UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2022

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: 001-38895

South Plains Financial, Inc.

(Exact name of registrant as specified in its charter)

Texas	**75-2453320**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5219 City Bank Parkway **Lubbock, Texas**	**79407**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (806) 792-7101

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $1.00 par value per share	SPFI	The Nasdaq Stock Market, LLC

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

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

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

Large accelerated filer	☐	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 November 7, 2022, the registrant had 16,999,841 shares of common stock, par value $1.00 per share, outstanding.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	September 30, 2022 (Unaudited)	December 31, 2021
ASSETS		
Cash and due from banks	$ 52,749	$ 68,425
Interest-bearing deposits in banks	277,213	418,396
Cash and cash equivalents	329,962	486,821
Securities available for sale	711,412	724,504
Loans held for sale	26,922	76,507
Loans held for investment	2,690,366	2,437,577
Allowance for loan losses	(39,657)	(42,098)
Loans held for investment, net	2,650,709	2,395,479
Accrued interest receivable	12,408	13,900
Premises and equipment, net	56,532	57,699
Bank-owned life insurance	72,874	71,978
Goodwill	19,508	19,508
Intangible assets, net	4,720	5,895
Mortgage servicing rights	28,424	19,700
Deferred tax asset, net	24,317	3,038
Other assets	54,902	26,826
Total assets	$ 3,992,690	$ 3,901,855
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 1,262,072	$ 1,071,367
Interest-bearing	2,198,464	2,269,855
Total deposits	3,460,536	3,341,222
Accrued expenses and other liabilities	68,048	31,038
Subordinated debt securities	75,914	75,775
Junior subordinated deferrable interest debentures	46,393	46,393
Total liabilities	3,650,891	3,494,428
Stockholders' equity:		
Common stock, $1.00 par value per share, 30,000,000 shares authorized; 17,064,640 and 17,760,243 issued and outstanding at September 30, 2022 and December 31, 2021, respectively	17,065	17,760
Additional paid-in capital	116,565	133,215
Retained earnings	281,679	242,750
Accumulated other comprehensive income (loss)	(73,510)	13,702
Total stockholders' equity	341,799	407,427
Total liabilities and stockholders' equity	$ 3,992,690	$ 3,901,855

The accompanying notes are an integral part of these consolidated financial statements.

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Interest income:				
Loans, including fees	$ 34,463	$ 30,818	$ 99,260	$ 89,458
Securities:				
Taxable	4,224	2,346	10,142	7,219
Non-taxable	1,128	1,160	3,409	3,487
Federal funds sold and interest-bearing deposits in banks	1,293	114	2,129	272
Total interest income	41,108	34,438	114,940	100,436
Interest expense:				
Deposits	4,537	2,030	8,744	6,373
Notes payable & other borrowings	—	—	—	43
Subordinated debt securities	1,012	1,013	3,037	3,044
Junior subordinated deferrable interest debentures	457	217	1,005	661
Total interest expense	6,006	3,260	12,786	10,121
Net interest income	35,102	31,178	102,154	90,315
Provision for loan losses	(782)	—	(2,867)	(1,918)
Net interest income, after provision for loan losses	35,884	31,178	105,021	92,233
Noninterest income:				
Service charges on deposit accounts	1,764	1,851	5,149	5,023
Income from insurance activities	4,856	3,794	8,003	6,146
Net gain on sales of loans	4,452	12,848	17,924	41,108
Bank card services and interchange fees	3,156	3,045	9,856	8,760
Other mortgage banking income	1,836	1,954	10,670	6,221
Investment commissions	391	430	1,403	1,390
Fiduciary fees	568	556	1,815	2,234
Other	3,914	1,313	8,649	3,659
Total noninterest income	20,937	25,791	63,469	74,541
Noninterest expense:				
Salaries and employee benefits	22,927	24,116	67,620	71,811
Occupancy and equipment, net	4,132	3,896	11,902	10,960
Professional services	2,523	1,388	7,795	4,483
Marketing and development	913	777	2,391	2,157
IT and data services	908	1,068	2,902	3,029
Bank card expenses	1,399	1,339	4,050	3,640
Appraisal expenses	359	790	1,432	2,350
Other	4,240	4,689	13,289	13,468
Total noninterest expense	37,401	38,063	111,381	111,898
Income before income taxes	19,420	18,906	57,109	54,876
Income tax expense	3,962	3,716	11,490	10,876
Net income	$ 15,458	$ 15,190	$ 45,619	$ 44,000

The accompanying notes are an integral part of these consolidated financial statements.

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (CONTINUED)
(Unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	**2021**	**2022**	**2021**
Earnings per share:				
Basic	$ 0.89	$ 0.85	$ 2.61	$ 2.44
Diluted	$ 0.86	$ 0.82	$ 2.52	$ 2.38
Net income	$ 15,458	$ 15,190	$ 45,619	$ 44,000
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available for sale	(39,102)	(5,964)	(126,076)	(13,835)
Less: Change in fair value on hedged state and municipal securities	5,332	760	15,681	4,943
Tax effect	7,092	1,093	23,183	1,867
Other comprehensive income (loss)	(26,678)	(4,111)	(87,212)	(7,025)
Comprehensive income (loss)	$ (11,220)	$ 11,079	$ (41,593)	$ 36,975

The accompanying notes are an integral part of these consolidated financial statements.

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)
(Dollars in thousands, except per share data)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
Nine Months Ended September 30,						
Balance at December 31, 2020	18,076,364	$ 18,076	$ 141,112	$ 189,521	$ 21,339	$ 370,048
Net income	—	—	—	44,000	—	44,000
Cash dividends declared - $0.21 per share	—	—	—	(3,784)	—	(3,784)
Other comprehensive loss	—	—	—	—	(7,025)	(7,025)
Exercise of employee stock options and vesting of restricted stock units, net of 2,906 shares for cashless exercise and net of 5,013 shares for taxes	20,552	21	(127)	—	—	(106)
Repurchases of common stock	(272,822)	(273)	(5,809)	—	—	(6,082)
Stock-based compensation	—	—	1,225	—	—	1,225
Balance at September 30, 2021	17,824,094	$ 17,824	$ 136,401	$ 229,737	$ 14,314	$ 398,276
Balance at December 31, 2021	17,760,243	$ 17,760	$ 133,215	$ 242,750	$ 13,702	$ 407,427
Net income	—	—	—	45,619	—	45,619
Cash dividends declared - $0.34 per share	—	—	—	(5,973)	—	(5,973)
Other comprehensive loss	—	—	—	—	(87,212)	(87,212)
Impact of adoption of Topic 842 related to leases	—	—	—	(717)	—	(717)
Exercise of employee stock options and vesting of restricted stock units, net of 16,255 shares for cashless exercise and net of 11,126 shares for taxes	34,010	34	(319)	—	—	(285)
Repurchases of common stock	(729,613)	(729)	(18,197)	—	—	(18,926)
Stock-based compensation	—	—	1,866	—	—	1,866
Balance at September 30, 2022	17,064,640	$ 17,065	$ 116,565	$ 281,679	$ (73,510)	$ 341,799
Three Months Ended September 30,						
Balance at June 30, 2021	18,014,398	$ 18,014	$ 140,212	$ 216,164	$ 18,425	$ 392,815
Net income	—	—	—	15,190	—	15,190
Cash dividends declared - $0.09 per share	—	—	—	(1,617)	—	(1,617)
Other comprehensive loss	—	—	—	—	(4,111)	(4,111)
Repurchases of common stock	(190,304)	(190)	(4,214)	—	—	(4,404)
Stock-based compensation	—	—	403	—	—	403
Balance at September 30, 2021	17,824,094	$ 17,824	$ 136,401	$ 229,737	$ 14,314	$ 398,276
Balance at June 30, 2022	17,417,094	$ 17,417	$ 125,332	$ 268,305	$ (46,832)	$ 364,222
Net income	—	—	—	15,458	—	15,458
Cash dividends declared - $0.12 per share	—	—	—	(2,084)	—	(2,084)
Other comprehensive loss	—	—	—	—	(26,678)	(26,678)
Exercise of employee stock options and vesting of restricted stock units, net of 11,431 shares for cashless exercise and net of 3,997 shares for taxes	13,673	14	(104)	—	—	(90)
Repurchases of common stock	(366,127)	(366)	(9,352)	—	—	(9,718)
Stock-based compensation	—	—	689	—	—	689
Balance at September 30, 2022	17,064,640	$ 17,065	$ 116,565	$ 281,679	$ (73,510)	$ 341,799

The accompanying notes are an integral part of these consolidated financial statements.

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30, 2022	Nine Months Ended September 30, 2021
Cash flows from operating activities:		
Net income	$ 45,619	$ 44,000
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	(2,867)	(1,918)
Depreciation and amortization	5,277	4,837
Accretion and amortization	3,089	3,399
Other gains, net	(65)	(139)
Net gain on sales of loans	(17,924)	(41,108)
Proceeds from sales of loans held for sale	659,061	1,243,380
Loans originated for sale	(594,246)	(1,189,693)
Deferred income tax expense	2,093	1,730
Earnings on bank-owned life insurance	(896)	(945)
Stock-based compensation	1,866	1,225
Change in valuation of mortgage servicing rights	(6,030)	(1,055)
Net change in:		
Accrued interest receivable and other assets	(2,734)	3,683
Accrued expenses and other liabilities	26,702	10,305
Net cash provided by operating activities	118,945	77,701
Cash flows from investing activities:		
Activity in securities available for sale:		
Purchases	(176,713)	(61,548)
Maturities, prepayments, and calls	60,772	94,978
Loan originations and principal collections, net	(252,828)	(209,047)
Purchases of premises and equipment	(3,294)	(2,319)
Proceeds from sales of premises and equipment	245	108
Proceeds from sales of foreclosed assets	1,884	1,048
Net cash used in investing activities	(369,934)	(176,780)
Cash flows from financing activities:		
Net change in deposits	119,314	237,894
Net change in short-term borrowings	—	(26,550)
Payments to tax authorities for stock-based compensation	(285)	(106)
Payments made on notes payable and other borrowings	—	(75,000)
Cash dividends on common stock	(5,973)	(3,784)
Payments to repurchase common stock	(18,926)	(6,082)
Net cash provided by financing activities	94,130	126,372
Net change in cash and cash equivalents	(156,859)	27,293
Beginning cash and cash equivalents	486,821	300,307
Ending cash and cash equivalents	$ 329,962	$ 327,600
Supplemental disclosures of cash flow information:		
Interest paid on deposits and borrowed funds	$ 12,953	$ 10,774
Income taxes paid	8,488	8,842
Supplemental schedule of noncash activities:		
Loans transferred to foreclosed assets	$ 465	$ 722
Additions to mortgage servicing rights	2,694	8,018

The accompanying notes are an integral part of these consolidated financial statements.

SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations – South Plains Financial, Inc. ("SPFI") is a Texas corporation and registered bank holding company that conducts its principal activities through its subsidiaries from offices located throughout Texas and Eastern New Mexico. Principal activities include commercial and retail banking, along with insurance, investment, trust, and mortgage services. The following are subsidiaries of SPFI:

Wholly-Owned, Consolidated Subsidiaries:	
City Bank	Bank subsidiary
Windmark Insurance Agency, Inc. ("Windmark")	Non-bank subsidiary
Ruidoso Retail, Inc.	Non-bank subsidiary
CB Provence, LLC	Non-bank subsidiary
CBT Brushy Creek, LLC	Non-bank subsidiary
CBT Properties, LLC	Non-bank subsidiary
Wholly-Owned, Equity Method Subsidiaries:	
South Plains Financial Capital Trusts (SPFCT) III-V	Non-bank subsidiaries

Basis of Presentation and Consolidation – The consolidated financial statements in this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2022 (this "Form 10-Q") include the accounts of SPFI and its wholly-owned consolidated subsidiaries (collectively referred to as the "Company") identified above. All significant intercompany balances and transactions have been eliminated in consolidation.

The interim consolidated financial statements in this Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Company's financial position, results of operations, and cash flows. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with the Company's audited consolidated financial statements, and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2021. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Determination of the adequacy of the allowance for loan losses is a material estimate that is particularly susceptible to significant change in the near term; the assumptions used in stock-based compensation, derivatives, mortgage servicing rights, the valuation of foreclosed assets, and fair values of financial instruments can also involve significant management estimates.

Securities – Investment securities may be classified into trading, held to maturity ("HTM") or available for sale ("AFS") portfolios. Securities that are held principally for resale in the near term are classified as trading. Securities that management has the ability and positive intent to hold to maturity are classified as HTM and recorded at amortized cost. Securities not classified as trading or HTM are AFS and are reported at fair value with unrealized gains and losses excluded from earnings, but included in the determination of other comprehensive income (loss). Management uses these assets as part of its asset/liability management strategy; they may be sold in response to changes in liquidity needs, interest rates, resultant prepayment risk changes, and other factors. Management determines the appropriate classification of securities at the time of purchase. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

When the fair value of a security is below its amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. The analysis considers (i) whether there is intent to sell securities prior to recovery and/or maturity, (ii) whether it is more likely than not that securities will have to be sold prior to recovery and/or maturity, and (iii) whether there is a credit loss component to the impairment. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of a security may be different than previously estimated, which could have a material effect on the Company's results of operations and financial condition.

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans, and premiums or discounts on purchased loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the straight-line method, which is not materially different from the effective interest method required by GAAP.

Loans are placed on nonaccrual status when, in management's opinion, collection of interest is unlikely, which typically occurs when principal or interest payments are more than ninety days past due. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses – The allowance for loan losses is established by management as an estimate to cover probable loan losses through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and general valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's review of the collectability of the loans in the Company's loan portfolio in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. Loans originated by the bank subsidiary are generally secured by specific items of collateral including real property, crops, livestock, consumer assets, and other business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on various factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the bank subsidiary to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. All loans rated substandard or worse and greater than $250 thousand are specifically reviewed to determine if they are impaired. Factors considered by management in determining whether a loan is impaired include payment status and the sources, amounts, and probabilities of estimated cash flow available to service debt in relation to amounts due according to contractual terms. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans that are determined to be impaired are then evaluated to determine estimated impairment, if any. GAAP allows impairment to be measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Loans that are not individually determined to be impaired or are not subject to the specific review of impaired status are subject to the general valuation allowance portion of the allowance for loan losses.

The Company may modify its loan agreement with a borrower. The modification will be considered a troubled debt restructuring ("TDR") if the following criteria are met: (1) the borrower is experiencing a financial difficulty and (2) the Company makes a concession that it would not otherwise make. Concessions may include debt forgiveness, interest rate change, or maturity extension. Each of these loans is impaired and is evaluated for impairment, with a specific reserve recorded as necessary based on probable losses related to collateral and cash flow. A loan will no longer be required to be reported as restructured in calendar years following the restructure if the interest rate at the time of restructure is greater than or equal to the rate the Company was willing to accept for a new extension of credit with similar risk and the loan is in compliance with its modified terms.

Acquired Loans – Loans that the Company acquires in connection with business combinations are recorded at fair value with no carryover of the acquired entity's related allowance for loan losses. The fair value of the acquired loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

Any loans the Company determines have evidence of deterioration of credit quality since origination, and it is probable, at acquisition, that all contractually required payments will not be collected, are considered to be purchase credit impaired loans. The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. These loans are accounted for under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality.* The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require the Company to evaluate the need for an additional allowance. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which the Company will then reclassify as accretable discount that will be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20, *Receivables—Nonrefundable Fees and Other Costs*. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that met the criteria for impaired or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company expects to fully collect the new carrying value (i.e., fair value) of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming at the date of acquisition and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

Mortgage Servicing Rights – When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in net gain on sale of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates present value of estimated future servicing income.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports change in fair value of servicing assets in earnings in the period in which the changes occur, and are included with other noninterest income in the combined financial statements. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Goodwill and Other Intangible Assets – Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is not amortized, but is tested for impairment on October 31 of each year or more frequently if events and circumstances exist that indicate that an impairment test should be performed. There was no goodwill impairment recorded for the nine months ended September 30, 2022 and the year ended December 31, 2021.

Core deposit intangible ("CDI") is a measure of the value of checking and savings deposit relationships acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding relative to an alternative source of funding. CDI is amortized over the estimated useful lives of the existing deposit relationships acquired, but does not exceed 10 years. Substantially all CDI is amortized using the sum of the years' digits method.

The remaining other intangible assets consist of customer relationship and employment agreement intangible assets and are amortized over their estimated useful lives of 5 years using the straight-line method.

Mortgage Banking Derivatives – Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market, forward commitments for the future delivery of these mortgage loans, and forward sales of mortgage-backed securities are accounted for as free standing derivatives. At the time of the interest rate lock, the Company determines whether the loan will be sold through a best efforts contract or a mandatory delivery contract.

In order to hedge the change in interest rates resulting from the commitments to fund the loans that will be sold through a best efforts contract, the Company enters into forward loans sales commitments for the future delivery of mortgage loans when interest rate locks are entered. At inception, these interest rate locks and the related forward loan sales commitments, adjusted for the expected exercise of the commitment before the loan is funded, are recorded with a zero value. Subsequent changes in fair value are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked.

In order to hedge the change in interest rates resulting from all other mortgage commitments to funds loans, the Company enters into forward sales of mortgage-backed securities contracts. At inception, these interest rate locks are recorded at fair value and are adjusted for the expected exercise of the commitment before the loan is funded. Subsequent changes in fair value are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. Changes in the fair values of these derivatives are included in net gain on sales of loans in the consolidated financial statements.

Derivatives – At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income (loss) and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income (loss) are amortized into earnings over the same periods which the hedged transactions will affect earnings.

Leases – During the second quarter of 2022, the Company adopted Accounting Standards Update ("ASU") No. 2016-02 — Leases (Topic 842), effective as of January 1, 2022, using the alternative transition method under the option to apply the lease standard at its effective date without adjusting the prior period comparative financial statements. The Company elected the package of practical expedients to not reassess: (i) whether any existing contracts are or contain a lease, (ii) the lease classification of any existing leases, and (iii) initial direct costs related to existing leases. The Company also elected to apply additional practical expedients to include both the lease and nonlease components of all leases as a single component and account for it as a lease and to use hindsight for leases existing at the adoption date. The Company recorded a $9.4 million right-of-use ("ROU") asset, offset by a $10.3 million lease liability, and a $717 thousand, net of tax, cumulative effect adjustment debit to retained earnings.

The Company determines if an arrangement is a lease at inception. Operating leases with a term of greater than one year are included in other assets and other liabilities on the Company's Consolidated Balance Sheets. Finance leases, if any, are included in premises and equipment and other liabilities on the Company's Consolidated Balance Sheets. The Company has lease agreements with lease and nonlease components, which are generally accounted for as a single lease component. The Company has made an accounting policy election not to recognize short-term lease assets and liabilities (less than a 12-month term) or equipment leases (deemed not significant) on its Consolidated Balance Sheets; instead, the Company recognizes the lease expense for these leases on a straight-line basis over the life of the lease.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized on the lease commencement date based on the present value of lease payments over the lease term. As most of the Company's leases do not provide an implicit rate, the Company uses an estimated incremental collateralized borrowing rate at lease inception, on a collateralized basis, over a similar term, when determining the present value of lease payments.

No significant judgments or assumptions were involved in developing the estimated operating lease liabilities as the Company's operating lease liabilities largely represent the future rental expenses associated with operating leases, and the incremental borrowing rates are based on publicly available interest rates. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease. These options to extend or terminate are assessed on a lease-by-lease basis, and the ROU assets and lease liabilities are adjusted when it is reasonably certain that an option will be exercised. Rental expense for lease payments is recognized on a straight-line basis over the lease term and is included in occupancy and equipment, net within our Consolidated Statements of Comprehensive Income (Loss).

The Company leases and subleases certain facilities and office space to outside parties; however, these leases are not significant.

Stock-Based Compensation – The Company sponsors an equity incentive plan under which options to acquire shares of the Company's common stock may be granted periodically to all full-time employees and directors of the Company or its affiliates at a specific exercise price. Shares are issued out of authorized and unissued common shares that have been reserved for issuance under such plan. Compensation cost is measured based on the estimated fair value of the award at the grant date and is recognized in earnings on a straight-line basis over the requisite service period. The fair value of stock options is estimated at the date of grant using a closed form option valuation ("Black-Scholes") option pricing model. This model requires assumptions as to the expected stock volatility, dividends, terms and risk-free rates. The expected volatility is based on the combination of the Company's historical volatility and the volatility of comparable peer banks. The expected term represents the period of time that options are expected to be outstanding from the grant date. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the appropriate life of each stock option.

Earnings per Share – Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the dilutive effect of additional potential shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Segment Information – The Company has two reportable segments: banking and insurance. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company's reportable segments are strategic business units that offer different products and services. Operations are managed and financial performance is evaluated on a Company-wide basis.

Reclassifications – Certain amounts from the 2021 consolidated financial statements have been reclassified to conform to the September 30, 2022 presentation.

Recent Accounting Pronouncements – FASB ASC constitutes GAAP for nongovernmental entities. Updates to ASC are prescribed in ASUs, which are not authoritative until incorporated into the ASC.

ASU 2021-01, Reference Rate Reform (Topic 848). In January 2021, the FASB issued ASU 2021-01 to clarify the scope of Topic 848 so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions in Topic 848. This update additionally clarified that a receive-variable-rate, pay-variable-rate cross-currency interest rate swap may be considered an eligible hedging instrument in a net investment hedge if both legs of the swap do not have the same repricing intervals and dates as a result of reference rate reform. This update was effective upon issuance and generally can be applied through December 31, 2022. See the discussion regarding the adoption of ASU 2020-04 below.

ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting. In March 2020, the FASB issued ASU 2020-04 and it provides optional expedients and exceptions for accounting related to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. This update applies only to contracts, hedging relationships and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform and do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, that an entity has elected certain optional expedients for and that are retained through the end of the hedging relationship. The expedients and exceptions in this update are available to all entities starting March 12, 2020 through December 31, 2022. The adoption of ASU 2020-04 did not significantly impact the Company's consolidated financial statements.

ASU 2019-12, Income Taxes, Simplifying the Accounting for Income Taxes (Topic 740). In December 2019, the FASB issued ASU 2019-12 to simplify the accounting for income taxes by removing certain exceptions to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The adoption of ASU 2019-12 did not have a material effect on the Company's financial statements.

ASU 2016-13 Financial Instruments - Credit Losses (Topic 326). The FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held to maturity securities, and debt securities. ASU 2016-13 is effective for the Company for annual periods beginning after December 15, 2022, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company has contracted with a third-party vendor to assist in the implementation of CECL. The model has been developed and validation is underway. The Company expects to adopt CECL effective January 1, 2023.

Subsequent Events – The Company has evaluated subsequent events and transactions from September 30, 2022 through the date this Form 10-Q was filed with the SEC for potential recognition or disclosure as required by GAAP.

2. SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, at the dates indicated follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2022				
Available for sale:				
State and municipal	$ 260,281	$ 14	$ (40,142)	$ 220,153
Mortgage-backed securities	445,312	—	(71,340)	373,972
Collateralized mortgage obligations	86,120	—	(310)	85,810
Asset-backed and other amortizing securities	22,166	—	(2,066)	20,100
Other securities	12,000	—	(623)	11,377
	$ 825,879	$ 14	$ (114,481)	$ 711,412

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2021				
Available for sale:				
State and municipal	$ 265,143	$ 10,615	$ (86)	$ 275,672
Mortgage-backed securities	302,973	4,230	(4,114)	303,089
Collateralized mortgage obligations	106,733	—	(413)	106,320
Asset-backed and other amortizing securities	26,046	1,108	(218)	26,936
Other securities	12,000	487	—	12,487
	$ 712,895	$ 16,440	$ (4,831)	$ 724,504

The amortized cost and fair value of securities at September 30, 2022 are presented below by contractual maturity (dollars in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Other securities are shown separately since they are not due at a single maturity date.

	Available for Sale	
	Amortized Cost	Fair Value
Within 1 year	$ 1,901	$ 1,906
After 1 year through 5 years	8,704	8,499
After 5 years through 10 years	19,532	18,582
After 10 years	242,144	202,543
Other	553,598	479,882
	$ 825,879	$ 711,412

At both September 30, 2022 and December 31, 2021, there were no holdings of securities of any one issuer, other than the U.S. government, its agencies, or its sponsored enterprises, in an amount greater than 10% of stockholders' equity.

Securities with a carrying value of approximately $449.9 million and $474.5 million at September 30, 2022 and December 31, 2021, respectively, were pledged to collateralize public deposits and for other purposes as required or permitted by law.

The following table segregates securities with unrealized losses at the periods indicated, by the duration they have been in a loss position (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2022						
State and municipal	$ 206,001	$ 37,371	$ 11,222	$ 2,771	$ 217,223	$ 40,142
Mortgage-backed securities	283,240	44,093	90,731	27,247	373,971	71,340
Collateralized mortgage obligations	85,810	310	—	—	85,810	310
Asset-backed and other amortizing securities	20,100	2,066	—	—	20,100	2,066
Other securities	11,378	623	—	—	11,378	623
	$ 606,529	$ 84,463	$ 101,953	$ 30,018	$ 708,482	$ 114,481
December 31, 2021						
State and municipal	$ 21,255	$ 86	$ —	$ —	$ 21,255	$ 86
Mortgage-backed securities	56,398	1,197	64,764	2,917	121,162	4,114
Collateralized mortgage obligations	106,320	413	—	—	106,320	413
Asset-backed and other amortizing securities	1,624	218	—	—	1,624	218
Other securities	—	—	—	—	—	—
	$ 185,597	$ 1,914	$ 64,764	$ 2,917	$ 250,361	$ 4,831

There were 174 securities with an unrealized loss at September 30, 2022, generally due to increases in market rates. Management does not believe that these losses are other than temporary as there is no intent to sell any of these securities before recovery and it is not probable the Company will be required to sell any of these securities before recovery, and credit loss, if any, is not material. These unrealized losses are largely due to significant increases in market interest rates experienced during the first nine months of 2022 over the yields available at the time the underlying securities were purchased, which was attributed to the Federal Open Market Committee ("FOMC") of the Board of Governors of the Federal Reserve System (the "Federal Reserve") repeatedly raising their target benchmark interest rate in the first nine months of 2022, resulting in subsequent prime rate increases of 300 basis points between March and September of 2022. The fair value is expected to recover as the securities approach their maturity date or if market yields for such investments decline in future periods. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2022, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Company's combined financial statements.

3. LOANS HELD FOR INVESTMENT

Loans held for investment are summarized by category as of the periods presented below (dollars in thousands):

	September 30, 2022	December 31, 2021
Commercial real estate	$ 869,231	$ 755,444
Commercial - specialized	368,204	378,725
Commercial - general	477,209	460,024
Consumer:		
1-4 family residential	424,802	387,690
Auto loans	309,110	240,719
Other consumer	80,524	68,113
Construction	161,286	146,862
	2,690,366	2,437,577
Allowance for loan losses	(39,657)	(42,098)
Loans, net	$ 2,650,709	$ 2,395,479

The Company has certain lending policies, underwriting standards, and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies, underwriting standards, and procedures on a regular basis and makes changes as appropriate. Management receives frequent reports related to loan originations, quality, concentrations, delinquencies, non-performing, and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geography.

Commercial – General and Specialized – Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Underwriting standards have been designed to determine whether the borrower possesses sound business ethics and practices, evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations, as agreed and ensure appropriate collateral is obtained to secure the loan. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as real estate, accounts receivable, or inventory, and include personal guarantees. Owner-occupied real estate is included in commercial loans, as the repayment of these loans is generally dependent on the operations of the commercial borrower's business rather than on income-producing properties or the sale of the properties. Commercial loans are grouped into two distinct sub-categories: specialized and general. Commercial related segments that are considered "specialized" include agricultural production and real estate loans, energy loans, and finance, investment, and insurance loans. Commercial related segments that contain a broader diversity of borrowers, sub-industries, or serviced industries are grouped into the "general category." These include goods, services, restaurant & retail, construction, and other industries.

Commercial Real Estate – Commercial real estate loans are also subject to underwriting standards and processes similar to commercial loans. These loans are underwritten primarily based on projected cash flows for income-producing properties and collateral values for non-income-producing properties. The repayment of these loans is generally dependent on the successful operation of the property securing the loans or the sale or refinancing of the property. Real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's real estate portfolio are diversified by type and geographic location. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry.

Construction – Loans for residential construction are for single-family properties to developers, builders, or end-users. These loans are underwritten based on estimates of costs and completed value of the project. Funds are advanced based on estimated percentage of completion for the project. Performance of these loans is affected by economic conditions as well as the ability to control costs of the projects.

Consumer – Loans to consumers include 1-4 family residential loans, auto loans, and other loans for recreational vehicles or other purposes. The Company utilizes a computer-based credit scoring analysis to supplement its policies and procedures in underwriting consumer loans. The Company's loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimizes the Company's risk. The Company generally requires mortgage title insurance and hazard insurance on 1-4 family residential loans.

The allowance for loan losses was $39.7 million at September 30, 2022, compared to $42.1 million at December 31, 2021. The ratio of allowance for loan losses to loans held for investment was 1.47% at September 30, 2022 and 1.73% at December 31, 2021.

The following table details the activity in the allowance for loan losses for the periods indicated (dollars in thousands). Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
For the three months ended September 30, 2022					
Commercial real estate	$ 13,903	$ (1,292)	$ —	$ —	$ 12,611
Commercial - specialized	3,355	(481)	(43)	874	3,705
Commercial - general	9,918	372	—	135	10,425
Consumer:					
1-4 family residential	5,329	247	(52)	37	5,561
Auto loans	3,958	(39)	(77)	50	3,892
Other consumer	1,443	282	(374)	104	1,455
Construction	1,879	129	—	—	2,008
	$ 39,785	$ (782)	$ (546)	$ 1,200	$ 39,657
For the three months ended September 30, 2021					
Commercial real estate	$ 17,288	$ 960	$ —	$ —	$ 18,248
Commercial - specialized	4,823	(596)	(16)	20	4,231
Commercial - general	8,948	(838)	(2)	63	8,171
Consumer:					
1-4 family residential	5,064	135	—	2	5,201
Auto loans	3,815	79	(111)	20	3,803
Other consumer	1,434	139	(213)	42	1,402
Construction	1,591	121	—	—	1,712
	$ 42,963	$ —	$ (342)	$ 147	$ 42,768

	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
For the nine months ended September 30, 2022					
Commercial real estate	$ 17,245	$ (5,052)	$ —	$ 418	$ 12,611
Commercial - specialized	4,363	(1,494)	(149)	985	3,705
Commercial - general	8,466	1,883	(315)	391	10,425
Consumer:					
1-4 family residential	5,268	346	(92)	39	5,561
Auto loans	3,653	344	(233)	128	3,892
Other consumer	1,357	678	(801)	221	1,455
Construction	1,746	428	(166)	—	2,008
	$ 42,098	$ (2,867)	$ (1,756)	$ 2,182	$ 39,657
For the nine months ended September 30, 2021					
Commercial real estate	$ 18,962	$ (714)	$ —	$ —	$ 18,248
Commercial - specialized	5,760	(1,627)	(21)	119	4,231
Commercial - general	9,227	(870)	(379)	193	8,171
Consumer:					
1-4 family residential	4,646	602	(52)	5	5,201
Auto loans	4,226	(88)	(438)	103	3,803
Other consumer	1,671	132	(590)	189	1,402
Construction	1,061	647	—	4	1,712
	$ 45,553	$ (1,918)	$ (1,480)	$ 613	$ 42,768

The following table shows the Company’s investment in loans disaggregated based on the method of evaluating impairment at the dates indicated (dollars in thousands):

	Recorded Investment		Allowance for Loan Losses	
	Individually Evaluated	Collectively Evaluated	Individually Evaluated	Collectively Evaluated
September 30, 2022				
Commercial real estate	$ —	$ 869,231	$ —	$ 12,611
Commercial - specialized	—	368,204	—	3,705
Commercial - general	3,469	473,740	108	10,317
Consumer:				
1-4 family residential	750	424,052	9	5,552
Auto loans	—	309,110	—	3,892
Other consumer	—	80,524	—	1,455
Construction	—	161,286	—	2,008
	$ 4,219	$ 2,686,147	$ 117	$ 39,540
December 31, 2021				
Commercial real estate	$ 1,101	$ 754,343	$ 584	$ 16,661
Commercial - specialized	—	378,725	—	4,363
Commercial - general	5,078	454,946	585	7,881
Consumer:				
1-4 family residential	1,592	386,098	175	5,093
Auto loans	—	240,719	—	3,653
Other consumer	—	68,113	—	1,357
Construction	—	146,862	—	1,746
	$ 7,771	$ 2,429,806	$ 1,344	$ 40,754

Impaired loan information at the dates indicated follows (dollars in thousands):

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
September 30, 2022						
Commercial real estate	$ —	$ —	$ —	$ —	$ —	$ 551
Commercial - specialized	—	—	—	—	—	—
Commercial - general	3,469	833	2,636	3,469	108	4,274
Consumer:						
1-4 family residential	750	486	264	750	9	1,171
Auto loans	—	—	—	—	—	—
Other consumer	—	—	—	—	—	—
Construction	—	—	—	—	—	—
	$ 4,219	$ 1,319	$ 2,900	$ 4,219	$ 117	$ 5,996
December 31, 2021						
Commercial real estate	$ 1,101	$ —	$ 1,101	$ 1,101	$ 584	$ 3,687
Commercial - specialized	—	—	—	—	—	—
Commercial - general	5,078	1,143	3,935	5,078	585	4,852
Consumer:						
1-4 family residential	1,592	880	712	1,592	175	1,857
Auto loans	—	—	—	—	—	—
Other consumer	—	—	—	—	—	—
Construction	—	—	—	—	—	—
	$ 7,771	$ 2,023	$ 5,748	$ 7,771	$ 1,344	$ 10,396

All impaired loans $250 thousand and greater were specifically evaluated for impairment. Interest income recognized using a cash-basis method on impaired loans for the nine months ended September 30, 2022 and the year ended December 31, 2021 was not significant. Additional funds committed to be advanced on impaired loans are not significant.

The table below provides an age analysis on accruing past-due loans and nonaccrual loans at the dates indicated (dollars in thousands):

	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual
September 30, 2022			
Commercial real estate	$ 573	$ 819	$ —
Commercial - specialized	139	30	40
Commercial - general	2,342	2	3,482
Consumer:			
1-4 family residential	1,366	1,763	1,384
Auto loans	499	150	—
Other consumer	1,415	125	39
Construction	382	—	—
	$ 6,716	$ 2,889	$ 4,945
December 31, 2021			
Commercial real estate	$ 393	$ 45	$ 1,101
Commercial - specialized	265	20	156
Commercial - general	4,032	97	5,236
Consumer:			
1-4 family residential	2,496	903	2,815
Auto loans	332	—	—
Other consumer	538	15	44
Construction	937	—	166
	$ 8,993	$ 1,080	$ 9,518

The Company grades its loans on a thirteen-point grading scale. These grades fit in one of the following categories: (i) pass, (ii) special mention, (iii) substandard, (iv) doubtful, or (v) loss. Loans categorized as loss are charged-off immediately. The grading of loans reflect a judgment by the Company about the risks of default associated with the loan. The Company reviews the grades on loans as part of the Company's on-going monitoring of the credit quality of the loan portfolio.

Pass loans have financial factors or nature of collateral that are considered reasonable credit risks in the normal course of lending and encompass several grades that are assigned based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring.

Special mention loans have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loans at some future date.

Substandard loans are inadequately protected by the current net worth and paying capacity of the borrower or by the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize collection and present the distinct possibility that some loss will be sustained if the deficiencies are not corrected. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to strengthen the Company’s position, and/or to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed. Substandard loans can be accruing or can be nonaccrual depending on the circumstances of the individual loans.

Doubtful loans have all the weaknesses inherent in substandard loans with the added characteristics that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. All doubtful loans are on nonaccrual.

The following table summarizes the internal classifications of loans at the dates indicated (dollars in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
September 30, 2022					
Commercial real estate	$ 841,324	$ —	$ 27,907	$ —	$ 869,231
Commercial - specialized	367,346	—	858	—	368,204
Commercial - general	448,397	—	28,812	—	477,209
Consumer:					
1-4 family residential	415,392	—	9,410	—	424,802
Auto loans	308,730	—	380	—	309,110
Other consumer	80,323	—	201	—	80,524
Construction	160,309	—	977	—	161,286
	$ 2,621,821	$ —	$ 68,545	$ —	$ 2,690,366
December 31, 2021					
Commercial real estate	$ 713,852	$ —	$ 41,592	$ —	$ 755,444
Commercial - specialized	372,797	—	5,928	—	378,725
Commercial - general	450,790	1,676	7,558	—	460,024
Consumer:					
1-4 family residential	379,458	—	8,232	—	387,690
Auto loans	239,869	—	850	—	240,719
Other consumer	67,822	—	291	—	68,113
Construction	146,696	—	166	—	146,862
	$ 2,371,284	$ 1,676	$ 64,617	$ —	$ 2,437,577

Under section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), banks may elect to deem that loan modifications do not result in a classification as a TDR if they are (1) related to the COVID-19 pandemic; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the national emergency or (B) December 31, 2020. Under section 540 of the Consolidated Appropriations Act, 2021 (the “Act”), section 4013 of the CARES Act was amended to extend the period for loan modifications to the earlier of (1) January 1, 2022, or (2) 60 days after the date of termination of the national emergency. The Company elected to adopt the provisions of the CARES Act and the Act.

Additionally, other short-term modifications made on a good faith basis in response to the COVID-19 pandemic to borrowers who were current prior to any relief are not TDRs under ASC 310-40 and the interagency statement released by the federal banking regulators on April 7, 2020 in response to the COVID-19 pandemic (the “Joint Interagency Regulatory Guidance”). This includes short-term (e.g., up to six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented.

In response to the COVID-19 pandemic, the Company implemented a short-term deferral modification program that complies with ASC 310-40 and the Joint Interagency Regulatory Guidance. As of September 30, 2022 and December 31, 2021, the Company had no loans under an active modification that comply with ASC 310-40 and the Joint Interagency Regulatory Guidance.

Beginning in April 2020, the Company began offering additional COVID-19 related deferral and modification of principal and/or interest payments to selected borrowers on a case-by-case basis that were outside the scope of the short-term deferral modification program. These additional modifications comply with the provisions of section 4013 of the CARES Act and section 501 of the Act. As of September 30, 2022, the Company had no remaining loans subject to these deferral and modification agreements. As of December 31, 2021 the Company had 3 loans totaling approximately $15.9 million subject to these deferral and modification agreements, representing 0.65% of outstanding loans held for investment.

There were no loans modified as a TDR during the nine months ended September 30, 2022 and the year ended December 31, 2021.

Management continues to closely monitor for credit changes resulting from the ongoing COVID-19 pandemic (or any current or future variants thereof), the rising interest rate environment, and the persistent high inflation levels in the United States and our market areas.

4. GOODWILL AND INTANGIBLES

The Company had goodwill of $19.5 million at September 30, 2022 and December 31, 2021.

Other intangible assets, which consist of CDI, customer lists, and employment agreements at the dates indicated are summarized below (dollars in thousands):

	September 30, 2022	December 31, 2021
Amortized intangible assets		
Core deposit intangible	$ 6,679	$ 6,679
Less: Accumulated amortization	(3,198)	(2,469)
	3,481	4,210
Other intangibles	2,972	2,972
Less: Accumulated amortization	(1,733)	(1,287)
	1,239	1,685
Other intangible assets, net	$ 4,720	$ 5,895

5. MORTGAGE SERVICING RIGHTS

The following table reflects the changes in fair value of the Company's mortgage servicing rights asset included in the Consolidated Balance Sheets, and other information related to the serviced portfolio, for the periods or dates presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Beginning balance	$ 27,505	$ 15,977	$ 19,700	$ 9,049
Additions	514	2,026	2,694	8,018
Valuation adjustment	405	119	6,030	1,055
Ending balance	$ 28,424	$ 18,122	$ 28,424	$ 18,122

	September 30, 2022	December 31, 2021
Mortgage loans serviced for others	$ 2,053,183	$ 1,953,095
Mortgage servicing rights assets as a percentage of serviced mortgage loans	1.38%	1.01%

The following table reflects the key assumptions used in measuring the fair value of the Company's mortgage servicing rights as of the dates indicated:

	September 30, 2022	December 31, 2021
Weighted average constant prepayment rate	7.34%	12.35%
Weighted average discount rate	9.14%	9.14%
Weighted average life in years	8.00	6.03

6. BORROWING ARRANGEMENTS

Subordinated Debt Securities

In December 2018, the Company issued $26.5 million in subordinated debt securities. $12.4 million of the subordinated debt securities have a maturity date of December 2028 and a weighted average fixed rate of 5.74% for the first five years. The remaining $14.1 million of subordinated debt securities have a maturity date of December 2030 and a weighted average fixed rate of 6.41% for the first seven years. After the fixed rate periods, the subordinated debt securities issued in December 2018 will float at the *Wall Street Journal* prime rate, with a floor of 4.5% and a ceiling of 7.5%. These subordinated debt securities pay interest quarterly, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these subordinated debt securities are intended to qualify for Tier 2 capital treatment, subject to regulatory limitations.

On September 29, 2020, the Company issued $50.0 million in subordinated debt securities. Proceeds from the issuance of these subordinated debt securities were reduced by approximately $926 thousand in debt issuance costs. The subordinated debt securities issued in September 2020 have a maturity date of September 2030 with a fixed rate of 4.50% for the first five years. After the expiration of the fixed rate period, the subordinated debt securities will reset quarterly at a variable rate equal to the then current three-month Secured Overnight Financing Rate, as published by the Federal Reserve Bank of New York, plus 438 basis points. These subordinated debt securities pay interest semi-annually, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these subordinated debt securities are intended to qualify for Tier 2 capital treatment, subject to regulatory limitations.

As of September 30, 2022, the total amount of the Company's subordinated debt securities outstanding was $76.5 million less approximately $604 thousand of remaining debt issuance costs for a total balance of $75.9 million. As of December 31, 2021, the total amount of subordinated debt securities outstanding was $76.5 million less approximately $697 thousand of remaining debt issuance costs for a total balance of $75.8 million.

Notes Payable and Other Borrowings

As of September 30, 2022 and December 31, 2021, City Bank had no outstanding advances from the Federal Home Loan Bank of Dallas ("FHLB").

7. STOCK-BASED COMPENSATION

Equity Incentive Plan

The 2019 Equity Incentive Plan ("Plan") was approved by the Company's Board of Directors on January 16, 2019 and by its shareholders on March 6, 2019. The purpose of the Plan is to: (i) attract and retain the best available personnel for positions of substantial responsibility, (ii) provide additional incentive to employees, directors and consultants, and (iii) promote the success of the Company's business. This Plan permits the grant of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares, and other stock-based awards. The maximum aggregate number of shares of common stock that may be issued pursuant to all awards under the Plan is 2,300,000. The maximum aggregate number of shares that may be issued under the Plan may be increased annually by up to 3% of the total issued and outstanding common shares of the Company at the beginning of each fiscal year.

The fair value of each option award is estimated on the date of grant using the Black-Scholes model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock and similar peer company averages. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes in to account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on U.S. Treasury yield curve in effect at the time of the grant.

Options

A summary of activity in the Plan for the period indicated is presented in the table below (dollars in thousands, except per share data):

Nine Months Ended September 30, 2022	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of year:	1,602,028	$ 15.42		$ 19,453
Granted	45,203	29.40		—
Exercised	(35,676)	13.25		(510)
Forfeited	(7,449)	19.30		(61)
Expired	(3,317)	18.05		(32)
Balance, September 30, 2022	1,600,789	$ 15.84	5.39	$ 18,850
Exercisable at end of period	1,186,948	$ 14.22	4.86	$ 15,834
Vested at end of period	1,186,948	$ 14.22	4.86	$ 15,834

A summary of assumptions used to calculate the fair values of the awards granted during the periods noted is presented below:

	Nine Months Ended September 30,	
	2022	2021
Expected volatility	40.20% to 40.29%	41.20% to 41.32%
Expected dividend yield	1.30%	1.00%
Expected term (years)	6.1 to 6.3	6.1 to 6.2
Risk-free interest rate	1.56% to 1.95%	0.52% to 0.83%
Weighted average grant date fair value	$ 10.54	$ 7.07

The total intrinsic value of options exercised during the nine months ended September 30, 2022 and September 30, 2021 was $516 thousand and $17 thousand, respectively.

Restricted Stock Awards and Units
A summary of activity in the Plan for the period indicated is presented in the table below:

	Number of Shares	Weighted-Average Grant Date Fair Value
Nine Months Ended September 30, 2022		
Outstanding at beginning of year:	42,767	$ 19.35
Granted	74,891	28.78
Vested	(25,715)	19.86
Forfeited	(4,688)	28.16
Balance, September 30, 2022	87,255	$ 26.82

Restricted stock units granted under the Plan typically vest from one to four years, but vesting periods may vary. Compensation expense for these grants will be recognized over the vesting period of the awards based on the fair value of the stock at the issue date.

The total unrecognized compensation cost for the awards outstanding under the Plan at September 30, 2022 was $3.3 million and will be recognized over a weighted average remaining period of 1.57 years. The total fair value of restricted stock units vested during each of the nine months ended September 30, 2022 and September 30, 2021 was $511 thousand and $489 thousand, respectively.

8. OFF-BALANCE-SHEET ACTIVITIES, COMMITMENTS AND CONTINGENCIES

Financial instruments with off-balance-sheet risk - The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Company’s consolidated financial statements. The Company’s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for recorded instruments.

Financial instruments whose contract amounts represent credit risk outstanding at the dates indicated follow (dollars in thousands):

	September 30, 2022	December 31, 2021
Commitments to grant loans and unfunded commitments under lines of credit	$ 741,347	$ 542,338
Standby letters of credit	12,563	12,418

Commitments to grant loans and extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management’s credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company requires collateral supporting those commitments if deemed necessary.

Litigation - In July 2020, a vendor claimed that City Bank had breached a contract by failing to timely pay amounts allegedly due and owing. City Bank vigorously rejected any such non-payment contentions and filed suit against the vendor. With the lawsuit, City Bank sought, among other claims and relief, an injunction against the vendor. After an evidentiary hearing, the court entered a temporary injunction against the vendor expressly prohibiting it from, among other things, terminating the contract pending trial. Based upon discovery in the lawsuit, City Bank also filed a breach of contract claim against the vendor alleging that the vendor violated City Bank's contractual exclusivity rights. The vendor has filed counterclaims, including for declaratory relief that the contracts should be declared unenforceable. In October 2021, the vendor filed a counterclaim alleging that City Bank's attempted enforcement of its exclusivity rights contravenes the Texas Free Enterprise and Antitrust Act. On or about September 23, 2022, the parties entered into a Settlement Agreement and Mutual Release, pursuant to which the parties agreed to the settlement and release of all claims and counterclaims in the lawsuit. Thereafter, the parties filed a joint motion to dismiss with prejudice and the court formally dismissed the case by order dated October 7, 2022. A gain contingency was recorded at settlement and that consideration was received on October 3, 2022.

The Company is a defendant in legal actions arising from time to time in the normal course of business. Management believes that the ultimate liability, if any, arising from these matters will not materially affect the combined financial statements, based on information known as of the date of the combined financial statements.

FHLB Letters of Credit - The Company may use FHLB letters of credit to pledge to certain public deposits. There were no FHLB letters of credit outstanding at September 30, 2022 or December 31, 2021.

9. LEASES

The Company leases space, primarily for branch facilities and small equipment under operating leases. The Company's leases often include one or more options to renew at the Company's discretion, and some of the Company's leases include options to terminate within one year. When it is reasonably certain that the Company will exercise the option to renew or extend the lease term, that option is included in estimating the value of the ROU asset and lease liability. The Company's leases contain customary restrictions and covenants and do not contain any residual value guarantees. The Company has certain intercompany leases and subleases between its subsidiaries, and these transactions and balances have been eliminated in consolidation and are not reflected in the tables and information presented below. As of September 30, 2022, the Company had no finance leases.

The balance sheet components of the Company's leases at the date indicated are as follows (dollars in thousands):

	September 30, 2022
Operating lease right of use assets (included in Other assets)	$ 8,284
Operating lease liabilities (included in Accrued expenses and other liabilities)	9,234

The Company does not generally enter into leases which contain variable payments, other than due to the passage of time. Operating lease costs, including short-term lease costs were $761 thousand and $2.2 million, respectively, for the three and nine months ended September 30, 2022. Operating lease costs were $648 thousand and $1.8 million, respectively, for the three and nine months ended September 30, 2021.

Supplemental cash flow information related to leases for the periods presented is as follows (dollars in thousands):

	Three Months Ended September 30, 2022	Nine Months Ended September 30, 2022
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows used in operating leases	$ 498	$ 1,479
Right-of-use assets obtained in exchange for new lease obligations:		
Operating leases	$ —	$ —

For operating leases the Company's weighted average remaining lease terms in years and weighted average discount rate was 9.85 and 4.65%, respectively, as of September 30, 2022.

Maturities of operating lease liabilities at September 30, 2022, under lease agreements that had commenced as of or subsequent to January 1, 2022, are presented below (dollars in thousands).

2022	$ 489
2023	1,859
2024	1,416
2025	993
2026	1,026
Thereafter	6,025
Total minimum lease payments	11,808
Less: Amount representing interest	(2,574)
Lease liabilities	$ 9,234

As of September 30, 2022, the Company had no significant additional operating leases that have not yet commenced.

10. CAPITAL AND REGULATORY MATTERS

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by its banking regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and its bank subsidiary's financial statements. Under capital guidelines and the regulatory framework for prompt corrective action, the Company and its bank subsidiary must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework ("Basel III"). Basel III, among other things, (i) introduced a new capital measure called Common Equity Tier 1 ("CET1"), (ii) specified that Tier 1 capital consists of CET1 and Additional Tier 1 Capital instruments meeting specified requirements, (iii) defined CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments as compared to existing regulations. Basel III became effective for the Company and its bank subsidiary on January 1, 2016 with certain transition provisions fully phased-in on January 1, 2019.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its bank subsidiary to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of September 30, 2022 and December 31, 2021, that the Company and its bank subsidiary met all capital adequacy requirements to which they are subject.

As of September 30, 2022, the bank subsidiary was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since September 30, 2022 that management believes have changed the bank subsidiary's category.

The Company and its bank subsidiary's actual capital amounts and ratios at the dates indicated follows (dollars in thousands):

	Actual		Minimum Required Under BASEL III Fully Phased-In		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2022						
Total Capital to Risk Weighted Assets:						
Consolidated	$ 551,832	16.46%	$ 352,000	10.50%	N/A	N/A
City Bank	448,194	13.37%	351,890	10.50%	$ 335,134	10.00%
Tier I Capital to Risk Weighted Assets:						
Consolidated	436,081	13.01%	284,952	8.50%	N/A	N/A
City Bank	408,357	12.18%	284,863	8.50%	268,107	8.00%
Common Equity Tier 1 to Risk Weighted Assets:						
Consolidated	391,081	11.67%	234,667	7.00%	N/A	N/A
City Bank	408,357	12.18%	234,593	7.00%	217,837	6.50%
Tier I Capital to Average Assets:						
Consolidated	436,081	10.95%	160,247	4.00%	N/A	N/A
City Bank	408,357	10.26%	160,122	4.00%	198,941	5.00%
December 31, 2021						
Total Capital to Risk Weighted Assets:						
Consolidated	$ 524,836	18.40%	$ 299,521	10.50%	N/A	N/A
City Bank	425,748	14.93%	299,465	10.50%	$ 285,205	10.00%
Tier I Capital to Risk Weighted Assets:						
Consolidated	413,322	14.49%	242,469	8.50%	N/A	N/A
City Bank	390,015	13.67%	242,424	8.50%	228,164	8.00%

Common Equity Tier 1 to Risk Weighted Assets:						
Consolidated	368,322	12.91%	199,681	7.00%	N/A	N/A
City Bank	390,015	13.67%	199,644	7.00%	185,383	6.50%
Tier I Capital to Average Assets:						
Consolidated	413,322	10.77%	154,592	4.00%	N/A	N/A
City Bank	390,015	10.16%	154,503	4.00%	191,859	5.00%

State banking regulations place certain restrictions on dividends paid by banks to their shareholders. Dividends paid by the Company's bank subsidiary would be prohibited if the effect thereof would cause the bank subsidiary's capital to be reduced below applicable minimum capital requirements.

11. DERIVATIVES

The Company utilizes interest rate swap agreements as part of its asset-liability management strategy to help manage its interest rate risk position. These interest rate swaps are designated and qualify as fair value hedges and are entered into to reduce exposure to changes in fair value of fixed rate financial instruments. The notional amount of the interest rate swaps do not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amounts and the other terms of the individual interest rate swap agreements.

The following table reflects the changes in fair value hedges included in the Consolidated Statements of Comprehensive Income (Loss) as of the periods indicated (dollars in thousands):

		Three Months Ended September 30,	
Interest Rate Contracts	**Location**	**2022**	**2021**
Interest rate swaps - fair value hedges	Interest income	$ 717	$ (347)
Fair value hedge ineffectiveness	Other noninterest expense	$ 75	$ 16

		Nine Months Ended September 30,	
Interest Rate Contracts	**Location**	**2022**	**2021**
Interest rate swaps - fair value hedges	Interest income	$ 376	$ (694)
Fair value hedge ineffectiveness	Other noninterest expense	$ 246	$ 90

The following table reflects the fair value hedges included in the Consolidated Balance Sheets at the dates indicated (dollars in thousands):

	September 30, 2022		December 31, 2021	
	Notional Amount	**Fair Value**	**Notional Amount**	**Fair Value**
Included in other liabilities:				
Interest rate swaps related to fixed rate loans	$ —	$ —	$ 9,775	$ 429
Interest rate swaps related to state and municipal securities	—	—	—	—
Included in other assets:				
Interest rate swaps related to fixed rate loans	$ 9,493	$ 518	$ —	$ —
Interest rate swaps related to state and municipal securities	123,760	21,121	123,760	5,686

Mortgage banking derivatives

The net gains (losses) relating to free standing derivative instruments used for risk management are summarized below as of the periods indicated (dollars in thousands):

	Location	Three Months Ended September 30, 2022	Three Months Ended September 30, 2021
Forward contracts related to mortgage loans held for sale	Net gain (loss) on sales of loans	$ (157)	$ (234)
Interest rate lock commitments	Net gain (loss) on sales of loans	$ 432	$ 486

	Location	Nine Months Ended September 30, 2022	Nine Months Ended September 30, 2021
Forward contracts related to mortgage loans held for sale	Net gain (loss) on sales of loans	$ (1,083)	$ 906
Interest rate lock commitments	Net gain (loss) on sales of loans	$ 549	$ (1,662)

The following table reflects the amount and fair value of mortgage banking derivatives in the Consolidated Balance Sheets at the dates indicated (dollars in thousands):

	September 30, 2022		December 31, 2021	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets:				
Forward contracts related to mortgage loans held for sale	$ —	$ —	$ —	$ —
Interest rate lock commitments	58,572	2,191	104,437	1,642
Total included in other assets	$ 58,572	$ 2,191	$ 104,437	$ 1,642
Included in other liabilities:				
Forward contracts related to mortgage loans held for sale	$ 55,103	$ 1,189	$ 93,120	$ 106
Interest rate lock commitments	—	—	—	—
Total included in other liabilities	$ 55,103	$ 1,189	$ 93,120	$ 106

The Company had received cash collateral of $19.1 million to offset asset derivative positions on its interest rate swaps at September 30, 2022. This amount is reported in other liabilities in the Consolidated Balance Sheets. The Company had advanced $1.1 million to offset liability derivative positions on its interest rate swaps at September 30, 2022. Additionally, the Company had advanced $440 thousand on its mortgage forward contracts at September 30, 2022. The advanced cash collateral amounts are reported in cash and due from banks in the Consolidated Balance Sheets.

12. EARNINGS PER SHARE

The factors used in the earnings per share computation for the periods indicated follow (dollars in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Net income	$ 15,458	$ 15,190	$ 45,619	$ 44,000
Weighted average common shares outstanding - basic	17,286,531	17,931,174	17,496,217	18,012,963
Effect of dilutive securities:				
Stock-based compensation awards	615,368	532,523	607,808	503,525
Weighted average common shares outstanding - diluted	17,901,899	18,463,697	18,104,025	18,516,488
Basic earnings per share	$ 0.89	$ 0.85	$ 2.61	$ 2.44
Diluted earnings per share	$ 0.86	$ 0.82	$ 2.52	$ 2.38

13. SEGMENT INFORMATION

Financial results by reportable segment as of the periods indicated are detailed below (dollars in thousands):

Three Months Ended September 30, 2022	Banking	Insurance	Consolidated
Net interest income	$ 35,102	$ —	$ 35,102
Provision for loan losses	782	—	782
Noninterest income	16,162	4,775	20,937
Noninterest expense	(34,460)	(2,941)	(37,401)
Income before income taxes	17,586	1,834	19,420
Income tax (expense) benefit	(3,577)	(385)	(3,962)
Net income	$ 14,009	$ 1,449	$ 15,458

Three Months Ended September 30, 2021	Banking	Insurance	Consolidated
Net interest income	$ 31,178	$ —	$ 31,178
Provision for loan losses	—	—	—
Noninterest income	22,043	3,748	25,791
Noninterest expense	(35,613)	(2,450)	(38,063)
Income before income taxes	17,608	1,298	18,906
Income tax (expense) benefit	(3,495)	(221)	(3,716)
Net income	$ 14,113	$ 1,077	$ 15,190

Nine Months Ended September 30, 2022	Banking	Insurance	Consolidated
Net interest income	$ 102,154	$ —	$ 102,154
Provision for loan losses	2,867	—	2,867
Noninterest income	55,714	7,755	63,469
Noninterest expense	(105,612)	(5,769)	(111,381)
Income before income taxes	55,123	1,986	57,109
Income tax (expense) benefit	(11,071)	(419)	(11,490)
Net income	$ 44,052	$ 1,567	$ 45,619

Nine Months Ended September 30, 2021	Banking	Insurance	Consolidated
Net interest income	$ 90,315	$ —	$ 90,315
Provision for loan losses	1,918	—	1,918
Noninterest income	68,536	6,005	74,541
Noninterest expense	(107,233)	(4,665)	(111,898)
Income before income taxes	53,536	1,340	54,876
Income tax (expense) benefit	(10,645)	(231)	(10,876)
Net income	$ 42,891	$ 1,109	$ 44,000

14. FAIR VALUE DISCLOSURES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Valuation techniques that are consistent with the market approach, the income approach and/or the cost approach are required by GAAP. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset. Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy for valuation inputs gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- *Level 3 Inputs* - Significant unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The following table summarizes fair value measurements at the dates indicated (dollars in thousands):

	Level 1	Level 2	Level 3	Total
September 30, 2022				
Assets (liabilities) measured at fair value on a recurring basis:				
Securities available for sale:				
State and municipal	$ —	$ 220,153	$ —	$ 220,153
Mortgage-backed securities	—	373,972	—	373,972
Collateralized mortgage obligations	—	85,810	—	85,810
Asset-backed and other amortizing securities	—	20,100	—	20,100
Other securities	—	11,377	—	11,377
Loans held for sale (mandatory)	—	17,213	—	17,213
Mortgage servicing rights	—	—	28,424	28,424
Asset derivatives	—	23,830	—	23,830
Liability derivatives	—	(1,189)	—	(1,189)
Assets measured at fair value on a non-recurring basis:				
Impaired loans	—	—	4,102	4,102
December 31, 2021				
Assets (liabilities) measured at fair value on a recurring basis:				
Securities available for sale:				
State and municipal	$ —	$ 275,672	$ —	$ 275,672
Mortgage-backed securities	—	303,089	—	303,089
Collateralized mortgage obligations	—	106,320	—	106,320
Asset-backed and other amortizing securities	—	26,936	—	26,936
Other securities	—	12,487	—	12,487
Loans held for sale (mandatory)	—	47,593	—	47,593
Mortgage servicing rights	—	—	19,700	19,700
Asset derivatives	—	7,328	—	7,328
Liability derivatives	—	(535)	—	(535)
Assets measured at fair value on a non-recurring basis:				
Impaired loans	—	—	6,427	6,427

Securities – Fair value is calculated based on market prices of similar securities using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded.

Loans held for sale (mandatory) – Loans held for sale originated for mandatory delivery are reported at fair value. Fair value is determined using quoted prices for similar assets, adjusted for specific attributes of that loan.

Mortgage servicing rights – Mortgage servicing rights are reported at fair value using Level 3 inputs. The mortgage servicing rights asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the mortgage servicing rights asset is impacted by a variety of factors, including prepayment and discount rates, which are significant unobservable inputs.

Derivatives – Fair value of derivatives is based on valuation models using observable market data as of the measurement date.

Impaired loans – Impaired loans are reported at the fair value of the underlying collateral, less estimated disposal costs, if repayment is expected solely from the sale of the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

The following table presents quantitative information about recurring and non-recurring Level 3 fair value measurements at the dates indicated (dollars in thousands):

		Fair Value	Valuation Techniques	Unobservable Inputs	Range of Discounts
September 30, 2022					
Non-recurring:					
Impaired loans	$	4,102	Third party appraisals or inspections	Collateral discounts and selling costs	20%-100%
Recurring:					
Mortgage servicing rights		28,424	Discounted cash flows	Conditional prepayment rate	7.34%
				Discount rate	9.14%
December 31, 2021					
Non-recurring:					
Impaired loans	$	6,427	Third party appraisals or inspections	Collateral discounts and selling costs	20%-100%
Recurring:					
Mortgage servicing rights		19,700	Discounted cash flows	Conditional prepayment rate	12.35%
				Discount rate	9.14%

The estimated fair values, and related carrying amounts, of the Company's financial instruments that are not previously disclosed in the recurring fair value section are as follows (dollars in thousands):

		Carrying Amount		Level 1		Level 2		Level 3		Total Fair Value
September 30, 2022										
Financial assets:										
Cash and cash equivalents	$	329,962	$	329,962	$	—	$	—	$	329,962
Loans held for investment, net		2,650,709		—		—		2,623,042		2,623,042
Loans held for sale (best efforts)		9,709		—		10,048		—		10,048
Accrued interest receivable		12,408		—		12,408		—		12,408
Financial liabilities:										
Deposits	$	3,460,536	$	—	$	3,459,611	$	—	$	3,459,611
Accrued interest payable		1,747		—		1,747		—		1,747
Junior subordinated deferrable interest debentures		46,393		—		34,598		—		34,598
Subordinated debt securities		75,914		—		71,962		—		71,962

		Carrying Amount		Level 1		Level 2		Level 3		Total Fair Value
December 31, 2021										
Financial assets:										
Cash and cash equivalents	$	486,821	$	486,821	$	—	$	—	$	486,821
Loans held for investment, net		2,395,479		—		—		2,397,079		2,397,079
Loans held for sale (best efforts)		28,914		—		29,500		—		29,500
Accrued interest receivable		13,900		—		13,900		—		13,900
Financial liabilities:										
Deposits	$	3,341,222	$	3,004,091	$	339,797	$	—	$	3,343,888
Accrued interest payable		1,914		—		1,914		—		1,914
Junior subordinated deferrable interest debentures		46,393		—		45,690		—		45,690
Subordinated debt securities		75,775		—		77,939		—		77,939

15. SUBSEQUENT EVENTS

On October 19, 2022, the Company declared a cash dividend of $0.12 per share of common stock to be paid on November 15, 2022 to all shareholders of record as of October 31, 2022.

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

The following discussion and analysis is intended to assist readers in understanding our financial condition as of and results of operations for the period covered by this Quarterly Report on Form 10-Q (this "Form 10-Q") and should be read in conjunction with our consolidated financial statements and the accompanying notes thereto included in this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2021 (the "2021 Annual Report on Form 10-K") filed with the Securities and Exchange Commission (the "SEC") pursuant to Rule 424(b) of the Securities Act of 1933, as amended (the "Securities Act"), on March 8, 2022. Unless we state otherwise or the context otherwise requires, references in this Form 10-Q to "we," "our," "us" and "the Company" refer to South Plains Financial, Inc., a Texas corporation, our wholly-owned banking subsidiary, City Bank, a Texas banking association and our other consolidated subsidiaries. References in this Form 10-Q to the "Bank" refer to City Bank.

Cautionary Notice Regarding Forward-Looking Statements

This Form 10-Q contains statements that we believe are "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "might," "should," "could," "predict," "potential," "believe," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "strive," "projection," "goal," "target," "outlook," "aim," "would," "annualized" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the following:

- our ability to effectively execute our expansion strategy and manage our growth, including identifying and consummating suitable acquisitions;
- business and economic conditions, particularly those affecting our market areas, as well as the concentration of our business in such market areas;
- the impact, duration and severity of the ongoing COVID-19 pandemic, or any current or future variants thereof, and the response of governmental authorities to the COVID-19 pandemic and our participation in COVID-19-related government programs such as the Paycheck Protection Program (the "PPP") administered by the Small Business Administration (the "SBA") and created under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act");
- the uncertain inflationary outlook in the United States and our market areas, and its impact on market interest rates, the economy and credit quality;
- high concentrations of loans secured by real estate located in our market areas;
- risks associated with our commercial loan portfolio, including the uncertain economic consequences of the ongoing COVID-19 pandemic, or any current or future variants thereof, or any deterioration in value of the general business assets that secure such loans;
- potential changes in the prices, values and sales volumes of commercial and residential real estate securing our real estate loans;
- risks associated with our agricultural loan portfolio, including the heightened sensitivity to weather conditions, commodity prices, and other factors generally outside the borrowers and our control;
- risks associated with the sale of crop insurance products, including termination of or substantial changes to the federal crop insurance program;
- risks related to the significant amount of credit that we have extended to a limited number of borrowers and in a limited geographic area;
- public funds deposits comprising a relatively high percentage of our deposits;
- potential impairment on the goodwill we have recorded or may record in connection with business acquisitions;
- our ability to maintain our reputation;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for loan losses;
- our ability to attract, hire and retain qualified management personnel;
- our dependence on our management team, including our ability to retain executive officers and key employees and their customer and community relationships;

- market interest rate fluctuations, which could have an adverse effect on our profitability;
- increases in market interest rates, which could negatively impact bond market values and result in a lower net book value;
- our ability to successfully manage the current rising market interest rate environment, our credit risk and the level of future non-performing assets and charge-offs;
- competition from banks, credit unions and other financial services providers;
- our ability to keep pace with technological change or difficulties we may experience when implementing new technologies;
- system failures, service denials, cyber-attacks and security breaches;
- our ability to maintain effective internal control over financial reporting;
- employee error, fraudulent activity by employees or customers and inaccurate or incomplete information about our customers and counterparties;
- increased capital requirements imposed by banking regulators, which may require us to raise capital at a time when capital is not available on favorable terms or at all;
- 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;
- costs and effects of litigation, investigations or similar matters to which we may be subject, including any effect on our reputation;
- natural disasters, severe weather, acts of god, acts of war or terrorism, outbreaks of hostilities, public health outbreaks (such as the ongoing COVID-19 pandemic), other international or domestic calamities, and other matters beyond our control;
- tariffs and trade barriers;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Act Wall Street Reform and Consumer Protection Act, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"), and others relating to banking, consumer protection, securities and tax matters; and
- changes in the laws, rules, regulations, interpretations or policies relating to financial institutions, accounting, tax, trade, monetary and fiscal matters, including our ability to navigate the uncertain impacts of quantitative tightening and current and future governmental monetary and fiscal policies, including the policies of the Board of Governors of the Federal Reserve System ("Federal Reserve") and as a result of initiatives of the Biden administration.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Form 10-Q and the risk factors set forth in our 2021 Annual Report on Form 10-K. Because of these risks and other uncertainties, our actual future results, performance or achievements, or industry results, may be materially different from the results indicated by the forward-looking statements in this Form 10-Q. In addition, our past results of operations are not necessarily indicative of our future results. Accordingly, you should not rely on any forward-looking statements, which represent our beliefs, assumptions and estimates only as of the dates on which such forward-looking statements were made. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by law.

Available Information

The Company maintains an Internet web site at *www.spfi.bank*. The Company makes available, free of charge, on its web site (under *www.spfi.bank/financials-filings/sec-filings*) the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Exchange Act as soon as reasonably practicable after the Company files such material with, or furnishes it to, the SEC. The Company also makes available, free of charge, through its web site (under *www.spfi.bank/corporate-governance/documents-charters*) links to the Company's Code of Conduct and the charters for its board committees. In addition, the SEC maintains an Internet site (at *www.sec.gov*) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

The Company routinely posts important information for investors on its web site (under *www.spfi.bank* and, more specifically, under the News & Events tab at *www.spfi.bank/news-events/press-releases*). The Company intends to use its web site as a means of disclosing material non-public information and for complying with its disclosure obligations under SEC Regulation FD (Fair Disclosure). Accordingly, investors should monitor the Company's web site, in addition to following the Company's press releases, SEC filings, public conference calls, presentations and webcasts.

The information contained on, or that may be accessed through, the Company's web site is not incorporated by reference into, and is not a part of, this Form 10-Q.

Overview

We are a bank holding company headquartered in Lubbock, Texas, and our wholly-owned subsidiary, City Bank is one of the largest independent banks in West Texas and has additional banking operations in the Dallas, El Paso, Greater Houston, the Permian Basin, and College Station, Texas markets, and the Ruidoso, New Mexico market. Through City Bank, we provide a wide range of commercial and consumer financial services to small and medium-sized businesses and individuals in our market areas. Our principal business activities include commercial and retail banking, along with insurance, investment, trust and mortgage services.

Recent Developments

COVID-19 Update

The COVID-19 pandemic has caused significant disruptions in the U.S. economy. At this time, we cannot predict the impact or how long the economy or our impacted clients will be disrupted by the ongoing COVID-19 pandemic and any current or future variants of COVID-19.

Throughout the COVID-19 pandemic, the Bank has been proactive with its borrowers in those sectors most affected by the COVID-19 pandemic and has offered loan modifications to borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. As part of the Bank's efforts to support its customers and protect the Bank, the Bank offered varying forms of loan modifications including 90-day payment deferrals, 6-month interest only terms, or in certain select cases periods of longer than 6 months of interest only, to provide borrowers relief. As of September 30, 2022, there were no remaining active loan modifications attributed to COVID-19.

The Paycheck Protection Program ("PPP") was created by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") and implemented by the U.S. Small Business Administration (the "SBA") in March 2020. Funding for the PPP expired on May 31, 2021. The PPP allowed entities to apply for a 1.00% interest rate loan with payments generally deferred until the date the lender receives the applicable forgiveness amount from the SBA. The Bank originated approximately 3,200 for a total of $309.2 million of PPP loans. As of September 30, 2022, the Company had approximately $2.0 million of PPP loans outstanding. The Company expects that the remaining PPP loans will be forgiven by the SBA or otherwise repaid over the next several quarters.

We are currently unable to fully assess or predict the extent of the effects of the COVID-19 pandemic, or any current or future variant of COVID-19, on our operations as the ultimate impact will depend on factors that are currently unknown and/or beyond our control. Please refer to Part II, Item 1A, "Risk Factors" in this Form 10-Q.

Results of Operations

We had net income of $15.5 million, or $0.86 per diluted common share, for the three months ended September 30, 2022, compared to net income of $15.2 million, or $0.82 per diluted common share for the three months ended September 30, 2021. Return on average equity (annualized) was 17.37% and return on average assets (annualized) was 1.53% for the three months ended September 30, 2022, compared to 15.24% and 1.61%, respectively, for the three months ended September 30, 2021.

We had net income of $45.6 million, or $2.52 per diluted common share for the nine months ended September 30, 2022, compared to net income of $44.0 million, or $2.38 per diluted common share for the nine months ended September 30, 2021. Return on average equity (annualized) was 16.25% and return on average assets (annualized) was 1.53% for the nine months ended September 30, 2022, compared to 15.32% and 1.57%, respectively, for the nine months ended September 30, 2021.

Net Interest Income

Net interest income is the principal source of the Company's net income and represents the difference between interest income (interest and fees earned on assets, primarily loans and investment securities) and interest expense (interest paid on deposits and borrowed funds). We generate interest income from interest-earning assets that we own, including loans and investment securities. We incur interest expense from interest-bearing liabilities, including interest-bearing deposits and other borrowings, notably FHLB advances and subordinated notes. To evaluate net interest income, we measure and monitor (i) yields on our loans and other interest-earning assets, (ii) the costs of our deposits and other funding sources, (iii) our net interest spread and (iv) 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 the annualized net interest income on a fully tax-equivalent basis divided by average interest-earning assets.

Changes in the market interest rates and interest rates we earn on interest-earning assets or pay on interest-bearing liabilities, as well as the volume and types of interest-earning assets, interest-bearing and noninterest-bearing liabilities, are usually the largest drivers of periodic changes in net interest spread, net interest margin and net interest income.

The following tables present, for the periods indicated, information about: (i) weighted average balances, the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) average balances, the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rates; (iii) net interest income; (iv) the interest rate spread; and (v) the net interest margin. For purposes of this table, interest income, net interest margin and net interest spread are shown on a fully tax-equivalent basis.

	Three Months Ended September 30,					
	2022			2021		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans, excluding PPP[(1)]	$ 2,666,429	$ 34,176	5.09%	$ 2,365,010	$ 28,947	4.86%
Loans - PPP	4,754	288	24.03	86,645	1,872	8.57
Investment securities – taxable	617,722	4,166	2.68	531,620	2,309	1.72
Investment securities – non-taxable	215,508	1,428	2.63	221,026	1,468	2.64
Other interest-earning assets[(2)]	293,636	1,351	1.83	284,369	151	0.21
Total interest-earning assets	3,798,049	41,409	4.33	3,488,670	34,747	3.95
Noninterest-earning assets	208,135			259,641		
Total assets	$ 4,006,184			$ 3,748,311		
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
NOW, savings and money market deposits	$ 1,873,786	$ 3,514	0.74%	$ 1,820,677	$ 1,005	0.22%
Time deposits	330,133	1,023	1.23	330,161	1,025	1.23
Short-term borrowings	4	—	0.00	725	—	0.00
Notes payable & other longer-term borrowings	—	—	0.00	—	—	0.00
Subordinated debt securities	75,914	1,012	5.29	75,728	1,013	5.31
Junior subordinated deferrable interest debentures	46,393	457	3.91	46,393	217	1.86
Total interest-bearing liabilities	$ 2,326,230	$ 6,006	1.02%	$ 2,273,684	$ 3,260	0.57%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	$ 1,248,804			$ 1,035,910		
Other liabilities	78,139			43,171		
Total noninterest-bearing liabilities	1,326,943			1,079,081		
Stockholders' equity	353,011			395,546		
Total liabilities and stockholders' equity	$ 4,006,184			$ 3,748,311		
Net interest income		$ 35,403			$ 31,487	
Net interest spread			3.30%			3.38%
Net interest margin[(3)]			3.70%			3.58%

Table of Contents

	Nine Months Ended September 30,					
	2022			2021		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans, excluding PPP[1]	$ 2,548,174	$ 97,321	5.11%	$ 2,246,650	$ 82,314	4.90%
Loans - PPP	19,509	1,941	13.30	141,040	7,147	6.78
Investment securities – taxable	592,069	10,058	2.27	540,380	7,118	1.76
Investment securities – non-taxable	216,951	4,315	2.66	219,242	4,414	2.69
Other interest-earning assets[2]	363,659	2,213	0.81	328,412	373	0.15
Total interest-earning assets	3,740,362	115,848	4.14	3,475,724	101,366	3.90
Noninterest-earning assets	236,296			261,449		
Total assets	$ 3,976,658			$ 3,737,173		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
NOW, savings and money market deposits	$ 1,905,000	$ 5,782	0.41%	$ 1,834,113	$ 3,259	0.24%
Time deposits	334,686	2,962	1.18	326,862	3,114	1.27
Short-term borrowings	4	—	0.00	10,725	5	0.06
Notes payable & other longer-term borrowings	—	—	0.00	26,188	38	0.19
Subordinated debt securities	75,852	3,037	5.35	75,682	3,044	5.38
Junior subordinated deferrable interest debentures	46,393	1,005	2.90	46,393	661	1.90
Total interest-bearing liabilities	$ 2,361,935	$ 12,786	0.72%	$ 2,319,963	$ 10,121	0.58%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	$ 1,174,783			$ 991,331		
Other liabilities	64,639			41,996		
Total noninterest-bearing liabilities	1,239,422			1,033,327		
Shareholders' equity	375,301			383,883		
Total liabilities and shareholders' equity	$ 3,976,658			$ 3,737,173		
Net interest income		$ 103,062			$ 91,245	
Net interest spread			3.42%			3.32%
Net interest margin[3]			3.68%			3.51%

(1) Average loan balances include nonaccrual loans and loans held for sale.
(2) Includes income and average balances for interest-earning deposits at other banks, nonmarketable securities, federal funds sold and other miscellaneous interest-earning assets.
(3) Net interest margin is calculated as the annualized net interest income, on a fully tax-equivalent basis, divided by average interest-earning assets.

Increases and decreases in interest income and interest expense result from changes in average balances (volume) of interest-earning assets and interest-bearing liabilities, as well as changes in average interest rates. The following tables sets forth the effects of changing rates and volumes on our net interest income during the period shown. Information is provided with respect to (i) effects on interest income attributable to changes in volume (change in volume multiplied by prior rate) and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). Change applicable to both volume and rate have been allocated to volume.

	Three Months Ended September 30,		
	2022 over 2021		
	Change due to:		Total Variance
	Volume	Rate	
	(Dollars in thousands)		
Interest-earning assets:			
Loans, excluding PPP	$ 3,689	$ 1,540	$ 5,229
Loans - PPP	(1,769)	185	(1,584)
Investment securities – taxable	374	1,483	1,857
Investment securities – non-taxable	(37)	(3)	(40)
Other interest-earning assets	5	1,195	1,200
Total increase (decrease) in interest income	2,262	4,400	6,662
Interest-bearing liabilities:			
NOW, Savings, MMDAs	29	2,480	2,509
Time deposits	—	(2)	(2)
Short-term borrowings	—	—	—
Notes payable & other borrowings	—	—	—
Subordinated debt securities	2	(3)	(1)
Junior subordinated deferrable interest debentures	—	240	240

Total increase (decrease) interest expense:	31	2,715	2,746
Increase (decrease) in net interest income	$ 2,231	$ 1,685	$ 3,916

	Nine Months Ended September 30, 2022 over 2021		
	Change due to:		Total
	Volume	Rate	Variance
	(Dollars in thousands)		
Interest-earning assets:			
Loans, excluding PPP	$ 11,047	$ 3,960	$ 15,007
Loans - PPP	(6,158)	952	(5,206)
Investment securities – taxable	681	2,259	2,940
Investment securities – non-taxable	(46)	(53)	(99)
Other interest-earning assets	40	1,800	1,840
Total increase (decrease) in interest income	5,564	8,918	14,482
Interest-bearing liabilities:			
NOW, Savings, MMDAs	126	2,397	2,523
Time deposits	75	(227)	(152)
Short-term borrowings	(5)	—	(5)
Notes payable & other borrowings	(38)	—	(38)
Subordinated debt securities	7	(14)	(7)
Junior subordinated deferrable interest debentures	—	344	344
Total increase (decrease) interest expense:	165	2,500	2,665
Increase (decrease) in net interest income	$ 5,399	$ 6,418	$ 11,817

Net interest income for the three months ended September 30, 2022 was $35.1 million, compared to $31.2 million for the three months ended September 30, 2021, an increase of $3.9 million, or 12.6%. The increase in net interest income was primarily due to increased interest income on loans, securities, and other interest-earning assets increase in interest income, partially offset by increased interest expense on deposits. Market interest rates continued to rise during the period, which is attributed to the Federal Open Market Committee ("FOMC") of the Board of Governors of the Federal Reserve System (the "Federal Reserve") raising their target benchmark interest rate in the third quarter of 2022, resulting in subsequent prime rate increases of 150 basis points, after increases of 150 basis points between March and June of 2022.

Interest income for the three months ended September 30, 2022 was $41.1 million, compared to $34.4 million for the three months ended September 30, 2021, an increase of $6.7 million, or 19.4%. This increase was comprised of increases of $3.6 million in loan interest income and $3.1 million in interest income from securities and other interest-earning assets. The increase in loan interest income was primarily due to an increase of $219.5 million in average loans outstanding and the rising interest rate environment. The increase in interest income on securities and other interest-earning assets was primarily due to securities purchases and rising market interest rates. During the third quarter of 2022, the Company recognized $277 thousand in deferred PPP-related SBA fees. At September 30, 2022, the Company had $124 thousand of deferred PPP fees that have not been accreted to income, the majority of which are expected to be recognized as PPP loans continue to be forgiven by the SBA over the next several quarters.

Interest expense for the three months ended September 30, 2022 increased $2.7 million, or 84.2%, compared to the three months ended September 30, 2021. The increase was principally due to growth in the average balances of interest-bearing deposits of $53.1 million during the third quarter of 2022 and an increase of 45 basis points on interest rates paid on these deposits as market interest rates continue to rise.

For the three months ended September 30, 2022, net interest margin and net interest spread were 3.70% and 3.30%, respectively, compared to 3.58% and 3.38% for the same three-month period in 2021, which reflects the changes in interest income and interest expense discussed above.

Net interest income for the nine months ended September 30, 2022 was $102.2 million, compared to $90.3 million for the nine months ended September 30, 2021, an increase of $11.8 million, or 13.1%. The increase in net interest income was primarily due to increased interest income on loans, securities, and other interest-earning assets increase in interest income, partially offset by increased interest expense on deposits. There was continued rising market interest rates during the period, which is attributed to the Federal Reserve, as noted above.

Interest income for the nine months ended September 30, 2022 was $114.9 million, compared to $100.4 million for the nine months ended September 30, 2021, an increase of $14.5 million, or 14.4%. This increase was primarily attributable to an increase of $180.0 million in average loans outstanding, an increase of 16 basis points in the yield on loans, and $4.4 million of interest income received related to four credits for the recovery of interest on previously charged-off credits, purchase discount principal recovery, and prepayment penalties during the second quarter of 2022, partially offset by an decrease of $5.2 million in PPP-related SBA interest and fees recognized as PPP loans were forgiven by the SBA or repaid.

Interest expense for the nine months ended September 30, 2022 increased $2.7 million, or 26.3%, compared to the nine months ended September 30, 2021. The increase was the primarily the result of growth in the average balances of interest-bearing deposits of $78.7 million during the period and an increase of 45 basis points on interest rates paid on these deposits as market interest rates continue to rise.

For the nine months ended September 30, 2022, net interest margin and net interest spread were 3.68% and 3.42%, respectively, compared to 3.51% and 3.32%, respectively, for the same nine-month period in 2021, which reflects the changes in interest income and interest expense discussed above.

Provision for Loan Losses

Credit risk is inherent in the business of making loans. We establish an allowance for loan losses through charges to earnings, which are shown in the consolidated statements of income as the provision for loan losses. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for loan losses is determined by conducting a quarterly evaluation of the adequacy of our allowance for loan losses and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to our earnings. The provision for loan losses and the amount of allowance for each period are dependent upon many factors, including loan growth, net charge offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in our market areas.

The Company recorded a negative provision for loan losses of $782 thousand for the three months ended September 30, 2022, compared to no provision being recorded for the three months ended September 30, 2021. There was a loan loss recovery of $822 thousand of a direct energy credit during the third quarter of 2022. The Company continued to experience improving credit metrics in the loan portfolio during the third quarter of 2022, specifically in the hotel segment, offset with organic loan growth, which resulted in the negative provision expense in the third quarter of 2022.

The Company recorded a negative provision for loan losses for the nine months ended September 30, 2022 of $2.9 million, compared to a negative provision of $1.9 million for the nine months ended September 30, 2021. The decrease in the provision for loan losses for the nine months ended September 30, 2022 compared to the nine months ended in 2021 is primarily due to improving credit metrics in the loan portfolio, specifically in the hotel segment, direct energy segment, and other Permian Basin-related credits, and a decline in the amount of loans that were actively under a COVID-19 pandemic-related modification. Nevertheless, there is continued uncertainty in the forecasted economic conditions due to the rising interest rate environment and persistent high inflation levels, and provisions for loan losses may be necessary in future periods.

Noninterest Income

While interest income remains the largest single component of total revenues, noninterest income is an important contributing component. The largest portion of our noninterest income is associated with our mortgage banking activities. Other sources of noninterest income include service charges on deposit accounts, bank card services and interchange fees, and income from insurance activities.

The following table sets forth the major components of our noninterest income for the periods indicated:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2022	2021	Increase (Decrease)	2022	2021	Increase (Decrease)
			(Dollars in thousands)			
Noninterest income:						
Service charges on deposit accounts	$ 1,764	$ 1,851	$ (87)	$ 5,149	$ 5,023	$ 126
Income from insurance activities	4,856	3,794	1,062	8,003	6,146	1,857
Bank card services and interchange fees	3,156	3,045	111	9,856	8,760	1,096
Mortgage banking activities	6,288	14,802	(8,514)	28,594	47,329	(18,735)
Investment commissions	391	430	(39)	1,403	1,390	13
Fiduciary income	568	556	12	1,815	2,234	(419)
Other income and fees(1)	3,914	1,313	2,601	8,649	3,659	4,990
Total noninterest income	$ 20,937	$ 25,791	$ (4,854)	$ 63,469	$ 74,541	$ (11,072)

(1) Other income and fees includes the increase in the cash surrender value of life insurance, safe deposit box rental, check printing, collections, legal settlements, wire transfer and other miscellaneous services.

Noninterest income for the three months ended September 30, 2022 was $20.9 million, compared to $25.8 million for the three months ended September 30, 2021, a decrease of $4.9 million, or 18.8%. Income from mortgage banking activities decreased $8.5 million, or 57.5%, to $6.3 million for the three months ended September 30, 2022 from $14.8 million for the three months ended September 30, 2021. This decrease in mortgage banking revenues was mainly the result of refinance activity slowing as mortgage rates have risen and overall mortgage activity has returned to a more historical level, as mortgage loan originations declined $222.2 million, or 59.4%. This decrease in noninterest income was partially offset by an increase of $1.1 million in income from insurance activities due to premium growth and $2.1 million of income related to legal settlements in the third quarter of 2022.

Noninterest income for the nine months ended September 30, 2022 was $63.5 million, compared to $74.5 million for the nine months ended September 30, 2021, a decrease of $11.1 million, or 14.9%. Income from mortgage banking activities decreased $18.7 million, or 39.6%, to $28.6 million for the nine months ended September 30, 2022 from $47.3 million for the nine months ended September 30, 2021. This decrease was primarily a result of a decrease of $595.5 million, or 50.1%, in mortgage loan originations, partially offset by an increase of $5.0 million in the fair value adjustment and an increase of $993 thousand in servicing income for the Company's mortgage servicing rights portfolio. Other noninterest income increased during the nine months ended September 30, 2022 primarily due to increased income from investments in a Small Business Investment Company ("SBIC") of $2.3 million, $2.1 million in legal settlements, and growth in income from insurance activities and bank card services and interchange fees, partially offset by a decrease of $419 thousand in fiduciary income.

Management is continuing to monitor and assess the industry changes related to the consumer overdraft fees, and changes already made or any future changes could negatively impact overdraft fee income.

Noninterest Expense

The following table sets forth the major components of our noninterest expense for the periods indicated:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2022	2021	Increase (Decrease)	2022	2021	Increase (Decrease)
	(Dollars in thousands)					
Noninterest expense:						
Salaries and employee benefits	$ 22,927	$ 24,116	$ (1,189)	$ 67,620	$ 71,811	$ (4,191)
Occupancy expense, net	4,132	3,896	236	11,902	10,960	942
Professional services	2,523	1,388	1,135	7,795	4,483	3,312
Marketing and development	913	777	136	2,391	2,157	234
IT and data services	908	1,068	(160)	2,902	3,029	(127)
Bankcard expenses	1,399	1,339	60	4,050	3,640	410
Appraisal expenses	359	790	(431)	1,432	2,350	(918)
Other expenses(1)	4,240	4,689	(449)	13,289	13,468	(179)
Total noninterest expense	$ 37,401	$ 38,063	$ (662)	$ 111,381	$ 111,898	$ (517)

(1) Other expenses include items such as telephone expenses, postage, courier fees, directors' fees, and insurance.

Noninterest expense for the three months ended September 30, 2022 was $37.4 million compared to $38.1 million for the three months ended September 30, 2021, a decrease of $0.7 million, or 1.7%. Salaries and employee benefits decreased $1.2 million, or 4.9%, from $24.1 million for the three months ended September 30, 2021 to $22.9 million for the three months ended September 30, 2022. This decrease in salaries and employee benefits expense was primarily driven by lower mortgage commissions due to the reduction in mortgage loan originations, partially offset by additional commercial lenders hired as part of a planned initiative. Professional services increased $1.1 million during the third quarter of 2022 primarily as the result of legal expenses as result of vendor dispute legal proceedings. Other variable mortgage-based expenses also declined during the period.

Noninterest expense for the nine months ended September 30, 2022 was $111.4 million, compared to $111.9 million for the nine months ended September 30, 2021, a decrease of $0.5 million, or 0.5%. Salaries and employee benefits decreased $4.2 million, or 5.8%, from $71.8 million for the nine months ended September 30, 2021 to $67.6 million for the nine months ended September 30, 2022. This decrease in salaries and employee benefits expense was primarily driven by lower mortgage commissions and other variable mortgage-based expenses due to the reduction in mortgage loan originations, partially offset by additional commercial lenders hired as part of a planned initiative. There was an increase in professional services expense of $3.3 million during the nine months ended September 30, 2022, primarily related to an increase of $2.6 million in legal fees as a result of vendor dispute legal proceedings and other legal matters.

Financial Condition

Our total assets increased $90.8 million, or 2.3%, to $3.99 billion at September 30, 2022, compared to $3.90 billion at December 31, 2021. Our gross loans held for investment increased $252.8 million, or 10.4%, to $2.69 billion at September 30, 2022, compared to $2.44 billion at December 31, 2021. Our securities portfolio decreased $13.1 million, or 1.8%, to $711.4 million at September 30, 2022, compared to $724.5 million at December 31, 2021. Total deposits increased $119.3 million, or 3.6%, to $3.46 billion at September 30, 2022, compared to $3.34 billion at December 31, 2021.

Loan Portfolio

Our loans represent the largest portion of earning assets, greater than our securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when reviewing the Company's financial condition. We originate substantially all of the loans in our portfolio, except certain loan participations that are independently underwritten by the Company prior to purchase.

Loans held for investment increased $252.8 million, or 10.4%, to $2.69 billion at September 30, 2022, compared to $2.44 billion at December 31, 2021. This increase in our loans was primarily the result of organic net loan growth of $291.0 million, partially offset by a decrease due to SBA forgiveness and repayments of $38.2 million in PPP loans during the first nine months of 2022. The organic loan growth remained relationship-focused and occurred primarily in commercial real estate loans, residential mortgage loans, and consumer auto loans, partially offset by a decrease in hotel loans.

The following table shows the contractual maturities of our loans held for investment portfolio at September 30, 2022:

	Due in One Year or Less	Due after One Year Through Five Years	Due after Five Years Through Fifteen Years	Due after Fifteen Years	Total
	(Dollars in thousands)				
Commercial real estate	$ 116,194	$ 426,898	$ 244,483	$ 81,656	$ 869,231
Commercial - specialized	98,706	159,969	63,261	46,268	368,204
Commercial - general	61,356	155,582	136,366	123,905	477,209
Consumer:					
1-4 family residential	31,870	74,860	74,777	243,295	424,802
Auto loans	3,064	161,110	144,937	—	309,111
Other consumer	4,887	47,487	28,150	—	80,524
Construction	139,837	2,661	938	17,849	161,285
Total loans	$ 455,914	$ 1,028,567	$ 692,912	$ 512,973	$ 2,690,366

The following table shows the distribution between fixed and adjustable interest rate loans for maturities greater than one year as of September 30, 2022:

	Fixed Rate	Adjustable Rate
	(Dollars in thousands)	
Commercial real estate	$ 326,890	$ 426,148
Commercial - specialized	69,927	199,571
Commercial - general	150,518	265,334
Consumer:		
1-4 family residential	231,728	161,204
Auto loans	306,047	—
Other consumer	75,271	365
Construction	1,617	19,832
Total loans	$ 1,161,998	$ 1,072,454

At September 30, 2022, there was $1.34 billion in adjustable rate loans, with $699.2 million of these loans that mature or reprice in the next twelve months. Of these loans that mature or reprice in the next twelve months, $486.2 million will reprice immediately upon changes in the underlying index rate, with the remaining $213.0 million being subject to floors above the current index or a future repricing date. The *Wall Street Journal* prime rate is the predominate index used by the Bank.

The Bank is primarily involved in real estate, commercial, agricultural and consumer lending activities with customers throughout Texas and Eastern New Mexico. We have a collateral concentration, as 68.4% of our loans were secured by real property as of September 30, 2022, compared to 69.4% as of December 31, 2021. We believe that these loans are not concentrated in any one single property type and that they are geographically dispersed throughout the areas we serve. Although the Bank has diversified portfolios, its debtors' ability to honor their contracts is substantially dependent upon the general economic conditions of the markets in which it operates, which consist primarily of agribusiness, wholesale/retail, oil and gas and related businesses, healthcare industries and institutions of higher education. Commercial real estate loans represent 37.9% of loans held for investment as of September 30, 2022 and represented 36.7% of loans held for investment as of December 31, 2021. Further, these loans are geographically diversified, primarily throughout the State of Texas as well as Eastern New Mexico.

We have established concentration limits in the loan portfolio for commercial real estate loans and unsecured lending, among other loan types. All loan types are within established limits. We use underwriting guidelines to assess the borrowers' historical cash flow to determine debt service, and we further stress test the debt service under higher interest rate scenarios. Financial and performance covenants are used in commercial lending to allow us to react to a borrower's deteriorating financial condition, should that occur.

Commercial Real Estate. Our commercial real estate portfolio includes loans for commercial property that is owned by real estate investors, construction loans to build owner-occupied properties, and loans to developers of commercial real estate investment properties and residential developments. Commercial real estate loans are subject to underwriting standards and processes similar to our commercial loans. These loans are underwritten primarily based on projected cash flows for income-producing properties and collateral values for non-income-producing properties. The repayment of these loans is generally dependent on the successful operation of the property securing the loans or the sale or refinancing of the property. Real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing our real estate portfolio are diversified by type and geographic location. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry.

Commercial real estate loans increased $113.8 million, or 15.1%, to $869.2 million as of September 30, 2022 from $755.4 million as of December 31, 2021. The increase was primarily driven by an increase of $69.8 million in commercial and residential land development loans and an increase of $64.2 million in retail loans, partially offset by a decrease of $20.4 million in hotel loans.

Commercial – General and Specialized. Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Underwriting standards have been designed to determine whether the borrower possesses sound business ethics and practices, to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations, and to ensure appropriate collateral is obtained to secure the loan. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as real estate, accounts receivable, or inventory, and typically include personal guarantees. Owner-occupied real estate is included in commercial loans, as the repayment of these loans is generally dependent on the operations of the commercial borrower's business rather than on income-producing properties or the sale of the properties. Commercial loans are grouped into two distinct sub-categories: specialized and general. Commercial related loans that are considered "specialized" include agricultural production and real estate loans, energy loans, and finance, investment, and insurance loans. Commercial related loans that contain a broader diversity of borrowers, sub-industries, or serviced industries are grouped into the "general category." These include goods, services, restaurant & retail, construction, and other industries.

Commercial general loans increased $17.2 million, or 3.7%, to $477.2 million as of September 30, 2022 from $460.0 million as of December 31, 2021. The increase in commercial general loans was primarily due to organic loan growth in restaurant & retail loans and construction company loans, partially offset by a decrease in PPP loans of $38.2 million.

Commercial specialized loans decreased $10.5 million, or 2.8%, to $368.2 million as of September 30, 2022 from $378.7 million as of December 31, 2021. This decrease was primarily due to an early payoff of an approximately $46 million of one energy sector loan and net repayments of $8.9 million in seasonal agricultural production loans, partially offset by organic loan growth of $40.4 million in finance, investment, and insurance loans.

Consumer. We utilize a computer-based credit scoring analysis to supplement our policies and procedures in underwriting consumer loans. Our loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimize our risk. Residential real estate loans are included in consumer loans. We generally require mortgage title insurance and hazard insurance on these residential real estate loans.

Consumer and other loans increased $117.9 million, or 16.9%, to $814.4 million as of September 30, 2022, from $696.5 million as of December 31, 2021. The increase in these loans was primarily a result of a $68.4 million increase in consumer auto loans as a result of increased demand for autos, along with adding several high-quality auto dealerships, and a $37.1 million increase in residential mortgage loans. As of September 30, 2022, our consumer loan portfolio was comprised of $424.8 million in 1-4 family residential loans, $309.1 million in auto loans, and $80.5 million in other consumer loans.

Construction. Loans for residential construction are for single-family properties to developers, builders, or end-users. These loans are underwritten based on estimates of costs and completed value of the project. Funds are advanced based on estimated percentage of completion for the project. Performance of these loans is affected by economic conditions as well as the ability to control costs of the projects.

Construction loans increased $14.4 million, or 9.8%, to $161.3 million as of September 30, 2022 from $146.9 million as of December 31, 2021. The increase resulted from continued higher demand for residential construction as a result of home shortages in many of our markets.

Paycheck Protection Program. Beginning in April 2020 and until funding expired on May 31, 2021, we originated loans to qualified small businesses under the PPP administered by the SBA under the provisions of the CARES Act. Loans covered by the PPP may be eligible for loan forgiveness for certain costs incurred related to payroll, group health care benefit costs and qualifying mortgage, rent and utility payments. The remaining loan balance after forgiveness of any amounts is still fully guaranteed by the SBA. Terms of the PPP loans include the following (i) maximum amount limited to the lesser of $10 million or an amount calculated using a payroll-based formula, (ii) maximum loan term of five years, (iii) interest rate of 1.00%, (iv) no collateral or personal guarantees are required, (v) no payments are required for six months following the loan disbursement date and (vi) loan forgiveness up to the full principal amount of the loan and any accrued interest, subject to certain requirements including that no more than 25% of the loan forgiveness amount may be attributable to non-payroll costs. In return for processing and booking the loan, the SBA paid the lender a processing fee tiered by the size of the loan (5% for loans of not more than $350 thousand; 3% for loans more than $350 thousand and less than $2 million; and 1% for loans of at least $2 million). At September 30, 2022, outstanding PPP loans totaled approximately $2.0 million and are included in commercial general loans.

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit to our customers is represented by the contractual or notional amount of those instruments. Commitments to extend credit and standby letters of credit are not recorded as an asset or liability by the Company until the instrument is exercised. The contractual or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments and conditional obligations as they do for on-balance sheet instruments. The amount and nature of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the potential borrower.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private short-term borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds collateral supporting those commitments for which collateral is deemed necessary.

The following table summarizes commitments we have made as of the dates presented.

	September 30, 2022	December 31, 2021
	(Dollars in thousands)	
Commitments to grant loans and unfunded commitments under lines of credit	$ 741,347	$ 542,338
Standby letters of credit	12,563	12,418
Total	$ 753,910	$ 554,756

Allowance for Loan Losses

The allowance for loan losses provides a reserve against which loan losses are charged as those losses become evident. Management evaluates the appropriate level of the allowance for loan losses on a quarterly basis. The analysis takes into consideration the results of an ongoing loan review process, the purpose of which is to determine the level of credit risk within the portfolio and to ensure proper adherence to underwriting and documentation standards. Additional allowances are provided to those loans which appear to represent a greater than normal exposure to risk. The quality of the loan portfolio and the adequacy of the allowance for loan losses is assessed by regulatory examinations and the Company's internal and external loan reviews. The allowance for loan losses consists of two elements: (1) specific valuation allowances established for probable losses on specific loans and (2) historical valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

To determine the adequacy of the allowance for loan losses, the loan portfolio is broken into categories based on loan type. Historical loss experience factors by category, adjusted for changes in trends and conditions, are used to determine an indicated allowance for each portfolio category. These factors are evaluated and updated based on the composition of the specific loan portfolio. Other considerations include volumes and trends of delinquencies, nonaccrual loans, levels of bankruptcies, criticized and classified loan trends, expected losses on real estate secured loans, new credit products and policies, economic conditions, concentrations of credit risk, and the experience and abilities of the Company's lending personnel. In addition to the portfolio evaluations, impaired loans with a balance of $250 thousand or more are individually evaluated based on facts and circumstances of the loan to determine if a specific allowance amount may be necessary. Specific allowances may also be established for loans whose outstanding balances are below the above threshold when it is determined that the risk associated with the loan differs significantly from the risk factor amounts established for its loan category.

The allowance for loan losses was $39.7 million at September 30, 2022, compared to $42.1 million at December 31, 2021, a decrease of $2.4 million, or 5.8%. The decrease is primarily a result of a negative provision for loan losses of $2.9 million being recorded during the first nine months of 2022 based on general improvement in the Company's credit metrics, a decline in the amount of loans that were actively under a modification, and a decrease in nonperforming loans, partially offset by the growth in the loan portfolio. Nevertheless, concerns regarding forecasted economic conditions continue to worsen due to the rising interest rate environment and persistent high inflation levels in the United States, and provisions for loan losses may be necessary in future periods.

The following tables provide an analysis of the allowance for loan losses and other data at the dates indicated.

	Three Months Ended September 30, 2022	Three Months Ended September 30, 2021	Nine Months Ended September 30, 2022	Nine Months Ended September 30, 2021
Net charge-offs (recoveries) during the period				
Commercial real estate	$ —	$ —	$ (418)	$ —
Commercial – specialized	(831)	(4)	(836)	(98)
Commercial – general	(135)	(61)	(76)	186
Consumer:				
1-4 family residential	15	(2)	53	47
Auto loans	27	91	105	335
Other consumer	270	171	580	401
Construction	—	—	166	(4)
Total net charge-offs (recoveries) during the period	(654)	195	(426)	867
Total average loans outstanding during period	$ 2,671,183	$ 2,451,655	$ 2,567,683	$ 2,387,690
Total ratio of net charge-offs (recoveries) to average loans during the period (annualized)	(0.10)%	0.03%	(0.02)%	0.05%

	September 30, 2022	December 31, 2021
	(Dollars in thousands)	
Total loans held for investment outstanding	$ 2,690,366	$ 2,437,577
Nonaccrual loans	$ 4,945	$ 9,518
Allowance for loan losses	$ 39,657	$ 42,098
Ratio of allowance to total loans held for investment	1.47%	1.73%
Ratio of allowance to nonaccrual loans	801.96%	442.30%
Ratio of nonaccrual loans to total loans held for investment	0.18%	0.39%

Net charge-offs (recoveries) totaled $(654) thousand and were (0.10)% (annualized) of average loans outstanding for the three months ended September 30, 2022, compared to $195 thousand and 0.03% (annualized) for the three months ended September 30, 2021. Net charge-offs totaled $(426) thousand and were (0.02)% (annualized) of average loans outstanding for the nine months ended September 30, 2022, compared to $867 thousand and 0.05% (annualized) for the nine months ended September 30, 2021. There was a $400 thousand recovery on a commercial tenant relationship in the second quarter of 2022 and an $822 thousand recovery on an energy relationship in the third quarter of 2022 that affected both of the period comparisons. The allowance for loan losses as a percentage of loans held for investment was 1.47% at September 30, 2022 and 1.73% at December 31, 2021.

While the entire allowance for loan losses is available to absorb losses from any part of our loan portfolio, the following table sets forth the allocation of the allowance for loan losses for the periods presented and the percentage of allowance in each classification to total allowance:

	September 30, 2022		December 31, 2021	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			
Commercial real estate	$ 12,611	31.8%	$ 17,245	41.0%
Commercial – specialized	3,705	9.3	4,363	10.4
Commercial – general	10,425	26.3	8,466	20.1
Consumer:				
1-4 family residential	5,561	14.0	5,268	12.5
Auto loans	3,892	9.8	3,653	8.7
Other consumer	1,455	3.7	1,357	3.2
Construction	2,008	5.1	1,746	4.1
Total allowance for loan losses	$ 39,657	100.0%	$ 42,098	100.0%

Asset Quality

Loans are considered delinquent when principal or interest payments are past due 30 days or more. Delinquent loans may remain on accrual status between 30 days and 90 days past due. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Typically, the accrual of interest on loans is discontinued when principal or interest payments are past due 90 days or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Loans are restored to accrual status when loans become well-secured and management believes full collectability of principal and interest is probable.

A loan is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include loans on nonaccrual status and performing restructured loans. Income from loans on nonaccrual status is recognized to the extent cash is received and when the loan's principal balance is deemed collectible. Depending on a particular loan's circumstances, we measure impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. A loan is considered collateral dependent when repayment of the loan is based solely on the liquidation of the collateral. Fair value, where possible, is determined by independent appraisals, typically on an annual basis. Between appraisal periods, the fair value may be adjusted based on specific events, such as if deterioration of quality of the collateral comes to our attention as part of our problem loan monitoring process, or if discussions with the borrower lead us to believe the last appraised value no longer reflects the actual market for the collateral. The impairment amount on a collateral-dependent loan is charged-off to the allowance if deemed not collectible and the impairment amount on a loan that is not collateral-dependent is set up as a specific reserve.

Real estate we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned ("OREO") until sold and is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis.

Nonperforming loans include nonaccrual loans and loans past due 90 days or more. Nonperforming assets consist of nonperforming loans plus OREO.

At September 30, 2022, our total nonaccrual loans were $4.9 million, or 0.18% of total loans held for investment, as compared to $9.5 million, or 0.39% of total loans held for investment, at December 31, 2021. These loans were reviewed for impairment and specific valuation allowances were established as necessary and included in the allowance for loan losses as of September 30, 2022 to cover any probable loss. There were eleven loans totaling $4.3 million that were removed from nonaccrual status during the second and third quarters of 2022. This was a result of principal paydowns, improved cash flow, and continued sustained payment performance.

Nonperforming loans were $7.8 million at September 30, 2022 and $10.6 million at December 31, 2021.

In cases where a borrower experiences financial difficulties and we make certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring ("TDR"). Included in certain loan categories of impaired loans are TDRs on which we have granted certain material concessions to the borrower as a result of the borrower experiencing financial difficulties. The concessions granted by us may include, but are not limited to: (1) a modification in which the maturity date, timing of payments or frequency of payments is modified, (2) an interest rate lower than the current market rate for new loans with similar risk, or (3) a combination of the first two factors.

If a borrower on a restructured accruing loan has demonstrated performance under the previous terms, is not experiencing financial difficulty and shows the capacity to continue to perform under the restructured terms, the loan will remain on accrual status. Otherwise, the loan will be placed on nonaccrual status until the borrower demonstrates a sustained period of performance, which generally requires six consecutive months of payments. Loans identified as TDRs are evaluated for impairment using the present value of the expected cash flows or the estimated fair value of the collateral, if the loan is collateral dependent. The fair value is determined, when possible, by an appraisal of the property less estimated costs related to liquidation of the collateral. The appraisal amount may also be adjusted for current market conditions. Adjustments to reflect the present value of the expected cash flows or the estimated fair value of collateral dependent loans are a component in determining an appropriate allowance for loan losses, and as such, may result in increases or decreases to the provision for loan losses in current and future earnings.

We had no loans restructured as TDRs during the first nine months of 2022 or 2021. TDRs are excluded from our nonperforming loans unless they otherwise meet the definition of nonaccrual loans or past due 90 days or more.

Securities Portfolio

The securities portfolio is the second largest component of the Company's interest-earning assets, and the structure and composition of this portfolio is important to an analysis of the financial condition of the Company. The securities portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Company; and (iv) it is an alternative interest-earning asset when loan demand is weak or when deposits grow more rapidly than loans.

The securities portfolio consists of securities classified as either held-to-maturity or available-for-sale. Securities available-for-sale consist primarily of state and municipal securities, mortgage-backed securities and U.S. government sponsored agency securities. We determine the appropriate classification at the time of purchase. All held-to-maturity securities are reported at amortized cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. All available-for-sale securities are reported at fair value.

Our securities portfolio decreased $13.1 million, or 1.8%, to $711.4 million at September 30, 2022, compared to $724.5 million at December 31, 2021. The increase was primarily due to $176.7 million in purchases, partially offset by $60.8 million in maturities, prepayments, and calls and a $126.1 million decline in the unrealized gain at September 30, 2022 as compared to December 31, 2021.

Certain securities have fair values less than amortized cost and, therefore, contain unrealized losses. During the three months ended September 30, 2022, the fair value of the Company's available for sale securities declined by $39.1 million, as a result of the significant increase in market interest rates during first nine months of 2022, which was attributed to the FOMC repeatedly raising their target benchmark interest rate in the first nine months of 2022, resulting in subsequent prime rate increases of 300 basis points between March and September of 2022. At September 30, 2022, we evaluated the securities which had an unrealized loss for other-than-temporary impairment and determined all declines in value to be temporary. We anticipate full recovery of amortized cost with respect to these securities by maturity, or sooner in the event of a more favorable market interest rate environment. We do not intend to sell these securities and it is not probable that we will be required to sell them before recovery of the amortized cost basis, which may be at maturity.

The following table sets forth certain information regarding contractual maturities and the weighted average yields of our investment securities as of the date presented. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligation with or without call or prepayment penalties.

	As of September 30, 2022							
	Due in One Year or Less		Due after One Year Through Five Years		Due after Five Years Through Ten Years		Due after Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in thousands)							
Available-for-sale								
State and municipal	$ 1,901	3.43%	$ 8,704	2.16%	$ 7,532	2.22%	$ 242,144	2.24%
Mortgage-backed securities	5	1.99%	3,008	1.98	54,125	2.21	388,174	2.20
Collateralized mortgage obligations	—	—	—	—	86,120	3.52	—	—
Asset-backed and other amortizing securities	—	—	—	—	1,758	2.92	20,408	2.81
Other securities	—	—	—	—	12,000	4.47	—	—
Total available-for-sale	$ 1,906	3.43%	$ 11,712	2.12%	$ 161,535	3.09%	$ 650,726	2.24%

	As of December 31, 2021							
	Due in One Year or Less		Due after One Year Through Five Years		Due after Five Years Through Ten Years		Due after Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in thousands)							
Available-for-sale								
State and municipal	$ 1,939	2.74%	$ 7,563	2.58%	$ 10,502	2.11%	$ 245,139	2.24%
Mortgage-backed securities	—	—	1,476	1.43	59,116	2.20	242,381	1.86
Collateralized mortgage obligations	—	—	—	—	106,733	0.56	—	—
Asset-backed and other amortizing securities	—	—	—	—	2,328	2.90	23,718	2.82
Other securities	—	—	—	—	12,000	4.47	—	—
Total available-for-sale	$ 1,939	2.74%	$ 9,039	2.39%	$ 190,679	1.43%	$ 511,238	2.09%

Deposits

Deposits represent the Company's primary and most vital source of funds. We offer a variety of deposit products including demand deposits accounts, interest-bearing products, savings accounts and certificate of deposits. We put continued effort into gathering noninterest-bearing demand deposit accounts through loan production, customer referrals, marketing staffs, mobile and online banking and various involvements with community networks.

Total deposits at September 30, 2022 were $3.46 billion, representing an increase of $119.3 million, or 3.6%, compared to $3.34 billion at December 31, 2021. The increase in total deposits since December 31, 2021 is primarily due to organic growth and customers maintaining higher balances. As of September 30, 2022, 36.5% of total deposits were comprised of noninterest-bearing demand accounts, 54.1% of interest-bearing non-maturity accounts and 9.4% of time deposits.

The following table shows the deposit mix as of the dates presented:

	September 30, 2022		December 31, 2021	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			
Noninterest-bearing deposits	$ 1,262,072	36.5%	$ 1,071,367	32.1%
NOW and other transaction accounts	353,871	10.2	395,322	11.8
Money market and other savings	1,518,485	43.9	1,534,795	45.9
Time deposits	326,108	9.4	339,738	10.2
Total deposits	$ 3,460,536	100.0%	$ 3,341,222	100.0%

Average deposit balances and weighted average rates paid on deposits, on an annualized basis, for the periods indicated are shown below.

	Three Months Ended September 30,			
	2022		2021	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
	(Dollars in thousands)			
Noninterest-bearing deposits	$ 1,248,804	0.00%	$ 1,035,910	0.00%
Interest-bearing deposits:				
NOW and interest-bearing demand accounts	345,048	0.62%	356,868	0.01%
Savings accounts	153,848	0.34%	134,436	0.09%
Money market accounts	1,374,890	0.82%	1,329,373	0.29%
Time deposits	330,133	1.23%	330,161	1.23%
Total interest-bearing deposits	2,203,919	0.82%	2,150,838	0.37%
Total deposits	$ 3,452,723	0.52%	$ 3,186,748	0.25%

	Nine Months Ended September 30,			
	2022		2021	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
	(Dollars in thousands)			
Noninterest-bearing deposits	$ 1,174,783	0.00%	$ 991,331	0.00%
Interest-bearing deposits:				
NOW and interest-bearing demand accounts	357,547	0.31%	349,646	0.03%
Savings accounts	150,133	0.18%	129,004	0.08%
Money market accounts	1,397,321	0.45%	1,355,463	0.31%
Time deposits	334,686	1.18%	326,862	1.27%
Total interest-bearing deposits	2,239,687	0.52%	2,160,975	0.39%
Total deposits	$ 3,414,470	0.34%	$ 3,152,306	0.27%

The scheduled maturities of uninsured certificates of deposits or other time deposits as of September 30, 2022 follows:

(Dollars in thousands)	Three Months	Three to Six Months	Six to 12 Months	After 12 Months	Total
	$ 37,983	$ 27,761	$ 12,920	$ 3,504	$ 82,168

The estimated amount of uninsured deposits as of September 30, 2022 was $1.15 billion.

Time deposits issued in amounts of more than $250 thousand represent the type of deposit most likely to affect the Company’s future earnings because of interest rate sensitivity. The effective cost of these funds is generally higher than other time deposits because the funds are usually obtained at premium rates of interest.

Borrowed Funds

In addition to deposits, we utilize advances from the FHLB and other borrowings as a supplementary funding source to finance our operations.

FHLB Advances. The FHLB allows us to borrow, both short and long-term, on a blanket floating lien status collateralized by first mortgage loans and commercial real estate loans as well as FHLB stock. At September 30, 2022 and December 31, 2021, we had total remaining borrowing capacity from the FHLB of $902.7 million and $903.9 million, respectively.

The following table sets forth our long-term FHLB borrowings as of and for the periods indicated:

	As of/For the Three Months Ended September 30,		As of/For the Nine Months Ended September 30,	
	2022	2021	2022	2021
	(Dollars in thousands)			
Amount outstanding at end of the period	$ —	$ —	$ —	$ —
Weighted average interest rate at end of the period	0.00%	0.00%	0.00%	0.00%
Maximum month-end balance during the period	$ —	$ —	$ —	$ 75,000
Average balance outstanding during the period	$ —	$ —	$ —	$ 26,188
Weighted average interest rate during the period	0.00%	0.00%	0.00%	0.19%

The Company has used FHLB letters of credit to pledge to certain public deposits. These letters of credit expired in July 2021 and the Company began pledging securities to these public funds rather than renewing the letters of credit. As a result, there were no FHLB letters of credit outstanding at September 30, 2022.

Federal Reserve Bank of Dallas. The Bank has a line of credit with the Federal Reserve Bank of Dallas (the “FRB”). The amount of the line is determined on a monthly basis by the FRB. The line is collateralized by a blanket floating lien on all agriculture, commercial and consumer loans. The amount of the line was $646.5 million and $593.6 million at September 30, 2022 and December 31, 2021, respectively. This line of credit was not used during the three or nine months ended September 30, 2022 or the same periods in 2021.

Lines of Credit. The Bank has uncollateralized lines of credit with multiple banks as a source of funding for liquidity management. The total amount of the lines was $160.0 million as of September 30, 2022 and December 31, 2021, respectively. The lines of credit were not used during the three or nine months ended September 30, 2022 or the three or nine months ended September 30, 2021.

Subordinated Debt Securities. The Company has subordinated debt securities that are intended to qualify for tier 2 capital treatment, subject to regulatory limitations. As of September 30, 2022, the total amount of subordinated debt securities outstanding was $76.5 million less approximately $604 thousand of remaining debt issuance costs for a total balance of $75.9 million.

Junior Subordinated Deferrable Interest Debentures and Trust Preferred Securities. Between March 2004 and June 2007, the Company formed three wholly-owned statutory business trusts solely for the purpose of issuing trust preferred securities, the proceeds of which were invested in junior subordinated deferrable interest debentures. The trusts are not consolidated and the debentures issued by the Company to the trusts are reflected in the Company's consolidated balance sheets. The Company records interest expense on the debentures in its consolidated financial statements. The amount of debentures outstanding was $46.4 million at September 30, 2022 and December 31, 2021. The Company has the right, as has been exercised in the past, to defer payments of interest on the securities for up to twenty consecutive quarters. During such time, corporate dividends may not be paid. The Company is current in its interest payments on the debentures.

The chart below indicates certain information, as of September 30, 2022, about each of the statutory trusts and the junior subordinated deferrable interest debentures, including the date the junior subordinated deferrable interest debentures were issued, outstanding amounts of trust preferred securities and junior subordinated deferrable interest debentures, the maturity date of the junior subordinated deferrable interest debentures, the interest rates on the junior subordinated deferrable interest debentures and the investment banker.

Name of Trust	**Issue Date**	**Amount of Trust Preferred Securities**	**Amount of Debentures**	**Stated Maturity Date of Trust Preferred Securities and Debentures(1)**	**Interest Rate of Trust Preferred Securities and Debentures(2)(3)**
			(Dollars in thousands)		
South Plains Financial Capital Trust III	2004	$ 10,000	$ 10,310	2034	3-mo. LIBOR + 265 bps; 3.83%
South Plains Financial Capital Trust IV	2005	20,000	20,619	2035	3-mo. LIBOR + 139 bps; 3.22%
South Plains Financial Capital Trust V	2007	15,000	15,464	2037	3-mo. LIBOR + 150 bps; 3.33%
Total		$ 45,000	$ 46,393		

(1) May be redeemed at the Company's option.
(2) Interest payable quarterly with principal due at maturity.
(3) Rate as of last reset date, prior to September 30, 2022.

Liquidity and Capital Resources

Liquidity

Liquidity refers to the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital and strategic cash flow needs, all at a reasonable cost. We continuously monitor our liquidity position to ensure that assets and liabilities are managed in a manner that will meet all short-term and long-term cash requirements. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders.

Interest rate sensitivity involves the relationships between rate-sensitive assets and liabilities and is an indication of the probable effects of interest rate fluctuations on the Company's net interest income. Interest rate-sensitive assets and liabilities are those with yields or rates that are subject to change within a future time period due to maturity or changes in market rates. The model is used to project future net interest income under a set of possible interest rate movements. The Company's Investment/Asset Liability Committee ("ALCO Committee") reviews this information to determine if the projected future net interest income levels would be acceptable. The Company attempts to stay within acceptable net interest income levels.

Our liquidity position is supported by management of liquid assets and access to alternative sources of funds. Our liquid assets include cash, interest-bearing deposits in correspondent banks, federal funds sold, and fair value of unpledged investment securities. Other available sources of liquidity include wholesale deposits, and additional borrowings from correspondent banks, FHLB advances, and the Federal Reserve discount window.

Our short-term and long-term liquidity requirements are primarily met through cash flow from operations, redeployment of prepaying and maturing balances in our loan and investment portfolios, and increases in customer deposits. Other alternative sources of funds will supplement these primary sources to the extent necessary to meet additional liquidity requirements on either a short-term or long-term basis.

We believe that we will be able to meet our contractual obligations as they come due through the maintenance of adequate cash levels. We expect to maintain adequate cash levels through profitability, loan and securities repayment and maturity activity and continued deposit gathering activities. We have in place various borrowing mechanisms for both short-term and long-term liquidity needs.

Capital Requirements

Total stockholders’ equity decreased to $341.8 million as of September 30, 2022, compared to $407.4 million as of December 31, 2021, a decrease of $65.6 million, or 16.1%. The decrease from December 31, 2021 was primarily the result of a decrease in accumulated other comprehensive income (“AOCI”) of $87.2 million, net of tax, repurchases of common stock of $18.9 million and $6.0 million of dividends paid, partially offset by $45.6 million in net earnings, for the nine months ended September 30, 2022 . The decrease in AOCI was attributed to the decline in fair value of our available for sale securities and fair value hedges, net of tax, as a result of the rising interest rate environment.

We are subject to various regulatory capital requirements administered by the federal and state banking regulators. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for “prompt corrective action” (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies. The capital amounts and classifications are subject to qualitative judgments by the federal banking regulators about components, risk weightings and other factors. Qualitative measures established by regulation to ensure capital adequacy required us to maintain minimum amounts and ratio of common equity tier 1 (“CET1”) capital, tier 1 capital and total capital to risk-weighted assets and of tier 1 capital to average consolidated assets, referred to as the “leverage ratio.”

The risk-based capital ratios measure the adequacy of a bank’s capital against the riskiness of its assets and off-balance sheet activities. Failure to maintain adequate capital is a basis for “prompt corrective action” or other regulatory enforcement action. In assessing a bank’s capital adequacy, regulators also consider other factors such as interest rate risk exposure; liquidity, funding and market risks; quality and level of earnings; concentrations of credit, quality of loans and investments; risks of any nontraditional activities; effectiveness of bank policies; and management’s overall ability to monitor and control risks.

At September 30, 2022, both we and the Bank met all the capital adequacy requirements to which we and the Bank were subject. At September 30, 2022, we and the Bank were “well capitalized” under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since September 30, 2022 that would materially adversely change such capital classifications. From time to time, we may need to raise additional capital to support our and the Bank’s further growth and to maintain our “well capitalized” status.

The following table presents our and the Bank’s regulatory capital ratios as of the dates indicated.

	September 30, 2022		December 31, 2021	
	Amount	**Ratio**	**Amount**	**Ratio**
	(Dollars in thousands)			
South Plains Financial, Inc.:				
Total capital (to risk-weighted assets)	$ 551,832	16.46%	$ 524,836	18.40%
Tier 1 capital (to risk-weighted assets)	436,081	13.01	413,322	14.49
CET1 capital (to risk-weighted assets)	391,081	11.67	368,322	12.91
Tier 1 capital (to average assets)	436,081	10.95	413,322	10.77
City Bank:				
Total capital (to risk-weighted assets)	$ 448,194	13.37%	$ 425,748	14.93%
Tier 1 capital (to risk-weighted assets)	408,357	12.18	390,015	13.67
CET1 capital (to risk-weighted assets)	408,357	12.18	390,015	13.67
Tier 1 capital (to average assets)	408,357	10.26	390,015	10.16

Community Bank Leverage Ratio

On September 17, 2019, the federal banking agencies jointly finalized a rule to be effective January 1, 2020 and intended to simplify the regulatory capital requirements described above for qualifying community banking organizations that opt into the Community Bank Leverage Ratio (“CBLR”) framework, as required by Section 201 of the EGRRCPA. The final rule became effective on January 1, 2020, and the CBLR framework became available for banks to use beginning with their March 31, 2020 Call Reports. Under the final rule, if a qualifying community banking organization opts into the CBLR framework and meets all requirements under the framework, it will be considered to have met the well-capitalized ratio requirements under the “prompt corrective action” regulations described above and will not be required to report or calculate risk-based capital. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 9%, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. Although the Company and the Bank are qualifying community banking organizations, the Company and the Bank have elected not to opt in to the CBLR framework at this time and will continue to follow the Basel III capital requirements as described above.

Treasury Stock

The Company repurchased stock in accordance with its stock repurchase program during the three and nine months ended September 30, 2022 and 2021. For the three months ended September 30, 2022, we repurchased 366,127 shares of common stock for a total of $9.7 million. For the nine months ended September 30, 2022, we repurchased 729,613 shares of common stock for a total of $18.9 million. These shares were retired immediately upon repurchase and not included in treasury stock. See Part II, Item 2, "Unregistered Sales of Equity Securities and Use of Proceeds," of this Form 10-Q for further information.

Interest Rate Sensitivity and Market Risk

As a financial institution, our primary component of market risk is interest rate volatility. Our interest rate risk policy provides management with the guidelines for effective funds management, and we have established a measurement system for monitoring our net interest rate sensitivity position. We have historically managed our sensitivity position within our established guidelines.

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 of 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 manage our exposure to interest rates by structuring our balance sheet in the ordinary course of business. Based upon the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Our exposure to interest rate risk is managed by the ALCO Committee, in accordance with policies approved by the Bank's Board. The ALCO Committee formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO Committee considers the impact on earnings and capital on the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO Committee 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, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO Committee reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management employs methodologies to manage interest rate risk, which include an analysis of relationships between interest-earning assets and interest-bearing liabilities and an interest rate shock simulation model.

We use interest rate risk simulation models and shock analyses to test the interest rate sensitivity of net interest income and fair value of equity, and the impact of changes in interest rates on other financial metrics. Contractual maturities and re-pricing opportunities of loans are incorporated in the model. The average lives of non-maturity deposit accounts are based on decay assumptions and are incorporated into the model. All of the assumptions used in our analyses 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.

On a quarterly basis, we run a simulation model for a static balance sheet and other scenarios. These models test the impact on net interest income from changes in market interest rates under various scenarios. Under the static model, rates are shocked instantaneously and ramped rates change over a 12-month and 24-month horizon based upon parallel and non-parallel yield curve shifts. Parallel shock scenarios assume instantaneous parallel movements in the yield curve compared to a flat yield curve scenario. Non-parallel simulation involves analysis of interest income and expense under various changes in the shape of the yield curve. Our internal policy regarding internal rate risk simulations currently specifies that for gradual parallel shifts of the yield curve, estimated net interest income at risk for the subsequent one-year period should not decline by more than 7.5% for a 100 basis point shift, 15% for a 200 basis point shift, and 22.5% for a 300 basis point shift.

The following tables summarize the simulated change in net interest income over a 12-month horizon as of the dates indicated:

	September 30, 2022	December 31, 2021
Change in Interest Rates (Basis Points)	Percent Change in Net Interest Income	Percent Change in Net Interest Income
+300	2.03%	6.89%
+200	1.29%	4.53%
+100	0.74%	2.02%
-100	(1.96)%	(1.05)%

Impact of Inflation

Our consolidated financial statements and related notes included elsewhere in this Form 10-Q have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). GAAP requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

The Company's asset and liability structure is substantially different from that of an industrial company in that virtually all assets and liabilities of the Company are monetary in nature. Management believes the impact of inflation on financial results depends upon the Company's ability to react to changes in interest rates and by such reaction, reduce the inflationary impact on performance. Interest rates do not necessarily move in the same direction, or at the same magnitude, as the prices of other goods and services. However, other operating expenses do reflect general levels of inflation. Management seeks to manage the relationship between interest rate-sensitive assets and liabilities in order to protect against wide net interest income fluctuations, including those resulting from inflation.
Various information shown elsewhere in this Report will assist in the understanding of how well the Company is positioned to react to changing interest rates and inflationary trends. In particular, additional information related to the Company's interest rate-sensitive assets and liabilities is contained in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Report under the heading "Interest Rate Sensitivity and Market Risk."

Non-GAAP Financial Measures

Our accounting and reporting policies conform to GAAP and the prevailing practices in the banking industry. However, we also evaluate our performance based on certain additional financial measures discussed in this Report as being non-GAAP financial measures. 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 GAAP as in effect from time to time in the U.S. in our statements of income, balance sheets 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 Report 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 Report may differ from that of other companies reporting measures with similar names. It is important to understand how other banking organizations calculate their financial measures with names similar to the non-GAAP financial measures we have discussed in this Report when comparing such non-GAAP financial measures.

Tangible Book Value Per Common Share. Tangible book value per share is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. The most directly comparable GAAP financial measure for tangible book value per common share is book value per common share. We believe that the tangible book value per common share measure is important to many investors in the marketplace who are interested in changes from period to period in book value per common share exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing total book value while not increasing our tangible book value.

Tangible Common Equity to Tangible Assets. Tangible common equity to tangible assets is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. We calculate tangible common equity, as described above, and tangible assets as total assets less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization. The most directly comparable GAAP financial measure for tangible common equity to tangible assets is total common stockholders' equity to total assets. We believe that this measure is important to many investors in the marketplace who are interested in the relative changes from period to period of tangible common equity to tangible assets, each exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing both total stockholders' equity and assets while not increasing our tangible common equity or tangible assets.

The following table reconciles, as of the dates set forth below, total stockholders' equity to tangible common equity and total assets to tangible assets and then presents book value per common share, tangible book value per common share, total stockholders' equity to total assets, and tangible common equity to tangible assets:

	September 30, 2022	December 31, 2021
	(Dollars in thousands)	
Total stockholders' equity	$ 341,799	$ 407,427
Less: Goodwill and other intangibles	(24,228)	(25,403)
Tangible common equity	$ 317,571	$ 382,024
Total assets	$ 3,992,690	$ 3,901,855
Less: Goodwill and other intangibles	(24,228)	(25,403)
Tangible assets	$ 3,968,462	$ 3,876,452
Shares outstanding	17,064,640	17,760,243
Total stockholders' equity to total assets	8.56%	10.44%
Tangible common equity to tangible assets	8.00%	9.85%
Book value per share	$ 20.03	$ 22.94
Tangible book value per share	$ 18.61	$ 21.51

Critical Accounting Policies and Estimates

Our accounting and reporting policies conform to GAAP and conform to general practices within the industry in which we operate. To prepare financial statements in conformity with GAAP, management makes estimates, assumptions and judgments based on available information. These estimates, assumptions and judgments affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements and, as this information changes, actual results could differ from the estimates, assumptions and judgments reflected in the consolidated financial statements. In particular, management has identified several accounting policies that, due to the estimates, assumptions and judgments inherent in those policies, are critical in understanding our consolidated financial statements.

The Jumpstart Our Business Startups Act (the “JOBS Act”) permits us an extended transition period for complying with new or revised accounting standards affecting public companies. We have elected to take advantage of this extended transition period, which means that the consolidated financial statements included in this Form 10-Q, as well as any financial statements that we file in the future, will not be subject to all new or revised accounting standards generally applicable to public companies for the transition period for so long as we remain an emerging growth company or until we affirmatively and irrevocably opt out of the extended transition period under the JOBS Act.

The following is a discussion of the critical accounting policies and significant estimates that we believe require us to make the most complex or subjective decisions or assessments. Additional information about these policies can be found in Note 1 of the Company’s consolidated financial statements as of September 30, 2022.

Securities. Investment securities may be classified into trading, held-to-maturity, or available-for-sale portfolios. Securities that are held principally for resale in the near term are classified as trading. Securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as trading or held-to-maturity are available-for-sale and are reported at fair value with unrealized gains and losses excluded from earnings, but included in the determination of other comprehensive income (loss). Management uses these assets as part of its asset/liability management strategy; they may be sold in response to changes in liquidity needs, interest rates, resultant prepayment risk changes, and other factors. Management determines the appropriate classification of securities at the time of purchase. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain or loss on sale of securities. The cost of securities sold is based on the specific identification method.

Loans. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans, and premiums or discounts on purchased loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the straight-line method, which is not materially different from the effective interest method required by GAAP.

Loans are placed on non-accrual status when, in management’s opinion, collection of interest is unlikely, which typically occurs when principal or interest payments are more than ninety days past due. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company’s allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and general valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. The Bank's loans are generally secured by specific items of collateral including real property, crops, livestock, consumer assets, and other business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on various factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. All loans rated substandard or worse and greater than $250 thousand are specifically reviewed to determine if they are impaired. Factors considered by management in determining whether a loan is impaired include payment status and the sources, amounts, and probabilities of estimated cash flow available to service debt in relation to amounts due according to contractual terms. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans that are determined to be impaired are then evaluated to determine estimated impairment, if any. GAAP allows impairment to be measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Loans that are not individually determined to be impaired or are not subject to the specific review of impaired status are subject to the general valuation allowance portion of the allowance for loan losses.

Loans Held for Sale. Loans held for sale are comprised of residential mortgage loans. Loans that are originated for best efforts delivery are carried at the lower of aggregate cost or fair value as determined by aggregate outstanding commitments from investors or current investor yield requirements. All other loans held for sale are carried at fair value. Loans sold are typically subject to certain indemnification provisions with the investor; management does not believe these provisions will have any significant consequences.

Mortgage Servicing Rights Asset. When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in net gain on sale of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates present value of estimated future servicing income.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports change in fair value of servicing assets in earnings in the period in which the changes occur, and are included with other noninterest income in the consolidated financial statements. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Goodwill and Other Intangible Assets. Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least annually or more frequently if events and circumstances exist that indicate that an impairment test should be performed. Intangible assets with definite lives are amortized over their estimated useful lives.

Recently Issued Accounting Pronouncements

See Note 1, Summary of Significant Accounting Policies, in the notes to the consolidated financial statements included elsewhere in this Form 10-Q regarding the impact of new accounting pronouncements which we have adopted.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The Company manages market risk, which, as a financial institution is primarily interest rate volatility, through the ALCO Committee of the Bank, in accordance with policies approved by its board of directors. The Company uses an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and fair value of equity, and the impact of changes in interest rates on other financial metrics. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Interest Rate Sensitivity and Market Risk” herein for a discussion of how we manage market risk.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this 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 any 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, or the Exchange Act) were effective as of the end of the period covered by this Form 10-Q.

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) that occurred during the three months ended September 30, 2022 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

The Company and its subsidiaries are subject to various legal actions, as described in our Annual Report on Form 10-K for the year ended December 31, 2021 (the "2021 Annual Report on Form 10-K") filed with the SEC on March 8, 2022.

As previously disclosed, in response to a Notice of Termination received from Kasasa, Ltd. f/k/a Moneyvue Financial, Inc., Bankvue Financial, Inc., and BancVue, Ltd. ("Kasasa") purporting to terminate a Software License and Maintenance Agreement (the "Software License Agreement"), Trademark License Agreement (the "Trademark License Agreement"), and Addendum to Software License Agreement ("Addendum") between the Company's wholly-owned banking subsidiary City Bank (the "Bank") and Kasasa, the Bank filed suit against Kasasa in Travis County, Texas, styled City Bank v. Kasasa, Ltd., Cause No. D-1-GN-20-003630, 53rd Judicial District, Travis County, Texas.

On or about September 23, 2022, the parties entered into a Settlement Agreement and Mutual Release (the "Settlement Agreement"), pursuant to which the parties agreed to the settlement and release of all claims related to the Software License Agreement, Trademark License Agreement, and Addendum, including all claims and counterclaims in the lawsuit. Thereafter, the parties filed a joint motion to dismiss with prejudice and the court formally dismissed the case by order dated October 7, 2022.

Except as described above or in our 2021 Annual Report on Form 10-K, we are not presently involved in any other litigation, nor to our knowledge is any litigation threatened against us, that in management's opinion would result in any material adverse effect on our financial position or results of operations or that is not expected to be covered by insurance.

Item 1A. Risk Factors

In evaluating an investment in any of our securities, investors should consider carefully, among other things, information under the heading "Cautionary Notice Regarding Forward-Looking Statements" in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of this Form 10-Q and the risk factors previously disclosed under the heading "Risk Factors" in Part I, Item 1A of our 2021 Annual Report on Form 10-K. There have been no material changes in the risk factors disclosed by the Company in the 2021 Annual Report on Form 10-K.

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

Issuer Purchases of Equity Securities

On October 29, 2021, the Company's board of directors approved a stock repurchase program, effective November 6, 2021, pursuant to which the Company may, from time to time, purchase up to $10.0 million of its outstanding shares of common stock (the "Repurchase Program"). The Repurchase Program had an expiration date of November 6, 2022. On May 18, 2022, the Company's board of directors approved a stock repurchase program pursuant to which the Company may, from time to time, purchase up to $15.0 million of its outstanding shares of common stock (the "New Repurchase Program"). The New Repurchase Program became effective on the date which the Repurchase Program expired due to depletion of funds previously allocated to it. The shares may be repurchased from time to time in privately negotiated transactions or the open market, including pursuant to a Rule 10b5-1 trading plan adopted by the Company, and in accordance with applicable regulations of the SEC. The Company is not obligated to purchase any shares of its common stock under the New Repurchase Program, and the timing and exact amount of any repurchases will depend on various factors, including the performance of the Company's stock price, general market and other conditions, applicable legal requirements and other factors. The New Repurchase Program may be terminated or amended by the Company's board of directors at any time prior to the expiration date, which is May 21, 2023.

The following table summarizes the share repurchase activity for the three months ended September 30, 2022.

	Total Shares Repurchased	Average Price Paid Per Share	Total Dollar Amount Purchased Pursuant to Publicly-Announced Plan	Maximum Dollar Amount Remaining Available for Repurchase Pursuant to Publicly-Announced Plan
July 2022	42,125	$ 24.04	$ 1,012,803	$ 12,500,532
August 2022	194,852	26.46	5,155,013	7,345,519
September 2022	129,150	27.49	3,550,729	3,794,789
Total	366,127			

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
3.1	Amended and Restated Certificate of Formation of South Plains Financial, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Form S-1 filed with the SEC on April 12, 2019) (File No. 333-230851).
3.2	Second Amended and Restated Bylaws of South Plains Financial, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on November 1, 2021) (File No. 001-38895).
31.1*	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following material from South Plains Financial, Inc.'s Form 10-Q for the quarter ended September 30, 2022, formatted in XBRL (eXtensible Business Reporting Language), filed herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Statements of Changes in Stockholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Unaudited Consolidated Financial Statements.

* Filed with this Form 10-Q

** Furnished with this Form 10-Q

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.

		South Plains Financial, Inc.
Date: November 8, 2022	By:	/s/ Curtis C. Griffith
		Curtis C. Griffith
		Chairman and Chief Executive Officer
Date: November 8, 2022	By:	/s/ Steven B. Crockett
		Steven B. Crockett
		Chief Financial Officer and Treasurer

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Curtis C. Griffith, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of South Plains Financial, Inc. (the “registrant”) for the quarter ended September 30, 2022 (this “report”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 8, 2022

By: /s/ Curtis C. Griffith
Curtis C. Griffith
Chairman and Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Steven B. Crockett, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of South Plains Financial, Inc. (the "registrant") for the quarter ended September 30, 2022 (this "report");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2022	By:	/s/ Steven B. Crockett
		Steven B. Crockett
		Chief Financial Officer

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 on Form 10-Q of South Plains Financial, Inc. (the “Company”) for the quarter ended September 30, 2022 (the “Report”), as filed with the Securities and Exchange Commission on the date hereof, I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or Section 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 results of operations of the Company.

Date: November 8, 2022

By: /s/ Curtis C. Griffith
Curtis C. Griffith
Chairman and Chief Executive Officer

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 on Form 10-Q of South Plains Financial, Inc. (the “Company”) for the quarter ended September 30, 2022 (the “Report”), as filed with the Securities and Exchange Commission on the date hereof, I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or Section 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 results of operations of the Company.

Date: November 8, 2022

By: /s/ Steven B. Crockett
Steven B. Crockett
Chief Financial Officer