Section 1: 10-Q (10-Q)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED September 30, 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: 001-37585

Allegiance Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Texas	**26-3564100**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

8847 West Sam Houston Parkway, N., Suite 200
Houston, Texas 77040
(Address of principal executive offices, including zip code)

(281) 894-3200
(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, par value, $1.00 per share	ABTX	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, smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☒		

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

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

As of October 30, 2019, the registrant had 20,810,603 shares common stock, $1.00 par value per share, outstanding.

ALLEGIANCE BANCSHARES, INC.
INDEX TO FORM 10-Q
September 30, 2019

PART I—FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2019	December 31, 2018
	(Dollars in thousands, except share data)	
ASSETS		
Cash and due from banks	$ 246,312	$ 118,771
Interest-bearing deposits at other financial institutions	54,307	150,176
Total cash and cash equivalents	300,619	268,947
Available for sale securities, at fair value	353,000	337,293
Loans held for investment	3,886,004	3,708,306
Less: allowance for loan losses	(29,808)	(26,331)
Loans, net	3,856,196	3,681,975
Accrued interest receivable	15,201	17,010
Premises and equipment, net	67,175	41,717
Other real estate owned	8,333	630
Federal Home Loan Bank stock	14,138	10,941
Bank owned life insurance	26,947	26,480
Goodwill	223,642	223,125
Core deposit intangibles, net	23,053	26,587
Other assets	17,536	20,544
TOTAL ASSETS	$ 4,905,840	$ 4,655,249
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 1,227,839	$ 1,209,300
Interest-bearing		
Demand	340,754	366,905
Money market and savings	1,114,233	879,840
Certificates and other time	1,214,659	1,206,491
Total interest-bearing deposits	2,669,646	2,453,236
Total deposits	3,897,485	3,662,536
Accrued interest payable	4,915	2,812
Borrowed funds	159,501	225,493
Subordinated debt	107,771	48,899
Other liabilities	29,860	12,525
Total liabilities	4,199,532	3,952,265
COMMITMENTS AND CONTINGENCIES (See Note 13)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $1 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $1 par value; 80,000,000 shares authorized; 20,736,779 shares issued and outstanding at September 30, 2019 and 21,937,740 shares issued and outstanding at December 31, 2018	20,737	21,938
Capital surplus	529,688	571,803
Retained earnings	149,389	112,131
Accumulated other comprehensive income (loss)	6,494	(2,888)
Total shareholders' equity	706,308	702,984
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 4,905,840	$ 4,655,249

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
	(Dollars in thousands, except per share data)			
INTEREST INCOME:				
Loans, including fees	$ 55,790	$ 32,988	$ 165,995	$ 94,951
Securities:				
Taxable	2,090	636	4,909	1,881
Tax-exempt	483	1,447	2,465	4,357
Deposits in other financial institutions	302	265	1,391	731
Total interest income	58,665	35,336	174,760	101,920
INTEREST EXPENSE:				
Demand, money market and savings deposits	4,975	1,248	13,216	3,111
Certificates and other time deposits	6,909	4,051	20,173	10,120
Borrowed funds	1,183	1,272	4,128	3,780
Subordinated debt	761	729	2,232	2,168
Total interest expense	13,828	7,300	39,749	19,179
NET INTEREST INCOME	44,837	28,036	135,011	82,741
Provision for loan losses	2,597	—	5,006	1,284
Net interest income after provision for loan losses	42,240	28,036	130,005	81,457
NONINTEREST INCOME:				
Nonsufficient funds fees	168	175	469	565
Service charges on deposit accounts	379	177	1,069	506
Gain on sale of securities	—	—	846	—
Gain on sale of other real estate	—	—	71	1
Bank owned life insurance income	153	137	467	416
Rebate from correspondent bank	900	613	2,680	1,621
Other	1,289	826	4,421	2,270
Total noninterest income	2,889	1,928	10,023	5,379
NONINTEREST EXPENSE:				
Salaries and employee benefits	20,221	12,965	59,320	38,537
Net occupancy and equipment	1,973	1,281	6,139	3,886
Depreciation	822	490	2,331	1,330
Data processing and software amortization	2,058	1,226	5,390	3,635
Professional fees	667	303	1,793	1,339
Regulatory assessments and FDIC insurance	(41)	505	1,489	1,533
Core deposit intangibles amortization	1,178	195	3,534	586
Communications	455	262	1,353	769
Advertising	449	351	1,770	1,021
Acquisition and merger-related expenses	—	196	1,326	821
Other	2,227	1,390	6,759	4,284
Total noninterest expense	30,009	19,164	91,204	57,741
INCOME BEFORE INCOME TAXES	15,120	10,800	48,824	29,095
Provision for income taxes	3,073	1,921	9,851	4,949
NET INCOME	$ 12,047	$ 8,879	$ 38,973	$ 24,146
EARNINGS PER SHARE:				
Basic	$ 0.57	$ 0.66	$ 1.83	$ 1.81
Diluted	$ 0.57	$ 0.65	$ 1.81	$ 1.77

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in thousands)			
Net income	$ 12,047	$ 8,879	$ 38,973	$ 24,146
Other comprehensive income (loss), before tax:				
Unrealized gain (loss) on securities:				
Change in unrealized holding gain (loss) on available for sale securities during the period	2,862	(2,265)	12,712	(8,106)
Reclassification of gain realized through the sale of securities	—	—	(846)	—
Total other comprehensive income (loss)	2,862	(2,265)	11,866	(8,106)
Deferred tax (expense) benefit related to other comprehensive income	(601)	476	(2,484)	1,774
Other comprehensive income (loss), net of tax	2,261	(1,789)	9,382	(6,332)
Comprehensive income	$ 14,308	$ 7,090	$ 48,355	$ 17,814

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock		Capital	Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Surplus	Earnings	Income (Loss)	Equity
			(in thousands, except share data)			
BALANCE AT JUNE 30, 2018	13,340,919	$ 13,341	$ 220,665	$ 90,089	$ (4,207)	$ 319,888
Net income				8,879		8,879
Other comprehensive loss					(1,789)	(1,789)
Common stock issued in connection with the exercise of stock options and restricted stock awards	55,784	56	717			773
Stock based compensation expense			380			380
BALANCE AT SEPTEMBER 30, 2018	13,396,703	$ 13,397	$ 221,762	$ 98,968	$ (5,996)	$ 328,131
BALANCE AT JUNE 30, 2019	21,147,179	$ 21,147	$ 541,979	$ 137,342	$ 4,233	$ 704,701
Net income				12,047		12,047
Other comprehensive income					2,261	2,261
Common stock issued in connection with the exercise of stock options and restricted stock awards	20,590	21	475			496
Repurchase of common stock	(430,990)	(431)	(13,555)			(13,986)
Stock based compensation expense			789			789
BALANCE AT SEPTEMBER 30, 2019	20,736,779	$ 20,737	$ 529,688	$ 149,389	$ 6,494	$ 706,308
BALANCE AT DECEMBER 31, 2017	13,226,826	$ 13,227	$ 218,408	$ 74,894	$ 336	$ 306,865
Net income				24,146		24,146
Other comprehensive loss					(6,332)	(6,332)
Reclassification of amounts within AOCI to retained earnings due to tax reform				(72)		(72)
Common stock issued in connection with the exercise of stock options and restricted stock awards	169,877	170	2,139			2,309
Stock based compensation expense			1,215			1,215
BALANCE AT SEPTEMBER 30, 2018	13,396,703	$ 13,397	$ 221,762	$ 98,968	$ (5,996)	$ 328,131
BALANCE AT DECEMBER 31, 2018	21,937,740	$ 21,938	$ 571,803	$ 112,131	$ (2,888)	$ 702,984
Cumulative effect of change in accounting principle related to ASU 2017-08				(1,715)		(1,715)
Total shareholders' equity at beginning of period, as adjusted (See Note 1)	21,937,740	21,938	571,803	110,416	(2,888)	701,269
Net income				38,973		38,973
Other comprehensive income					9,382	9,382
Common stock issued in connection with the exercise of stock options and restricted stock awards	160,640	160	1,402			1,562
Repurchase of common stock	(1,361,601)	(1,361)	(45,794)			(47,155)
Stock based compensation expense			2,277			2,277
BALANCE AT SEPTEMBER 30, 2019	20,736,779	$ 20,737	$ 529,688	$ 149,389	$ 6,494	$ 706,308

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 38,973	$ 24,146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	5,865	1,916
Provision for loan losses	5,006	1,284
Net amortization of premium on investments	2,613	2,413
Excess tax benefit related to the exercise of stock options	(105)	(420)
Bank owned life insurance income	(467)	(416)
Net accretion of discount on loans	(7,112)	(207)
Net accretion of discount on subordinated debt	83	82
Net accretion of discount on certificates of deposit	(287)	(3)
Net gain on the sale or write down of premises, equipment and other real estate	(71)	(1)
Net gain on sale of securities	(846)	—
Federal Home Loan Bank stock dividends	(332)	(268)
Stock based compensation expense	2,277	1,215
Net change in lease right-of-use assets	1,467	—
Decrease (increase) in accrued interest receivable and other assets	1,340	(2,846)
Increase in accrued interest payable and other liabilities	6,359	5,563
Net cash provided by operating activities	54,763	32,458
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of available for sale securities	2,245,919	2,014,951
Proceeds from sales of available for sale securities	149,366	—
Purchase of available for sale securities	(2,401,762)	(2,015,970)
Net change in total loans	(135,197)	(172,625)
Purchase of bank premises and equipment	(12,279)	(1,857)
Net (purchases) redemptions of Federal Home Loan Bank stock	(2,865)	1,279
Net cash paid for the LoweryBank branch acquisition	(32,867)	—
Net cash (used in) provided by investing activities	(189,685)	(174,222)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in noninterest-bearing deposits	4,659	106,595
Net increase in interest-bearing deposits	214,828	113,225
Paydowns on borrowed funds	(65,992)	(71,000)
Proceeds from subordinated notes issuance, net of offering expenses	58,692	—
Proceeds from the issuance of common stock, stock option exercises and the ESPP	1,562	2,309
Repurchase of common stock	(47,155)	—
Net cash provided by financing activities	166,594	151,129
NET CHANGE IN CASH AND CASH EQUIVALENTS	31,672	9,365
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	268,947	182,103
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 300,619	$ 191,468
SUPPLEMENTAL CASH FLOW INFORMATION:		
Income taxes paid	$ 8,000	$ 4,700
Interest paid	37,645	17,682
Operating lease cash flows	2,713	—
SUPPLEMENTAL NONCASH DISCLOSURE:		
Lease right-of-use asset	$ 13,277	$ —
Loans transferred to other real estate	7,703	—

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2019
(Unaudited)

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations-Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank, (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. The Company derives substantially all of its revenues and income from the operation of the Bank. The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small to medium-sized businesses, professionals and individual customers. The Company operated 27 full-service bank offices in the Houston region, which it defines as the Houston-The Woodlands-Sugar Land and Beaumont-Port Arthur metropolitan statistical areas, with 26 bank offices and one loan production office in the Houston metropolitan area and one bank office location in Beaumont, just outside of the Houston metropolitan area as of September 30, 2019. The Bank provides its customers with a variety of banking services including checking accounts, savings accounts and certificates of deposit, and its primary lending products are commercial, personal, automobile, mortgage and home improvement loans. The Bank also offers safe deposit boxes, automated teller machines, drive-through services and 24-hour depository facilities.

Basis of Presentation-The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions between the Company and the Bank have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2018. Operating results for the three and nine months ended September 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

Significant Accounting and Reporting Policies

The Company’s significant accounting and reporting policies can be found in Note 1 of the Company’s annual financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

New Accounting Standards

Adoption of New Accounting Standards

ASU 2016-02, “Leases (Topic 842)." ASU 2016-02 requires lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and 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. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 became effective for the Company on January 1, 2019. The Company adopted the standard through the required modified retrospective approach by applying the allowed transition method whereby comparative periods were not restated and a cumulative effect adjustment to the opening balance of retained earnings was recognized as of January 1, 2019. Topic 842 requires the recognition of a lease liability measured as the present value of unpaid lease payments for operating leases where the Company is the lessee, and a corresponding right-of-use (ROU) asset for the right to use the leased properties. The Company elected not to reassess whether contracts are or contain leases, lease classification or initial direct costs for existing leases, a set of practical expedients for transition provided by ASU 2016-12. Further, the Company elected the practical expedient to use hindsight in determining the lease term and assessing impairment. The election of the hindsight practical expedient resulted in longer lease terms for a limited number of strategic locations based on relevant factors as of the adoption date. The Company implemented a lease management system to assist in centralizing, maintaining and accounting for all leases to ensure the Company meets the ASU’s reporting and disclosure requirements. Prior comparable periods are presented in accordance with previous guidance under Accounting Standards Codification (ASC) 840, “Leases.” As of January 1, 2019, right-of-use assets and related lease liabilities totaled $15.3 million and $15.7 million, respectively. See Note 6 – Leases for further information regarding the Company’s leases on certain properties and equipment under operating leases.

ASU 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities.” ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 became effective for the Company on January 1, 2019. Upon adoption, the Company recognized a cumulative effect reduction in retained earnings totaling $1.7 million.

Newly Issued But Not Yet Effective Accounting Standards

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” Among other things, ASU 2016-13 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. Financial institutions and other organizations will now use forward-looking information to better form their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. 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 is effective for the Company on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company has formed a cross functional team and, with the assistance of a third-party provider, is assessing the Company's data and system needs to evaluate the impact that adoption of this standard will have on the financial condition and results of operations of the Company. The Company expects the adoption of ASU 2016-13 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. ASU 2016-13 permits the use of estimation techniques that are practical and relevant to the Company’s circumstances, as long as they are applied consistently over time and reasonably estimate expected credit losses in accordance with the standard. The Company has developed its current expected credit loss estimation model and is working through its implementation plan which includes documentation of processes, internal controls and data sources; model development and documentation; and system configuration. The Company plans to implement the cohort method to estimate expected credit losses. This method will estimate credit losses over a forecast horizon and revert to long term historical loss experience. The cohort method also incorporates reasonable and supportable forecasts of economic conditions into the estimate which will require significant judgement. The Company will continue to perform and enhance parallel runs throughout 2019 as new processes, policies and controls are finalized. The impact of the standard will depend on the composition of the Company’s portfolio as well as economic conditions and forecasts at the time of adoption.

ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for the Company on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on the Company's financial statements.

2. ACQUISITIONS

Acquisitions are accounted for using the acquisition method of accounting. Accordingly, the assets and liabilities of an acquired entity are recorded at their fair value at the acquisition date. The excess of the purchase price over the estimated fair value of the net assets is recorded as goodwill. The results of operations for an acquisition have been included in the Company’s consolidated financial results beginning on the respective acquisition date.

The measurement period for the Company to determine the fair values of acquired identifiable assets and assumed liabilities will end at the earlier of (1) twelve months from the date of the acquisition or (2) as soon as the Company receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. The following acquisitions were completed on the dates indicated below:

2018 Acquisition

Acquisition of Post Oak Bancshares, Inc.—On October 1, 2018, the Company completed the acquisition of Post Oak Bancshares, Inc. ("Post Oak") and its wholly-owned subsidiary Post Oak Bank, N.A. headquartered in Houston, Texas. Post Oak operated thirteen bank offices, twelve located throughout the greater Houston metropolitan area and one in Beaumont, just outside of the Houston metropolitan area. The Company acquired Post Oak to further expand its Houston, Texas area market. Goodwill resulted from a combination of expected operational synergies and an enhanced branching network. Goodwill is not expected to be deductible for tax purposes.

Pursuant to the merger agreement, the Company issued 8,402,010 shares of Company common stock for all outstanding shares of Post Oak common stock and paid $21 thousand in cash for any fractional shares held by Post Oak shareholders. Additionally, all outstanding Post Oak options were assumed by Allegiance and converted using the 0.7017 exchange ratio to 299,352 options at a weighted average exercise price of $12.83 per option. Based on the $41.70 per share closing price of Allegiance common stock on September 28, 2018, the total transaction value was approximately $359.0 million. The acquisition was accounted for under the acquisition method of accounting in accordance with ASC Topic 805, Business Combinations. The Company recognized goodwill of $183.7 million which is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, none of which is expected to be deductible for tax purposes. The intangible assets recognized in the transaction are amortized utilizing an accelerated method over their ten year estimated useful lives.

As of September 30, 2019, the Company finalized its valuation of all assets and liabilities acquired, resulting in no changes to preliminary acquisition accounting adjustments. A summary of the purchase price allocation is as follows (in thousands):

Fair value of consideration paid:		
Common shares issued (8,402,010 shares)	$	350,364
Stock options issued (299,352)		8,639
Cash in lieu of fractional shares		21
Total consideration paid	$	359,024
Fair value of assets acquired:		
Cash and cash equivalents	$	230,416
Investment securities		42,779
Loans		1,164,281
Premises and equipment		21,988
Core deposit intangibles		25,128
Other assets		18,076
Total assets acquired	$	1,502,668
Fair value of liabilities assumed:		
Deposits	$	1,291,310
Other borrowed funds		30,000
Other liabilities		6,070
Total liabilities assumed		1,327,380
Fair value of net assets acquired	$	175,288
Goodwill resulting from acquisition	$	183,736

The fair value of net assets acquired includes fair value adjustments to certain acquired loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. The following presents details of all loans acquired as of October 1, 2018:

	Contractual Balance	Fair Value	Discount
	(Dollars in thousands)		
Commercial and industrial	$ 221,098	$ 217,204	$ (3,894)
Real estate:			
Commercial real estate (including multi-family residential)	450,947	443,512	(7,435)
Commercial real estate construction and land development	167,386	165,387	(1,999)
1-4 family residential (including home equity)	288,304	285,099	(3,205)
Residential construction	23,812	23,812	-
Consumer and other	29,684	29,267	(417)
Total loans	$ 1,181,231	$ 1,164,281	$ (16,950)

In connection with the Post Oak acquisition, the Company acquired loans both with and without evidence of credit quality deterioration since origination. The acquired loans were initially recorded at fair value with no carryover of any allowance for loan losses. Acquired loans were segregated between those considered to be purchased credit impaired (“PCI”) loans and those without credit impairment at acquisition.

The Company incurred approximately $1.3 million of pre-tax acquisition and merger-related expenses reflected on the Company’s income statement during the nine months ended September 30, 2019 related to the Post Oak acquisition.

2019 Acquisition

Acquisition of LoweryBank Branch—On February 1, 2019, the Bank completed the acquisition of LoweryBank, the Sugar Land location of Huntington State Bank. The Bank paid $32.9 million in cash to acquire certain assets which included approximately $45.0 million in loans and assumed approximately $16.0 million in customer deposits. The Bank consolidated its existing Sugar Land bank office into this new bank office location, which was less than one mile away. The acquisition of LoweryBank was accounted for under the acquisition method of accounting in accordance with ASC Topic 805, Business Combinations. The Company recognized goodwill of $578 thousand which is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, which is expected to be deductible for tax purposes. Income and expense generated from acquired assets and liabilities assumed would not have a material impact, therefore, proforma numbers are not presented.

3. GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS

Changes in the carrying amount of the Company’s goodwill and core deposit intangible assets were as follows:

	Goodwill	Core Deposit Intangibles
	(Dollars in thousands)	
Balance as of December 31, 2017	$ 39,389	$ 3,274
Amortization	—	(586)
Balance as of September 30, 2018	39,389	2,688
Balance as of December 31, 2018	$ 223,125	$ 26,587
Acquisition of LoweryBank branch	578	—
Measurement period adjustment	(61)	—
Amortization	—	(3,534)
Balance as of September 30, 2019	$ 223,642	$ 23,053

Goodwill is recorded on the acquisition date of an entity. During the measurement period, the Company may record subsequent adjustments to goodwill for provisional amounts recorded at the acquisition date. There was a $61 thousand measurement period adjustment recorded during the first quarter 2019 related to the Post Oak Bank acquisition.

Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangible assets has occurred. If any such impairment is determined, a write-down is recorded. As of September 30, 2019, there were no impairments recorded on goodwill and other intangible assets.

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of September 30, 2019 is as follows (dollars in thousands):

Remaining 2019	$ 1,179
2020	3,922
2021	3,296
2022	3,003
2023	2,323
Thereafter	9,330
Total	$ 23,053

4. SECURITIES

The amortized cost and fair value of investment securities were as follows:

	September 30, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$ 30,250	$ 332	$ (325)	$ 30,257
Municipal securities	71,782	4,034	—	75,816
Agency mortgage-backed pass-through securities	97,374	1,779	(126)	99,027
Agency collateralized mortgage obligations	99,702	2,138	(166)	101,674
Corporate bonds and other	45,661	580	(15)	46,226
Total	$ 344,769	$ 8,863	$ (632)	$ 353,000

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$ 8,570	$ 161	$ (46)	$ 8,685
Municipal securities	219,068	1,258	(3,541)	216,785
Agency mortgage-backed pass-through securities	66,987	237	(1,029)	66,195
Corporate bonds and other	46,303	15	(690)	45,628
Total	$ 340,928	$ 1,671	$ (5,306)	$ 337,293

As of September 30, 2019, the Company's management did not expect to sell any securities classified as available for sale with material unrealized losses, and the Company believes it is more likely than not it will not be required to sell any of these securities before their anticipated recovery, at which time the Company will receive full value for the securities. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2019, management believed the unrealized losses in the previous table are temporary and no other than temporary impairment loss has been realized in the Company's consolidated statements of income.

The amortized cost and fair value of investment securities at September 30, 2019, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$ 29,040	$ 29,136
Due after one year through five years	21,274	21,722
Due after five years through ten years	49,782	51,194
Due after ten years	47,597	50,247
Subtotal	147,693	152,299
Agency mortgage-backed pass through and collateralized mortgage obligation securities	197,076	200,701
Total	$ 344,769	$ 353,000

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

	September 30, 2019					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$ 22,651	$ (324)	$ 438	$ (1)	$ 23,089	$ (325)
Agency mortgage-backed pass-through securities	9,819	(62)	8,578	(64)	18,397	(126)
Agency collateralized mortgage obligations	17,005	(166)	—	—	17,005	(166)
Corporate bonds and other	—	—	1,505	(15)	1,505	(15)
Total	$ 49,475	$ (552)	$ 10,521	$ (80)	$ 59,996	$ (632)

	December 31, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$ 999	$ —	$ 1,417	$ (46)	$ 2,416	$ (46)
Municipal securities	10,140	(29)	136,934	(3,512)	147,074	(3,541)
Agency mortgage-backed pass-through securities	17,168	(209)	22,819	(820)	39,987	(1,029)
Corporate bonds and other	13,634	(35)	29,014	(655)	42,648	(690)
Total	$ 41,941	$ (273)	$ 190,184	$ (5,033)	$ 232,125	$ (5,306)

There were no securities sold during the three months ended September 30, 2019. The Company sold $149.4 million in securities and recorded gross gains of $1.4 million and gross losses of $576 thousand for a net gain of $846 thousand during the nine months ended September 30, 2019. There were no securities sold during the three months and nine months ended September 30, 2018. At September 30, 2019 and December 31, 2018, the Company did not own securities of any one issuer, other than the U.S government and its agencies, in an amount greater than 10% of consolidated shareholders' equity at such respective dates.

The carrying value of pledged securities was $25.2 million at September 30, 2019 and $28.9 million at December 31, 2018, respectively. The majority of the securities were pledged to collateralize public fund deposits.

5. LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio balances, net of unearned income and fees, consist of various types of loans primarily made to borrowers located within Texas and are classified by major type as follows:

	September 30, 2019	December 31, 2018
	(Dollars in thousands)	
Commercial and industrial	$ 675,055	$ 702,037
Mortgage warehouse	36,594	48,274
Real estate:		
Commercial real estate (including multi-family residential)	1,859,721	1,650,912
Commercial real estate construction and land development	386,723	430,128
1-4 family residential (including home equity)	695,520	649,311
Residential construction	189,608	186,411
Consumer and other	42,783	41,233
Total loans	3,886,004	3,708,306
Allowance for loan losses	(29,808)	(26,331)
Loans, net	$ 3,856,196	$ 3,681,975

Acquired Loans

PCI loans

The Company has loans that were acquired and for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of PCI loans included in the consolidated balance sheet and the related outstanding balance owed at September 30, 2019 are presented in the table below (dollars in thousands):

	As of September 30, 2019	As of December 31, 2018
Outstanding balance	$ 20,206	$ 26,862
Less: Discount	(2,991)	(3,599)
Recorded investment	$ 17,215	$ 23,263

Acquired loans were recorded through acquisition accounting without an allowance. There was an allocation of $231 thousand established in the allowance for loan losses relating to PCI loans at September 30, 2019.

Changes in the accretable yield for PCI loans for the three and nine months ended September 30, 2019 were as follows (dollars in thousands):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Balance at beginning of period	$ 2,195	$ 436
Measurement period adjustment	-	2,674
Additions	-	-
Reclassifications from nonaccretable	88	301
Accretion	(379)	(1,507)
Balance at September 30, 2019	$ 1,904	$ 1,904

There were no PCI loans at September 30, 2018.

Nonaccrual and Past Due Loans

An aging analysis of the recorded investment in past due loans, segregated by class of loans, is as follows:

	September 30, 2019					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$ 4,162	$ —	$ 4,162	$ 8,033	$ 662,860	$ 675,055
Mortgage warehouse	—	—	—	—	36,594	36,594
Real estate:						
Commercial real estate (including multi-family residential)	9,203	—	9,203	15,356	1,835,162	1,859,721
Commercial real estate construction and land development	147	—	147	9,050	377,526	386,723
1-4 family residential (including home equity)	2,585	—	2,585	1,992	690,943	695,520
Residential construction	932	—	932	—	188,676	189,608
Consumer and other	93	—	93	184	42,506	42,783
Total loans	$ 17,122	$ —	$ 17,122	$ 34,615	$ 3,834,267	$ 3,886,004

	December 31, 2018					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$ 1,951	$ —	$ 1,951	$ 10,861	$ 689,225	$ 702,037
Mortgage warehouse	—	—	—	—	48,274	48,274
Real estate:						
Commercial real estate (including multi-family residential)	3,502	—	3,502	17,776	1,629,634	1,650,912
Commercial real estate construction and land development	1,300	—	1,300	974	427,854	430,128
1-4 family residential (including home equity)	3,643	—	3,643	3,201	642,467	649,311
Residential construction	—	—	—	—	186,411	186,411
Consumer and other	91	—	91	141	41,001	41,233
Total loans	$ 10,487	$ —	$ 10,487	$ 32,953	$ 3,664,866	$ 3,708,306

Impaired Loans

Impaired loans by class of loans are set forth in the following tables.

	As of September 30, 2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$ 3,568	$ 3,683	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	6,715	6,795	—
Commercial real estate construction and land development	9,050	9,050	—
1-4 family residential (including home equity)	1,598	1,598	—
Residential construction	—	—	—
Consumer and other	57	57	—
Total	20,988	21,183	—
With an allowance recorded:			
Commercial and industrial	8,450	8,845	4,354
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	11,749	11,749	2,236
Commercial real estate construction and land development	3,114	3,114	191
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	32	32	28
Total	23,345	23,740	6,809
Total:			
Commercial and industrial	12,018	12,528	4,354
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	18,464	18,544	2,236
Commercial real estate construction and land development	12,164	12,164	191
1-4 family residential (including home equity)	1,598	1,598	—
Residential construction	—	—	—
Consumer and other	89	89	28
	$ 44,333	$ 44,923	$ 6,809

	As of December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$ 4,354	$ 4,771	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	11,322	11,322	—
Commercial real estate construction and land development	1,326	1,326	—
1-4 family residential (including home equity)	2,742	2,741	—
Residential construction	—	—	—
Consumer and other	3	3	—
Total	19,747	20,163	—
With an allowance recorded:			
Commercial and industrial	9,150	9,545	3,898
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	11,542	11,542	2,641
Commercial real estate construction and land development	3,114	3,114	190
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	23,806	24,201	6,729
Total:			
Commercial and industrial	13,504	14,316	3,898
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	22,864	22,864	2,641
Commercial real estate construction and land development	4,440	4,440	190
1-4 family residential (including home equity)	2,742	2,741	—
Residential construction	—	—	—
Consumer and other	3	3	—
	$ 43,553	$ 44,364	$ 6,729

The following table presents average impaired loans and interest recognized on impaired loans for the three and nine months ended September 30, 2019 and 2018:

	Three Months Ended September 30,			
	2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$ 12,268	$ 94	$ 12,979	$ 119
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	18,762	86	18,242	181
Commercial real estate construction and land development	12,005	52	695	5
1-4 family residential (including home equity)	1,609	—	2,993	4
Residential construction	—	—	—	—
Consumer and other	91	1	—	—
Total	$ 44,735	$ 233	$ 34,909	$ 309

	Nine Months Ended September 30,			
	2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$ 12,265	$ 261	$ 13,370	$ 316
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	19,453	279	18,409	497
Commercial real estate construction and land development	10,263	140	600	8
1-4 family residential (including home equity)	1,641	4	3,033	9
Residential construction	—	—	—	—
Consumer and other	96	—	—	—
Total	$ 43,718	$ 684	$ 35,412	$ 830

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including factors such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. The Company analyzes loans individually by classifying the loans by credit risk. As part of the ongoing monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks risk ratings to be used as credit quality indicators.

The following is a general description of the risk ratings used:

Pass—Loans classified as pass are loans with low to average risk and not otherwise classified as watch, special mention, substandard or doubtful. In addition, the guaranteed portion of SBA loans are considered pass risk rated loans.

Watch—Loans classified as watch loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.

Special Mention—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These classified loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

Based on the most recent analysis performed, the risk category of loans by class of loan at September 30, 2019 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$ 633,253	$ 9,167	$ 7,547	$ 25,008	$ 80	$ 675,055
Mortgage warehouse	36,594	—	—	—	—	36,594
Real estate:						
Commercial real estate (including multi-family residential)	1,782,152	30,240	7,891	39,438	—	1,859,721
Commercial real estate construction and land development	372,601	1,296	1,350	11,476	—	386,723
1-4 family residential (including home equity)	663,642	15,720	7,214	8,944	—	695,520
Residential construction	184,410	2,867	2,331	—	—	189,608
Consumer and other	42,203	7	335	238	—	42,783
Total loans	$ 3,714,855	$ 59,297	$ 26,668	$ 85,104	$ 80	$ 3,886,004

The following table presents the risk category of loans by class of loan at December 31, 2018:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$ 656,783	$ 9,696	$ 13,874	$ 21,684	$ —	$ 702,037
Mortgage warehouse	48,274	—	—	—	—	48,274
Real estate:						
Commercial real estate (including multi-family residential)	1,570,243	29,702	7,101	43,866	—	1,650,912
Commercial real estate construction and land development	424,460	729	2,149	2,790	—	430,128
1-4 family residential (including home equity)	629,657	3,797	4,216	11,641	—	649,311
Residential construction	186,411	—	—	—	—	186,411
Consumer and other	40,673	31	301	228	—	41,233
Total loans	$ 3,556,501	$ 43,955	$ 27,641	$ 80,209	$ —	$ 3,708,306

Allowance for Loan Losses

The following table presents the activity in the allowance for loan losses by portfolio type for the three and nine months ended September 30, 2019 and 2018:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
				(Dollars in thousands)				
Allowance for loan losses:								
Three Months Ended								
Balance June 30, 2019	$ 8,255	$ —	$ 12,940	$ 2,257	$ 3,376	$ 1,004	$ 108	$ 27,940
Provision for loan losses	1,322	—	613	(222)	608	247	29	2,597
Charge-offs	(769)	—	—	(44)	—	—	—	(813)
Recoveries	84	—	—	—	—	—	—	84
Net charge-offs	(685)	—	—	(44)	—	—	—	(729)
Balance September 30, 2019	$ 8,892	$ —	$ 13,553	$ 1,991	$ 3,984	$ 1,251	$ 137	$ 29,808
Nine Months Ended								
Balance December 31, 2018	$ 8,351	$ —	$ 11,901	$ 2,724	$ 2,242	$ 1,040	$ 73	$ 26,331
Provision for loan losses	1,668	—	1,729	(689)	2,037	211	50	5,006
Charge-offs	(1,357)	—	(80)	(44)	(295)	—	(8)	(1,784)
Recoveries	230	—	3	—	—	—	22	255
Net (charge-offs) recoveries	(1,127)	—	(77)	(44)	(295)	—	14	(1,529)
Balance September 30, 2019	$ 8,892	$ —	$ 13,553	$ 1,991	$ 3,984	$ 1,251	$ 137	$ 29,808
Allowance for loan losses:								
Three Months Ended								
Balance June 30, 2018	$ 9,154	$ —	$ 9,203	$ 2,288	$ 2,189	$ 914	$ 83	$ 23,831
Provision for loan losses	(621)	—	(2)	447	35	153	(12)	—
Charge-offs	(235)	—	—	—	(25)	—	—	(260)
Recoveries	15	—	—	—	—	—	—	15
Net charge-offs	(220)	—	—	—	(25)	—	—	(245)
Balance September 30, 2018	$ 8,313	$ —	$ 9,201	$ 2,735	$ 2,199	$ 1,067	$ 71	$ 23,586
Nine Months Ended								
Balance December 31, 2017	$ 7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$ 23,649
Provision for loan losses	2,002	—	(1,113)	210	84	125	(24)	1,284
Charge-offs	(2,123)	—	(41)	—	(25)	—	—	(2,189)
Recoveries	740	—	102	—	—	—	—	842
Net (charge-offs) recoveries	(1,383)	—	61	—	(25)	—	—	(1,347)
Balance September 30, 2018	$ 8,313	$ —	$ 9,201	$ 2,735	$ 2,199	$ 1,067	$ 71	$ 23,586

The following table presents the balance of the allowance for loan losses by portfolio type based on the impairment method as of September 30, 2019 and December 31, 2018:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
				(Dollars in thousands)				
Allowance for loan losses related to:								
September 30, 2019								
Individually evaluated for impairment	$ 4,354	$ —	$ 2,236	$ 191	$ —	$ —	$ 28	$ 6,809
Collectively evaluated for impairment	4,509	-	11,198	1,792	3,909	1,251	109	22,768
PCI	29	—	119	8	75	—	—	231
Total allowance for loan losses	$ 8,892	$ —	$ 13,553	$ 1,991	$ 3,984	$ 1,251	$ 137	$ 29,808
December 31, 2018								
Individually evaluated for impairment	$ 3,898	$ —	$ 2,641	$ 190	$ —	$ —	$ —	$ 6,729
Collectively evaluated for impairment	4,453	—	9,260	2,534	2,242	1,040	73	19,602
Total allowance for loan losses	$ 8,351	$ —	$ 11,901	$ 2,724	$ 2,242	$ 1,040	$ 73	$ 26,331

The following table presents the recorded investment in loans held for investment by portfolio type based on the impairment method as of September 30, 2019 and December 31, 2018:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
				(Dollars in thousands)				
Recorded investment in loans:								
September 30, 2019								
Individually evaluated for impairment	$ 12,018	$ —	$ 18,464	$ 12,164	$ 1,598	$ —	$ 89	$ 44,333
Collectively evaluated for impairment	663,037	36,594	1,841,257	374,559	693,922	189,608	42,694	3,841,671
Total loans evaluated for impairment	$ 675,055	$ 36,594	$ 1,859,721	$ 386,723	$ 695,520	$ 189,608	$ 42,783	$ 3,886,004
December 31, 2018								
Individually evaluated for impairment	$ 13,504	$ —	$ 22,864	$ 4,440	$ 2,742	$ —	$ 3	$ 43,553
Collectively evaluated for impairment	688,533	48,274	1,628,048	425,688	646,569	186,411	41,230	3,664,753
Total loans evaluated for impairment	$ 702,037	$ 48,274	$ 1,650,912	$ 430,128	$ 649,311	$ 186,411	$ 41,233	$ 3,708,306

Troubled Debt Restructurings

As of September 30, 2019 and December 31, 2018, the Company had a recorded investment in troubled debt restructurings of $27.5 million and $33.1 million, respectively. The Company allocated $4.5 million and $3.0 million of specific reserves for troubled debt restructurings at September 30, 2019 and December 31, 2018, respectively.

The following tables present information regarding loans modified in a troubled debt restructuring during the three and nine months ended September 30, 2019 and 2018:

	Three Months Ended September 30,					
	2019			2018		
	Number of Contracts	Pre-Modification of Outstanding Recorded Investment	Post Modification of Outstanding Recorded Investment	Number of Contracts	Pre-Modification of Outstanding Recorded Investment	Post Modification of Outstanding Recorded Investment
	(Dollars in thousands)					
Troubled Debt Restructurings						
Commercial and industrial	4	$ 1,502	$ 1,502	1	$ 200	$ 200
Mortgage warehouse	—	—	—	—	—	—
Real estate:						
Commercial real estate (including multi-family residential)	—	—	—	—	—	—
Commercial real estate construction and land development	—	—	—	—	—	—
1-4 family residential (including home equity)	—	—	—	—	—	—
Residential construction	—	—	—	—	—	—
Consumer and other	—	—	—	—	—	—
Total	4	$ 1,502	$ 1,502	1	$ 200	$ 200

	Nine Months Ended September 30,					
	2019			2018		
	Number of Contracts	Pre-Modification of Outstanding Recorded Investment	Post Modification of Outstanding Recorded Investment	Number of Contracts	Pre-Modification of Outstanding Recorded Investment	Post Modification of Outstanding Recorded Investment
	(Dollars in thousands)					
Troubled Debt Restructurings						
Commercial and industrial	11	$ 2,069	$ 2,069	9	$ 1,797	$ 1,797
Mortgage warehouse	—	—	—	—	—	—
Real estate:						
Commercial real estate (including multi-family residential)	1	303	303	—	—	—
Commercial real estate construction and land development	—	—	—	—	—	—
1-4 family residential (including home equity)	1	396	396	—	—	—
Residential construction	—	—	—	—	—	—
Consumer and other	1	38	38	—	—	—
Total	14	$ 2,806	$ 2,806	9	$ 1,797	$ 1,797

Troubled debt restructurings resulted in a $251 thousand charge-off during the three and nine months ended September 30, 2019. Troubled debt restructurings resulted in charge-offs of $55 thousand and $72 thousand during the three and nine months ended September 30, 2018, respectively.

As of September 30, 2019, seven loans for a total of $4.7 million were modified under a troubled debt restructuring during the previous twelve-month period that subsequently defaulted during the nine months ended September 30, 2019. As of September 30, 2018, a $29 thousand loan was modified under a troubled debt restructurings during the previous twelve-month period that subsequently defaulted during the nine months ended September 30, 2018. Default is determined at 90 or more days past due. The modifications primarily related to extending the amortization periods of the loans. The Company did not grant principal reductions on any restructured loans. There were no commitments to lend additional amounts to troubled debt restructured loans for the three and nine months ended September 30, 2019 and 2018. During the nine months ended September 30, 2019, the Company added $2.8 million in new troubled debt restructurings, of which $2.7 million was still outstanding on September 30, 2019. During the nine months ended September 30, 2018, the Company added $1.8 million in new troubled debt restructurings, all of which were still outstanding on September 30, 2018.

6. LEASES

Lease payments over the expected term are discounted using the Company’s incremental borrowing rate for borrowings of similar terms. Generally, the Company cannot be reasonably certain about whether or not it will renew a lease until such time as the lease is within the last two years of the existing lease term. When the Company is reasonably certain that a renewal option will be exercised, it measures/remeasures the right-of-use asset and related lease liability using the lease payments specified for the renewal period or, if such amounts are unspecified, the Company generally assumes an increase (evaluated on a case-by-case basis in light of prevailing market conditions) in the lease payment over the final period of the existing lease term.

There were no sale and leaseback transactions, leveraged leases or lease transactions with related parties during the nine months ended September 30, 2019.

At September 30, 2019, the Company leased 14 branch locations and office space along with equipment. On the September 30, 2019 balance sheet, the right-of-use asset is classified within premises and equipment and the lease liability is included in other liabilities. All leases were classified as operating leases. Leases with an initial term of 12 months or less are not recorded on the balance sheet and the related lease expense is recognized on a straight-line basis over the lease term. During the third quarter 2019, Allegiance Bank purchased two previously leased properties for a total of $10.7 million.

Operating lease costs classified as occupancy and equipment expense were $848 thousand and $2.7 million for the three and nine months ended September 30, 2019, respectively. Included in these amounts were short-term lease costs of $132 thousand and $506 thousand for the three and nine months ended September 30, 2019, respectively.

Certain leases include options to renew, with renewal terms that can extend the lease term from one to five years. Lease assets and liabilities include related options that are reasonably certain of being exercised. The depreciable life of leased assets are limited by the expected lease term.

Supplemental lease information at or for the nine months ended September 30, 2019 is as follows (dollars in thousands):

Balance Sheet:		
Operating lease asset classified as premises and equipment	$	11,810
Operating lease liability classified as other liabilities		12,116
Income Statement:		
Operating lease cost classified as occupancy and equipment expense	$	2,733
Weighted average lease term, in years		5.70
Weighted average discount rate		3.19%

A maturity analysis of the Company's lease liabilities at September 30, 2019 is as follows (dollars in thousands):

Lease payments due:	
Within one year	$ 2,885
After one but within two years	2,867
After two but within three years	2,608
After three but within four years	2,204
After four but within five years	1,596
After five years	3,293
Total lease payments	$ 15,453
Discount on cash flows	(3,337)
Total lease liability	$ 12,116

7. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value represents the exchange price that would be received from selling an asset or paid to transfer a liability, otherwise known as an "exit price," in the principal or most advantageous market available to the entity in an orderly transaction between market participants on the measurement date.

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2—Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Significant unobservable inputs that reflect management's judgment and assumptions that market participants would use in pricing an asset or liability that are supported by little or no market activity.

The carrying amounts and estimated fair values of financial instruments that are reported on the balance sheet are as follows:

	As of September 30, 2019				
	Carrying	Estimated Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					
Cash and cash equivalents	$ 300,619	$ 300,619	$ —	$ —	$ 300,619
Available for sale securities	353,000	—	353,000	—	353,000
Loans held for investment, net of allowance	3,856,196	—	—	3,888,672	3,888,672
Accrued interest receivable	15,201	9	1,560	13,632	15,201
Financial liabilities					
Deposits	$ 3,897,485	$ —	$ 3,902,191	$ —	$ 3,902,191
Accrued interest payable	4,915	—	4,915	—	4,915
Borrowed funds	159,501	—	159,501	—	159,501
Subordinated debt	107,771	—	107,771	—	107,771

	As of December 31, 2018				
	Carrying Amount	Estimated Fair Value			
		Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					
Cash and cash equivalents	$ 268,947	$ 268,947	$ —	$ —	$ 268,947
Available for sale securities	337,293	—	337,293	—	337,293
Loans held for investment, net of allowance	3,681,975	—	—	3,674,241	3,674,241
Accrued interest receivable	17,010	65	3,498	13,447	17,010
Financial liabilities					
Deposits	$ 3,662,536	$ —	$ 3,653,244	$ —	$ 3,653,244
Accrued interest payable	2,812	—	2,812	—	2,812
Borrowed funds	225,493	—	230,445	—	230,445
Subordinated debt	48,899	—	49,663	—	49,663

The following tables present fair values for assets measured at fair value on a recurring basis:

	September 30, 2019			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$ —	$ 30,257	$ —	$ 30,257
Municipal securities	—	75,816	—	75,816
Agency mortgage-backed pass-through securities	—	99,027	—	99,027
Agency collateralized mortgage obligations	—	101,674		101,674
Corporate bonds and other	—	46,226	—	46,226
Total	$ —	$ 353,000	$ —	$ 353,000

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$ —	$ 8,685	$ —	$ 8,685
Municipal securities	—	216,785	—	216,785
Agency mortgage-backed pass-through securities	—	66,195	—	66,195
Corporate bonds and other	—	45,628	—	45,628
Total	$ —	$ 337,293	$ —	$ 337,293

There were no liabilities measured at fair value on a recurring basis as of September 30, 2019 or December 31, 2018. There were no transfers between levels during the nine months ended September 30, 2019 or 2018.

The following table presents certain assets and liabilities 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 such as evidence of impairment.

	As of September 30, 2019		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			
Commercial and industrial	$ —	$ —	$ 4,096
Commercial real estate (including multi-family residential)	—	—	9,513
Commercial real estate construction and land development	—	—	2,923
Consumer and other	—	—	4
Other real estate owned	—	—	8,333
	$ —	$ —	$ 24,869

	As of December 31, 2018		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			
Commercial and industrial	$ —	$ —	$ 5,252
Commercial real estate (including multi-family residential)	—	—	8,901
Commercial real estate construction and land development	—	—	2,924
Other real estate owned	—	—	630
	$ —	$ —	$ 17,707

Impaired Loans with Specific Allocation of Allowance

During the nine months ended September 30, 2019 and the year ended December 31, 2018, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses. At September 30, 2019, the total reported fair value of impaired loans of $16.5 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $23.3 million that was reduced by specific allowance allocations totaling $6.8 million. At December 31, 2018, the total reported fair value of impaired loans of $17.1 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $23.8 million that was reduced by specific allowance allocations totaling $6.7 million.

Other Real Estate Owned

At September 30, 2019, the $8.3 million balance of other real estate owned consisted of three foreclosed commercial real estate properties, one commercial tract of land, one residential vacant lot and one foreclosed residential rental property recorded as a result of obtaining the physical possession of the property. The Company had $630 thousand of other real estate owned at December 31, 2018.

8. DEPOSITS

Time deposits that met or exceeded the Federal Deposit Insurance Corporation insurance limit of $250 thousand at September 30, 2019 and December 31, 2018 were $488.0 million and $509.3 million, respectively.

Scheduled maturities of time deposits for the next five years are as follows (dollars in thousands):

Within one year	$ 244,325
After one but within two years	624,573
After two but within three years	145,761
After three but within four years	102,882
After four but within five years	97,118
Total	$ 1,214,659

The Company had $276.3 million and $235.1 million of brokered deposits as of September 30, 2019 and December 31, 2018, respectively. There were no major concentrations of deposits with any one depositor at September 30, 2019 and December 31, 2018.

9. BORROWINGS AND BORROWING CAPACITY

The Company has an available line of credit with the Federal Home Loan Bank ("FHLB") of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At September 30, 2019, the Company had a total borrowing capacity of $1.67 billion, of which $1.41 billion was available and $261.8 million was outstanding. FHLB advances of $125.0 million were outstanding at September 30, 2019, at a weighted average interest rate of 2.54%. Letters of credit were $136.8 million at September 30, 2019, of which $45.5 million will expire during the remaining months of 2019, $88.8 million will expire in 2020 and $2.5 million will expire in 2021.

On December 28, 2018, the Company amended its revolving credit agreement to increase the maximum commitment to advance funds to $45.0 million which will reduce annually by $7.5 million beginning in December 2020 and on each December 22nd for the following years thereafter. The Company is required to repay any outstanding balance in excess of the then-current maximum commitment amount. The revised agreement will mature in December 2025 and is secured by 100% of the capital stock of the Bank. At September 30, 2019, the balance of the revolving credit agreement was $34.6 million. The credit agreement contains certain restrictive covenants. At September 30, 2019, the Company believes it was in compliance with all such debt covenants and had not been made aware of any noncompliance by the lender. The interest rate on the debt is the Prime Rate minus 25 basis points, or 4.75%, at September 30, 2019, and is paid quarterly.

10. SUBORDINATED DEBT

Junior Subordinated Debentures

On January 1, 2015, the Company acquired F&M Bancshares, Inc. and assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III. Each of these trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by such trust, provided such trust has funds available for such obligations.

Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

The Company assumed the junior subordinated debentures with an aggregate original principal amount of $11.3 million and a current carrying value at September 30, 2019 of $9.5 million. At acquisition, the Company recorded a discount of $2.5 million on the debentures. The difference between the carrying value and contractual balance will be recognized as a yield adjustment over the remaining term for the debentures. At September 30, 2019, the Company had $11.3 million outstanding in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts. The junior subordinated debentures are included in tier 1 capital under current regulatory guidelines and interpretations.

A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at September 30, 2019 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate(1)	Junior Subordinated Debt Owed to Trusts	Maturity Date(2)
		(Dollars in thousands)			
Farmers & Merchants Capital Trust II	November 13, 2003	$ 7,500	3 month LIBOR + 3.00%	$ 7,732	November 8, 2033
Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609	July 7, 2035
				$ 11,341	

(1) The 3-month LIBOR in effect as of September 30, 2019 was 2.1252%.
(2) All debentures are currently callable.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of $40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Bank Notes") due December 15, 2027. The Bank Notes were issued at a price equal to 100% of the principal amount, resulting in net proceeds to the Bank of $39.4 million.

The Bank Notes bear a fixed interest rate of 5.25% per annum until (but excluding) December 15, 2022, payable semi-annually in arrears. From December 15, 2022, the Bank Notes will bear a floating rate of interest equal to 3-Month LIBOR + 3.03% until the Bank Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Bank Notes will be redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Bank Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Bank Notes are not subject to redemption at the option of the holders.

In September 2019, the Company completed the issuance of $60.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Company Notes") due October 1, 2029. The Company Notes were issued at a price equal to 100% of the principal amount, resulting in net proceeds to the Company of $58.7 million. The Company intends to use the net proceeds from the offering to support its growth and for general corporate purposes.

The Company Notes bear a fixed interest rate of 4.70% per annum until (but excluding) October 1, 2024, payable semi-annually in arrears on April 1 and October 1, commencing on April 1, 2020. Thereafter, from October 1, 2024 through the maturity date, October 1, 2029, or earlier redemption date, the Company Notes will bear interest at a floating rate equal to the then-current three-month LIBOR, plus 313 basis points (3.13%) for each quarterly interest period (subject to certain provisions set forth under "Description of the Notes—Interest Rates and Interest Payment Dates" included in the Prospectus Supplement), payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year. Any redemption will be at a redemption price equal to 100% of the principal amount of Company Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Company Notes are not subject to redemption at the option of the holders.

11. INCOME TAXES

The amount of the Company's federal and state income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income and the amount of other nondeductible items. For the three and nine months ended September 30, 2019, income tax expense was $3.1 million and $9.9 million, respectively, compared with $1.9 million and $4.9 million for the three and nine months ended September 30, 2018, respectively. The effective income tax rate for the three and nine months ended September 30, 2019 was 20.3% and 20.2%, respectively, compared to 17.8% and 17.0% for the three and nine months ended September 30, 2018, respectively.

Interest and penalties related to tax positions are recognized in the period in which they begin accruing or when the entity claims the position that does not meet the minimum statutory thresholds. The Company does not have any uncertain tax positions and does not have any interest and penalties recorded in the income statement for the three and nine months ended September 30, 2019. The Company is no longer subject to examination by the U.S. Federal Tax Jurisdiction for the years prior to 2015.

12. STOCK BASED COMPENSATION

At September 30, 2019, the Company had two stock-based employee compensation plans with awards outstanding. In connection with the acquisition of Post Oak Bancshares, Inc. on October 1, 2018, the Company assumed the Post Oak Bancshares, Inc. Stock Option Plan, under which no additional awards will be issued. During 2019, the Company's Board of Directors and shareholders approved the 2019 Amended and Restated Stock Awards and Incentive Plan (the "Plan") covering certain awards of stock-based compensation to key employees and directors of the Company. Under the Plan, the Company is authorized to issue a maximum aggregate of 3,200,000 shares of stock, up to 1,800,000 of which may be issued through incentive stock options. The Company accounts for stock based employee compensation plans using the fair value-based method of accounting. The Company recognized total stock based compensation expense of $789 thousand and $2.3 million for the three and nine months ended September 30, 2019, respectively, and $380 thousand and $1.2 million for the three and nine months ended September 30, 2018, respectively.

Stock Options

Options to purchase a total of 1,309,231 shares of Company stock have been granted as of September 30, 2019. Options are exercisable for up to 10 years from the date of the grant and are generally fully vested four years after the date of grant. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

A summary of the activity in the stock option plans during the nine months ended September 30, 2019 is set forth below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands)		(In years)	(In thousands)
Options outstanding, December 31, 2018	802	$ 18.88	4.61	$ 10,830
Options granted	—	—		
Options exercised	(98)	15.89		
Options forfeited	(4)	27.85		
Options outstanding, September 30, 2019	700	$ 19.25	3.98	$ 8,983
Options vested and exercisable, September 30, 2019	646	$ 18.28	3.71	$ 8,924

As of September 30, 2019, there was $509 thousand of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of 0.99 years.

Restricted Stock Awards

During the nine months ended September 30, 2019, the Company issued 84,522 shares of restricted stock. The forfeiture restrictions on restricted shares generally lapse over a period of four years, and the shares are considered outstanding at the date of issuance. The Company accounts for restricted stock grants by recording the fair value of the grant on the award date as compensation expense over the vesting period.

A summary of the activity of the nonvested shares of restricted stock during the nine months ended September 30, 2019 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
	(Shares in thousands)	
Nonvested share awards outstanding, December 31, 2018	143	$ 37.48
Share awards granted	85	34.95
Share awards vested	(17)	33.75
Unvested share awards forfeited or cancelled	(19)	38.50
Nonvested share awards outstanding, September 30, 2019	192	$ 36.44

As of September 30, 2019, there was $6.7 million of total unrecognized compensation cost related to the restricted stock awards which is expected to be recognized over a weighted-average period of 3.22 years.

13. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in the Company's consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve to varying degrees elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.

The contractual amounts of financial instruments with off-balance sheet risk are as follows:

	September 30, 2019		December 31, 2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Commitments to extend credit	$ 517,669	$ 556,833	$ 471,440	$ 530,546
Standby letters of credit	13,491	3,843	14,217	9,067
Total	$ 531,160	$ 560,676	$ 485,657	$ 539,613

Commitments to extend credit include lines of credit as well as commitments to make new loans. Commitments to make loans are generally made for an approval period of 120 days or fewer. As of September 30, 2019, the funded fixed rate loan commitments had interest rates ranging from 1.95% to 8.70% with a weighted average maturity and rate of 3.24 years and 5.22%, respectively. As of December 31, 2018, the funded fixed rate loan commitments had interest rates ranging from 1.95% to 8.70% with a weighted average maturity and rate of 2.94 years and 5.26%, respectively.

Litigation

From time to time, the Company is subject to claims and litigation arising in the ordinary course of business. In the opinion of management, the Company is not party to any legal proceedings the resolution of which it believes would have a material adverse effect on the Company's business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against the Company could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect the Company's reputation, even if resolved in its favor. The Company intends to defend itself vigorously against any future claims or litigation.

14. REGULATORY CAPITAL MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines, and for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors. Failure to meet minimum capital requirements can cause regulators to initiate actions that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. The final rules implementing Basel Committee on Banking Supervision's capital guideline for U.S. Banks (Basel III Rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and were fully phased in on January 1, 2019. Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reached 2.5% on January 1, 2019. Management believes as of September 30, 2019 and December 31, 2018 the Company and the Bank met all capital adequacy requirements to which they were then subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If less than well capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

The following is a summary of the Company's and the Bank's actual and required capital ratios at September 30, 2019 and December 31, 2018:

	Actual		For Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
				(Dollars in thousands)				
ALLEGIANCE BANCSHARES, INC.								
(Consolidated)								
As of September 30, 2019								
Total Capital (to risk weighted assets)	$ 590,698	14.70%	$ 321,431	8.00%	$ 421,878	10.500%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	453,119	11.28%	180,805	4.50%	281,252	7.000%	N/A	N/A
Tier 1 Capital (to risk weighted assets)	462,616	11.51%	241,073	6.00%	341,520	8.500%	N/A	N/A
Tier 1 Capital (to average tangible assets)	462,616	10.06%	184,030	4.00%	184,030	4.000%	N/A	N/A
As of December 31, 2018								
Total Capital (to risk weighted assets)	$ 531,453	13.70%	$ 310,295	8.00%	$ 383,020	9.875%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	456,223	11.76%	174,541	4.50%	247,266	6.375%	N/A	N/A
Tier 1 Capital (to risk weighted assets)	465,637	12.01%	232,721	6.00%	305,446	7.875%	N/A	N/A
Tier 1 Capital (to average tangible assets)	465,637	10.61%	175,621	4.00%	175,621	4.000%	N/A	N/A
ALLEGIANCE BANK								
As of September 30, 2019								
Total Capital (to risk weighted assets)	$ 562,604	14.01%	$ 321,287	8.00%	$ 421,689	10.500%	$ 401,609	10.00%
Common Equity Tier 1 Capital (to risk weighted assets)	493,213	12.28%	180,724	4.50%	281,126	7.000%	261,046	6.50%
Tier 1 Capital (to risk weighted assets)	493,213	12.28%	240,965	6.00%	341,368	8.500%	321,287	8.00%
Tier 1 Capital (to average tangible assets)	493,213	10.73%	183,922	4.00%	183,922	4.000%	229,903	5.00%
As of December 31, 2018								
Total Capital (to risk weighted assets)	$ 524,660	13.53%	$ 310,179	8.00%	$ 382,877	9.875%	$ 387,724	10.00%
Common Equity Tier 1 Capital (to risk weighted assets)	458,844	11.83%	174,476	4.50%	247,174	6.375%	252,021	6.50%
Tier 1 Capital (to risk weighted assets)	458,844	11.83%	232,634	6.00%	305,333	7.875%	310,179	8.00%
Tier 1 Capital (to average tangible assets)	458,844	10.45%	175,552	4.00%	175,552	4.000%	219,440	5.00%

15. EARNINGS PER COMMON SHARE

Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. Restricted shares are considered outstanding at the date of grant, accounted for as participating securities and included in basic and diluted weighted average common shares outstanding.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019		2018		2019		2018	
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in thousands, except per share data)							
Net income attributable to shareholders	$ 12,047		$ 8,879		$ 38,973		$ 24,146	
Basic:								
Weighted average shares outstanding	20,981	$ 0.57	13,371	$ 0.66	21,321	$ 1.83	13,320	$ 1.81
Diluted:								
Add incremental shares for:								
Dilutive effect of stock option exercises	275		266		270		285	
Total	21,256	$ 0.57	13,637	$ 0.65	21,591	$ 1.81	13,605	$ 1.77

Stock options for 51,875 shares were not considered in computing diluted earnings per common share as of September 30, 2019 as they were antidilutive. There were no antidilutive shares as of September 30, 2018.

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

Except where the context otherwise requires or where otherwise indicated, in this Quarterly Report on Form 10-Q the terms "we," "us," "our," "Company" and "our business" refer to Allegiance Bancshares, Inc. and our wholly-owned banking subsidiary, Allegiance Bank, a Texas banking association, and the terms "Allegiance Bank" or the "Bank" refer to Allegiance Bank. In this Quarterly Report on Form 10-Q, we refer to the Houston-The Woodlands-Sugar Land metropolitan statistical area, or MSA, and the Beaumont-Port Arthur MSA as the "Houston region."

Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We also may make forward-looking statements in our other documents filed with or furnished to the SEC. In addition, our senior management may make forward-looking statements orally to investors, analysts, representatives of the media and others. Statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "projects," "estimates," "plans" and similar expressions or future or conditional verbs such as "will," "should," "would," "may" and "could" are generally forward-looking in nature and not historical facts, although not all forward-looking statements include the foregoing. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond our control. Many possible events or factors could affect our future financial results and performance and could cause such results or performance to differ materially from those expressed in our forward-looking statements.

While there is no assurance that any list of risks and uncertainties or risk factors is complete, below are certain factors which could cause our actual results to differ from those in our forward-looking statements:

- risks related to the concentration of our business in the Houston region, including risks associated with volatility or decreases in oil and gas prices or prolonged periods of lower oil and gas prices;
- general market conditions and economic trends nationally, regionally and particularly in the Houston region;
- our ability to retain executive officers and key employees and their customer and community relationships;
- our ability to recruit and retain successful bankers that meet our expectations in terms of customer and community relationships and profitability;
- risks related to our strategic focus on lending to small to medium-sized businesses;
- our ability to implement our growth strategy, including through the identification of acquisition candidates that will be accretive to our financial condition and results of operations, as well as permitting decision-making authority at the bank office level;
- risks related to any businesses we acquire in the future, including exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs associated with integrating systems, technology platforms, procedures and personnel, the need for additional capital to finance such transactions and possible failures in realizing the anticipated benefits from such acquisitions;
- risks associated with our owner-occupied commercial real estate loan and other commercial real estate loan portfolios, including the risks inherent in the valuation of the collateral securing such loans;
- risks associated with our commercial and industrial loan portfolio, including the risk for deterioration in value of the general business assets that generally secure such loans;
- the accuracy and sufficiency of the assumptions and estimates we make in establishing reserves for potential loan losses and other estimates;
- risk of deteriorating asset quality and higher loan charge-offs, as well as the time and effort necessary to resolve nonperforming assets;
- potential changes in the prices, values and sales volumes of commercial and residential real estate securing our real estate loans;
- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;
- potential fluctuations in the market value and liquidity of the securities we hold for sale;

- risk of impairment of investment securities, goodwill, other intangible assets or deferred tax assets;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, which may adversely affect our pricing and terms;
- risks associated with negative public perception of the Company;
- our ability to maintain an effective system of disclosure controls and procedures and internal controls over financial reporting;
- risks associated with fraudulent and negligent acts by our customers, employees or vendors;
- our ability to keep pace with technological change or difficulties when implementing new technologies;
- risks associated with system failures or failures to protect against cybersecurity threats, such as breaches of our network security;
- our ability to comply with privacy laws and properly safeguard personal, confidential or proprietary information;
- risks associated with data processing system failures and errors;
- potential risk of environmental liability related to owning or foreclosing on real property;
- the institution and outcome of litigation and other legal proceeding against us or to which we become subject;
- our ability to maintain adequate liquidity and to raise necessary capital to fund our acquisition strategy and operations or to meet increased minimum regulatory capital levels;
- our ability to comply with various governmental and regulatory requirements applicable to financial institutions;
- the impact of recent and future legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, such as the further implementation of the Dodd-Frank Act;
- governmental monetary and fiscal policies, including the policies of the Federal Reserve;
- our ability to comply with supervisory actions by federal and state banking agencies;
- changes in the scope and cost of FDIC insurance and other coverage;
- systemic risks associated with the soundness of other financial institutions;
- the effects of war or other conflicts, acts of terrorism (including cyberattacks) or other catastrophic events, including storms, droughts, tornadoes and flooding, that may affect general economic conditions; and
- other risks and uncertainties listed from time to time in our reports and documents filed with the SEC.

Further, these forward-looking statements speak only as of the date on which they were made and we undertake no obligation to update or revise any forward-looking statements to reflect events or circumstances after the date on which any such statement is made or to reflect the occurrence of unanticipated events, unless required to do so under the federal securities laws. Other factors not identified above, including those described under the headings “Risk Factors”, "Quantitative and Qualitative Disclosures about Market Risk" and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 and in our Annual Report on Form 10-K for the year ended December 31, 2018 may also cause actual results to differ materially from those described in our forward-looking statements. Most of these factors are difficult to anticipate and are generally beyond our control. You should consider these factors in connection with considering any forward-looking statements that may be made by us.

Overview

We generate most of our revenues from interest income on loans, service charges on customer accounts and interest income from investments in securities. We incur interest expense on deposits and other borrowed funds and noninterest expenses such as salaries and employee benefits and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings that are used to fund those assets. Net interest income is our largest source of revenue. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the interest expenses of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities. Net interest margin is calculated as net interest income divided by average interest-earning assets. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and shareholders’ equity, also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a “volume change.” Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas and specifically in the Houston region, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our target market and throughout the state of Texas.

Our net interest income is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a “rate change.” Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in the unemployment rate, the money supply, political and international conditions and conditions in domestic and foreign financial markets.

Our objective is to grow and strengthen our community banking franchise by deploying our super-community banking strategy and pursuing select strategic acquisitions in the Houston region. We have positioned ourselves to be a leading provider of personalized commercial banking services by emphasizing the strength and capabilities of local bank office management and by providing superior customer service. We have made the strategic decision to focus on the Houston region because of our deep roots and experience operating through a variety of economic cycles in this large and vibrant market.

Super-community banking strategy. Our super-community banking strategy emphasizes local delivery of the excellent customer service associated with community banking combined with the products, efficiencies and scale associated with larger banks. By empowering our personnel to make certain business decisions at a local level in order to respond quickly to customers' needs, we are able to establish and foster strong relationships with customers through superior service. We operate full-service bank offices and employ lenders with strong underwriting credentials who are authorized to make loan and underwriting decisions up to prescribed limits at the bank office level. We support bank office operations with a centralized credit approval process for larger credit relationships, loan operations, information technology, core data processing, accounting, finance, treasury and treasury management support, deposit operations and executive and board oversight. We emphasize lending to and banking with small to medium-sized businesses, with which we believe we can establish stronger relationships through excellent service and provide lending that can be priced on terms that are more attractive to us than would be achieved by lending to larger businesses. We believe this approach produces a clear competitive advantage by delivering an extraordinary customer experience and fostering a culture dedicated to achieving both superior external and internal service levels.

We plan to continue to emphasize the super-community banking strategy to organically grow our presence in the Houston region through:

- increasing the productivity of existing bankers, as measured by loans, deposits and fee income per banker, while enhancing profitability by leveraging our existing operating platform;
- focusing on local and individualized decision-making, allowing us to provide customers with rapid decisions on loan requests, which we believe allows us to effectively compete with larger financial institutions;
- identifying and hiring additional seasoned bankers in the Houston region who will thrive within our super-community banking model, and opening additional branches where we are able to attract seasoned bankers; and
- developing new products designed to serve the increasingly diversified Houston economy, while preserving our strong culture of risk management.

Select strategic acquisitions. We intend to continue to expand our market position in the Houston region through organic growth, including the development of de novo branch locations, and a disciplined acquisition strategy. We focus on like-minded community banks with similar lending strategies to our own when evaluating acquisition opportunities. We believe that our management’s experience in assessing, executing and integrating target institutions will allow us to capitalize on acquisition opportunities.

Critical Accounting Policies

Our accounting policies are integral to understanding our results of operations. Our accounting policies are described in detail in Note 1 to our Annual Report on Form 10-K for the year ended December 31, 2018. We believe that of our accounting policies, the following may involve a higher degree of judgment and complexity:

Securities

Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value. Unrealized gains and losses are excluded from earnings and reported, net of tax, as a separate component of shareholders' equity until realized. Securities within the available for sale portfolio may be used as part of our asset/liability strategy and may be sold in response to changes in interest rate risk, prepayment risk or other similar economic factors.

Interest earned on these assets is included in interest income. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates debt securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement, and (2) OTTI related to other factors, which is recognized in other comprehensive income, net of applicable taxes. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the security.

Nonperforming and Past Due Loans

Loans are placed on nonaccrual status when payment in full of principal or interest is not expected or upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection. If the decision is made to continue accruing interest on the loan, periodic reviews are made to confirm the accruing status of the loan. Nonaccrual loans and loans past due 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

When available information confirms that specific loans, or portions thereof, are uncollectible, these amounts are charged off against the allowance. All loan types are considered delinquent after 30 days past due and are typically charged off or charged down no later than 120 days past due, with consideration of, but not limited to, the following criteria in determining the need and optional timing of the charge-off or charge-down: (1) the Bank is in the process of repossession or foreclosure and there appears to be a likely deficiency, (2) the collateral securing the loan has been sold and there is an actual deficiency, (3) the Bank is proceeding with lengthy legal action to collect its balance, (4) the borrower is unable to be located or (5) the borrower has filed bankruptcy. Events requiring charge-offs occur when a shortfall is identified between the recorded investment in the loan and the underlying value of the collateral.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance that is established through charges to income in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for loan losses charged to income that increase the allowance.

Throughout the year, management estimates the probable incurred losses in the loan portfolio to determine if the allowance for loan losses is adequate to absorb such losses. The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired. We follow a loan review program to evaluate the credit risk in the loan portfolio. Loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. The general component covers non-impaired loans and is based on industry and our specific historical loan loss experience, volume, growth and composition of the loan portfolio, the evaluation of our loan portfolio through our internal loan review process, general current economic conditions both internal and external to us that may affect the borrower's ability to pay, value of collateral and other qualitative relevant risk factors. Based on a review of these estimates, we adjust the allowance for loan losses to a level determined by management to be adequate. Estimates of loan losses are inherently subjective as they involve an exercise of judgment.

Our allowance for loan losses, both in dollars and as a percentage of total loans, is impacted by acquisition accounting. As part of acquisition accounting, acquired loans are initially recognized at fair value with no corresponding allowance for loan losses. Initial fair value of the loans includes consideration of expected credit losses.

Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and therefore classified as impaired. Subsequent to identification as a troubled debt restructuring, such loans are then evaluated for impairment on an individual basis whereby we determine the amount of reserve in accordance with the accounting policy for the impaired loans as part of our allowance for loan losses calculation. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Goodwill

Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is assessed annually for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Goodwill acquired in a purchase business combination that is determined to have an indefinite useful life, is not amortized, but tested for impairment. Goodwill is the only intangible asset with an indefinite life on our balance sheet. We perform our annual impairment review during the fourth quarter, as of October 1st. However, if we become aware of quantitative or qualitative data that suggests goodwill impairment has occurred, we will test on an interim basis as well. At September 30, 2019, our book value per share was higher than our market value per share, so we performed an interim assessment as of September 30 and concluded there was no evidence of impairment.

Recently Issued Accounting Pronouncements

We have evaluated new accounting pronouncements that have recently been issued and have determined that there are no new accounting pronouncements that should be described in this section that will impact the Company's operations, financial condition or liquidity in future periods. Refer to Note 1 of the Company's consolidated financial statements for a discussion of recent accounting pronouncements that have been adopted by the Company or that will require enhanced disclosures in the Company's financial statements in future periods.

Results of Operations

Net income was $12.0 million, or $0.57 per diluted share, for the third quarter 2019 compared to $8.9 million, or $0.65 per diluted share, for the third quarter 2018. The third quarter 2019 results included $1.4 million of pre-tax severance expense. Annualized returns on average assets, average shareholders' equity and average tangible shareholders' equity were 0.98%, 6.73% and 10.33%, respectively, compared to 1.18%, 10.80% and 12.40%, respectively, for the three months ended September 30, 2019 and 2018, respectively. Average return on tangible shareholders' equity is a non-GAAP financial measure. See the GAAP to non-GAAP reconciliation table provided for a more detailed analysis. The efficiency ratio decreased to 62.88% for the third quarter 2019 from 63.95% for the third quarter 2018. The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income plus noninterest income, excluding net gains and losses on the sale of loans, securities and assets. Additionally, taxes and provision for loan losses are not part of this calculation.

Net income was $39.0 million, or $1.81 per diluted share, for the nine months ended September 30, 2019 compared to $24.1 million, or $1.77 per diluted share, for the nine months ended September 30, 2018. The nine months ended September 30, 2019 results include $1.4 million of pre-tax severance expense and $1.3 million of acquisition and merger-related expenses. The nine months ended September 30, 2018 results include $1.8 million and $821 thousand of core system and acquisition and merger-related expenses, respectively. Annualized returns on average assets, average shareholders' equity and average tangible shareholders' equity were 1.09%, 7.36% and 11.35%, respectively, compared to 1.10%, 10.16% and 11.72%, respectively, for the nine months ended

September 30, 2019 and 2018, respectively. The efficiency ratio decreased to 63.25% for the nine months ended September 30, 2019 from 65.52% for the nine months ended September 30, 2018.

Net Interest Income

Three months ended September 30, 2019 compared with three months ended September 30, 2018. Net interest income before the provision for loan losses for the three months ended September 30, 2019 was $44.8 million compared with $28.0 million for the three months ended September 30, 2018, an increase of $16.8 million, or 59.9%. The increase in net interest income was primarily due to the increase in average interest-earning asset balances from the acquisitions of Post Oak and LoweryBank, as well as organic growth for the year.

Interest income was $58.7 million for the three months ended September 30, 2019, an increase of $23.3 million, or 66.0%, compared with the three months ended September 30, 2018, primarily due to an increase of $22.8 million of interest income and fees on loans as a result of the Post Oak acquisition, organic growth and increased yield on loans. Average loans outstanding increased $1.49 billion, or 62.3%, for the same period. The average yield on loans also increased to 5.72% for the three months ended September 30, 2019 from 5.49% for the same period in 2018. Additionally, interest income during the three months ended September 30, 2019 and 2018 included acquisition accounting loan discount accretion of $1.9 million and $0, respectively.

Interest expense was $13.8 million for the three months ended September 30, 2019, an increase of $6.5 million, or 89.4%, compared to the three months ended September 30, 2018. This increase was primarily due to higher funding costs on FHLB borrowings and interest-bearing deposits, as well as the increase in average interest-bearing liabilities. The cost of average interest-bearing liabilities increased to 188 basis points for the three months ended September 30, 2019 compared to 153 basis points for the same period in 2018. Average interest-bearing liabilities increased $1.02 billion for the three months ended September 30, 2019 compared to the three months ended September 30, 2018 primarily due to deposits acquired in the Post Oak acquisition and organic deposit growth.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the three months ended September 30, 2019 was 4.16%, an increase of 6 basis points compared to 4.10% for the three months ended September 30, 2018. The increase in the net interest margin on a tax equivalent basis was primarily due to the impact of net acquisition accounting adjustments partially offset by the increase in funding costs on interest-bearing deposits and borrowed funds. The impact of net acquisition accounting adjustments of $2.0 million on the tax equivalent net interest margin was an increase of 19 basis points for the three months ended September 30, 2019. The average yield on interest-earning assets and the average rate paid on interest-bearing liabilities for the third quarter 2019 increased by 30 basis points and 35 basis points, respectively, over the same period in 2018. The average yield on interest-earning assets, 5.43%, and the average rate paid on interest-bearing liabilities, 1.88%, as of September 30, 2019, were primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of the underlying assets and liabilities. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 21% federal tax rate for the three months ended September 30, 2019 and 2018, thus making tax-exempt yields comparable to taxable asset yields.

The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended September 30,					
	2019			2018		
	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest-earning Assets:						
Loans	$ 3,870,205	$ 55,790	5.72%	$ 2,384,966	$ 32,988	5.49%
Securities	359,392	2,573	2.84%	304,254	2,083	2.72%
Deposits in other financial institutions	55,070	302	2.17%	47,518	265	2.21%
Total interest-earning assets	4,284,667	$ 58,665	5.43%	2,736,738	$ 35,336	5.12%
Allowance for loan losses	(28,593)			(24,059)		
Noninterest-earning assets	600,004			276,997		
Total assets	$ 4,856,078			$ 2,989,676		
Liabilities and Shareholders' Equity						
Interest-bearing Liabilities:						
Interest-bearing demand deposits	$ 332,652	$ 943	1.13%	$ 181,284	$ 389	0.85%
Money market and savings deposits	1,099,937	4,032	1.45%	530,240	859	0.64%
Certificates and other time deposits	1,269,886	6,909	2.16%	896,253	4,051	1.79%
Borrowed funds	158,358	1,183	2.96%	234,776	1,272	2.15%
Subordinated debt	51,607	761	5.85%	48,805	729	5.93%
Total interest-bearing liabilities	2,912,440	$ 13,828	1.88%	1,891,358	$ 7,300	1.53%
Noninterest-bearing Liabilities:						
Noninterest-bearing demand deposits	1,198,564			761,935		
Other liabilities	35,030			10,179		
Total liabilities	4,146,034			2,663,472		
Shareholders' equity	710,044			326,204		
Total liabilities and shareholders' equity	$ 4,856,078			$ 2,989,676		
Net interest rate spread			3.55%			3.59%
Net interest income and margin(1)		$ 44,837	4.15%		$ 28,036	4.06%
Net interest income and margin (tax equivalent)(2)		$ 44,924	4.16%		$ 28,292	4.10%

(1) The net interest margin is equal to annualized net interest income divided by average interest-earning assets.
(2) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 21% for the three months ended September 30, 2019 and 2018 and other applicable effective tax rates.

Nine months ended September 30, 2019 compared with nine months ended September 30, 2018. Net interest income before the provision for loan losses for the nine months ended September 30, 2019 was $135.0 million compared with $82.7 million for the nine months ended September 30, 2018, an increase of $52.3 million, or 63.2%. The increase in net interest income was primarily due to the increase in average interest-earning asset balances from the acquisitions of Post Oak and LoweryBank, as well as organic loan growth, partially offset by increased interest expense in interest-bearing liabilities.

Interest income was $174.8 million for the nine months ended September 30, 2019, an increase of $72.8 million, or 71.5%, compared with the nine months ended September 30, 2018, primarily due to an increase of $71.0 million of interest income and fees on loans as a result of the Post Oak acquisition, organic growth and increased yield on loans. Average loans outstanding increased $1.49 billion, or 64.4%, for the same period. The average yield on loans also increased to 5.82% for the nine months ended September 30, 2019 from 5.47% for the same period in 2018. Additionally, interest income during the nine months ended September 30, 2019 and 2018 included acquisition accounting loan discount accretion of $7.1 million and $207 thousand, respectively.

Interest expense was $39.7 million for the nine months ended September 30, 2019, an increase of $20.6 million, or 107.3%, compared to the nine months ended September 30, 2018. This increase was primarily due to higher funding costs on FHLB borrowings and interest-bearing deposits, as well as, the increase in average interest-bearing liabilities. The cost of average interest-bearing liabilities increased to 184 basis points for the nine months ended September 30, 2019 compared to 136 basis points for the same period in 2018. Average interest-bearing liabilities increased $1.00 billion for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018 primarily due to deposits acquired in the Post Oak acquisition and organic growth in deposits.

Tax equivalent net interest margin for the nine months ended September 30, 2019 was 4.27%, an increase of 10 basis points compared to 4.17% for the nine months ended September 30, 2018. The increase in the net interest margin on a tax equivalent basis was primarily due to the impact of net acquisition accounting adjustments partially offset by the increase in funding costs on interest-bearing deposits and borrowed funds. The impact of net acquisition accounting adjustments of $7.8 million on the tax equivalent net interest margin was an increase of 25 basis points for the nine months ended September 30, 2019. The average yield on interest-earning assets and the average rate paid on interest-bearing liabilities for the nine months ended 2019 increased 42 basis points and 48 basis points, respectively, over the same period in 2018. The average yield on interest-earning assets, 5.51%, and the average rate paid on interest-bearing liabilities, 1.84%, as of September 30, 2019, were primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of the underlying assets and liabilities.

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The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccrual loans have been included in the table as loans carrying a zero yield.

	Nine Months Ended September 30,					
	2019			2018		
	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest-Earning Assets:						
Loans	$ 3,812,827	$ 165,995	5.82%	$ 2,319,727	$ 94,951	5.47%
Securities	352,074	7,374	2.80%	310,709	6,238	2.68%
Deposits in other financial institutions	79,309	1,391	2.34%	49,205	731	1.99%
Total interest-earning assets	4,244,210	$ 174,760	5.51%	2,679,641	$ 101,920	5.09%
Allowance for loan losses	(27,500)			(24,254)		
Noninterest-earning assets	581,932			276,777		
Total assets	$ 4,798,642			$ 2,932,164		
Liabilities and Shareholders' Equity						
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	$ 340,310	$ 3,058	1.20%	$ 190,228	$ 914	0.64%
Money market and savings deposits	992,349	10,158	1.37%	534,925	2,197	0.55%
Certificates and other time deposits	1,301,478	20,173	2.07%	841,849	10,120	1.61%
Borrowed funds	198,839	4,128	2.78%	265,401	3,780	1.90%
Subordinated debt	49,849	2,232	5.99%	48,746	2,168	5.95%
Total interest-bearing liabilities	2,882,825	$ 39,749	1.84%	1,881,149	$ 19,179	1.36%
Noninterest-Bearing Liabilities:						
Noninterest-bearing demand deposits	1,179,914			724,493		
Other liabilities	28,270			8,742		
Total liabilities	4,091,009			2,614,384		
Shareholders' equity	707,633			317,780		
Total liabilities and shareholders' equity	$ 4,798,642			$ 2,932,164		
Net interest rate spread			3.67%			3.73%
Net interest income and margin		$ 135,011	4.25%		$ 82,741	4.13%
Net interest income and net interest margin (tax equivalent)		$ 135,413	4.27%		$ 83,551	4.17%

(1) The net interest margin is equal to annualized net interest income divided by average interest-earning assets.
(2) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 21% for the nine months ended September 30, 2019 and 2018 and other applicable effective tax rates.

The following table presents information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest-earnings assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes in interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

	For the Three Months Ended September 30, 2019 vs. 2018			For the Nine Months Ended September 30, 2019 vs. 2018		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest-earning Assets:						
Loans	$ 20,567	$ 2,235	$ 22,802	$ 61,042	$ 10,002	$ 71,044
Securities	380	110	490	819	317	1,136
Deposits in other financial institutions	42	(5)	37	449	211	660
Total increase in interest income	20,989	2,340	23,329	62,310	10,530	72,840
Interest-bearing Liabilities:						
Interest-bearing demand deposits	323	231	554	718	1,426	2,144
Money market and savings deposits	915	2,258	3,173	1,882	6,079	7,961
Certificates and other time deposits	1,679	1,179	2,858	5,535	4,518	10,053
Borrowed funds	(414)	325	(89)	(946)	1,294	348
Subordinated debt	42	(10)	32	49	15	64
Total increase in interest expense	2,545	3,983	6,528	7,238	13,332	20,570
Increase (decrease) in net interest income	$ 18,444	$ (1,643)	$ 16,801	$ 55,072	$ (2,802)	$ 52,270

Provision for Loan Losses

Our allowance for loan losses is established through charges to income in the form of the provision in order to bring our allowance for loan losses to a level deemed appropriate by management. The allowance for loan losses was $29.8 million at September 30, 2019 and $26.3 million at December 31, 2018, representing 0.77% and 0.71% of total loans, respectively. We recorded a $2.6 million provision for loan losses for the three months ended September 30, 2019. No provision was recorded for the three months ended September 30, 2018. We recorded a $5.0 million and $1.3 million provision for loan losses for the nine months ended September 30, 2019 and 2018, respectively. The increase in the provision for the three and nine months ended September 30, 2019 compared to the three and nine months ended September 30, 2018 was primarily due to an increase in organic loan growth and the reduction and elimination of our Hurricane Harvey reserve during 2018 that was created in 2017.

Noninterest Income

Our primary sources of noninterest income are service charges on deposit accounts, nonsufficient funds fees, rebates from correspondent banks and debit card and ATM card income. Noninterest income does not include loan origination fees, which are recognized over the life of the related loan as an adjustment to yield using the interest method.

Three months ended September 30, 2019 compared with three months ended September 30, 2018. Noninterest income totaled $2.9 million for the three months ended September 30, 2019 compared with $1.9 million for the same period in 2018, an increase of $961 thousand, or 49.8%. Noninterest income for the three months ended September 30, 2019 included additional income associated with the acquired loan and deposit accounts from the Post Oak acquisition and additional rebates from correspondent banks.

Nine months ended September 30, 2019 compared with nine months ended September 30, 2018. Noninterest income totaled $10.0 million for the nine months ended September 30, 2019 compared with $5.4 million for the same period in 2018, an increase of $4.6 million, or 86.3%, primarily due to additional noninterest income resulting from the Post Oak acquisition, additional rebates from correspondent banks along with the $846 thousand net gain on the sale of securities.

The following table presents, for the periods indicated, the major categories of noninterest income:

	For the Three Months Ended September 30, 2019	For the Three Months Ended September 30, 2018	Increase (Decrease)	For the Nine Months Ended September 30, 2019	For the Nine Months Ended September 30, 2018	Increase (Decrease)
	(Dollars in thousands)					
Nonsufficient funds fees	$ 168	$ 175	$ (7)	$ 469	$ 565	$ (96)
Service charges on deposit accounts	379	177	202	1,069	506	563
Gain on sale of securities	—	—	—	846	—	846
Gain on sale of other real estate	—	—	—	71	1	70
Bank owned life insurance income	153	137	16	467	416	51
Debit card and ATM card income	510	300	210	1,478	858	620
Rebate from correspondent bank	900	613	287	2,680	1,621	1,059
Other(1)	779	526	253	2,943	1,412	1,531
Total noninterest income	$ 2,889	$ 1,928	$ 961	$ 10,023	$ 5,379	$ 4,644

(1) Other includes wire transfer and letter of credit fees, among other items.

Noninterest Expense

Three months ended September 30, 2019 compared with three months ended September 30, 2018. Noninterest expense was $30.0 million for the three months ended September 30, 2019 compared to $19.2 million for the three months ended September 30, 2018, an increase of $10.8 million, or 56.6%. This increase over the third quarter 2018 was primarily due to additional expenses associated with increased headcount and bank offices from the Post Oak acquisition. Additionally, the third quarter 2019 included $1.4 million of severance expense partially offset by a $676 thousand FDIC Small Bank Assessment Credit.

Nine months ended September 30, 2019 compared with nine months ended September 30, 2018. Noninterest expense was $91.2 million for the nine months ended September 30, 2019 compared to $57.7 million for the nine months ended September 30, 2018, an increase of $33.5 million, or 58.0%. This increase over the nine months ended September 30, 2018 was primarily due to additional expenses related to increased headcount and bank offices along with acquisition and merger-related expenses from the Post Oak acquisition. Additionally, the nine months ended September 30, 2019 included $1.4 million of severance expense partially offset by a $676 thousand FDIC Small Bank Assessment Credit.

The following table presents, for the periods indicated, the major categories of noninterest expense:

	For the Three Months Ended September 30, 2019	For the Three Months Ended September 30, 2018	Increase (Decrease)	For the Nine Months Ended September 30, 2019	For the Nine Months Ended September 30, 2018	Increase (Decrease)
	(Dollars in thousands)					
Salaries and employee benefits(1)	$ 20,221	$ 12,965	$ 7,256	$ 59,320	$ 38,537	$ 20,783
Net occupancy and equipment	1,973	1,281	692	6,139	3,886	2,253
Depreciation	822	490	332	2,331	1,330	1,001
Data processing and software amortization	2,058	1,226	832	5,390	3,635	1,755
Professional fees	667	303	364	1,793	1,339	454
Regulatory assessments and FDIC insurance	(41)	505	(546)	1,489	1,533	(44)
Core deposit intangibles amortization	1,178	195	983	3,534	586	2,948
Communications	455	262	193	1,353	769	584
Advertising	449	351	98	1,770	1,021	749
Acquisition and merger-related expenses	—	196	(196)	1,326	821	505
Other real estate expense	137	42	95	450	185	265
Printing and supplies	83	74	9	429	259	170
Other	2,007	1,274	733	5,880	3,840	2,040
Total noninterest expense	$ 30,009	$ 19,164	$ 10,845	$ 91,204	$ 57,741	$ 33,463

(1) Total salaries and employee benefits includes $789 thousand and $380 thousand for the three months ended September 30, 2019 and 2018, respectively, and $2.3 million and $1.2 million for the nine months ended September 30, 2019 and 2018, respectively, in stock based compensation expense.

Salaries and employee benefits. Salaries and benefits increased $7.3 million, or 56.0%, for the three months ended September 30, 2019 compared to the same period in 2018 and increased $20.8 million, or 53.9%, for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018 primarily due to a significant increase in the total size of our workforce between these periods as our full-time equivalent employees increased to 582 at September 30, 2019 from 380 as of September 30, 2018. The primary increase in headcount was from employees added through the Post Oak acquisition and to support organic growth. Additionally, we recorded $1.4 million of severance expense during the three months ended September 30, 2019.

Data Processing and software amortization. Data processing and software amortization increased $832 thousand, or 67.9%, for the three months ended September 30, 2019 compared to the same period in 2018 and increased $1.8 million, or 48.3%, for the nine months ended September 30, 2019 compared to the same period in 2018 primarily due to expenses from added scale as a result of the Post Oak acquisition and to increase efficiencies.

Acquisition and merger-related expenses. Acquisition and merger-related expenses are primarily legal, advisory and accounting fees associated with the Post Oak acquisition. These expenses also include data processing conversion costs, severance and contract termination costs.

Efficiency Ratio

The efficiency ratio is a supplemental financial measure utilized in management's internal evaluation of our performance and is not calculated based on generally accepted accounting principles. We monitor the efficiency ratio in comparison with changes in our total assets and loans, and we believe that maintaining or reducing the efficiency ratio during periods of growth over the long-term will demonstrate the scalability of our operating platform. We calculate our efficiency ratio by dividing total noninterest expense by the sum of net interest income plus total noninterest income, excluding net gains and losses on the sale of loans, securities and assets. Additionally, taxes and provision for loan losses are not included in this calculation. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income and/or being invested to generate future income, while a decrease would indicate a more efficient allocation of resources. Our efficiency ratio was 62.88% and 63.25% for the three and nine months ended September 30, 2019, respectively, compared to 63.95% and 65.52% for the three and nine months ended September 30, 2018, respectively.

Income Taxes

The amount of federal and state income tax expense is influenced by the amount of pre-tax income, tax-exempt income and other nondeductible expenses. Income tax expense increased $1.2 million, or 60.0%, to $3.1 million for the three months ended September 30, 2019 compared with $1.9 million for the same period in 2018. Income tax expense also increased $4.9 million, or 99.1%, to $9.9 million for the nine months ended September 30, 2019 compared with $4.9 million for the same period in 2018. Our effective tax rate was 20.3% and 20.2% for the three and nine months ended September 30, 2019, respectively, compared to 17.8% and 17.0% for the three and nine months ended September 30, 2018, respectively. Our effective tax rate increased slightly for the three and nine months ended September 30, 2019 compared to the same periods in 2018 as municipal securities and BOLI represent smaller portions of our revenue mix.

Financial Condition

Loan Portfolio

At September 30, 2019, total loans were $3.89 billion, an increase of $177.7 million, or 4.8%, compared with December 31, 2018, primarily due to organic growth within our loan portfolio and loans acquired in the LoweryBank acquisition.

Total loans as a percentage of deposits were 99.7% and 101.2% as of September 30, 2019 and December 31, 2018, respectively. Total loans as a percentage of assets were 79.2% and 79.7% as of September 30, 2019 and December 31, 2018, respectively.

Lending activities originate from the efforts of our lenders, with an emphasis on lending to small to medium-sized businesses and companies, professionals and individuals located in the Houston region.

The following table summarizes our loan portfolio by type of loan as of the dates indicated:

	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial and industrial	$ 675,055	17.3%	$ 702,037	18.9%
Mortgage warehouse	36,594	0.9%	48,274	1.3%
Real estate:				
Commercial real estate (including multi-family residential)	1,859,721	47.9%	1,650,912	44.6%
Commercial real estate construction and land development	386,723	10.0%	430,128	11.6%
1-4 family residential (including home equity)	695,520	17.9%	649,311	17.5%
Residential construction	189,608	4.9%	186,411	5.0%
Consumer and other	42,783	1.1%	41,233	1.1%
Total loans	3,886,004	100.0%	3,708,306	100.0%
Allowance for Loan Losses	(29,808)		(26,331)	
Loans, net	$ 3,856,196		$ 3,681,975	

The principal categories of our loan portfolio are discussed below:

Commercial and Industrial. We make commercial and industrial loans in our market area that are underwritten primarily on the basis of the borrower's ability to service the debt from income. Our commercial and industrial loan portfolio decreased by $27.0 million, or 3.8%, to $675.1 million as of September 30, 2019 from $702.0 million as of December 31, 2018.

Mortgage Warehouse. We make loans to unaffiliated mortgage loan originators collateralized by mortgage promissory notes which are segregated in our mortgage warehouse portfolio. These promissory notes originated by our mortgage warehouse customers carry terms and conditions as would be expected in the competitive permanent mortgage market and serve as collateral under a traditional mortgage warehouse arrangement whereby such promissory notes are warehoused under a revolving credit facility to allow for the end investor (or purchaser) of the note to receive a complete loan package and remit funds to the bank. For mortgage promissory notes secured by residential property, the warehouse time is normally 10 to 20 days. For mortgage promissory notes secured by commercial property, the warehouse time is normally 40 to 50 days. The funded balance of the mortgage warehouse portfolio can have significant fluctuation based upon market demand for the product, level of home sales and refinancing activity, market interest rates, and velocity of end investor processing times. Volumes of the portfolio tend to peak at the end of each month. Our mortgage warehouse portfolio decreased $11.7 million, or 24.2%, to $36.6 million as of September 30, 2019 from $48.3 million at December 31, 2018 as we made the strategic decision to exit this line of business during the second quarter of 2019.

Commercial Real Estate (Including Multi-Family Residential). We make loans collateralized by owner-occupied, nonowner-occupied and multi-family real estate to finance the purchase or ownership of real estate. As of September 30, 2019 and December 31, 2018, 53.6% and 51.4%, respectively, of our commercial real estate loans were owner-occupied. Our commercial real estate loan portfolio increased $208.8 million, or 12.6%, to $1.86 billion as of September 30, 2019 from $1.65 billion as of December 31, 2018, as a result of organic loan growth and loans acquired from LoweryBank. Included in our commercial real estate portfolio are multi-family residential loans. Our multi-family loans increased to $86.1 million as of September 30, 2019 from $78.4 million as of December 31, 2018. We had 148 multi-family loans with an average loan size of $581 thousand as of September 30, 2019.

Commercial Real Estate Construction and Land Development. We make commercial real estate construction and land development loans to fund commercial construction, land acquisition and real estate development construction. Commercial real estate construction and land development loans decreased $43.4 million, or 10.1%, to $386.7 million as of September 30, 2019 compared to $430.1 million as of December 31, 2018.

1-4 Family Residential (Including Home Equity). Our residential real estate loans include the origination of 1-4 family residential mortgage loans (including home equity and home improvement loans and home equity lines of credit) collateralized by owner-occupied residential properties located in our market area. Our residential real estate portfolio (including home equity) increased $46.2 million, or 7.1%, to $695.5 million as of September 30, 2019 from $649.3 million as of December 31, 2018. The home equity, home improvement and home equity lines of credit portion of our residential real estate portfolio increased $14.8 million, or 15.5%, to $110.2 million as of September 30, 2019 from $95.4 million as of December 31, 2018.

Residential Construction. We make residential construction loans to home builders and individuals to fund the construction of single-family residences with the understanding that such loans will be repaid from the proceeds of the sale of the homes by builders or with the proceeds of a mortgage loan. These loans are secured by the real property being built and are made based on our assessment of the value of the property on an as-completed basis. Our residential construction loans portfolio increased $3.2 million, or 1.7%, to $189.6 million as of September 30, 2019 from $186.4 million as of December 31, 2018.

Consumer and Other. Our consumer and other loan portfolio is made up of loans made to individuals for personal purposes. Our consumer and other loan portfolio increased $1.6 million, or 3.8%, to $42.8 million as of September 30, 2019 from $41.2 million as of December 31, 2018.

Asset Quality

Nonperforming Assets

We have procedures in place to assist us in maintaining the overall quality of our loan portfolio. We have established underwriting guidelines to be followed by our officers and monitor our delinquency levels for any negative or adverse trends.

We had $34.6 million and $33.0 million in nonperforming loans as of September 30, 2019 and December 31, 2018, respectively.

The following table presents information regarding nonperforming assets as of the dates indicated.

	As of September 30, 2019	As of December 31, 2018
	(Dollars in thousands)	
Nonaccrual loans:		
Commercial and industrial	$ 8,033	$ 10,861
Mortgage warehouse	—	—
Real estate:		
Commercial real estate (including multi-family residential)	15,356	17,776
Commercial real estate construction and land development	9,050	974
1-4 family residential (including home equity)	1,992	3,201
Residential construction	—	—
Consumer and other	184	141
Total nonaccrual loans	34,615	32,953
Accruing loans 90 or more days past due	—	—
Total nonperforming loans	34,615	32,953
Other real estate	8,333	630
Other repossessed assets	—	—
Total nonperforming assets	$ 42,948	$ 33,583
Restructured loans(1)	$ 12,325	$ 13,494
Nonperforming assets to total assets	0.88%	0.72%
Nonperforming loans to total loans	0.89%	0.89%

(1) Restructured loans represent the balance at the end of the respective period for those loans modified in a troubled debt restructuring that are not already presented as a nonperforming loan.

Potential problem loans are included in the loans that are accruing, restructured and impaired that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. Potential problem loans contain potential weaknesses that could improve, persist or further deteriorate. At September 30, 2019 and December 31, 2018, we had $14.2 million and $16.0 million, respectively, in loans of this type which are not included in any of the nonaccrual or 90 days past due loan categories. At September 30, 2019, potential problem loans consisted of twenty-four credit relationships. Of the total outstanding balance at September 30, 2019, 33.5% related to eight customers in the energy industry, 26.2% related to three customers in the consumer services industry, 17.0% related to one customer in the residential rental real estate industry, 8.3% related to one customer in the manufacturing industry, 6.6% related to three customers in the construction services industry, 4.7% related to three customers in the commercial services industry, 2.9% related to one customer in the convenience store industry, 0.7% related to three customers in the freight transportation industry and 0.2% related to one customer with a consumer loan. Weakness in these organizations' operating performance, financial condition and borrowing base deficits for certain energy-related credits, among other factors, have caused us to heighten the attention given to these credits. If potential problem loans were to become impaired, they would impact the allocation of our allowance for loan losses through assignment of a specific reserve at the time of impairment.

Allowance for Credit Losses

The allowance for loan losses is a valuation allowance that is established through charges to earnings in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged-off that increase the allowance and (3) provisions for loan losses charged to income that increase the allowance.

Under accounting standards for business combinations, acquired loans are recorded at fair value on the date of acquisition. This fair value adjustment eliminates any of the seller's allowance associated with such loans as of the purchase date as any credit exposure associated with such loans is incorporated into the fair value adjustment. A provision for loan losses is recorded for the emergence of new incurred and estimable losses on acquired loans after the acquisition date in excess of the recorded discount.

All loans acquired from Post Oak and LoweryBank were recorded at fair value without a carryover of the allowance for loan losses. The discount recognized on acquired loans is prospectively accreted, increasing our basis in such loans. Due to acquisition accounting, our allowance for loan losses to total loans may not be comparable to our peers particularly as it relates to the allowance to gross loan percentage and the allowance to nonperforming loans. Recognizing that acquired purchased credit impaired loans have been de minimis, we monitor credit quality trends on a post-acquisition basis with an emphasis on past due, charge-off, classified loan and nonperforming trends. The amount of discount recorded by the Company on the acquisition date of the Post Oak acquisition was $17.0 million, or 1.43%, on loans acquired. The amount of discount recorded by the Company on the acquisition date of the LoweryBank branch acquisition was $573 thousand, or 1.30%, on loans acquired. The remaining discount on the balance of acquired loans as of September 30, 2019 was $7.2 million. The discount on purchased loans considers anticipated credit losses on that portfolio; therefore, no allowance for credit losses was established on the acquisition date. The unaccreted discount represents additional protection against potential losses and is presented as a reduction of the recorded investment in the loans rather than an allowance for loan losses. We will continue to monitor the portfolio for credit deterioration and establish additional allowances over the remaining discount as needed.

At September 30, 2019, our allowance for loan losses amounted to $29.8 million, or 0.77%, of total loans compared with $26.3 million, or 0.71%, as of December 31, 2018. The $3.5 million increase in the allowance at September 30, 2019 compared to the year ended December 31, 2018 was primarily due to the required reserve associated with organic growth. We believe that the allowance for loan losses at September 30, 2019 and December 31, 2018 was adequate to cover probable incurred losses in the loan portfolio as of such dates. The ratio of annualized net charge-offs to average loans outstanding was 0.05% for the nine months ended September 30, 2019 compared to annualized net charge-offs of 0.08% for the nine months ended September 30, 2018 and 0.06% for the year ended December 31, 2018.

The following table presents, as of and for the periods indicated, an analysis of the allowance for loan losses and other related data:

	As of and for the Nine Months Ended September 30,	
	2019	2018
	(Dollars in thousands)	
Average loans outstanding	$ 3,812,827	$ 2,319,727
Gross loans outstanding at end of period	3,886,004	2,440,926
Allowance for loan losses at beginning of period	26,331	23,649
Provision for loan losses	5,006	1,284
Charge-offs:		
Commercial and industrial loans	(1,357)	(2,123)
Mortgage warehouse	—	—
Real estate:		
Commercial real estate (including multi-family residential)	(80)	(41)
Commercial real estate construction and land development	(44)	—
1-4 family residential (including home equity)	(295)	(25)
Residential construction	—	—
Consumer and other	(8)	—
Total charge-offs for all loan types	(1,784)	(2,189)
Recoveries:		
Commercial and industrial loans	230	740
Mortgage warehouse	—	—
Real estate:		
Commercial real estate (including multi-family residential)	3	102
Commercial real estate construction and land development	—	—
1-4 family residential (including home equity)	—	—
Residential construction	—	—
Consumer and other	22	—
Total recoveries for all loan types	255	842
Net charge-offs	(1,529)	(1,347)
Allowance for loan losses at end of period	$ 29,808	$ 23,586
Allowance for loan losses to total loans	0.77%	0.97%
Net charge-offs to average loans (1)	0.05%	0.08%
Allowance for loan losses to nonperforming loans	86.11%	157.84%

(1) Interim periods annualized.

Available for Sale Securities

We use our securities portfolio to provide a source of liquidity, to provide an appropriate return on funds invested, to manage interest rate risk and to meet pledging and regulatory capital requirements. As of September 30, 2019, the carrying amount of investment securities totaled $353.0 million, an increase of $15.7 million, or 4.7%, compared with $337.3 million as of December 31, 2018. Securities represented 7.2% of total assets as of September 30, 2019 and December 31, 2018.

All of the securities in our securities portfolio are classified as available for sale. Securities classified as available for sale are measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, as accumulated comprehensive income or loss until realized. Interest earned on securities is included in interest income.

The following table summarizes the amortized cost and fair value of the securities in our securities portfolio as of the dates shown:

	September 30, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$ 30,250	$ 332	$ (325)	$ 30,257
Municipal securities	71,782	4,034	—	75,816
Agency mortgage-backed pass-through securities	97,374	1,779	(126)	99,027
Agency collateralized mortgage obligations	99,702	2,138	(166)	101,674
Corporate bonds and other	45,661	580	(15)	46,226
Total	$ 344,769	$ 8,863	$ (632)	$ 353,000

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$ 8,570	$ 161	$ (46)	$ 8,685
Municipal securities	219,068	1,258	(3,541)	216,785
Agency mortgage-backed pass-through securities	66,987	237	(1,029)	66,195
Corporate bonds and other	46,303	15	(690)	45,628
Total	$ 340,928	$ 1,671	$ (5,306)	$ 337,293

As of September 30, 2019, we did not expect to sell any securities classified as available for sale with material unrealized losses; and management believes that we more likely than not will not be required to sell any securities before their anticipated recovery, at which time we will receive full value for the securities. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. Management does not believe any of the securities are impaired due to reasons of credit quality. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Accordingly, as of September 30, 2019, management believes any impairment in our securities is temporary, and no impairment loss has been realized in our consolidated statements of income.

The following table summarizes the contractual maturity of securities and their weighted average yields as of the dates indicated. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures. Available for sale securities are shown at amortized cost. For purposes of the table below, municipal securities are calculated on a tax equivalent basis.

	September 30, 2019									
	Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
	(Dollars in thousands)									
Available for Sale										
U.S. government and agency securities	$ —	0.00%	$ 5,446	3.30%	$ 22,975	3.13%	$ 1,829	2.74%	$ 30,250	3.13%
Municipal securities	5,487	2.62%	3,697	3.19%	25,808	3.68%	36,790	3.68%	71,782	3.58%
Agency mortgage-backed pass-through securities	—	0.00%	1,035	2.70%	13,953	3.00%	82,386	3.11%	97,374	3.09%
Agency collateralized mortgage obligations	—	0.00%	—	0.00%	34,603	2.84%	65,098	2.53%	99,702	2.63%
Corporate bonds and other	23,553	2.61%	12,131	2.36%	1,000	8.00%	8,977	3.72%	45,661	2.88%
Total	$ 29,040	2.61%	$ 22,309	2.74%	$ 98,339	3.20%	$195,080	3.05%	$344,769	3.03%

	December 31, 2018									
	Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
	(Dollars in thousands)									
Available for Sale										
U.S. government and agency securities	$ 999	2.37%	$ 5,399	3.30%	$ —	0.00%	$ 2,172	2.74%	$ 8,570	3.05%
Municipal securities	3,772	2.06%	37,422	2.03%	86,391	3.05%	91,483	3.84%	219,068	3.19%
Agency mortgage-backed pass-through securities	—	0.00%	34	4.05%	13,466	2.92%	53,487	3.21%	66,987	3.15%
Corporate bonds and other	10,106	2.36%	30,854	2.56%	1,000	8.00%	4,343	4.17%	46,303	2.78%
Total	$ 14,877	2.29%	$ 73,709	2.34%	$ 100,857	3.09%	$ 151,485	3.61%	$ 340,928	3.12%

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers may have the right to prepay their obligations. Mortgage-backed securities and collateralized mortgage obligations are typically issued with stated principal amounts and are backed by pools of mortgage loans with varying maturities. The term of the underlying mortgages and loans may vary significantly due to the ability of a borrower to prepay and, in particular, monthly pay downs on mortgage-backed securities tend to cause the average life of the securities to be much different than the stated contractual maturity. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and, consequently, the average life of this security will be lengthened. If interest rates begin to fall, prepayments may increase, thereby shortening the estimated life of this security.

As of September 30, 2019 and December 31, 2018, we did not own securities of any one issuer (other than the U.S. government and its agencies or sponsored entities) for which the aggregate adjusted cost exceeded 10% of our consolidated shareholders’ equity.

The average yield of our securities portfolio was 2.80% during the nine months ended September 30, 2019 compared with 2.68% for the nine months ended September 30, 2018.

Goodwill and Core Deposit Intangible Assets

Our goodwill as of September 30, 2019 was $223.6 million compared to $223.1 million as of December 31, 2018 due to goodwill resulting from the acquisition of the LoweryBank branch in February 2019. Goodwill resulting from business combinations represents the excess of the consideration paid over the fair value of the net assets acquired and liabilities assumed. Goodwill is assessed annually for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Our core deposit intangible assets, net as of September 30, 2019 and December 31, 2018, was $23.1 million and $26.6 million, respectively. Core deposit intangible assets are amortized over their estimated useful life of seven to ten years.

Premises and Equipment, net

Premises and equipment, net increased by $25.5 million, or 61.0%, to $67.2 million at September 30, 2019 from $41.7 million at December 31, 2018, primarily due to the adoption of ASU 2016-02, Leases (Topic 842), on January 1, 2019, which resulted in the Company recognizing a right of use asset of $15.3 million. Additionally, we purchased two properties totaling $10.7 million during the third quarter of 2019.

Deposits

Our lending and investing activities are primarily funded by deposits. We offer a variety of deposit accounts having a wide range of interest rates and terms including demand, savings, money market and certificates and other time accounts. We rely primarily on convenient locations, personalized service and our customer relationships to attract and retain these deposits. We seek customers that will engage in both a lending and deposit relationship with us.

Total deposits at September 30, 2019 were $3.90 billion, an increase of $234.9 million, or 6.4%, compared with $3.66 billion at December 31, 2018. Noninterest-bearing deposits at September 30, 2019 were $1.23 billion, an increase of $18.5 million, or 1.5%, compared with $1.21 billion at December 31, 2018. Interest-bearing deposits at September 30, 2019 were $2.67 billion, an increase of $216.4 million, or 8.8%, compared with $2.45 billion at December 31, 2018.

Borrowings

We have an available line of credit with the Federal Home Loan Bank ("FHLB") of Dallas, which allows us to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At September 30, 2019, we had a total borrowing capacity of $1.67 billion, of which $1.41 billion was available and $261.8 million was outstanding. FHLB advances of $125.0 million were outstanding at September 30, 2019, at a weighted average interest rate of 2.54%. Letters of credit were $136.8 million at September 30, 2019, of which $45.5 million will expire during the remaining months of 2019, $88.8 million will expire in 2020 and $2.5 million will expire in 2021.

Credit Agreement

On December 28, 2018, we amended our revolving credit agreement to increase the maximum commitment to advance funds to $45.0 million which will reduce annually by $7.5 million beginning in December 2020 and on each December 22nd for the following years thereafter. We are required to repay any outstanding balance in excess of the then-current maximum commitment amount. The revised agreement will mature in December 2025 and is secured by 100% of the capital stock of the Bank.

Our credit agreement contains certain restrictive covenants, including limitations on our ability to incur additional indebtedness or engage in certain fundamental corporate transactions, such as mergers, reorganizations and recapitalizations. Additionally, the Bank is required to maintain a “well-capitalized” rating, a minimum return on assets of 0.65%, measured quarterly, a ratio of loan loss reserve to nonperforming loans equal to or greater than 75%, measured quarterly, and a ratio of nonperforming assets to aggregate equity plus loan loss reserves minus intangible assets of less than 35%, measured quarterly.

On September 9, 2019, in connection with the issuance of the Company Notes described in “Note 10. Subordinated Debt – Subordinated Notes,” the lender under our credit agreement waived certain restrictions on incurring additional indebtedness solely with respect to the Company Notes.

At September 30, 2019, the balance of the revolving credit agreement was $34.6 million. The interest rate on the debt is the Prime Rate minus 25 basis points, or 4.75%, at September 30, 2019, and is paid quarterly. At September 30, 2019, we believe we were in compliance with our debt covenants and had not been made aware of any noncompliance by the lender.

Off-Balance Sheet Items

In the normal course of business, we enter into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets.

Commitments to Extend Credit. We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. The amount and type of collateral obtained, if considered necessary by us, upon extension of credit, is based on management’s credit evaluation of the customer. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses.

Standby Letters of Credit. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. If the customer does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment and we would have the rights to the underlying collateral. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

As of September 30, 2019 and December 31, 2018, we had outstanding $1.07 billion and $1.00 billion, respectively, in commitments to extend credit and $17.3 million and $23.3 million, respectively, in commitments associated with outstanding letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

Liquidity and Capital Resources

Liquidity

Liquidity is the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital, strategic cash flow needs and to maintain reserve requirements to operate on an ongoing basis and manage unexpected events, all at a reasonable cost. During the nine months ended September 30, 2019 and the year ended December 31, 2018, our liquidity needs have been primarily met by deposits, borrowed funds, security and loan maturities and amortizing investment and loan portfolios. The Bank has access to purchased funds from correspondent banks and advances from the FHLB are available under a security and pledge agreement to take advantage of investment opportunities.

Our largest source of funds is deposits, and our largest use of funds is loans. Our average loans increased $1.49 billion, or 64.4%, for the nine months ended September 30, 2019 compared with the nine months ended September 30, 2018. We predominantly invest excess deposits in Federal Reserve Bank of Dallas balances, securities, interest-bearing deposits at other banks or other short-term liquid investments until the funds are needed to fund loan growth. Our securities portfolio had a weighted average life of 7.0 years and modified duration of 5.5 years at September 30, 2019, and a weighted average life of 6.1 years and modified duration of 5.1 years at December 31, 2018.

As of September 30, 2019 and December 31, 2018, we had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

Capital Resources

Capital management consists of providing equity to support our current and future operations. We are subject to capital adequacy requirements imposed by the Federal Reserve, and the Bank is subject to capital adequacy requirements imposed by the FDIC. Both the Federal Reserve and the FDIC have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Under current guidelines, the minimum ratio of total capital to risk-weighted assets (which are primarily the credit risk equivalents of balance sheet assets and certain off-balance sheet items such as standby letters of credit) is 8.0%. At least half of total capital must be composed of tier 1 capital, which includes common shareholders' equity (including retained earnings), less goodwill, other disallowed intangible assets, and disallowed deferred tax assets, among other items. The Federal Reserve also has adopted a minimum leverage ratio, requiring tier 1 capital of at least 4.0% of average quarterly total consolidated assets, net of goodwill and certain other intangible assets, for all but the most highly rated bank holding companies. The federal banking agencies have also established risk-based and leverage capital guidelines that FDIC-insured depository institutions are required to meet. These regulations are generally similar to those established by the Federal Reserve for bank holding companies.

Under the Federal Deposit Insurance Act, the federal bank regulatory agencies must take "prompt corrective action" against undercapitalized U.S. depository institutions. U.S. depository institutions are assigned one of five capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized," and are subjected to different regulation corresponding to the capital category within which the institution falls. A depository institution is deemed to be "well capitalized" if the banking institution has a total risk-based capital ratio of 10.0% or greater, a tier 1 risk-based capital ratio of 8.0% or greater, a common equity tier 1 capital ratio of 6.5% and a leverage ratio of 5.0% or greater, and the institution is not subject to an order, written agreement, capital directive or prompt corrective action directive to meet and maintain a specific level for any capital measure. Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category. In addition, the final rules implementing Basel Committee on Banking Supervision's capital guideline for U.S. Banks (Basel III Rules) became effective for us on January 1, 2015 with full compliance with all of the requirements phased in over a multi-year schedule, and were fully phased in on January 1, 2019. Starting in January 2016, the implementation of the capital conservation buffer was effective for us starting at the 0.625% level and increasing 0.625% each year thereafter, until it reached 2.5% on January 1, 2019. The Basel III Rules subject a banking organization to certain limitations on capital distributions, equity repurchases and discretionary bonus payments to executive officers if the organization does not maintain the capital conservation buffer.

Failure to meet capital guidelines could subject the institution to a variety of enforcement remedies by federal bank regulatory agencies, including: termination of deposit insurance by the FDIC, restrictions on certain business activities and appointment of the FDIC as conservator or receiver. As of September 30, 2019 and December 31, 2018, the Bank was well capitalized.

Total shareholder's equity was $706.3 million at September 30, 2019, compared with $703.0 million at December 31, 2018, a slight increase of $3.3 million. This increase was primarily the result of net income of $39.0 million and an increase in accumulated other comprehensive income of $9.4 million partially offset by the repurchase and cancellation of common stock during the nine months ended September 30, 2019.

The following table provides a comparison of our leverage and risk-weighted capital ratios as of the dates indicated to the minimum and well-capitalized regulatory standards, as well as with the capital conservation buffer:

	Actual Ratio	Minimum Required For Capital Adequacy Purposes	Minimum Required Plus Capital Conservation Buffer	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions
Allegiance Bancshares, Inc. (Consolidated)				
As of September 30, 2019				
Total capital (to risk weighted assets)	14.70%	8.00%	10.500%	N/A
Common equity Tier 1 capital (to risk weighted assets)	11.28%	4.50%	7.000%	N/A
Tier 1 capital (to risk weighted assets)	11.51%	6.00%	8.500%	N/A
Tier 1 capital (to average assets)	10.06%	4.00%	4.000%	N/A
As of December 31, 2018				
Total capital (to risk weighted assets)	13.70%	8.00%	9.875%	N/A
Common equity Tier 1 capital (to risk weighted assets)	11.76%	4.50%	6.375%	N/A
Tier 1 capital (to risk weighted assets)	12.01%	6.00%	7.875%	N/A
Tier 1 capital (to average tangible assets)	10.61%	4.00%	4.000%	N/A
Allegiance Bank				
As of September 30, 2019				
Total capital (to risk weighted assets)	14.01%	8.00%	10.500%	10.00%
Common equity Tier 1 capital (to risk weighted assets)	12.28%	4.50%	7.000%	6.50%
Tier 1 capital (to risk weighted assets)	12.28%	6.00%	8.500%	8.00%
Tier 1 capital (to average tangible assets)	10.73%	4.00%	4.000%	5.00%
As of December 31, 2018				
Total capital (to risk weighted assets)	13.53%	8.00%	9.875%	10.00%
Common equity Tier 1 capital (to risk weighted assets)	11.83%	4.50%	6.375%	6.50%
Tier 1 capital (to risk weighted assets)	11.83%	6.00%	7.875%	8.00%
Tier 1 capital (to average tangible assets)	10.45%	4.00%	4.000%	5.00%

GAAP Reconciliation and Management's Explanation of Non-GAAP Financial Measures

We identify certain financial measures discussed in this Quarterly Report on Form 10-Q as being "non-GAAP financial measures." In accordance with the SEC's rules, we classify a financial measure as being a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles as in effect from time to time in the United States in our statements of income, balance sheet or statements of cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios or statistical measures calculated using exclusively either financial measures calculated in accordance with GAAP, operating measures or other measures that are not non-GAAP financial measures or both.

The non-GAAP financial measures that we discuss in this Quarterly Report on Form 10-Q should not be considered in isolation or as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the manner in which we calculate the non-GAAP financial measures that we discuss in this Quarterly Report on Form 10-Q may differ from that of other companies reporting measures with similar names. You should understand how such other banking organizations calculate their financial measures similar or with names similar to the non-GAAP financial measures we have discussed in this Quarterly Report on Form 10-Q when comparing such non-GAAP financial measures.

Our management, financial analysts and investment bankers use the non-GAAP financial measure "Return on Average Tangible Shareholders' Equity" in their analysis of our performance. Return on average tangible shareholders' equity is computed by dividing net earnings by average total shareholders' equity reduced by average goodwill and core deposit intangibles, net of accumulated amortization. For return on average tangible shareholders' equity, the most directly comparable financial measure calculated in accordance with GAAP is return on average shareholders' equity. This measure is important to investors because it measures the performance of the business consistently, exclusive of changes in intangible assets.

We believe this non-GAAP financial measure provides useful information to management and investors that is supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP; however, we acknowledge that non-GAAP financial measures have a number of limitations. As such, you should not view these disclosures as a substitute for results determined in accordance with GAAP, and they are not necessarily comparable to non-GAAP financial measures that other companies use. The following reconciliation tables provide a more detailed analysis of this non-GAAP financial measure:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
	(Dollars and share amounts in thousands, except per share data)			
Net income	$ 12,047	$ 8,879	$ 38,973	$ 24,146
Average shareholders' equity	$ 710,044	$ 326,204	$ 707,633	$ 317,780
Less: Average goodwill and core deposit intangibles, net	247,404	42,203	248,427	42,394
Average tangible shareholders' equity	$ 462,640	$ 284,001	$ 459,206	$ 275,386
Return on average tangible shareholders' equity(1)	10.33%	12.40%	11.35%	11.72%

(1) Annualized.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Asset/Liability Management and Interest Rate Risk

Our asset liability and interest rate risk policy provides management with the guidelines for effective balance sheet management. We have established a measurement system for monitoring our net interest rate sensitivity position. It is our objective to manage our sensitivity position within our established guidelines.

As a financial institution, a component of the market risk that we face is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential for economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

We have not entered into instruments such as leveraged derivatives, interest rate swaps, financial options, financial future contracts or forward delivery contracts for the purpose of reducing interest rate risk. Based upon the nature of our operations, we are not subject to foreign exchange rate or commodity price risk. We do not own any trading assets. We manage our exposure to interest rates by structuring our balance sheet in the ordinary course of a community banking business.

Our exposure to interest rate risk is managed by our Asset Liability Committee (“ALCO”), which is composed of certain members of our board of directors and Bank management, in accordance with policies approved by our Board of Directors. The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits, and consumer and commercial deposit activity. We use an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. All instruments on the balance sheet are modeled at the instrument level, incorporating all relevant attributes such as next reset date, reset frequency, and call dates, as well as prepayment assumptions for loans and securities, and decay rates for nonmaturity deposits. Assumptions based on past experience are incorporated into the model for nonmaturity deposit account decay rates. The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model’s simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

We utilize static balance sheet rate shocks to estimate the potential impact on net interest income of changes in interest rates under various rate scenarios. This analysis estimates a percentage of change in the metric from the stable rate base scenario versus alternative scenarios of rising and falling market interest rates by instantaneously shocking a static balance sheet.

The following table summarizes the simulated change in net interest income over a 12-month horizon and the economic value of equity as of the dates indicated:

Change in Interest	Percent Change in Net Interest Income		Percent Change in Economic Value of Equity	
Rates (Basis Points)	As of September 30, 2019	As of December 31, 2018	As of September 30, 2019	As of December 31, 2018
+300	(4.8)%	0.9%	8.9%	0.2%
+200	(2.9)%	0.9%	8.2%	0.9%
+100	(1.4)%	0.6%	5.4%	1.0%
Base	0.0%	0.0%	0.0%	0.0%
-100	2.0%	(1.1)%	(8.9)%	(2.7)%

These results are primarily due to the duration of our loan and securities portfolio and the expected behavior of demand, money market and savings deposits during such rate fluctuations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) were effective as of the end of the period covered by this report. See Exhibits 31.1 and 31.2 for the Certification statements issued by the Company's Chief Executive Officer and Chief Financial Officer, respectively.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are subject to claims and litigation arising in the ordinary course of business. In the opinion of management, we are not party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect our reputation, even if resolved in our favor. We intend to defend ourselves vigorously against any future claims or litigation.

ITEM 1A. RISK FACTORS

In evaluating an investment in any of the Company's securities, investors should consider carefully, among other things, information under the heading "Cautionary Notice Regarding Forward-Looking Statements" in this Form 10-Q and in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and such other risk factors as the Company may disclose or has disclosed in other reports and statements filed with the Securities and Exchange Commission. As of September 30, 2019, there were no material changes to the risk factors disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 and in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None.

(b) None.

(c) The following table summarizes the Company's repurchase activity during the three months ended September 30, 2019.

Period	Total Number of Shares Purchased as Part of Publicly Announced Plan	Remaining Share Repurchase Authorization(1)	Total Number of Shares Purchased	Average Price Paid Per Share
July 1, 2019 to July 31, 2019	—	1,000,000	—	—
August 1, 2019 to August 31, 2019	322,111	677,889	322,111	$ 32.01
September 1, 2019 to September 30, 2019	108,879	569,010	108,879	$ 33.75

(1) Maximum number of shares that may yet be purchased under the publicly announced program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
1.1	Underwriting Agreement, dated September 20, 2019, by and among Allegiance Bancshares, Inc. and the several underwriters party thereto (incorporated herein by reference to Exhibit 1.1 of the Company's 8-K filed on September 24, 2019)
2.1	Agreement and Plan of Reorganization by and between Allegiance Bancshares, Inc. and Post Oak Bancshares, Inc. dated April 30, 2018 (incorporated herein by reference to Exhibit 2.1 to the Company's Form 8-K filed on May 1, 2018)
3.1	Amended and Restated Certificate of Formation of Allegiance Bancshares, Inc. (incorporated herein by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-206536) (the "Registration Statement"))
3.2	Amended and Restated Bylaws of Allegiance Bancshares, Inc. (incorporated herein by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-206536) (the "Registration Statement"))
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registration Statement)
4.2	Subordinated Debt Indenture, dated as of September 20, 2019, between Allegiance Bancshares, Inc. and U.S. Bank National Association, as trustee (incorporated herein by reference to Exhibit 4.1 to the Company's Form 8-K filed on October 1, 2019)
4.3	First Supplemental Indenture, dated as of September 27, 2019, between Allegiance Bancshares, Inc. and U.S. Bank National Association, as trustee (incorporated herein by reference to Exhibit 4.2 to the Company's Form 8-K filed on October 1, 2019)
4.4	Form of 4.70% Fixed-to-Floating Rate Subordinated Note due 2029 (included as Exhibit A in Exhibit 4.3 hereto)
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101. SCH*	XBRL Taxonomy Extension Schema Document Exhibit
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed with this Quarterly Report on Form 10-Q.
** Furnished with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

	Allegiance Bancshares, Inc. (Registrant)
Date: November 1, 2019	/s/ George Martinez George Martinez Chairman and Chief Executive Officer
Date: November 1, 2019	/s/ Paul P. Egge Paul P. Egge Chief Financial Officer

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13a-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, George Martinez, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Allegiance Bancshares, Inc.;

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 officers 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(s) 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: November 1, 2019

/s/ George Martinez
George Martinez
Chairman and Chief Executive Officer

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Paul P. Egge, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Allegiance Bancshares, Inc.;

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 officers 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(s) 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: November 1, 2019

/s/ Paul P. Egge
Paul P. Egge
Chief Financial Officer

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Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

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 of Allegiance Bancshares, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George Martinez, Chairman 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, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company as of the dates and for the periods expressed in the Report.

IN WITNESS WHEREOF, the undersigned has executed this Certificate, effective as of November 1, 2019.

/s/ George Martinez
George Martinez
Chairman and Chief Executive Officer

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Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

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 of Allegiance Bancshares, Inc. (the “Company”) on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Paul P. Egge, 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, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company as of the dates and for the periods expressed in the Report.

IN WITNESS WHEREOF, the undersigned has executed this Certificate, effective as of November 1, 2019.

/s/ Paul P. Egge
Paul P. Egge
Chief Financial Officer

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