017 and incorporated herein by reference.

⁽⁶⁾ Filed as exhibit 4.2 to the Current Report on Form 8-K filed with the SEC on March 24, 2017 and incorporated herein by reference.

⁽⁷⁾ Filed as exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on May 23, 2019 and incorporated herein by reference.

⁽⁸⁾ Filed as exhibit 10.2 to the Current Report on Form 8-K filed with the SEC on May 23, 2019 and incorporated herein by reference.

⁽⁹⁾ Filed as exhibit 10.3 to the Current Report on Form 8-K filed with the SEC on May 23, 2019 and incorporated herein by reference.

The Company does not have any long-term debt instruments under which securities are authorized exceeding 10% of the total assets of the Company and its subsidiaries on a consolidated basis. The Company will furnish to the SEC, upon its request, a copy of all long-term debt instruments.

SIGNATURES

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

INVESTAR HOLDING CORPORATION

Date: August 9, 2019

/s/ John J. D'Angelo

John J. D'Angelo

President and Chief Executive Officer

(Principal Executive Officer)

Date: August 9, 2019

/s/ Christopher L. Hufft

Christopher L. Hufft

Chief Financial Officer

(Principal Financial Officer)

CERTIFICATIONS

I, John J. D'Angelo, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2019 of Investar Holding Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2019

/s/ John J. D'Angelo

John J. D'Angelo
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, Christopher L. Hufft, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2019 of Investar Holding Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2019

/s/ Christopher L. Hufft

Christopher L. Hufft

Chief Financial Officer

(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report on Form 10-Q of Investar Holding Corporation (the "Company") for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John J. D'Angelo, President and Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

Date: August 9, 2019

/s/ John J. D'Angelo

John J. D'Angelo
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report on Form 10-Q of Investar Holding Corporation (the “Company”) for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Christopher L. Hufft, Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

Date: August 9, 2019

/s/ Christopher L. Hufft

Christopher L. Hufft
Chief Financial Officer
(Principal Financial Officer)