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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2023

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: 001-37886

CAPSTAR FINANCIAL HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Tennessee **(State or other jurisdiction of incorporation or organization)**	**81-1527911** **(IRS Employer Identification No.)**
1201 Demonbreun Street, Suite 700 **Nashville, Tennessee** **(Address of principal executive offices)**	**37203** **(zip code)**

(615) 732-6400

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $1.00 par value per share	**CSTR**	**Nasdaq Global Select Market**

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

None

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 ☒

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

	Shares outstanding as of November 1, 2023
Common Stock, par value $1.00 per share	20,711,969

CAPSTAR FINANCIAL HOLDINGS, INC.
QUARTERLY REPORT ON FORM 10-Q
TABLE OF CONTENTS

TERMINOLOGY

The terms “we,” “our,” “us,” “CapStar,” “the Company,” “CSTR” and “CapStar Financial” that appear in this Quarterly Report on Form 10-Q (this “Report”) refer to CapStar Financial Holdings, Inc. and its wholly-owned subsidiary, CapStar Bank, which we sometimes refer to as “CapStar Bank,” “our bank subsidiary,” “the Bank” and “our Bank”. The term “Old National” refers to Old National Bancorp, an Indiana corporation.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (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, statements relating to the Company’s assets, business, cash flows, condition (financial or otherwise), credit quality, financial performance, liquidity, short and long-term performance goals, prospects, results of operations, strategic initiatives, the benefits, cost and synergies of completed acquisitions or dispositions, and the timing, benefits, costs and synergies of future acquisitions, disposition and other growth opportunities. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “aspire,” “estimate,” “intend,” “plan,” “project,” “projection,” “forecast,” “roadmap,” “goal,” “target,” “would,” and “outlook,” or the negative version of those words or other comparable words of a future or forward-looking nature. Forward-looking statements express only management's beliefs regarding future results or events and are subject to inherent uncertainty, risks and changes in circumstances, many of which are outside of management's control. Uncertainty, risks, changes in circumstances and other factors could cause the Company's actual results to differ materially from those projected in the forward-looking statements. Factors that could cause actual results to differ from those discussed in such forward-looking statements include, but are not limited to: (1) difficulty attracting and retaining highly-effective employees; (2) our ability to successfully execute our business plan; (3) difficulty growing or sustaining deposit and loan balances; (4) changes in consumer preferences, spending and borrowing habits, and demand for our products and services; (5) negative economic and political conditions that adversely affect the general economy, especially in the communities and markets in which we conduct our business, the banking sector, housing prices, the real estate market, the job market, consumer confidence, the financial condition of our borrowers and consumer spending habits, which may affect, among other things, the levels of non-performing assets, charge-offs and provision expense; (6) credit risk, including the risk that negative credit quality trends may lead to a deterioration of asset quality, risk that our allowance for credit losses may not be sufficient to absorb actual losses in our loan portfolio, and risk from concentrations within our loan portfolio; (7) market risk, including interest rate and liquidity risk; (8) operational risk, including cybersecurity risk and risk of fraud, data processing system failures, and network breaches; (9) increased competition, including competition from non-bank financial institutions; (10) changes in regulations, laws, taxes, government policies, monetary policies and accounting policies affecting bank holding companies and their subsidiaries; (11) regulatory enforcement actions and adverse legal actions; (12) other economic, competitive, technological, operational, governmental, regulatory, and market factors affecting our operations; and (13) risks relating to our proposed acquisition by Old National Bancorp, including, without limitation, (i) the risk that the proposed merger may not be completed in a timely manner or at all; (ii) the failure to satisfy the conditions to the consummation of the proposed merger, including obtaining the requisite approval of the Company’s shareholders or required regulatory approvals within the time period provided in the merger agreement; (iii) the occurrence of any event, change or other circumstance that could give rise to the termination of the merger agreement; (iv) effect of the announcement or pendency of the proposed merger on the Company’s business relationships, operating results and business generally; (v) risks that the proposed transaction disrupts current plans and operations of the Company; (vi) potential difficulties in retaining the Company’s customers and employees as a result of the proposed transaction; (vii) diversion of management’s attention from ongoing business operations and opportunities; (viii) certain restrictions during the pendency of the proposed transaction that may impact the Company’s ability to pursue certain business opportunities; and (ix) expected cost savings, synergies and other financial benefits from the merger not being realized within the expected time frames and costs or difficulties relating to integration matters being greater than expected. The foregoing factors should not be construed as exhaustive and should be read in conjunction with the section entitled “Risk Factors” included in this Report. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from our forward-looking statements. Accordingly, you should not place undue reliance on any such forward-looking statements. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with the section entitled “Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2022 (the “2022 Form 10-K”) and in future reports that we file with the Securities and Exchange Commission. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from our forward-looking statements. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date of this Report, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by law. New risks and uncertainties may emerge from time to time, and it is not possible for us to predict their occurrence or how they will affect us.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Balance Sheets
(In thousands, except share data)

	September 30, 2023 (unaudited)	December 31, 2022
Assets		
Cash and due from banks	$ 21,403	$ 25,280
Interest-bearing deposits in financial institutions	322,076	105,558
Federal funds sold	8,914	4,467
Total cash and cash equivalents	352,393	135,305
Securities available-for-sale, at fair value net of allowance for credit losses of $2,000 and $0 at September 30, 2023 and December 31, 2022, respectively	354,024	396,416
Securities held-to-maturity, fair value of $0 and $1,240 at September 30, 2023 and December 31, 2022, respectively	—	1,240
Loans held for sale, includes $15,981 and $12,636 measured at fair value at September 30, 2023 and December 31, 2022, respectively	36,391	44,708
Loans held for investment	2,292,241	2,312,798
Less allowance for credit losses on loans	(24,157)	(23,806)
Loans, net	2,268,084	2,288,992
Premises and equipment, net	23,150	24,855
Restricted equity securities	13,441	16,632
Accrued interest receivable	12,299	10,511
Goodwill and other intangibles	44,965	46,069
Other real estate owned, net	11	—
Other assets	159,782	152,441
Total assets	$ 3,264,540	$ 3,117,169
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing	$ 432,203	$ 512,076
Interest-bearing	947,998	749,857
Savings and money market accounts	618,609	709,190
Time	797,870	708,696
Total deposits	2,796,680	2,679,819
Federal Home Loan Bank advances	50,000	15,000
Subordinated notes	29,766	29,666
Other liabilities	42,455	38,502
Total liabilities	2,918,901	2,762,987
Shareholders' equity:		
Common stock, voting, $1 par value; 25,000,000 shares authorized; 20,739,942 and 21,714,380 shares issued and outstanding at September 30, 2023 and December 31, 2022, respectively	20,740	21,714
Additional paid-in capital	227,195	240,863
Retained earnings	154,696	141,657
Accumulated other comprehensive loss, net of tax	(56,992)	(50,052)
Total shareholders' equity	345,639	354,182
Total liabilities and shareholders' equity	$ 3,264,540	$ 3,117,169

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Income (Unaudited)
(In thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Interest income:				
Loans, including fees	$ 35,441	$ 27,335	$ 102,215	$ 71,476
Securities:				
Taxable	1,964	1,966	5,940	5,643
Tax-exempt	301	314	923	958
Federal funds sold	40	7	163	31
Restricted equity securities	300	215	788	544
Interest-bearing deposits in financial institutions	3,218	617	6,305	1,076
Total interest income	41,264	30,454	116,334	79,728
Interest expense:				
Interest-bearing deposits	6,672	1,205	14,092	2,279
Savings and money market accounts	4,393	1,603	10,906	2,401
Time deposits	8,777	1,332	21,713	2,271
Federal funds purchased	—	2	—	2
Federal Home Loan Bank advances	660	365	2,283	461
Subordinated notes	393	394	1,181	1,181
Total interest expense	20,895	4,901	50,175	8,595
Net interest income	20,369	25,553	66,159	71,133
Provision for credit losses:				
(Recovery of) provision for credit losses on loans	(1,017)	867	(447)	926
Provision for credit losses on available-for-sale securities	—	—	2,000	—
Recovery of provision for credit losses on unfunded commitments	(544)	—	(650)	—
Total (recovery of) provision for credit losses	(1,561)	867	903	926
Net interest income after provision for credit losses	21,930	24,686	65,256	70,207
Noninterest income:				
Deposit service charges	1,347	1,251	3,979	3,575
Interchange and debit card transaction fees	1,195	1,245	3,293	3,803
Mortgage banking	749	765	2,997	4,436
Tri-Net	19	(2,059)	46	39
Wealth management	441	385	1,241	1,284
SBA lending	531	560	2,599	1,054
Net gain on sale of securities	—	7	5	8
Other noninterest income	1,996	1,118	4,605	4,038
Total noninterest income	6,278	3,272	18,765	18,237
Noninterest expense:				
Salaries and employee benefits	9,573	8,712	30,447	28,191
Data processing and software	3,245	2,861	9,750	8,355
Occupancy	1,161	1,092	3,451	3,266
Equipment	591	743	2,087	2,235
Professional services	674	468	2,361	1,653
Regulatory fees	435	269	1,267	814
Amortization of intangibles	352	415	1,104	1,291
Other noninterest expense	1,041	3,371	4,831	6,935
Total noninterest expense	17,072	17,931	55,298	52,740
Income before income taxes	11,136	10,027	28,723	35,704
Income tax expense	2,211	1,988	5,548	7,018
Net income	$ 8,925	$ 8,039	$ 23,175	$ 28,686
Per share information:				
Basic net income per share of common stock	$ 0.43	$ 0.37	$ 1.10	$ 1.30
Diluted net income per share of common stock	$ 0.43	$ 0.37	$ 1.09	$ 1.30
Weighted average shares outstanding:				
Basic	20,808,677	21,938,259	21,142,177	22,051,950
Diluted	20,823,971	21,988,085	21,172,712	22,104,687

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net income	$ 8,925	$ 8,039	$ 23,175	$ 28,686
Other comprehensive income (loss):				
Unrealized gains (losses) on securities available-for-sale:				
Unrealized losses arising during the period	(9,220)	(22,230)	(9,369)	(68,202)
Reclassification adjustment for gains included in net income	—	(8)	(5)	(8)
Tax effect	2,388	5,784	2,434	17,700
Other comprehensive loss, net of tax	(6,832)	(16,454)	(6,940)	(50,510)
Comprehensive income (loss)	$ 2,093	$ (8,415)	$ 16,235	$ (21,824)

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(In thousands, except share and per share data)

	Common Stock, voting		Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total shareholders' equity
	Shares	Amount				
Balance December 31, 2021	22,166,129	$ 22,166	$ 248,709	$ 110,489	$ (1,270)	$ 380,094
Net restricted common stock activity	65,550	66	(153)	—	—	(87)
Stock-based compensation expense	—	—	388	—	—	388
Repurchase of common stock	(36,608)	(37)	(730)	—	—	(767)
Common stock dividends declared ($0.06 per share)	—	—	—	(1,320)	—	(1,320)
Net income	—	—	—	10,673	—	10,673
Other comprehensive loss	—	—	—	—	(20,064)	(20,064)
Balance March 31, 2022	22,195,071	22,195	248,214	119,842	(21,334)	368,917
Net restricted common stock activity	(3,719)	(4)	4	—	—	—
Stock-based compensation expense	—	—	325	—	—	325
Net exercise of common stock options	5,800	6	45	—	—	51
Repurchase of common stock	(262,598)	(263)	(5,091)	—	—	(5,354)
Common stock dividends declared ($0.10 per share)	—	—	—	(2,184)	—	(2,184)
Net income	—	—	—	9,972	—	9,972
Other comprehensive loss	—	—	—	—	(13,992)	(13,992)
Balance June 30, 2022	21,934,554	21,934	243,497	127,630	(35,326)	357,735
Net restricted common stock activity	(2,930)	(2)	(39)	—	—	(41)
Stock-based compensation expense	—	—	258	—	—	258
Common stock dividends declared ($0.10 per share)	—	—	—	(2,172)	—	(2,172)
Net income	—	—	—	8,039	—	8,039
Other comprehensive loss	—	—	—	—	(16,454)	(16,454)
Balance September 30, 2022	21,931,624	$ 21,932	$ 243,716	$ 133,497	$ (51,780)	$ 347,365
Balance December 31, 2022	21,714,380	$ 21,714	$ 240,863	$ 141,657	$ (50,052)	$ 354,182
Net restricted common stock activity	113,068	113	(211)	—	—	(98)
Stock-based compensation expense	—	—	399	—	—	399
Repurchase of common stock	(465,834)	(465)	(7,174)	—	—	(7,639)
Common stock dividends declared ($0.10 per share)	—	—	—	(2,136)	—	(2,136)
Net income	—	—	—	6,446	—	6,446
Other comprehensive income	—	—	—	—	6,201	6,201
Adoption of new accounting standard, net of tax	—	—	—	(3,444)	—	(3,444)
Balance at March 31, 2023	21,361,614	21,362	233,877	142,523	(43,851)	353,911
Net restricted common stock activity	(30,900)	(32)	31	—	—	(1)
Stock-based compensation expense	—	—	361	—	—	361
Net exercise of common stock options	7,600	8	59	—	—	67
Repurchase of common stock	(453,822)	(454)	(5,623)	—	—	(6,077)
Common stock dividends declared ($0.11 per share)	—	—	—	(2,291)	—	(2,291)
Net income	—	—	—	7,804	—	7,804
Other comprehensive loss	—	—	—	—	(6,309)	(6,309)
Balance at June 30, 2023	20,884,492	20,884	228,705	148,036	(50,160)	347,465
Net restricted common stock activity	(12,061)	(12)	(61)	-	-	(73)
Stock-based compensation expense	-	-	426	-	-	426
Net exercise of common stock options	7,621	8	60	-	-	68
Repurchase of common stock	(140,110)	(140)	(1,935)	-	-	(2,075)
Common stock dividends declared ($0.11 per share)	-	-	-	(2,265)	-	(2,265)
Net income	-	-	-	8,925	-	8,925
Other comprehensive loss	-	-	-	-	(6,832)	(6,832)
Balance at September 30, 2023	20,739,942	$ 20,740	$ 227,195	$ 154,696	$ (56,992)	$ 345,639

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2023	2022
Cash flows from operating activities:		
Net income	$ 23,175	$ 28,686
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for credit losses	903	926
Amortization of discounts on acquired loans and deferred fees, net	373	473
Depreciation and amortization	2,186	2,391
Net amortization of premiums on investment securities	1,079	1,426
Net gain on sale of securities	(5)	(8)
Mortgage banking	(2,997)	(4,436)
Tri-Net	(46)	(39)
SBA lending	(2,599)	(1,054)
Net gain on disposal of premises and equipment	(5)	(14)
Net gain on sale of other real estate owned	—	(7)
Stock-based compensation	1,186	971
Deferred income tax expense	(403)	2,394
Origination of loans held for sale	(200,616)	(533,326)
Proceeds from loans held for sale	214,575	448,369
Cash payments arising from operating leases	(910)	(1,633)
Amortization of debt issuance expense	100	101
Net increase in accrued interest receivable and other assets	(4,271)	(7,098)
Net decrease in accrued interest payable and other liabilities	531	(4,674)
Net cash provided by (used in) operating activities	32,256	(66,552)
Cash flows from investing activities:		
Activities in securities available-for-sale:		
Purchases	—	(66,512)
Sales	2,506	—
Maturities, prepayments and calls	27,448	54,955
Activities in securities held-to-maturity:		
Maturities, prepayments and calls	1,230	—
Net redemption (purchase) of restricted equity securities	3,191	(2,172)
Net decrease (increase) in loans	19,678	(194,087)
Purchase of premises and equipment	(674)	(428)
Proceeds from the sale of premises and equipment	1,310	415
Proceeds from sale of other real estate	—	108
Proceeds from bank owned life insurance	802	1,545
Net cash provided by (used in) investing activities	55,491	(206,176)
Cash flows from financing activities:		
Net increase (decrease) in deposits	116,861	(50,608)
Proceeds from Federal Home Loan Bank advances	535,500	300,000
Payments on Federal Home Loan Bank advances	(500,500)	(180,000)
Repurchase of common stock	(15,791)	(6,123)
Exercise of common stock options, net of repurchase of restricted shares	(37)	(75)
Common stock dividends paid	(6,692)	(5,678)
Net cash provided by financing activities	129,341	57,516
Net increase (decrease) in cash and cash equivalents	217,088	(215,212)
Cash and cash equivalents at beginning of period	135,305	415,125
Cash and cash equivalents at end of period	$ 352,393	$ 199,913
Supplemental disclosures of cash paid:		
Interest paid	$ 41,727	$ 7,513
Income taxes paid	6,552	9,305
Supplemental disclosures of noncash transactions:		
Transfer of loans to other real estate	$ 11	$ —
Loans charged off to the allowance for credit losses on loans	972	556
Lease liabilities arising from obtaining right-of-use assets	721	570
Unrealized losses on securities available for sale, net of tax	(6,940)	(50,510)
Loans transferred from held for sale to held for investment	—	131,079

See accompanying notes to consolidated financial statements (unaudited).

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements as of and for the period ended September 30, 2023 include CapStar Financial Holdings, Inc. and its wholly owned subsidiary, CapStar Bank (the “Bank”, together referred to as the “Company”). Significant intercompany transactions and accounts are eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and do not include all information and notes required by U.S. generally accepted accounting principles (“U.S. GAAP”) for complete financial statements. All adjustments consisting of normally recurring accruals that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. These unaudited consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and related notes appearing in the 2022 Form 10-K.

Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders' equity or net income.

Adoption of New Accounting Standards

On January 1, 2023, the Company adopted ASU 2016-13 *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as amended, which replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss ("CECL") methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) ("unfunded commitments"). In addition, ASC 326 made changes to the accounting for available-for-sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities management does not intend to sell or believes that it is more likely than not they will be required to sell.

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and unfunded commitments credit exposures. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP ("incurred loss"). The Company recorded a net decrease to retained earnings of $3.4 million as of January 1, 2023 for the cumulative adoption effect of adopting ASC 326. The transition adjustment includes a $1.5 million increase in the allowance for credit losses ("ACL") on loans inclusive of a $0.2 million reclassification of purchased accounting discounts reclassified to the ACL on loans, a $3.4 million increase in the ACL on unfunded commitments credit exposures, and a $1.3 million increase in deferred tax assets.

The Company adopted ASC 326 using the prospective transition approach for financial assets purchased with credit deterioration ("PCD") that were previously classified as purchased credit impaired ("PCI") and accounted for under ASC 310-30. In accordance with the standard, management did not reassess whether PCI assets met the criteria of PCD assets as of the date of adoption. On January 1, 2023, the amortized cost basis of the PCD assets were adjusted to reflect the addition of $0.2 million of the ACL. The remaining noncredit discount (based on the adjusted amortized cost basis) will be accreted into interest income at the effective interest rate as of January 1, 2023. As allowed by ASC 326, the Company elected to maintain pools of loans accounted for under ASC 310-30.

Debt Securities

Debt securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts on securities are generally amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Premiums on callable debt securities are amortized to their earliest call date. Gains and losses on sale are recorded on the trade date and determined using the specific identification method.

A debt security is placed on non-accrual status at the time any principal or interest payments become over 90 days delinquent. Interest accrued but not received for a security placed on non-accrual is reversed against interest income.

ACL - Available-for-Sale Securities

For available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or if it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for sale that do not meet the aforementioned criteria, the Company evaluated whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considered the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an ACL is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an ACL is recognized in other comprehensive income.

Changes in the ACL are recorded as credit loss expense (or reversal). Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on available-for-sale debt securities totaled $1.8 million at September 30, 2023 and is excluded from the estimate of credit losses.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at amortized cost, net of the ACL. Amortized cost is the principal balance outstanding, net of purchase premiums and discounts, and deferred loan fees and costs. Accrued interest receivable totaled $10.5 million at September 30, 2023 and was reported in accrued interest receivable on the consolidated balance sheets and is excluded from the estimate of credit losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued and placed on non-accrual status at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Mortgage loans are charged off at 180 days past due, and commercial loans are charged off to the extent principal or interest is deemed uncollected. Consumer and credit card loans continue to accrue interest until they are charged off no later than 120 days past due unless the loan is in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Purchase Credit Deteriorated ("PCD") Loans

The Company has purchased loans, some of which have experienced more than insignificant credit deterioration since origination. PCD loans are recorded at the amount paid. An ACL is determined using the same methodology as other loans held for investment. The initial ACL determined on a collective basis is allocated to individual loans. The sum of the loan's purchase price and ACL becomes its initial amortized cost basis. The differences between the initial amortized cost basis and the par value of the loan is a noncredit discount or premium, which is amortized into interest income over the life of the loan. Subsequent changes to the ACL are recorded through credit loss expense.

Upon adoption of ASC 326, the Company elected to maintain pools of loans that were previously accounted for under ASC 310-30 and will continue to account for these pools as a unit of account. Loans are only removed from the existing pools if they are written off, paid off, or sold. Upon adoption of ASC 326, the ACL was determined for each pool and added to the pool's carrying amount to establish a new amortized cost basis. The difference between the unpaid principal balance of the pool and the new amortized cost basis is the noncredit premium or discount which will be amortized into interest income over the remaining life of the pool. Changes to the ACL after adoption are recorded through credit loss expense.

ACL - Loans

The ACL is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the ACL when management believes the uncollectibility of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off.

Management estimates the ACL balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors.

The ACL is measured on a collective (pool) basis when similar risk characteristics exist. The Company has identified the following portfolio segments and measures the ACL for each using a discounted cash flow methodology at the loan level, with loss rates, prepayment assumptions and curtailment assumptions driven by each loan’s collateral type.

Owner occupied commercial real estate - Loans in this category are susceptible to business failure and general economic conditions.

Non owner occupied commercial real estate - Common risks for this loan category are declines in general economic conditions, declines in real estate value, declines in occupancy rates, and lack of suitable alternative use for the property.

Commercial & industrial - Risks to this loan category include the inability to monitor the condition of the collateral, which often consists of inventory, accounts receivable and other non-real estate assets. Equipment and inventory obsolescence can also pose a risk. Declines in general economic conditions and other events can cause cash flows to fall to levels insufficient to service debt.

Commercial construction - Risks common to commercial construction loans are cost overruns, changes in market demand for property, inadequate long-term financing arrangements and declines in real estate values.

Residential mortgage - Residential mortgage loans are susceptible to weakening general economic conditions, increases in unemployment rates and declining real estate values.

Home equity lines of credit - Risks common to home equity lines of credit are general economic conditions, including an increase in unemployment rates, and declining real estate values that reduce or eliminate the borrower’s home equity.

Residential construction - Residential construction loans are susceptible to the same risks as residential mortgage loans. Changes in market demand for property lead to longer marketing times resulting in higher carrying costs and declining values.

Consumer - Risks common to consumer direct loans include unemployment and changes in local economic conditions as well as the inability to monitor collateral consisting of personal property.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not included in the collective evaluation. When management determines that foreclosure is probable expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Discounted Cash Flow Method

The Company uses the discounted cash flow method to estimate expected credit losses for all loan segments. The Company generates cash flow projections at the instrument level and adjusts payment expectations for estimated prepayment speed, curtailments, time to recovery, probability of default, and loss given default. The modeling of expected prepayment speeds and curtailment rates are based on historical internal data. The prepayment speeds additionally use peer data to backfill a complete time series and utilizes a forward-looking third-party prepayment model, which considers current conditions and reasonable and supportable forecasts of future economic conditions.

The Company uses regression analysis of historical internal and peer data to determine suitable loss drivers to utilize when modeling lifetime probability of default and loss given default. This analysis also determines how expected probability of default and loss given default will react to forecasted levels of the loss drivers.

For all discounted cash flow models, management has determined that four quarters represents a reasonable and supportable forecast period and reverts back to a historical loss rate over four quarters on a straight-line basis. Management leverages economic projections around unemployment rates from the Federal Open Market Committee to inform its loss driver forecasts over the four-quarter forecast period.

The combination of adjustments for credit expectations (default and loss) and timing expectations (prepayment, curtailment, and time to recovery) produces an expected cash flow stream at the instrument level. Instrument effective yield is calculated, net of the impacts of prepayment assumptions, and the instrument expected cash flows are then discounted at that effective yield to produce an instrument-level net present value of expected cash flows (“NPV”). An ACL is established for the difference between the instrument’s NPV and amortized cost basis.

Qualitative Factors

The Company uses qualitative factors for model limitations and risk uncertainty as well as for loan segment specific risks that cannot be addressed in the quantitative methods. Any additional qualitative factor reserves needed will be approved by the Allowance Committee quarterly.

Individually Evaluated Assets

Loans that do not share risk characteristics are evaluated on an individual basis. When the Company has determined that foreclosure on a collateral dependent loan is probable, or when the borrower is experiencing financial difficulty and the Company expects repayment of the loan to be provided substantially through the operation or sale of the collateral, the ACL is measured based on the difference between the fair value of the collateral and the amortized cost basis of the loan as of the measurement date. When repayment is expected to be from the operation of the collateral, expected credit losses are calculated as the amount by which the amortized cost basis of the loan exceeds the present value of expected cash flows from the operation of the collateral. The Company may, in the alternative, measure the expected credit loss as the amount by which the amortized cost basis of the loan exceeds the estimated fair value of the collateral. When repayment is expected to be from the sale of the collateral, expected credit losses are calculated as the amount by which the amortized costs basis of the loan exceeds the fair value of the underlying collateral less estimated cost to sell. The ACL may be zero if the fair value of the collateral at the measurement date exceeds the amortized cost basis of the loan.

Determining the Contractual Term: Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications unless either of the following applies: management has a reasonable expectation at the reporting date that a modification will be executed with an individual borrower or the extension or renewal options included in the original or modified contract at the reporting date are not unconditionally cancellable by the Company.

ACL - Unfunded commitments

The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The ACL on unfunded commitments is adjusted through credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. The ACL is calculated using the same aggregate reserve rates calculated for the funded portion of loans at the portfolio level applied to the amount of commitments expected to fund. The Company has identified pools of unfunded commitments which align with loans held for investment. The ACL on unfunded commitments is recorded on the other liabilities line item of the balance sheet.

ASU 2022-02, Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures

In March 2022, the FASB issued ASU 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,* which eliminates the accounting guidance for troubled debt restructurings by creditors in ASC 310-40, Receivables – Troubled Debt Restructurings by Creditors, while enhancing disclosure requirements for certain loan refinancings and restructurings involving borrowings that are experiencing financial difficulty. Specifically, rather than applying the troubled debt restructuring recognition and measurement guidance, creditors will evaluate all loan modifications to determine if they result in a new loan or a continuation of the existing loan. Losses associated with troubled debt restructurings should be incorporated in a creditor's estimate of its ACL. Additionally, public business entities are required to disclose current-period gross write-offs by year of origination for loan financing receivables and net investment in leases. The Company has adopted the standard as of January 1, 2023 with little to no impact to its accounting, and has included the additional required disclosures herein.

NOTE 2 – SECURITIES

The amortized cost and fair value of securities available-for-sale and held-to-maturity at September 30, 2023 and December 31, 2022 are summarized as follows (in thousands):

	September 30, 2023				December 31, 2022			
	Amortized Cost	Gross unrealized gains	Gross unrealized (losses)	Estimated fair value	Amortized Cost	Gross unrealized gains	Gross unrealized (losses)	Estimated fair value
Securities available-for-sale:								
U. S. government agency securities	$ 13,175	$ —	$ (1,903)	$ 11,272	$ 14,537	$ —	$ (1,635)	$ 12,902
State and municipal securities	74,807	4	(9,910)	64,901	77,562	129	(9,379)	68,312
Mortgage-backed securities	277,630	—	(60,725)	216,905	300,488	—	(55,660)	244,828
Asset-backed securities	3,189	—	(90)	3,099	3,332	—	(62)	3,270
Other debt securities	64,642	30	(6,825)	57,847	70,542	3	(3,441)	67,104
Total	$ 433,443	$ 34	$ (79,453)	$ 354,024	$ 466,461	$ 132	$ (70,177)	$ 396,416
Securities held-to-maturity:								
State and municipal securities	$ —	$ —	$ —	$ —	$ 1,240	$ —	$ —	$ 1,240
Total	$ —	$ —	$ —	$ —	$ 1,240	$ —	$ —	$ 1,240

*Amortized cost of other debt securities is net of ACL totaling $2.0 million at September 30, 2023.

Results from sales, maturities, prepayments and calls of securities available for sale were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Proceeds	$ 9,675	$ 13,430	$ 29,954	$ 54,955
Gross gains	—	8	6	8
Gross losses	—	—	(1)	—

The amortized cost and fair value of securities at September 30, 2023, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Available-for-sale	
	Amortized cost	Estimated fair value
Due in less than one year	$ 1,162	$ 1,080
Due one to five years	17,624	16,214
Due five to ten years	98,688	86,619
Due beyond ten years	35,150	30,107
Mortgage-backed securities	277,630	216,905
Asset-backed securities	3,189	3,099
Total	$ 433,443	$ 354,024

Securities with a market value of $186.8 million at September 30, 2023 were pledged to collateralize public deposits, and Federal Home Loan Bank advances.

Securities in an unrealized loss position for which an ACL has not been recorded as of September 30, 2023 and December 31, 2022, and the length of time they were in continuous loss positions as of such dates are as follows (in thousands):

September 30, 2023	Less than 12 months		12 months or more		Total	
	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses
U. S. government agency securities	$ —	$ —	$ 11,272	$ (1,903)	$ 11,272	$ (1,903)
State and municipal securities	16,581	(241)	46,798	(9,669)	63,379	(9,910)
Mortgage-backed securities	1,280	(73)	215,624	(60,652)	216,904	(60,725)
Asset-backed securities	—	—	3,099	(90)	3,099	(90)
Other debt securities	1,889	(111)	55,928	(6,714)	57,817	(6,825)
Total temporarily impaired securities	$ 19,750	$ (425)	$ 332,721	$ (79,028)	$ 352,471	$ (79,453)
December 31, 2022						
U. S. government agency securities	$ 6,243	$ (836)	$ 6,659	$ (799)	$ 12,902	$ (1,635)
State and municipal securities	12,952	(422)	41,779	(8,957)	54,731	(9,379)
Mortgage-backed securities	81,751	(7,647)	161,708	(48,013)	243,459	(55,660)
Asset-backed securities	3,270	(62)	—	—	3,270	(62)
Other debt securities	41,018	(2,028)	24,084	(1,413)	65,102	(3,441)
Total temporarily impaired securities	$ 145,234	$ (10,995)	$ 234,230	$ (59,182)	$ 379,464	$ (70,177)

At adoption of ASC 326 on January 1, 2023, calculated credit losses and, thus, the related ACL on held-to-maturity debt securities were not material due to the high credit quality of the portfolio. As a result, no ACL was recorded on the held-to-maturity portfolio at January 1, 2023. There are no held-to-maturity debt securities as of September 30, 2023.

At December 31, 2022, the Company owned certain securities related to Signature Bank ("Signature") which, following the first quarter failure of Signature, were deemed to have significant credit losses and no probable recovery. As such, a $2.0 million provision for credit loss was recorded with a corresponding ACL in the three months ended March 31, 2023. The Company has performed an assessment of its portfolio in an unrealized loss position and has determined no other credit losses present as of September 30, 2023. See Note 1 for additional details on the adoption of ASC 326 as it relates to the securities portfolio.

At September 30, 2023, there were 314 debt securities available-for-sale that were in an unrealized loss position. The Company does not intend to sell nor believes it will be required to sell securities in an unrealized loss position prior to the recovery of their amortized cost basis. Unrealized losses at September 30, 2023 were primarily attributable to the rising interest rate environment. The majority of the investment portfolio was either government guaranteed or an issuance of a government sponsored entity or highly rated by major credit rating agencies.

As of September 30, 2023, the Signature securities for which an ACL has been recorded are on non-accrual. No other securities are past due or on non-accrual.

The following table shows a rollforward of the ACL on available for sale securities for the nine months ended September 30, 2023:

	Other debt securities
Balance at December 31, 2022	$ —
Adoption of CECL	—
Additions for securities for which no previous expected credit losses were recognized	2,000
Total	$ 2,000

NOTE 3 – LOANS AND ALLOWANCE FOR CREDIT LOSSES

A summary of the loans held for investment portfolio as of September 30, 2023 and December 31, 2022 follows (in thousands):

	September 30, 2023	December 31, 2022
Commercial real estate - owner occupied	$ 280,273	$ 246,109
Commercial real estate - non-owner occupied	799,084	803,611
Consumer real estate	429,028	402,615
Construction and land development	205,486	229,972
Commercial and industrial	485,028	496,347
Consumer	50,860	53,382
Other	42,482	80,762
Total	2,292,241	2,312,798
Allowance for credit losses on loans	(24,157)	(23,806)
Total loans, net	$ 2,268,084	$ 2,288,992

Non-accrual and Past Due Loans

The following table presents the recorded investment in loans by aging category and accrual status of September 30, 2023 and December 31, 2022 by class of loans (in thousands):

	Accruing						
	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due	Non-Accrual Loans	Total
September 30, 2023							
Commercial real estate - owner occupied	$ —	$ —	$ 5	$ 5	$ 280,155	$ 113	$ 280,273
Commercial real estate - non-owner occupied	—	—	—	—	798,634	450	799,084
Consumer real estate	661	118	225	1,004	426,153	1,871	429,028
Construction and land development	—	—	—	—	205,481	5	205,486
Commercial and industrial	597	26	463	1,086	481,713	2,229	485,028
Consumer	270	98	139	507	48,591	1,762	50,860
Other	—	—	—	—	42,482	—	42,482
Total	$ 1,528	$ 242	$ 832	$ 2,602	$ 2,283,209	$ 6,430	$ 2,292,241

	Accruing						
	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due	Non-Accrual Loans	Total
December 31, 2022							
Commercial real estate - owner occupied	$ —	$ —	$ —	$ —	$ 239,351	$ 4,982	$ 244,333
Commercial real estate - non-owner occupied	—	—	—	—	802,107	—	802,107
Consumer real estate	456	231	87	774	393,893	456	395,123
Construction and land development	—	—	—	—	229,896	8	229,904
Commercial and industrial	76	53	744	873	489,842	4,065	494,780
Consumer	178	39	14	231	52,731	54	53,016
Other	—	—	37	37	80,535	—	80,572
Purchased credit impaired	175	149	143	467	11,347	1,149	12,963
Total	$ 885	$ 472	$ 1,025	$ 2,382	$ 2,299,702	$ 10,714	$ 2,312,798

The following table presents the recorded investment in nonaccrual loans as of September 30, 2023 by class of loans (in thousands):

	Non-Accrual loans with no allowance	Non-Accrual loans with allowance	Total Non-Accrual Loans
Commercial real estate - owner occupied	$ —	$ 113	$ 113
Commercial real estate - non-owner occupied	—	450	450
Consumer real estate	769	1,102	1,871
Construction and land development	—	5	5
Commercial and industrial	—	2,229	2,229
Consumer	1,707	55	1,762
Other	—	—	—
Total	$ 2,476	$ 3,954	$ 6,430

The Company recognized no interest income on nonaccrual loans during the three or nine months ended September 30, 2023.

Risk Ratings

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes all commercial loans individually and assigns each loan a risk rating. This analysis is performed at origination by the relationship manager and credit department personnel. On at least an annual basis, an independent party performs a formal credit risk review of a sample of the loan portfolio. Among other things, this review assesses the appropriateness of the loan's risk rating. The Company uses the following definitions for risk ratings:

- *Pass* – Loans in this category are considered to have a low probability of default and do not meet the criteria of the risk categories below.
- *Special Mention* – A special mention asset possesses deficiencies or potential weaknesses deserving of management's attention. If uncorrected, such weaknesses or deficiencies may expose the Company to an increased risk of loss in the future.
- *Substandard* – A substandard asset is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard.
- *Doubtful* – A doubtful asset has all weaknesses inherent in one classified substandard, with the added characteristic that weaknesses make collection or liquidation in full, on the basis of existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high, but certain important and reasonable specific pending factors which may work to the advantage and strengthening of the asset exist, therefore, its classification as an estimated loss is deferred until a more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

The following table provides the risk category of loans by applicable class of loans and vintage year as of September 30, 2023 (in thousands):

	Term Loans by Origination Year								
	2023	2022	2021	2020	2019	Prior	Revolvers	Revolvers converted to term loans	Total
Commercial real estate - owner occupied									
Pass	$ 19,566	$ 90,202	$ 86,763	$ 32,044	$ 19,490	$ 23,846	$ 1,842	$ —	$ 273,753
Special Mention	—	—	2,490	—	—	1,708	—	—	4,198
Substandard	—	1,583	—	—	158	581	—	—	2,322
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 19,566	$ 91,785	$ 89,253	$ 32,044	$ 19,648	$ 26,135	$ 1,842	$ —	$ 280,273
Current period gross charge-offs	—	—	—	—	—	—	—	—	—
Commercial real estate - non-owner occupied									
Pass	$ 34,448	$ 293,182	$ 219,866	$ 104,411	$ 39,937	$ 87,736	$ 19,053	$ —	$ 798,633
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	236	—	—	—	—	215	—	451
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 34,448	$ 293,418	$ 219,866	$ 104,411	$ 39,937	$ 87,736	$ 19,268	$ —	$ 799,084
Current period gross charge-offs	—	—	—	—	—	—	—	—	—
Consumer real estate									
Pass	$ 27,492	$ 87,441	$ 35,727	$ 16,490	$ 14,821	$ 42,165	$ 197,553	$ 2,146	$ 423,835
Special Mention	164	2,194	—	—	—	235	—	12	2,605
Substandard	—	912	26	36	188	1,176	164	1	2,503
Doubtful	47	—	—	—	—	—	38	—	85
Total	$ 27,703	$ 90,547	$ 35,753	$ 16,526	$ 15,009	$ 43,576	$ 197,755	$ 2,159	$ 429,028
Current period gross charge-offs	38	—	—	—	—	—	—	—	38
Construction and land development									
Pass	$ 18,303	$ 121,171	$ 53,105	$ 3,880	$ 5,779	$ 2,237	$ 1,006	$ —	$ 205,481
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	5	—	—	5
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 18,303	$ 121,171	$ 53,105	$ 3,880	$ 5,779	$ 2,242	$ 1,006	$ —	$ 205,486
Current period gross charge-offs	—	—	—	—	—	—	—	—	—
Commercial and industrial									
Pass	$ 50,514	$ 135,912	$ 78,551	$ 43,961	$ 15,090	$ 8,282	$ 135,303	$ —	$ 467,613
Special Mention	127	1,073	2,132	6,012	—	—	1,995	—	11,339
Substandard	7	—	58	3,299	—	—	2,307	245	5,916
Doubtful	—	—	—	109	22	—	29	—	160
Total	$ 50,648	$ 136,985	$ 80,741	$ 53,381	$ 15,112	$ 8,282	$ 139,634	$ 245	$ 485,028
Current period gross charge-offs	—	92	167	98	59	—	122	—	538
Consumer									
Pass	$ 15,185	$ 11,783	$ 4,790	$ 1,938	$ 540	$ 386	$ 14,219	$ 101	$ 48,942
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	15	136	1,740	16	10	—	—	—	1,917
Doubtful	—	—	1	—	—	—	—	—	1
Total	$ 15,200	$ 11,919	$ 6,531	$ 1,954	$ 550	$ 386	$ 14,219	$ 101	$ 50,860
Current period gross charge-offs	11	58	32	30	12	144	—	—	287
Other									
Pass	$ 5,574	$ 6,752	$ 20,209	$ 4,902	$ 364	$ 1,911	$ 2,207	$ —	$ 41,919
Special Mention	—	69	—	—	395	—	—	—	464
Substandard	46	—	1	52	—	—	—	—	99
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 5,620	$ 6,821	$ 20,210	$ 4,954	$ 759	$ 1,911	$ 2,207	$ —	$ 42,482
Current period gross charge-offs	—	—	—	—	—	109	—	—	109
Total Portfolio									
Pass	$ 171,082	$ 746,443	$ 499,011	$ 207,626	$ 96,021	$ 166,563	$ 371,183	$ 2,247	$ 2,260,176
Special Mention	291	3,336	4,622	6,012	395	1,943	1,995	12	18,606
Substandard	68	2,867	1,825	3,403	356	1,762	2,686	246	13,213
Doubtful	47	—	1	109	22	—	67	—	246
Total	$ 171,488	$ 752,646	$ 505,459	$ 217,150	$ 96,794	$ 170,268	$ 375,931	$ 2,505	$ 2,292,241
Current period gross charge-offs	$ 49	$ 150	$ 199	$ 128	$ 71	$ 253	$ 122	$ -	$ 972

The following table provides the risk category of loans by applicable class of loans as of December 31, 2022 (in thousands):

	Non-impaired Loans					
December 31, 2022	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total Impaired Loans**	**Total**
Commercial real estate - owner occupied	$ 234,619	$ 4,731	$ 440	$ —	$ 4,543	$ 244,333
Commercial real estate - non-owner occupied	802,107	—	—	—	—	802,107
Consumer real estate	393,734	555	467	—	367	395,123
Construction and land development	229,897	—	—	—	7	229,904
Commercial and industrial	477,081	516	12,751	127	4,305	494,780
Consumer	52,911	—	84	2	19	53,016
Other	80,504	—	68	—	—	80,572
Purchased credit impaired	11,595	68	1,259	41	—	12,963
Total	$ 2,282,448	$ 5,870	$ 15,069	$ 170	$ 9,241	$ 2,312,798

Modifications

Occasionally, the Company modifies loans to borrowers in financial distress by providing principal forgiveness, term extension, an other-than-insignificant payment delay or interest rate reduction. When principal forgiveness is provided, the amount of forgiveness is charged-off against the ACL.

In some cases, the Company provides multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted.

The following table represents the loans at September 30, 2023 that were both experiencing financial difficulty and modified during the nine months ended September 30, 2023, by class and by type of modification. No modifications were made during the three months ended September 30, 2023. The percentage of loans that were modified to borrowers in financial distress as compared to the total loans of each class is also presented below.

	Payment Delay	**Term Extension**	**Total Class of Loans**
Commercial and industrial	$ 5,049	$ 320	1.11 %
Total	$ 5,049	$ 320	0.23 %

The Company has not committed to lend additional amounts to the borrowers included in the previous table.

The Company closely monitors the performance of loans that are modified to borrowers experiencing financial difficulty to understand the effectiveness of its modification efforts. Such loans that had been modified in the last 12 months are all current with no loans past due.

The following table presents the financial effect of the loan modifications represented above to borrowers experiencing financial difficulty for the nine months ended September 30, 2023:

	Weighted-Average Payment Delay	**Weighted-Average Term Extension**
Commercial and industrial	4 mos.	3 mos.
Total	4 mos.	3 mos.

No loans modified during the three or nine months ended September 30, 2023 are in payment default.

Upon the Company's determination that a modified loan has subsequently been deemed uncollectible, the loan is written off. Therefore, the recorded investment of the loan is reduced by the uncollectible amount and the allowance for credit losses is adjusted by the same amount.

The following table presents collateral dependent loans, which are individually evaluated to determine expected credit losses, as of September 30, 2023 by class of loan and type of collateral.

	Real Estate	Total
Commercial real estate - owner occupied	$1,169	$1,169
Total	$1,169	$1,169

Allowance for Credit Loss

The following table details the changes in the ACL for the three and nine month periods ended September 30, 2023 and 2022 (in thousands):

For the three months ended September 30,	CECL					Incurred Loss				
	2023					2022				
	Beginning Balance	Charge-Offs	Recoveries	Provision	Ending Balance	Beginning Balance	Charge-Offs	Recoveries	Provision	Ending Balance
Commercial real estate - owner occupied	$ 2,362	$ —	$ —	$ (16)	$ 2,346	$ 1,852	$ —	$ —	$ 14	$ 1,866
Commercial real estate - non-owner occupied	6,907	—	—	(382)	6,525	5,297	—	—	678	5,975
Consumer real estate	3,811	(38)	—	(43)	3,730	2,555	—	1	392	2,948
Construction and land development	3,949	—	—	(650)	3,299	3,271	—	—	40	3,311
Commercial and industrial	5,998	(231)	45	(57)	5,755	7,464	(46)	7	(419)	7,006
Consumer	1,501	(119)	35	355	1,772	498	(64)	14	3	451
Other	996	(51)	9	(224)	730	747	(37)	5	159	874
Total allowance for credit losses - loans	$ 25,524	$ (439)	$ 89	$ (1,017)	$ 24,157	$ 21,684	$ (147)	$ 27	$ 867	$ 22,431
Allowance for credit losses - unfunded commitments	$ 3,563	$ -	$ -	$ (544)	$ 3,019	$ 319	$ -	$ -	$ -	$ 319

For the nine months ended September 30,	CECL							Incurred Loss				
	2023							2022				
	Beginning Balance	Adoption of CECL	Jan. 1, 2023	Charge-Offs	Recoveries	Provision	Ending Balance	Beginning Balance	Charge-Offs	Recoveries	Provision	Ending Balance
Commercial real estate - owner occupied	$1,967	$209	$2,176	$—	$—	$170	$2,346	$1,685	$(12)	$225	$(32)	$1,866
Commercial real estate - non-owner occupied	5,967	(632)	5,335	—	—	1,190	6,525	5,439	—	—	536	5,975
Consumer real estate	3,153	650	3,803	(38)	44	(79)	3,730	2,412	—	2	534	2,948
Construction and land development	3,830	(266)	3,564	—	—	(265)	3,299	3,769	—	—	(458)	3,311
Commercial and industrial	7,654	(995)	6,659	(538)	50	(416)	5,755	7,441	(205)	30	(260)	7,006
Consumer	430	1,127	1,557	(287)	163	339	1,772	397	(211)	95	170	451
Other	805	1,404	2,209	(109)	16	(1,386)	730	555	(128)	11	436	874
Total	$23,806	$1,497	$25,303	$(972)	$273	$(447)	$24,157	$21,698	$(556)	$363	$926	$22,431
Allowance for credit losses - unfunded commitments	$319	$3,350	$3,669	$-	$-	$(650)	$3,019	$319	$-	$-	$-	$319

As of September 30, 2023, the Company used a one-year reasonable and supportable forecast period. The changes in loss rates used as the basis for the estimate of credit losses during this period were modeled using both the Company's own historical data and historical data from peer banks and macroeconomic forecast data obtained from a third party vendor, which were then applied to the Company’s recent default experience as a starting point. The decrease in the ACL compared to January 1, 2023 was primarily attributable to a decrease in the loan portfolio, changes in various loan attributes at the instrument level, qualitative factors and an improvement in economic metrics such as forecasted unemployment. For periods beyond the reasonable and supportable forecast period of one year, the Company reverted to historical credit loss information on a straight line basis over two years.

The Company maintains an allowance for unfunded commitments exposures. The allowance for unfunded commitments credit exposures is adjusted as a provision for credit loss expense. The estimate includes consideration of the likelihood that funding will occur, which is based on a historical funding study derived from internal information, and an estimate of expected credit losses on commitments expected to be funded over its estimated life, which are the same loss rates that are used in computing the allowance for credit losses on loans. The ACL for unfunded loan commitments of $3.0 million and $0.3 million at September 30, 2023 and December 31, 2022, respectively, is separately classified on the balance sheet within Other Liabilities.

Incurred Loss Impairment Methodology

A breakdown of the ALL and the loan portfolio by loan category as previously required by ASC Topic 310 at December 31, 2022 follows (in thousands):

	Commercial real estate - owner occupied	Commercial real estate - non-owner occupied	Consumer real estate	Construction and land development	Commercial and industrial	Consumer	Other	Total
December 31, 2022								
Allowance for Loan Losses:								
Collectively evaluated for impairment	$ 1,967	$ 5,967	$ 3,153	$ 3,830	$ 6,909	$ 378	$ 805	$ 23,009
Individually evaluated for impairment	—	—	—	—	716	—	—	716
Purchased credit impaired	—	—	—	—	29	52	—	81
Balances, end of period	$ 1,967	$ 5,967	$ 3,153	$ 3,830	$ 7,654	$ 430	$ 805	$ 23,806
Loans:								
Collectively evaluated for impairment	$ 239,790	$ 802,107	$ 394,756	$ 229,897	$ 490,475	$ 52,997	$ 80,572	$ 2,290,594
Individually evaluated for impairment	4,543	—	367	7	4,305	19	—	9,241
Purchased credit impaired	1,776	1,504	7,492	68	1,567	366	190	12,963
Balances, end of period	$ 246,109	$ 803,611	$ 402,615	$ 229,972	$ 496,347	$ 53,382	$ 80,762	$ 2,312,798

The following table presents additional detail on loans individually evaluated for impairment as previously required by ASC Topic 310 as of December 31, 2022 (in thousands):

	December 31, 2022		
	Recorded investment	Unpaid principal balance	Related allowance
With no related allowance recorded:			
Commercial real estate - owner occupied	$ 4,543	$ 4,551	$ —
Commercial real estate - non-owner occupied	—	—	—
Consumer real estate	367	393	—
Construction and land development	7	8	—
Commercial and industrial	420	412	—
Consumer	19	19	—
Other	—	—	—
Subtotal	5,356	5,383	—
With an allowance recorded:			
Commercial real estate - owner occupied	—	—	—
Commercial real estate - non-owner occupied	—		
Consumer real estate	—	—	—
Construction and land development	—	—	—
Commercial and industrial	3,885	4,061	716
Consumer	—	—	—
Other	—	—	—
Subtotal	3,885	4,061	716
Total	$ 9,241	$ 9,444	$ 716

The average balances of impaired loans and income recognized on impaired loans while they were considered impaired under Incurred Loss are presented below for the period indicated (in thousands).

	Three Months Ended September 30, 2022		Nine Months Ended September 30, 2022	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
With no related allowance recorded:				
Commercial real estate - owner occupied	$ 4,988	$ 59	$ 5,075	$ 234
Commercial real estate - non-owner occupied	—	—	—	—
Consumer real estate	548	6	337	7
Construction and land development	8	—	9	—
Commercial and industrial	106	2	79	3
Consumer	11	—	12	—
Other	—	—	—	—
Subtotal	5,661	67	5,512	244
With an allowance recorded:				
Commercial real estate - owner occupied	—	—	—	—
Commercial real estate - non-owner occupied	—	—		
Consumer real estate	—	—	—	—
Construction and land development	—	—	—	—
Commercial and industrial	—	—	—	—
Consumer	—	—	—	—
Other	—	—	—	—
Subtotal	—	—	—	—
Total	$ 5,661	$ 67	$ 5,512	$ 244

The following table presents changes in the carrying value of PCI loans (in thousands) for the periods indicated:

	Three Months Ended	Nine Months Ended
	September 30, 2022	
Balance at beginning of period	$ 15,809	$ 19,261
Change due to payments received and accretion	(1,439)	(4,810)
Reclassification of discount to allowance for loan losses	—	(81)
Balance at end of period	$ 14,370	$ 14,370

The following table presents changes in the accretable yield for PCI loans (in thousands) for the periods indicated:

	Three Months Ended	Nine Months Ended
	September 30, 2022	
Balance at beginning of period	$ 4,992	$ 5,763
Accretion	(376)	(1,245)
Reclassification from nonaccretable difference	—	304
Other, net	—	(206)
Balance at end of period	$ 4,616	$ 4,616

PCI loans had no impact on the ALL for the three or nine months ended September 30, 2022.

Loans Held for Sale

A summary of the loans held for sale as of September 30, 2023 and December 31, 2022 follows (in thousands):

	September 30, 2023	December 31, 2022
Residential mortgage	$ 15,981	$ 12,636
Guaranteed portion of SBA loans	20,410	32,072
Total	$ 36,391	$ 44,708

NOTE 4 – SHORT TERM BORROWINGS AND LONG-TERM DEBT

Short-Term Borrowings

The Company had outstanding advances of $50.0 million and $15.0 million as of September 30, 2023 and December 31, 2022, respectively.

	September 30, 2023		December 31, 2022	
Year	Amount	Interest Rates	Amount	Interest Rates
2023	$ 50,000	5.17 %	$ 15,000	4.33 %

Advances from the FHLB are collateralized by investment securities with a market value of $17.5 million and certain commercial and residential real estate mortgage loans totaling $735.7 million under a blanket mortgage collateral agreement. At September 30, 2023, the amount of available credit from the FHLB totaled $426.6 million.

Subordinated Notes

The Company issued $30.0 million of fixed-to-floating rate subordinated notes during the third quarter of 2020, which were recorded net of issuance costs of $0.6 million, that mature June 30, 2030. Beginning on or after June 30, 2025, the Company may redeem the notes, in whole or in part, at their principal amount plus any accrued and unpaid interest. The notes have a fixed interest rate of 5.25% per annum for the first five years. Thereafter, the interest rate will reset quarterly to an interest rate per annum equal to a benchmark rate (which is expected to be Three-Month Term SOFR) plus 513 basis points. The carrying value of subordinated notes was $29.8 million as of September 30, 2023 and $29.7 million as of December 31, 2022.

NOTE 5– ACCUMULATED OTHER COMPREHENSIVE LOSS

The following were changes in accumulated other comprehensive loss by component, net of tax, for the periods ended September 30, 2023 and 2022 (in thousands):

	Unrealized Gains and Losses on Available for Sale Securities
Nine Months Ended September 30, 2023	
Beginning balance	$ (50,052)
Other comprehensive loss before reclassification, net of tax	(6,936)
Amounts reclassified from accumulated other comprehensive loss, net of tax	(4)
Net current period other comprehensive loss	(6,940)
Ending Balance	$ (56,992)
Nine Months Ended September 30, 2022	
Beginning balance	$ (1,270)
Other comprehensive loss before reclassification, net of tax	(50,504)
Amounts reclassified from accumulated other comprehensive loss, net of tax	(6)
Net current period other comprehensive loss	(50,510)
Ending Balance	$ (51,780)

The following amounts were reclassified out of each component of accumulated other comprehensive income (loss) for the nine months ended September 30, 2023 and 2022 (in thousands). No reclassifications occurred in the three months ended September 30, 2023 or 2022.

Details about Accumulated Other Comprehensive Income (Loss) Components	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022	Affected Line Item in the Statement Where Net Income is Presented
Realized gains on available- for-sale securities	$ 5	$ 8	Net gain on sale of securities
	(1)	(2)	Income tax expense
	$ 4	$ 6	Net of tax

NOTE 6 – COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company has outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet.

The following table sets forth outstanding financial instruments whose contract amounts represent credit risk as of September 30, 2023 and December 31, 2022 (in thousands):

	Contract or notional amount	
	September 30, 2023	December 31, 2022
Financial instruments whose contract amounts represent credit risk:		
Unused commitments to extend credit	$ 1,013,932	$ 1,112,950
Standby letters of credit	9,331	7,288
Total	$ 1,023,263	$ 1,120,238

The Company is party to litigation and claims arising in the normal course of business. Management believes that the liabilities, if any, arising from such litigation and claims as of September 30, 2023, will not have a material impact on the financial statements of the Company.

NOTE 7 – DERIVATIVES

The Company utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

Interest Rate Swaps

The Company enters into swaps to facilitate customer transactions and meet their financing needs. Upon entering into these transactions the Company enters into offsetting positions with large U.S. financial institutions in order to minimize market risk to the Company. A summary of the Company's customer related interest rate swaps was as follows (in thousands):

	September 30, 2023		December 31, 2022	
	Notional amount	Estimated fair value	Notional amount	Estimated fair value
Interest rate swap agreements:				
Pay fixed/receive variable swaps	$ 35,173	$ 2,250	$ 35,641	$ (2,343)
Pay variable/receive fixed swaps	35,173	(2,250)	35,641	2,343
Total	$ 70,346	$ —	$ 71,282	$ —

Mortgage Banking Derivatives

The Company enters into various derivative agreements with customers in the form of interest-rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The derivatives are valued using a model that utilizes market interest rates and other unobservable inputs. Changes in the fair value of these commitments due to fluctuations in interest rates that are to be originated to our loans held for sale portfolio are economically hedged through the use of forward sale commitments of mortgage-backed securities. The gains and losses arising from this derivative activity are reflected in current period earnings under mortgage banking income. Interest rate lock commitments are valued using a model with significant unobservable market parameters. Forward sale commitments are valued based on quoted prices for similar assets in an active market with inputs that are observable.

The net (losses) gains relating to mortgage banking derivative instruments included in mortgage banking income were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Mortgage loan interest rate lock commitments	$ (77)	$ (870)	$ 243	$ (940)
Mortgage-backed securities forward sales commitments	(10)	350	10	356
Total	$ (87)	$ (520)	$ 253	$ (584)

The amount and fair value of mortgage banking derivatives included in the consolidated balance sheets were as follows (in thousands):

	September 30, 2023		December 31, 2022	
	Notional amount	Estimated fair value	Notional amount	Estimated fair value
Included in other assets:				
Mortgage loan interest rate lock commitments	$ 18,889	$ 249	$ 19,413	$ 6
Mortgage-backed securities forward sales commitments	16,750	37	12,500	27

NOTE 8 – REGULATORY CAPITAL REQUIREMENTS

The Company and the Bank are subject to regulatory capital requirements administered by the Federal Reserve and the Bank is also subject to the regulatory capital requirements of the Tennessee Department of Financial Institutions. Failure to meet capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that could, in that event, have a material adverse effect on the institutions' financial statements. The relevant regulations require the Company and the Bank to meet specific capital adequacy guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting principles. The capital classifications of the Company and the Bank are also subject to qualitative judgments by their regulators about components, risk weightings, and other factors. Those qualitative judgments could also affect the capital status of the Company and the Bank and the amount of dividends the Company and the Bank may distribute. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of September 30, 2023, the Company and the Bank met all regulatory capital adequacy requirements to which they are subject.

The Company's and the Bank's capital amounts and ratios as of September 30, 2023 and December 31, 2022 are presented in the following table (dollars in thousands).

	Actual		Minimum capital requirement (1)		Minimum to be well-capitalized (2)	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2023:						
Total capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	$ 412,219	15.36 %	$ 214,661	8.0 %	N/A	N/A
CapStar Bank	399,089	14.85	215,064	8.0	$ 268,830	10 %
Tier I capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	358,912	13.38	160,996	6.0	N/A	N/A
CapStar Bank	375,548	13.97	161,298	6.0	215,064	8.00
Common equity Tier 1 capital to risk weighted assets:						
CapStar Financial Holdings, Inc.	358,912	13.38	120,747	4.5	N/A	N/A
CapStar Bank	359,048	13.36	120,974	4.5	174,740	6.50
Tier I capital to average assets:						
CapStar Financial Holdings, Inc.	358,912	11.08	129,591	4.0	N/A	N/A
CapStar Bank	375,548	11.60	129,533	4.0	161,916	5.00
At December 31, 2022:						
Total capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	$ 410,704	14.51 %	$ 226,491	8.0 %	N/A	N/A
CapStar Bank	402,453	14.22	226,407	8.0	$ 283,009	10 %
Tier I capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	356,913	12.61	169,868	6.0	N/A	N/A
CapStar Bank	378,328	13.37	169,805	6.0	226,407	8.00
Common equity Tier 1 capital to risk weighted assets:						
CapStar Financial Holdings, Inc.	356,913	12.61	127,401	4.5	N/A	N/A
CapStar Bank	361,828	12.79	127,354	4.5	183,956	6.50
Tier I capital to average assets:						
CapStar Financial Holdings, Inc.	356,913	11.40	125,202	4.0	N/A	N/A
CapStar Bank	378,328	12.10	125,089	4.0	156,361	5.00

(1) For the calendar year 2023, the Company must maintain a capital conservation buffer of Tier 1 common equity capital in excess of minimum risk-based capital ratios by at least 2.5% to avoid limits on capital distributions and certain discretionary bonus payments to executive officers and similar employees.

(2) For the Company to be well-capitalized, the Bank must be well-capitalized and the Company must not be subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Federal Reserve to meet and maintain a specific capital level for any capital measure.

NOTE 9 – EARNINGS PER SHARE

The following is a summary of the basic and diluted earnings per share calculation for the three and nine month periods ended September 30, 2023 and 2022 (in thousands except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Basic net income per share calculation:				
Numerator – Net income	$ 8,925	$ 8,039	$ 23,175	$ 28,686
Denominator – Average common shares outstanding	20,808,677	21,938,259	21,142,177	22,051,950
Basic net income per share	$ 0.43	$ 0.37	$ 1.10	$ 1.30
Diluted net income per share calculation:				
Numerator – Net income	$ 8,925	$ 8,039	$ 23,175	$ 28,686
Denominator – Average common shares outstanding	20,808,677	21,938,259	21,142,177	22,051,950
Dilutive shares contingently issuable	15,294	49,826	30,535	52,737
Average diluted common shares outstanding	20,823,971	21,988,085	21,172,712	22,104,687
Diluted net income per share	$ 0.43	$ 0.37	$ 1.09	$ 1.30

NOTE 10 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Bank used the following methods and significant assumptions to estimate fair value:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2), using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded and values debt securities by relying on quoted prices for the specific securities and the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). See below for additional discussion of Level 3 valuation methodologies and significant inputs. The fair values of all securities are determined from third party pricing services without adjustment.

Derivatives-Interest Rate Swaps: The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2). The Bank's derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. The fair values of all interest rate swaps are determined from third party pricing services without adjustment.

Individually Evaluated Loans: The fair value of individually evaluated loans, formerly "impaired" under incurred loss methodology, with specific allocations of the ACL is generally based on recent appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans. Such adjustments result in a Level 3 classification of the inputs for determining fair value. Collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Individually evaluated loans are evaluated on at least a quarterly basis for additional impairment and adjusted in accordance with the loan policy.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach with data from comparable properties. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Appraisals may be adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and/or management’s expertise and knowledge of the collateral. Such adjustments result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The Company had no other real estate owned carried at fair value at September 30, 2023 or December 31, 2022.

Loans Held For Sale: Loans held for sale are carried at either fair value, if elected, or the lower of cost or fair value on a pool-level basis. Origination fees and costs for loans held for sale recorded at lower of cost or market are capitalized in the basis of the loan and are included in the calculation of realized gains and losses upon sale. Origination fees and costs are recognized in earnings at the time of origination for loans held for sale that are recorded at fair value. Fair value is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Derivatives-Mortgage Loan Interest Rate Lock Commitments: Interest rate lock commitments that relate to the origination of mortgage loans that will be held for sale are recorded at fair value, determined as the amount that would be required to settle each derivative instrument at the balance sheet date. The fair value of the interest rate lock commitment is derived from the fair value of related mortgage loans, which is based on observable market data and includes the expected net future cash flows related to servicing of the loans. In estimating the fair value of an interest rate lock commitment, the Company assigns a probability to the interest rate lock commitment based on an expectation that it will be exercised and the loan will be funded (a “pull through” rate). The expected pull through rates are applied to the fair value of the unclosed mortgage pipeline, resulting in a Level 3 fair value classification. The pull through rate is a statistical analysis of our actual rate lock fallout history to determine the sensitivity of the residential mortgage loan pipeline compared to interest rate changes and other deterministic values. New market prices are applied based on updated loan characteristics and new fallout ratios (i.e., the inverse of the pull through rate) are applied accordingly. Significant increases (decreases) in the pull through rate in isolation result in a significantly higher (lower) fair value measurement. Changes to the fair value of interest rate lock commitments are recognized based on interest rate changes, changes in the probability that the commitment will be exercised, and the passage of time.

Derivatives-Mortgage-Backed Securities Forward Sales Commitments: The Company utilizes mortgage-backed securities forward sales commitments to hedge mortgage loan interest rate lock commitments. Mortgage-backed securities forward sales commitments are recorded at fair value based on quoted prices for similar assets in an active market with inputs that are observable, resulting in a Level 2 fair value classification.

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	Fair value measurements at September 30, 2023			
	Carrying Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Securities available-for-sale:				
U. S. government agency securities	$ 11,272	$ —	$ 11,272	$ —
State and municipal securities	64,901	—	64,901	—
Mortgage-backed securities	216,905	—	216,905	—
Asset-backed securities	3,099	—	3,099	—
Other debt securities	57,847	—	57,847	—
Loans held for sale	15,981	—	15,981	—
Derivative assets:				
Interest rate swaps - customer related	2,250	—	2,250	—
Mortgage loan interest rate lock commitments	249	—	—	249
Mortgage-backed securities forward sales commitments	37	—	37	—
Liabilities:				
Derivative liabilities:				
Interest rate swaps - customer related	(2,250)	—	(2,250)	—

	Fair value measurements at December 31, 2022			
	Carrying Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Securities available-for-sale:				
U. S. government agency securities	$ 12,902	$ —	$ 12,902	$ —
State and municipal securities	68,312	—	68,312	—
Mortgage-backed securities	244,828	—	244,828	—
Asset-backed securities	3,270	—	3,270	—
Other debt securities	67,104	—	67,104	—
Loans held for sale	12,636	—	12,636	—
Derivative assets:				
Interest rate swaps - customer related	2,343	—	2,343	—
Mortgage loan interest rate lock commitments	6	—	—	6
Mortgage-backed securities forward sales commitments	27	—	27	—
Liabilities:				
Derivative liabilities:				
Interest rate swaps - customer related	(2,343)	—	(2,343)	—

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2023 and 2022 (in thousands):

	Mortgage Loan Interest Rate Lock Commitments	
	2023	2022
Balance of recurring Level 3 assets at January 1st	$ 6	$ 696
Total gains or losses for the period:		
Included in mortgage banking income	243	(940)
Balance of recurring Level 3 assets at September 30th	$ 249	$ (244)

The following table presents quantitative information about recurring Level 3 fair value measurements (dollars in thousands):

September 30, 2023		Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted-Average)
Assets:					
Non-hedging derivatives:					
Mortgage loan interest rate lock commitments	$	249	Consensus pricing	Origination pull-through rate	80% - 100% (95%)

December 31, 2022		Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted-Average)
Assets:					
Non-hedging derivatives:					
Mortgage loan interest rate lock commitments	$	6	Consensus pricing	Origination pull-through rate	80% - 100% (94%)

Assets measured at fair value on a nonrecurring basis as of September 30, 2023 and December 31, 2022 are summarized below (in thousands).

	Carrying Value	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Fair value measurements at September 30, 2023				
Assets:				
Individually evaluated loans:				
Commercial and industrial	$2,546	—	—	$2,546
Fair value measurements at December 31, 2022				
Assets:				
Impaired loans:				
Commercial and industrial	$3,169	—	—	$3,169

The following table presents quantitative information about September 30, 2023 and December 31, 2022 Level 3 fair value measurements for assets measured at fair value on a non-recurring basis (dollars in thousands):

September 30, 2023	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted-Average)
Individually evaluated loans:				
Commercial and industrial	$2,546	Income approach	Fair value discount	10%
December 31, 2022				
Impaired loans:				
Commercial and industrial	$3,069	Sales comparison approach	Appraisal discounts	10%
Commercial and industrial	100	Income approach	Fair value discount	9%

Fair Value of Financial Instruments

The carrying value and estimated fair values of the Bank's financial instruments at September 30, 2023 and December 31, 2022 were as follows (in thousands):

	September 30, 2023		December 31, 2022		
	Carrying amount	Fair value	Carrying amount	Fair value	Fair value level of input
Financial assets:					
Cash and due from banks, interest-bearing deposits in financial institutions	$ 343,479	$ 343,479	$ 130,838	$ 130,838	Level 1
Federal funds sold	8,914	8,914	4,467	4,467	Level 1
Securities available-for-sale	354,024	354,024	396,416	396,416	Level 2
Securities held-to-maturity	—	—	1,240	1,240	Level 2
Loans held for sale	36,391	37,945	44,708	46,585	Level 2
Restricted equity securities	13,441	N/A	16,632	N/A	N/A
Loans held for investment	2,292,241	2,225,995	2,312,798	2,265,617	Level 3
Accrued interest receivable	12,299	12,299	10,511	10,511	Level 2
Other assets	94,350	94,350	93,230	93,230	Level 2 / Level 3
Financial liabilities:					
Deposits	2,796,680	2,789,811	2,679,819	2,659,822	Level 2
Subordinated notes and Federal Home Loan bank advances and other borrowings	79,766	79,734	44,666	43,831	Level 2
Other liabilities	10,698	10,698	4,605	4,605	Level 3

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

(a) Cash and Due from Banks, Interest-Bearing Deposits in Financial Institutions

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

(b) Restricted Equity Securities

It is not practical to determine the fair value of restricted securities due to restrictions placed on their transferability.

(c) Loans Held for Sale

Loans held for sale include residential mortgage loans, the guaranteed portion of SBA loans, and Tri-Net loans. The fair value of residential mortgage and SBA loans held for sale is measured using an exit price notion. The fair value of Tri-Net loans held for sale is measured using an exit price notion in as much as observable market data is available. Where there is no observable market data, the fair value of Tri-Net loans held for sale is estimated using discounted cash flow models. There were no Tri-Net loans held for sale as of September 30, 2023 or December 31, 2022.

(d) Loans

The fair value of loans was measured using an exit price notion. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral.

(e) Accrued Interest Receivable

The carrying amounts of accrued interest approximate fair value.

(f) Other Assets

Included in other assets are bank owned life insurance and certain interest rate swap agreements. The fair values of interest rate swap agreements are based on independent pricing services that utilize pricing models with observable market inputs. For bank owned life insurance, the carrying amount is based on the cash surrender value and is a reasonable estimate of fair value.

(g) Deposits

The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated by discounted cash flow models, using current market interest rates offered on certificates with similar remaining maturities.

(h) Federal Home Loan Bank Advances and Subordinated Debt

The fair value of fixed rate Federal Home Loan Bank Advances and subordinated notes is estimated using discounted cash flow models, using current market interest rates offered on certificates, advances and other borrowings with similar remaining maturities.

(i) Other Liabilities

Included in other liabilities are accrued interest payable and certain interest rate swap agreements. The fair values of interest rate swap agreements are based on independent pricing services that utilize pricing models with observable market inputs. The carrying amounts of accrued interest approximate fair value.

(j) Off-Balance Sheet Instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

(k) Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

NOTE 11 – SUBSEQUENT EVENTS

On October 26, 2023, Old National Bancorp (NASDAQ: ONB) ("Old National") and the Company entered into a definitive merger agreement for Old National to acquire CapStar in an all-stock transaction with an aggregate value of approximately $344 million, or $16.64 per share of CapStar common stock, based on Old National's 30-day volume weighted average closing stock price ending October 25, 2023. Under the terms of the merger agreement, shareholders of the Company will receive, in respect of each share of common stock of the Company held by them, 1.155 shares of common stock of ONB. The closing of the transaction is subject to both regulatory and CapStar shareholder approval. Effective October 27, 2023, the Company terminated its share repurchase program previously approved on May 25, 2023, which had authorized the Company to repurchase up to $20 million of shares of common stock through January 31, 2024. The Company had repurchased $3.5 million under the plan through termination date.

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

The following is a discussion of our financial condition at September 30, 2023 and December 31, 2022 and our results of operations for the three and nine months ended September 30, 2023 and 2022. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes in Part I - Item 1 of this Report, "Cautionary Note Regarding Forward-Looking Statements" and the risk factors discussed in our 2022 10-K and referenced in Part II, Item 1.A. of this Report and the other reports we have filed with the SEC after we filed our 2022 10-K. Annualized results for interim periods may not be indicative of results for the full year or future periods.

The following discussion and analysis pertains to our historical results on a consolidated basis. However, because we conduct all of our material business operations through our wholly-owned subsidiary, CapStar Bank, the following discussion and analysis relates to activities primarily conducted at the subsidiary level.

All dollar amounts in the tables in this section are in thousands of dollars, except share or per share data or when otherwise specifically noted.

Overview

The third quarter of 2023 resulted in $0.43 diluted net income per share of common stock, an increase of 16.2% compared to the third quarter of 2022. Annualized return on average assets was 1.10% for the third quarter of 2023 compared to 1.01% for the same period in 2022.

For the nine months ended September 30, 2023, diluted net income per share of common stock was $1.09, a decrease of 16.2% compared to the same period in 2022. Annualized return on average assets was 0.97% for the nine months ended September 30, 2023 compared to 1.22% for the same period in 2022.

At September 30, 2023, loans held for investment decreased to $2.29 billion, as compared to $2.31 billion at December 31, 2022. Total deposits increased to $2.80 billion at September 30, 2023 from $2.68 billion at December 31, 2022.

Our primary revenue sources are net interest income and fees from various financial services provided to customers. Net interest income is the difference between interest income earned on loans, investment securities and other interest earning assets less interest expense on deposit accounts and other interest bearing liabilities. Loan volume and interest rates earned on those loans are critical to overall profitability. Similarly, deposit volume is crucial to funding loans and rates paid on deposits directly impact profitability. Business volumes are influenced by competition, new business acquisition efforts and economic factors including market interest rates, business spending and consumer confidence.

Net interest income decreased $5.2 million, or 20.3%, for the three months ended September 30, 2023, compared to the same period in 2022 and decreased $5.0 million or 7.0% for the nine months ended September 30, 2023 compared to the same period in 2022. Net interest margin decreased to 2.71% for the three months ended September 30, 2023, compared with 3.50% for the same period of 2022 and decreased to 3.0% for the nine months ended September 30, 2023 from 3.29% for the same period in 2022. The decrease in net interest margin was attributable to the rising rate environment over the last 12 months as deposits repriced more quickly than loans.

The three months ended September 30, 2023 yielded a $1.6 million recovery of credit loss expense compared to $0.9 million provision for credit loss expense for the comparable period of 2022 and an expense of $0.9 million for the nine months ended September 30, 2023 compared to $0.9 million for the same period of 2022. The provision for the nine months ended September 30, 2023 largely reflects the $2.0 million provision expense related to the Signature Bank ("Signature") subordinated debt in available-for-sale debt securities in the first quarter of 2023 offset by the $1.6 million recovery in the third quarter driven by a decrease in loan volume as well as an improvement in unemployment rates which influence the CECL model.

Total noninterest income for the third quarter of 2023 increased $3.0 million, or 91.9%, compared with the same period in 2022, and comprised 24% of total revenues. Noninterest income for the nine months ended September 30, 2023 increased $0.5 million or 2.9% when compared to the same period in 2022 and comprised 22% of revenues. The increase of the three months ended September 30, 2023 versus the same period in 2022 is primarily attributable to Tri-Net losses in the three months ended September 30, 2022. The increase for the nine months ended September 30, 2023 versus the same period in 2022 is primarily attributable to an increase in SBA lending revenue offset by a decline in mortgage banking income.

Total noninterest expense for the three months ended September 30, 2023 decreased $0.9 million, or 4.8%, compared to the same period in 2022 and increased $2.6 million or 4.9% for the nine months ended September 30, 2023 compared to the same period in 2022. For both periods, salaries and benefits expense increased as well as data processing and software, professional service, and regulatory expenses. The third quarter of 2022 included a wire fraud loss and operational loss totaling $2.2 million. A recovery of the wire fraud loss was realized in the third quarter of 2023 in the amount of $0.5 million. Our efficiency ratio for the three months ended September 30, 2023 was 64.07% compared to 62.21% for the same period in 2022 and 65.11% for the nine months ended September 30, 2023 compared to 59.01% for the same period in 2022.

Common equity tier 1 capital to risk weighted assets, summarized in Note 8 of the consolidated financial statements, is a useful measure in evaluating the quality and adequacy of capital. Our consolidated ratio of common equity tier 1 capital to risk weighted assets was

13.38% as of September 30, 2023, compared with 12.61% at December 31, 2022.

Recent Events

On October 26, 2023, Old National and the Company entered into a definitive merger agreement for Old National to acquire CapStar in an all-stock transaction with an aggregate value of approximately $344 million, or $16.64 per share of CapStar common stock, based on Old National's 30-day volume weighted average closing stock price ending October 25, 2023. Under the terms of the agreement, shareholders of the Company will receive, in respect of each share of common stock of the Company held by them, 1.155 shares of common stock of ONB. The closing of the transaction is subject to both regulatory and CapStar shareholder approval.

The following sections provide more details on subjects presented in this overview.

Critical Accounting Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Our accounting and reporting estimates are in accordance with GAAP and conform to general practices within the banking industry. Estimates that are susceptible to significant changes include accounting for the allowance for credit losses and fair value measurements, both of which require significant judgments by management. Actual results could differ significantly from those estimates. Also, different assumptions in the application of these accounting estimates could result in material changes in our consolidated financial position or consolidated results of operations. Except as described below, there have been no significant changes to critical accounting estimates as discussed in the MD&A in our 2022 10-K.

Allowance for Credit Losses ("ACL")

Since the adoption of CECL on January 1, 2023, the ACL represents management's estimate of credit losses for the remaining estimated life of financial instruments, with particular applicability on our balance sheet to loans and unfunded loan commitments. Estimating the amount of the ACL requires significant judgment and the use of estimates related to historical experience, current conditions, reasonable and supportable forecasts, and the value of collateral on collateral-dependent loans. The loan portfolio also represents the largest asset type on our consolidated balance sheet. Loan losses are charged against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors.

There are many factors affecting the ACL; some are quantitative while others require qualitative judgment. Although management believes its process for determining the allowance adequately considers all the potential factors that could potentially result in credit losses, the process includes subjective elements and is susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provision for credit losses could be required that could adversely affect our earnings or financial position in future periods.

Note 1 to the consolidated financial statements includes additional information on accounting policies related to the ACL.

Results of Operations

The following is a summary of our results of operations:

	Three Months Ended September 30, 2023	Three Months Ended September 30, 2022	2023 - 2022 Percent Increase (Decrease)	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022	2023 - 2022 Percent Increase (Decrease)
Interest income	$ 41,264	$ 30,454	35.5 %	$ 116,334	$ 79,728	45.9 %
Interest expense	20,895	4,901	326.3 %	50,175	8,595	483.8 %
Net interest income	20,369	25,553	(20.3)%	66,159	71,133	(7.0)%
(Recovery of) provision for credit losses	(1,561)	867	100.0 %	903	926	(2.5)%
Net interest income after provision for loan losses	21,930	24,686	(11.2)%	65,256	70,207	(7.1)%
Noninterest income	6,278	3,272	91.9 %	18,765	18,237	2.9 %
Noninterest expense	17,072	17,931	(4.8)%	55,298	52,740	4.9 %
Net income before income taxes	11,136	10,027	11.1 %	28,723	35,704	(19.6)%
Income tax expense	2,211	1,988	11.2 %	5,548	7,018	(20.9)%
Net income	$ 8,925	$ 8,039	11.0 %	$ 23,175	$ 28,686	(19.2)%
Basic net income per share of common stock	$ 0.43	$ 0.37	16.2 %	$ 1.10	$ 1.30	(15.4)%
Diluted net income per share of common stock	$ 0.43	$ 0.37	16.2 %	$ 1.09	$ 1.30	(16.2)%

Annualized return on average assets and annualized return on average shareholders’ equity were 1.10% and 10.18%, respectively, for the third quarter of 2023, compared with 1.01% and 8.76%, respectively, for the same period in 2022.

Annualized return on average assets and annualized return on average shareholders’ equity were 0.97% and 8.85%, respectively, for the nine months ended September 30, 2023, compared with 1.22% and 10.41%, respectively, for the same period in 2022.

Net Interest Income

The largest component of our net income is net interest income – the difference between the income earned on interest-earning assets and the interest paid on deposits and borrowed funds used to support our assets. Net interest income divided by total average interest-earning assets represents our net interest margin. The major factors that affect net interest income and net interest margin are changes in volumes, the yield on interest-earning assets and the cost of interest-bearing liabilities. Our margin can also be affected by economic conditions, the competitive environment, loan demand and deposit flow. Our ability to respond to changes in these factors by using effective asset-liability management techniques is critical to maintaining the stability of the net interest margin and our net interest income.

The following tables set forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for interest-earning assets and interest-bearing liabilities, net interest spread and net interest margin for the three and nine month periods ended September 30, 2023 and 2022:

	For the Three Months Ended September 30,					
	2023			2022		
	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate
Interest-Earning Assets						
Loans (1)	$ 2,332,622	$ 35,157	5.98 %	$ 2,241,355	$ 26,128	4.62 %
Loans held for sale	34,625	284	3.25 %	94,811	1,207	5.05 %
Securities:						
Taxable investment securities (2)	328,666	2,264	2.76 %	396,358	2,181	2.20 %
Investment securities exempt from federal income tax (3)	52,059	301	2.93 %	54,575	314	2.92 %
Total securities	380,725	2,565	2.78 %	450,933	2,495	2.29 %
Cash balances in other banks	242,700	3,218	5.26 %	120,624	617	2.03 %
Funds sold	2,012	40	7.89 %	755	7	3.65 %
Total interest-earning assets	2,992,684	41,264	5.48 %	2,908,478	30,454	4.17 %
Noninterest-earning assets	238,054			238,363		
Total assets	$ 3,230,738			$ 3,146,841		
Interest-Bearing Liabilities						
Interest-bearing deposits:						
Interest-bearing transaction accounts	$ 915,604	6,672	2.89 %	$ 821,545	1,205	0.58 %
Savings and money market deposits	597,310	4,393	2.92 %	709,591	1,603	0.90 %
Time deposits	831,791	8,777	4.19 %	462,036	1,332	1.14 %
Total interest-bearing deposits	2,344,705	19,842	3.36 %	1,993,172	4,140	0.82 %
Borrowings and repurchase agreements	79,746	1,053	5.24 %	88,584	761	3.41 %
Total interest-bearing liabilities	2,424,451	20,895	3.42 %	2,081,756	4,901	0.93 %
Noninterest-bearing deposits	415,651			666,096		
Total funding sources	2,840,102			2,747,852		
Noninterest-bearing liabilities	42,841			34,851		
Shareholders' equity	347,795			364,138		
Total liabilities and shareholders' equity	$ 3,230,738			$ 3,146,841		
Net interest spread (4)			2.06 %			3.23 %
Net interest income/margin (5)		$ 20,369	2.71 %		$ 25,553	3.50 %

Footnotes appear below second table.

	For the Nine Months Ended September 30,					
	2023			2022		
	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate
Interest-Earning Assets						
Loans (1)	$2,357,260	$101,453	5.75%	$2,131,159	$68,481	4.30%
Loans held for sale	33,763	762	3.02%	99,749	2,995	4.01%
Securities:						
Taxable investment securities (2)	344,726	6,728	2.60%	413,229	6,187	2.00%
Investment securities exempt from federal income tax (3)	53,112	923	2.93%	55,798	958	2.90%
Total securities	397,838	7,651	2.65%	469,027	7,145	2.10%
Cash balances in other banks	166,563	6,305	5.06%	189,681	1,076	0.76%
Funds sold	3,026	163	7.20%	9,547	31	0.43%
Total interest-earning assets	2,958,450	116,334	5.27%	2,899,163	79,728	3.69%
Noninterest-earning assets	234,433			243,822		
Total assets	$3,192,883			$3,142,985		
Interest-Bearing Liabilities						
Interest-bearing deposits:						
Interest-bearing transaction accounts	$842,880	14,092	2.24%	$895,097	2,279	0.34%
Savings and money market deposits	624,189	10,906	2.34%	680,331	2,401	0.47%
Time deposits	788,795	21,713	3.68%	393,594	2,271	0.77%
Total interest-bearing deposits	2,255,864	46,711	2.77%	1,969,022	6,951	0.47%
Borrowings and repurchase agreements	89,639	3,464	5.17%	63,099	1,644	3.50%
Total interest-bearing liabilities	2,345,503	50,175	2.86%	2,032,121	8,595	0.57%
Noninterest-bearing deposits	454,323			707,084		
Total funding sources	2,799,826			2,739,205		
Noninterest-bearing liabilities	42,890			35,396		
Shareholders’ equity	350,167			368,384		
Total liabilities and shareholders’ equity	$3,192,883			$3,142,985		
Net interest spread (4)			2.41%			3.12%
Net interest income/margin (5)		$66,159	3.00%		$71,133	3.29%

(1) Average loan balances include nonaccrual loans. Interest income on loans includes amortization of deferred loan fees, net of deferred loan costs.

(2) Taxable investment securities include restricted equity securities.

(3) Yields on tax exempt securities are shown on a tax equivalent basis.

(4) Net interest spread is the average yield on total interest-earning assets minus the average rate on total interest-bearing liabilities.

(5) Net interest margin is annualized net interest income calculated on a tax equivalent basis divided by total average interest-earning assets for the period.

The following table reflects, for the periods indicated, the changes in our net interest income due to changes in the volume of interest-earning assets and interest-bearing liabilities and the associated rates earned or paid on these assets and liabilities.

	Three Months Ended September 30, 2023 Compared to 2022 Increase (Decrease) Due to Changes In			Nine Months Ended September 30, 2023 Compared to 2022 Increase (Decrease) Due to Changes In		
	Volume	Rate	Net	Volume	Rate	Net
Interest-Earning Assets						
Loans	$1,097	$7,932	$9,029	$7,891	$25,081	$32,972
Loans held for sale	(591)	(332)	(923)	(1,626)	(607)	(2,233)
Securities:						
Taxable investment securities	(169)	252	83	(668)	1,209	541
Investment securities exempt from federal income tax	(14)	1	(13)	(45)	10	(35)
Total securities	(183)	253	70	(713)	1,219	506
Cash balances in other banks	1,011	1,590	2,601	(115)	5,344	5,229
Funds Sold	19	14	33	(6)	138	132
Total interest-earning assets	1,353	9,457	10,810	5,431	31,175	36,606
Interest-Bearing Liabilities						
Interest-bearing transaction accounts	153	5,314	5,467	(125)	11,938	11,813
Savings and money market deposits	(212)	3,002	2,790	(180)	8,685	8,505
Time deposits	1,714	5,731	7,445	4,081	15,361	19,442
Borrowings and repurchase agreements	(67)	359	292	849	971	1,820
Total interest-bearing liabilities	1,588	14,406	15,994	4,625	36,955	41,580
Net Interest Income	$(235)	$(4,949)	$(5,184)	$806	$(5,780)	$(4,974)

The net interest margin was 2.71% and 3.50% for the third quarters of 2023 and 2022, respectively. The nine months ended September 30, 2023 had a net interest margin of 3.00% compared to 3.29% for the same period in 2022. The decrease in net interest margin for both periods was primarily due to the rising rate environment over the past 12 months as deposits repriced more quickly than loans.

The increase in market interest rates over the past year, with the federal funds rate rising to 5.50% as of September 30, 2023 versus 3.25% as of September 30, 2022, contributed to a decline in average non-interest bearing deposits and interest bearing transaction accounts, as shown in the tables above, offset by an increase in time deposits.

Average non-interest bearing deposits represented 15.1% of total deposits for the quarter ended September 30, 2023 compared to 25.0% for the quarter ending September 30, 2022, offset by an increase in higher cost time deposits. Similarly, average non-interest bearing deposits represented 16.8% of total deposits for the nine months ended September 30, 2023 compared to 26.4% for the same period of 2022. Deposit costs increased across all interest-bearing account types.

Provision for Credit Losses

Prior to January 1, 2023, the allowance for credit losses was based on the then-applicable incurred loss model and represented an estimate of probable incurred losses in the loan portfolio and unfunded commitments at the end of each reporting period. Since the adoption of CECL on January 1, 2023, the allowance for credit losses represents management’s estimate of life of loan credit losses in the loan portfolio and unfunded loan commitments and debt securities. The allowance for unfunded commitments, which is included in other liabilities in the consolidated balance sheets, represents expected losses on unfunded loan commitments that are expected to result in outstanding loan balances. Management’s estimate of credit losses under CECL is determined using a model that relies on reasonable and supportable forecasts and historical loss information to determine the balance of the ACL and resulting provision for credit losses.

For the three months ended September 30, 2023, there was a recovery of expense of $1.6 million compared to an expense of $0.9 million for the comparable period in 2022. For the nine months ended September 30, 2023, there was a provision expense of $0.9 million, which included a $2.0 million provision expense on the Signature subordinated debt in available-for-sale debt securities, compared to $0.9 million for the comparable period in 2022.

The recovery of credit losses on loans was $1.0 million and $0.5 million for the three and nine month periods ended September 30, 2023, respectively, compared to provisions of $0.9 million for the comparable periods in 2022. Net charge-offs for the three and nine months ended September 30, 2023 were $350 thousand and $699 thousand, respectively, compared to $120 thousand and $193 thousand for the three and nine comparable periods of 2022, respectively. Our ACL on loans at September 30, 2023 was 1.05% of total loans held for investment compared to 1.03% as of December 31, 2022. The recovery of provision during the third quarter of 2023 is largely driven by a decrease in loan volume as well as an improvement in economic metrics such as forecasted unemployment rates.

A recovery of provision of $0.5 million and $0.7 million related to unfunded commitments was recorded in the three and nine months ended September 30, 2023, respectively, related to the decrease in unfunded balances, changes in their composition, and other qualitative factors. The related ACL as a percentage of unfunded commitments decreased to 0.39% as of September 30, 2023 compared to 0.44% as of CECL adoption on January 1, 2023.

The $2.0 million provision on available-for-sale securities related to expected credit losses on the Signature subordinated debt following its first quarter 2023 failure. A corresponding ACL is recorded on the balance sheet in available-for-sale debt securities. Should such expected credit losses have been experienced under the incurred loss model prior to our adoption of CECL on January 1, 2023, they would have been recorded in other noninterest expense as other than temporary impairment with no corresponding allowance on the balance sheet.

See “Notes to Consolidated Financial Statements (Unaudited) — Note 3 — Loans and Allowance for Credit Losses on Loans” and Note 2 — "Securities" for additional information on our allowance for credit losses.

Noninterest Income

In addition to net interest income, we generate recurring noninterest income. Our banking operations generate revenue from service charges on deposit accounts, interchange and debit card transaction fees, originating and selling mortgage, commercial real estate and SBA loans, wealth management and gains (losses) on sales of securities. In addition to these types of recurring noninterest income, we own insurance on several key employees and record income within "Other noninterest income" based upon the increase in the cash surrender value of these policies.

The following table sets forth the principal components of noninterest income for the periods indicated.

	Three Months Ended September 30,		2023 - 2022 Percent Increase (Decrease)	Nine Months Ended September 30,		2023 - 2022 Percent Increase (Decrease)
	2023	2022		2023	2022	
Noninterest income:						
Deposit service charges	$ 1,347	$ 1,251	*7.7 %*	$ 3,979	$ 3,575	*11.3 %*
Interchange and debit card transaction fees	1,195	1,245	*(4.0)%*	3,293	3,803	*(13.4)%*
Mortgage banking	749	765	*(2.1)%*	2,997	4,436	*(32.4)%*
Tri-Net	19	(2,059)	*(100.9)%*	46	39	*17.9 %*
Wealth management	441	385	*14.5 %*	1,241	1,284	*(3.3)%*
SBA lending	531	560	*(5.2)%*	2,599	1,054	*146.6 %*
Net gain on sale of securities	—	7	*(100.0)%*	5	8	*(37.5)%*
Other noninterest income	1,996	1,118	*78.5 %*	4,605	4,038	*14.0 %*
Total noninterest income	$ 6,278	$ 3,272	*91.9 %*	$ 18,765	$ 18,237	*2.9 %*

Deposit service charges increased for the three and nine months ended September 30, 2023 compared to the same periods in 2022. These amounts originate from our commercial and consumer deposit accounts.

Interchange and debit card transaction fees fluctuate based upon transaction volumes, which were lower for the three and nine months ended September 30, 2023 compared to the same period in 2022.

Mortgage banking income consists of fees and gains from the origination of loans in our markets that are subsequently sold to third-party investors. Generally, mortgage banking income increases in lower interest rate environments and more robust housing markets and declines in rising interest rate environments and more challenging housing markets. Mortgage banking income will fluctuate from period to period as the rate environment changes. The declines above are indicative of the mortgage market responding to the higher rate environment.

Tri-Net represents a line of business which generally originates and sells commercial real estate loans to third-party investors. All of these loan sales transfer servicing rights to the buyer. Tri-Net activity remained limited in 2023 as the Company assessed market pricing. Comparatively, in the second and third quarters of 2022, the Company transferred a cumulative $131.1 million of Tri-Net loans from loans held for sale to loans held for investment due to the adverse impact of rapidly rising interest rates on pricing and investor demand. This resulted in a $1.3 million realized loss on sale of loans and a $2.2 million unrealized loss on loans transferred to held for investment, partially offset by a $1.6 million gain on its hedge instruments in the three months ended September 30, 2022. For the nine months ended September 30, 2022, Tri-Net results included a $1.3 million realized loss on sale of loans and a $2.4 million unrealized loss on loans transferred to held for investment, partially offset by a $1.6 million gain on its hedge instruments.

Noninterest income for SBA lending, which represents gains on sales of guaranteed portions of SBA loans, increased for the nine month period ended September 30, 2023 when compared to the same period in 2022 as the Company expanded the SBA team in the fourth quarter of 2022. Income for the three month periods remained relatively stable.

Other noninterest income primarily consists of loan related fees, bank-owned life insurance, and other service-related fees. The three months ended September 30, 2023 had increased servicing income and Small Business Investment Company (SBIC) income when compared to the same period in 2022 as well as a $0.4 million death benefit income from bank-owned life insurance. When comparing the nine months ended September 30, 2023 to the same period in 2022, servicing income and SBIC income are increased while death benefit income from bank-owned life insurance decreased $0.5 million when compared to 2022.

Noninterest Expense

The following table presents the primary components of noninterest expense for the periods indicated.

	Three Months Ended September 30,		2023 - 2022 Percent Increase (Decrease)	Nine Months Ended September 30,		2023 - 2022 Percent Increase (Decrease)
	2023	2022		2023	2022	
Noninterest expense:						
Salaries and employee benefits	$9,573	$8,712	*9.9%*	$30,447	$28,191	*8.0%*
Data processing and software	3,245	2,861	*13.4%*	9,750	8,355	*16.7%*
Occupancy	1,161	1,092	*6.3%*	3,451	3,266	*5.7%*
Equipment	591	743	*(20.5)%*	2,087	2,235	*(6.6)%*
Professional services	674	468	*44.0%*	2,361	1,653	*42.8%*
Regulatory fees	435	269	*61.7%*	1,267	814	*55.7%*
Amortization of intangibles	352	415	*(15.2)%*	1,104	1,291	*(14.5)%*
Other operating	1,041	3,371	*(69.1)%*	4,831	6,935	*(30.3)%*
Total noninterest expense	$17,072	$17,931	*(4.8)%*	$55,298	$52,740	*4.9%*

Salaries and employee benefits expense increased for the three and nine months ended September 30, 2023 compared to the same periods in 2022. This is partially due to the $0.8 million voluntary executive incentive reversals in the third quarter of 2022 following two operational loss incidents. At September 30, 2023, our associate base decreased to 366 compared to 387 at September 30, 2022.

Regulatory fees expenses increased for the three and nine months ended September 30, 2023 compared to the same periods in 2022 as the FDIC increased assessment rates in the current year.

Other operating noninterest expenses in 2022 include the $2.2 million aforementioned operation loss incidents which were recorded in the third quarter of 2022. Comparatively, $0.5 million of this loss was recovered in the third quarter of 2023.

Our efficiency ratio was 64.07% and 62.21% for the three months ended September 30, 2023 and 2022, respectively, and 65.11% and 59.01% for the nine months ended September 30, 2023 and 2022, respectively, with the increase being driven by the aforementioned noninterest expense factors combined with a decline in total revenue for the three and nine months ended September 30, 2023 when compared to the same periods of 2022. The efficiency ratio is the ratio of noninterest expense to the sum of net interest income and noninterest income and measures the amount of expense that is incurred to generate a dollar of revenue.

Income Tax Provision

The Company’s effective tax rate for the three month period ended September 30, 2023 remained relatively stable at 19.9% compared to 19.8% for the three month period ended September 30, 2022 and decreased slightly from 19.7% to 19.3% for the nine months ended September 30, 2023 compared to the same period in 2022.

The effective tax rate for the three and nine months ended September 30, 2023 compared favorably versus the statutory tax rate due to our investments in qualified municipal securities, tax benefits from our real estate investment trust, company owned life insurance, state tax credits, net of the effect of certain non-deductible expenses and the recognition of excess tax benefits related to stock compensation.

Financial Condition

Balance Sheet

Total assets increased $147.4 million, or 4.7%, from $3.12 billion on December 31, 2022 to $3.26 billion on September 30, 2023. Loans held for investment declined $20.6 million, or 0.9% when compared to December 31, 2022. Loans held for sale decreased $8.3 million, or 18.6%, when compared to December 31, 2022.

Total liabilities increased $155.9 million, or 5.6%, from $2.76 billion on December 31, 2022 to $2.92 billion on September 30, 2023. Deposits increased $116.9 million, or 4.4%.

Loans

The composition of loans at September 30, 2023 and December 31, 2022 and the percentage of each classification to total loans are summarized as follows:

	September 30, 2023		December 31, 2022	
	Amount	Percent	Amount	Percent
Commercial real estate - owner occupied	$ 280,273	*12.2%*	$ 246,109	*10.7%*
Commercial real estate - non-owner occupied	799,084	*34.8%*	803,611	*34.7%*
Consumer real estate	429,028	*18.7%*	402,615	*17.4%*
Construction and land development	205,486	*9.0%*	229,972	*9.9%*
Commercial and industrial	485,028	*21.2%*	496,347	*21.5%*
Consumer	50,860	*2.2%*	53,382	*2.3%*
Other	42,482	*1.9%*	80,762	*3.5%*
Total loans	$ 2,292,241	*100.0%*	$ 2,312,798	*100.0%*

Our principal market for lending is the State of Tennessee and adjacent states that can be effectively accessed from our banking offices. Our target borrower profile includes consumers, small to medium sized businesses, professional firms, real estate investors and developers, and their owners and managers. Our growth since 2018 has been concentrated in borrowers meeting that profile. Our primary competition is community, regional, and national banks operating in our primary markets. In seeking customer banking relationships, we rely on a model of delivering services through a qualified banker meeting all the banking service needs of the business and its primary stakeholders.

At September 30, 2023, our loan portfolio composition remained relatively consistent versus December 31, 2022. Our loan growth since inception has been reflective of the target market that we serve with commercial real estate loans making up 47% of the portfolio. The repayment of owner-occupied properties is largely dependent on the operations of the tenant, while non-owner occupied properties is dependent upon the operation, refinance, or sale of the underlying real estate.

Non-Performing Loans and Assets

Information summarizing non-performing assets, including non-accrual loans follows:

	September 30, 2023		December 31, 2022	
Non-accrual loans:				
Commercial real estate - owner occupied	$	113	$	4,982
Commercial real estate - non-owner occupied		450		—
Consumer real estate		1,871		456
Construction and land development		5		8
Commercial and industrial		2,229		4,065
Consumer		1,762		54
Other		—		—
PCI (Under incurred loss methodology)		—		1,149
Total non-accrual loans	$	6,430	$	10,714
Non-performing loans		6,430		10,714
Other real estate owned		11		—
Non-performing assets	$	6,441	$	10,714
Non-performing loans to loans held for investment		0.28 %		0.46 %
Non-performing assets to total assets		0.20 %		0.34 %

Non-performing loans to total loans decreased to 0.28% at September 30, 2023 compared to 0.46% at December 31, 2022 as two large relationships returned to accrual status based on positive financial performance and timely payments.

Allocation of ACL

	September 30, 2023		December 31, 2022	
	Amount	Percent	Amount	Percent
Commercial real estate - owner occupied	$2,346	*9.7%*	$1,967	*8.2%*
Commercial real estate - non-owner occupied	6,525	*27.1%*	5,967	*25.1%*
Consumer real estate	3,730	*15.4%*	3,153	*13.2%*
Construction and land development	3,299	*13.7%*	3,830	*16.1%*
Commercial and industrial	5,755	*23.8%*	7,654	*32.2%*
Consumer	1,772	*7.3%*	430	*1.8%*
Other	730	*3.0%*	805	*3.4%*
Total loans	$24,157	*100.00%*	$23,806	*100.00%*

Securities

The composition of securities at September 30, 2023 and December 31, 2022 are summarized as follows:

	September 30, 2023		December 31, 2022	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available-for-sale:				
U. S. government agency securities	$13,175	$11,272	$14,537	$12,902
State and municipal securities	74,807	64,901	77,562	68,312
Mortgage-backed securities	277,630	216,905	300,488	244,828
Asset-backed securities	3,189	3,099	3,332	3,270
Other debt securities	64,642	57,847	70,542	67,104
Total	$433,443	$354,024	$466,461	$396,416
Securities held-to-maturity:				
State and municipal securities	$—	$—	$1,240	$1,240
Total	$433,443	$354,024	$467,701	$397,656

Our investment securities had a fair value of $354.0 million at September 30, 2023 compared to $397.7 million at December 31, 2023. The Company recorded a provision for credit loss on available-for-sale securities and a corresponding ACL of $2.0 million during the first quarter of 2023 related to ownership in Signature subordinated debt securities which, following

Signature's first quarter failure, were deemed to have significant credit losses and no probable recovery. The Company has performed an assessment of its corporate debt securities which is largely made up of other financial institution investment grade subordinated debt based on various factors including liquidity and soundness of the underlying financial institution and credit rating and no other such credit losses are expected to be present in the Company's portfolio as of September 30, 2023.

Deposits

The composition of deposits at September 30, 2023 and December 31, 2022 and the percentage of each classification to total deposits are summarized as follows:

	September 30, 2023		December 31, 2022	
	Amount	**Percent**	**Amount**	**Percent**
Noninterest-bearing	$432,203	*15.5%*	$512,076	*19.1%*
Interest-bearing	947,998	*33.9%*	749,857	*28.0%*
Savings and money market accounts	618,609	*22.1%*	709,190	*26.5%*
Time	797,870	*28.5%*	708,696	*26.4%*
Total deposits	$2,796,680	*100.0%*	$2,679,819	*100.0%*

Deposits have increased $116.9 million or, 17.3% when annualized, to $2.80 billion as of September 30, 2023 compared to December 31, 2022. This increase is driven by our interest-bearing transaction accounts and time deposit accounts and partially offset by decreases in our non-interest bearing and savings and money market accounts.

Asset/Liability Management and Interest Rate Risk

Managing interest rate risk is fundamental for the financial services industry. The primary objective of interest rate risk management is to mitigate effects of interest rate changes on net income. By considering both on and off-balance sheet financial instruments, management evaluates interest rate sensitivity while attempting to optimize net interest income within the constraints of prudent capital adequacy, liquidity needs, and customer requirements.

Interest Rate Simulation Sensitivity Analysis

We use earnings at risk, or EAR, simulations to assess the impact of changing rates on earnings under a variety of scenarios and time horizons. The simulation model is designed to reflect the dynamics of interest earning assets, interest bearing liabilities and off-balance sheet financial instruments. These simulations utilize both instantaneous and parallel changes in the level of interest rates, as well as non-parallel changes such as changing slopes and twists of the yield curve. Static simulation models are based on current exposures and assume a constant balance sheet with no growth. By estimating the effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. The simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and does not indicate actual expected results.

At September 30, 2023, our EAR static simulation results indicated that our net interest income over the next year is estimated to benefit modestly from further rate increases while being adversely impacted by falling interest rates. This indicates that our assets generally reprice faster than our liabilities, which results in a favorable impact to net interest income when market interest rates increase and an unfavorable impact to net interest income when market interest rates decline. Many assumptions are used to calculate the impact of interest rate fluctuations on our net interest income, such as asset prepayments, non-maturity deposit price sensitivity, and key rate drivers. Because of the inherent use of these estimates and assumptions in the model, our actual results may, and most likely will, differ from our static EAR results. In addition, static EAR results do not include actions that our management may undertake to manage the risks in response to anticipated changes in interest rates or client behavior. For example, as part of our asset/liability management strategy, management has the ability to increase asset duration and/or decrease liability duration in order to reduce asset sensitivity, or to decrease asset duration and/or increase liability duration in order to increase asset sensitivity.

The following table illustrates the results of our EAR analysis regarding the extent to which our net interest income over the next 12 months would change if prevailing interest rates increased or decreased immediately by the specified amounts.

	Net interest income change
Increase 300bp	9.6%
Increase 200bp	5.5%
Increase 100bp	2.6
Decrease 100bp	(3.0)
Decrease 200bp	(5.5)
Decrease 300bp	(7.5)

Liquidity

Liquidity risk is the risk that we will be unable to meet our obligations as they become due because of an inability to liquidate assets or obtain adequate funding. Management has established a comprehensive process for identifying, measuring, monitoring and controlling liquidity risk. Because of its critical importance to the viability of the Bank, liquidity risk management is fully integrated into our risk management processes. Critical elements of our liquidity risk management include: effective corporate governance consisting of oversight by the board of directors and active involvement by management; appropriate strategies, policies, procedures, and limits used to manage and mitigate liquidity risk; comprehensive liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds) that are commensurate with the complexity and business activities of the Bank; active management of intraday liquidity and collateral; an appropriately diverse mix of funding sources; adequate levels of highly liquid marketable securities free of legal, regulatory, or operational impediments, that can be used to meet liquidity needs in stressful situations; comprehensive contingency funding plans that sufficiently address potential adverse liquidity events and emergency cash flow requirements; and internal controls and internal audit processes sufficient to determine the adequacy of the institution’s liquidity risk management process.

The role of liquidity management is to ensure funds are available to meet depositors’ withdrawal and borrowers’ credit demands while at the same time maximizing profitability. This is accomplished by balancing changes in demand for funds with changes in the supply of those funds. Liquidity is provided by short-term liquid assets that can be converted to cash, investment securities available-for-sale, various lines of credit, and the ability to attract funds from external sources, principally deposits.

Overall liquidity sources total $1.7 billion as of September 30, 2023. Our most liquid assets are comprised of cash and due from banks, interest-bearing deposits in financial institutions, available-for-sale marketable investment securities and federal funds sold. Interest-bearing deposits in financial institutions totaled $322.1 million at September 30, 2023, representing an increase of $216.5 million from December 31, 2022. The fair value of the available-for-sale investment portfolio was $354.0 million at September 30, 2023, a decrease of $42.4 million from December 31, 2022. We pledge portions of our investment securities portfolio to secure public fund deposits, derivative positions and Federal Home Loan Bank advances. At September 30, 2023, total investment securities pledged for these purposes comprised 53% of the estimated fair value of the investment portfolio, leaving $167.2 million of unpledged securities. Other sources of funds available to meet daily needs include $424.6 million of borrowing capacity from the FHLB of Cincinnati, $302.2 million of borrowing capacity from the Federal Reserve Bank of Atlanta’s discount window and federal funds lines with correspondent banks totaling $115.0 million at September 30, 2023. We also have the ability to issue an additional $218.0 million of brokered CDs based on internal limits and $62.6 million of additional funding capacity through the Federal Reserve's Bank Term Funding Program.

The Company has a diversified deposit portfolio comprised 88% of customer deposits and 12% of brokered deposits. Correspondent Banking customers account for 11.3% of customer deposits. As of September 30, 2023 66.7% of deposits were insured or collateralized.

We have a large base of non-maturity customer deposits, defined as demand, savings, and money market deposit accounts. At September 30, 2023, such deposits totaled $2.0 billion and represented approximately 71% of our total deposits.

The principal source of cash for CapStar Financial Holdings, Inc. (the “Parent Company”) is dividends paid to it as the sole shareholder of the Bank. At September 30, 2023, the Bank was able to pay up to $98.6 million in dividends to the Parent Company without regulatory approval subject to the ongoing capital requirements of the Bank.

Accordingly, management currently believes that our funding sources are at sufficient levels to satisfy our short-term and long-term liquidity needs.

Capital Resources

At September 30, 2023, shareholders' equity decreased to $345.6 million compared to December 31 2022 balance of $354.2 million. The decrease was due to other comprehensive loss, share repurchases, dividend payments, and the impact of the CECL adoption on January 1, 2023, offset by net income. As of September 30, 2023, the Company and the Bank were well-capitalized under the regulatory framework for prompt corrective action.

Off-Balance Sheet Arrangements

In the normal course of business, we enter into various transactions that, in accordance with U.S. GAAP, are not included in our consolidated balance sheet. We enter into these transactions to meet the financing needs of our clients. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets. Most of these commitments mature within two years and are expected to expire without being drawn upon. Standby letters of credit are included in the determination of the amount of risk-based capital that the Company and the Bank are required to hold.

We enter into contractual loan commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon clients maintaining specific credit standards until the time of loan funding.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of a client to a third party. In the event that the client does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek recovery from the client. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

We minimize our exposure to loss under loan commitments and standby letters of credit by subjecting them to the same credit approval and monitoring procedures as we do for on-balance sheet instruments. We assess the credit risk associated with certain commitments to extend credit and establish a liability for expected credit losses. The effect on our revenue, expenses, cash flows and liquidity of the unused portions of these commitments cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Our off-balance sheet arrangements are summarized in Note 6 of the consolidated financial statements.

Non-GAAP Financial Measures

This Report includes the following financial measures that have been prepared other than in accordance with U.S. GAAP ("non-GAAP financial measures"): tangible book value per share; tangible book value per share of common stock less after-tax unrealized available for sale investment losses; tangible common equity to tangible assets and tangible common equity; to tangible assets less after-tax unrealized available for sale investment losses. The Company believes that these non-GAAP financial measures (i) provide useful information to management and investors that is supplementary to its financial condition, results of operations and cash flows computed in accordance with U.S. GAAP, (ii) enable a more complete understanding of factors and trends affecting the Company's business, and (iii) allow investors to evaluate the Company's performance in a manner similar to management, the financial services industry, bank stock analysts and bank regulators; however, the Company acknowledges that its non-GAAP financial measures have a number of limitations. As such, you should not view these disclosures as a substitute for results determined in accordance with U.S. GAAP, and they are not necessarily comparable to non-GAAP financial measures that other companies use.

The following table presents a reconciliation of the non-GAAP measures referenced above to the most directly comparable U.S. GAAP financial measures.

	For the three months ended		For the nine months ended	
	9/30/2023	9/30/2022	9/30/2023	9/30/2022
Annualized pretax preprovision return on assets				
Annualized return on assets (GAAP)	1.10%	1.01%	0.97%	1.22%
Effect of income tax and provision expense	0.08%	0.36%	0.27%	0.34%
Annualized pretax preprovision return on assets	1.18%	1.37%	1.24%	1.56%
Effect of operational (recoveries) losses	(0.07)%	0.28%	(0.02)%	0.09%
Effect of the reversal of executive incentives	—	(0.10)%	—	(0.03)%
Adjusted annualized pretax preprovision return on assets	1.11%	1.55%	1.22%	1.62%
Annualized return on tangible common equity				
Annualized return on equity (GAAP)	10.18%	8.76%	8.85%	10.41%
Effect of goodwill and other intangibles	1.52%	1.29%	1.32%	1.53%
Return on tangible common equity	11.70%	10.05%	10.17%	11.94%
Effect of operational (recoveries) losses	(0.65)%	2.74%	(0.22)%	0.91%
Effect of the reversal of executive incentives	—	(0.96)%	—	(0.32)%
Adjusted return on tangible common equity	11.05%	11.83%	9.95%	12.53%
Tangible book value per share of common stock				
Book value per share of common stock (GAAP)	$16.67	$15.84	$16.67	$15.84
Effect of goodwill and other intangibles	(2.17)	(2.12)	(2.17)	(2.12)
Tangible book value per share of common stock	$14.50	$13.72	$14.50	$13.72
Tangible book value per share of common stock less after-tax unrealized available for sale investment losses				
Tangible book value per share of common stock	$14.50	$13.72	$14.50	$13.72
Effect of after-tax unrealized losses	2.83	2.44	2.83	2.44
Tangible book value per share of common stock less after-tax unrealized available for sale investment losses	$17.33	$16.16	$17.33	$16.16
Tangible common equity to tangible assets				
Equity to Assets (GAAP)	10.59%	10.97%	10.59%	10.97%
Effect of goodwill and other intangibles	(1.25)%	(1.32)%	(1.25)%	(1.32)%
Tangible common equity to tangible assets	9.34%	9.65%	9.34%	9.65%
Tangible common equity to tangible assets less after-tax unrealized available for sale investment losses				
Tangible common equity to tangible assets	9.34%	9.65%	9.34%	9.65%
Effect of after-tax unrealized losses	1.62%	1.52%	1.62%	1.52%
Tangible common equity to tangible assets less after-tax unrealized available for sale investment losses	10.96%	11.17%	10.96%	11.17%
Adjusted annualized noninterest expense as a percentage of average assets				
Annualized noninterest expense as a percentage of average assets	2.10%	2.26%	2.32%	2.24%
Effect of operational recoveries (losses)	0.06%	(0.28)%	0.02%	(0.09)%
Effect of the reversal of executive incentives	—	0.10%	—	0.03%
Adjusted annualized noninterest expense as a percentage of average assets	2.16%	2.08%	2.34%	2.18%

Impact of Inflation

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with U.S. GAAP and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

There have been no material changes in our market risk as of September 30, 2023 from that presented in our 2022 10-K. Information about our interest rate sensitivity is included in “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Simulation Sensitivity Analysis” of this Report and incorporated herein by this reference.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company, with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Report. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of the end of the period covered by this Report.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f)) that occurred during the period covered by this Report that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, the Holding Company and the Bank are parties to various legal proceedings. Additionally, in the ordinary course of business, the Holding Company and the Bank are subject to regulatory examinations and investigations. Based on our current knowledge and advice of counsel, in the opinion of management there is no such pending or threatened legal matter which would result in a material adverse effect upon our consolidated financial condition or results of operations.

Items 1A. Risk Factors

For information regarding factors that could affect the Company's results of operations, financial condition and liquidity, see the risk factors disclosed in the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2022.

As a result of the Company entering into the merger agreement with Old National, certain additional risk factors have been identified:

Failure to complete the merger could negatively impact the Company.

If the merger is not completed for any reason, there may be various adverse consequences and the Company may experience negative reactions from the financial markets and from its customers and employees. For example, the Company’s business may have been impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger. Additionally, if the merger agreement is terminated, the market price of the Company common stock could decline to the extent that current market prices reflect a market assumption that the merger will be beneficial and will be completed. The Company also could be subject to litigation related to any failure to complete the merger or to proceedings commenced against the Company to perform its obligations under the merger agreement. If the merger agreement is terminated under certain circumstances, the Company may be required to pay a termination fee of $11.25 million to Old National.

Additionally, the Company has incurred and will incur substantial expenses in connection with the negotiation and completion of the transactions contemplated by the merger agreement, as well as the costs and expenses of preparing, filing, printing, and mailing the proxy statement/prospectus, and all filing and other fees paid in connection with the merger. If the merger is not completed, the Company would have to pay these expenses without realizing the expected benefits of the merger.

Regulatory approvals may not be received, may take longer than expected, or may impose conditions that are not presently anticipated or that could have an adverse effect on the combined company following the merger.

Before the merger and the subsequent merger of CapStar Bank and Old National Bank may be completed, various approvals, consents and non-objections must be obtained from certain authorities, including the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency. In determining whether to grant these approvals, such regulatory authorities consider a variety of factors, including the regulatory standing of each party. These approvals could be delayed or not obtained at all, including due to an adverse development in either party’s regulatory standing or in any other factors considered by regulators when granting such approvals; governmental, political or community group inquiries, investigations or opposition; or changes in legislation or the political environment generally.

The approvals that are granted may impose terms and conditions, limitations, obligations or costs, or place restrictions on the conduct of the combined company’s business or require changes to the terms of the transactions contemplated by the merger agreement. There can be no assurance that regulators will not impose any such conditions, limitations, obligations or restrictions and that such conditions, limitations, obligations or restrictions will not have the effect of delaying the completion of any of the transactions contemplated by the merger agreement, imposing additional material costs on or materially limiting the revenues of the combined company following the merger or otherwise reducing the anticipated benefits of the merger if the merger were consummated successfully within the expected timeframe. In addition, there can be no assurance that any such conditions, terms, obligations or restrictions will not result in the delay or abandonment of the merger. Additionally, the completion of the merger is conditioned on the absence of certain orders, injunctions or decrees by any court or regulatory agency of competent jurisdiction that would prohibit or make illegal the completion of any of the transactions contemplated by the merger agreement.

In addition, despite the parties’ commitments to using their reasonable best efforts to comply with conditions imposed by regulators, under the terms of the merger agreement, neither Old National nor the Company is required to take any action, or agree to any condition or restriction that would reasonably be expected to have a material adverse effect on Old National and its subsidiaries, taken as a whole, after giving effect to the merger (measured on a scale relative to the Company and its subsidiaries, taken as a whole).

The Company will be subject to business uncertainties and contractual restrictions while the merger is pending.

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on the Company. These uncertainties may impair the Company's ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with the Company to seek to change existing business relationships with the Company. In addition, due to certain restrictions in the merger agreement on the conduct of business prior to completing the merger, we may be unable, during the pendency of the merger to pursue certain actions, even if such actions would prove beneficial, and we may have to forgo certain opportunities we might otherwise pursue.

Shareholder litigation related to the merger could prevent or delay the completion of the merger, result in the payment of damages or otherwise negatively impact the business and operations of the Company.

Shareholders may bring claims in connection with the proposed merger and among other remedies, may seek damages or an injunction preventing the merger from closing. If any plaintiff were successful in obtaining an injunction prohibiting the Company from completing the merger or any other transactions contemplated by the merger agreement, then such injunction may delay or prevent the effectiveness of the merger and could result in costs to the Company, including costs in connection with the defense or settlement of any shareholder lawsuits filed in connection with the merger. Further, such lawsuits and the defense or settlement of any such lawsuits may have an adverse effect on the financial condition and results of operations of the Company.

The merger agreement may be terminated in accordance with its terms and the merger may not be completed.

The merger agreement is subject to a number of conditions which must be fulfilled in order to complete the merger. Those conditions include (1) receipt of Company shareholder approval, (2) the admission for listing on the Nasdaq Stock Exchange of the shares of Old National common stock to be issued in the merger, (3) receipt of required regulatory approvals, including the approval of the Federal Reserve Board and the Office of the Comptroller of the Currency, (4) effectiveness of the registration statement on Form S-4 for the Old National common stock to be issued in the merger, and (5) the absence of any order, injunction, decree or other legal restraint preventing or making illegal the completion of the merger or any of the other transactions contemplated by the merger agreement. Each party's obligation to complete the merger is also subject to certain additional customary conditions, including (1) relating to the accuracy of the representations and warranties of the other party, (2) performance in all material respects by the other party of its obligations under the merger agreement, (3) absence of a material adverse effect on the other party and (4) receipt by such party of an opinion from its counsel to the effect that the merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended. Additionally, Old National's obligation to close is subject to the Company's adjusted tangible shareholder's equity as of the month-end prior to five business days before the closing date exceeding a specified minimum value.

These conditions to the closing may not be fulfilled in a timely manner or at all, and, accordingly, the merger may not be completed. In addition, the parties can mutually decide to terminate the merger agreement at any time, before or after the requisite shareholder and shareholder approvals, or Old National or the Company may elect to terminate the merger agreement in certain other circumstances.

Because the market price of Old National common stock may fluctuate, the Company shareholders cannot be certain of the market value of the merger consideration they will receive.

In the merger, each share of Company common stock issued and outstanding immediately prior to the effective time, will be converted into 1.155 shares of Old National common stock. This exchange ratio is fixed and will not be adjusted for changes in the market price of either Old National common stock or the Company common stock. Changes in the price of Old National common stock between now and the time of the merger will affect the value that the Company shareholders will receive in the merger. Neither Old National nor the Company is permitted to terminate the merger agreement as a result of any increase or decrease in the market price of Old National common stock or the Company common stock.

Stock price changes may result from a variety of factors, including general market and economic conditions, changes in Old National's and the Company's businesses, operations and prospects, the volatility in the prices of securities in global financial markets, including market prices of Old National, the Company and other banking companies, the effects of regulatory considerations and tax laws, many of which are beyond Old National's and the Company's control. Therefore, the Company shareholders will not know the market value of the consideration that they will receive until the effective time.

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

Issuer Purchases of Equity Securities

The following table shows information relating to the repurchase of shares of common stock by the Company during the three months ended September 30, 2023.

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan (1)	Maximum remaining dollar value of shares that may be purchased under the plan
July 1 - July 31	42,683	$ 13.32	42,683	$18.48 million
August 1 -August 31	57,172	13.96	57,172	$17.68 million
September 1 - September 30	45,255	13.78	40,255	$17.13 million
Total	145,110	$ 13.71	140,110	$17.13 million

(1) On May 25, 2023 the board of directors approved an update to the Company's share repurchase program which authorized the Company to repurchase up to $20 million of shares of common stock after the previous $10 million program was completed. The plan was terminated effective October 27, 2023 as part of events noted in Note 11 - Subsequent events.

Item 5. Other Information

Reference is made to the Company's definitive proxy statement filed with the Securities and Exchange Commission on March 10, 2023 (the "Proxy Statement") in connection with the Company's annual meeting of shareholders held on April 19, 2023. On page 37 of the Proxy Statement, under the heading "Executive Compensation – Option Exercises and Stock Vested," the Company disclosed information concerning the vesting of restricted stock units (RSUs) and performance stock units (PSUs) for Named Executive Officers (NEOs) during the year ended December 31, 2022. The information in the Proxy Statement was based on an estimate made at the time of issuance of the Proxy Statement of performance being achieved at 116.27% of target. That performance metric has now been determined to be at 120% of target rather than 116.27% of target – as a result, we are updating that information - therefore, the Option Exercises and Stock Vested section of the Proxy Statement is hereby deleted in its entirety and replaced with the following:

Option Exercises and Stock Vested

The following table contains information concerning the vesting of RSUs and PSUs during the fiscal year ended December 31, 2022, for the NEOs.

Option Exercises and Stock Vested

	Stock Awards	
Name (1)	Number of Shares Acquired on Vesting (#) (2)	Value Realized on Vesting ($) (3)
Timothy K. Schools	21,789	360,712
Michael J. Fowler	685	12,097
Jennie L. O'Bryan	1,142	23,225
Christopher G. Tietz	13,348	227,146
Kenneth E. Webb	377	6,658
Denis J. Duncan	2,504	38,549

(1) Mr. Davis had no shares vest during 2022.

(2) In the Proxy Statement, this column included 2020 PSUs based upon achievement of 116.27% of target based on performance on the relative operational metrics (as of September 30, 2022) and RTSR (as of December 31, 2022). This column now includes updated information that reflects finalized performance metrics of 120% of target.

(3) Calculated by multiplying the close price of the common stock on the Nasdaq Global Select Market on the date of vesting by the number shares of RSUs acquired upon vesting. For Messrs. Schools and Tietz, the amount reported is the aggregate shares vesting from multiple grants of RSUs. The value of the 2020 PSUs is calculated by multiplying the close price of the common stock on the

Nasdaq Global Select Stock on August 8, 2023, by the number of shares acquired on vesting using the performance on the applicable metrics referenced in footnote #2 to this table.

Item 6. Exhibits

Exhibit Number	Description
2.1*	Agreement and Plan of Merger, dated as of October 26, 2023, by and between the Company and Old National (incorporated by reference herein to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 31, 2023)
3.1	Charter of CapStar Financial Holdings, Inc. (incorporated by reference herein to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (File Number 333-213367) filed on August 29, 2016)
3.2	Articles of Amendment to the Charter of CapStar Financial Holdings, Inc. (incorporated by reference herein to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 29, 2020)
3.3	Amended and Restated Bylaws of CapStar Financial Holdings, Inc. (incorporated by reference herein to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 28, 2019)
10.1	First Amendment to Change in Control Continuity Agreement, dated as of October 26, 2023, by and among the Company, CapStar Bank and Timothy K. Schools (incorporated by reference herein to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 31, 2023)
10.2	Letter Agreement Amendment to Employment Agreement and Change in Control Continuity Agreement, dated as of October 26, 2023, by and among the Company, CapStar Bank and Kenneth E. Webb (incorporated by reference herein to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on October 31, 2023)
31.1	Certification of Chief Executive Officer of CapStar Financial Holdings, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.
31.2	Certification of Chief Financial Officer of CapStar Financial Holdings, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.
32.1	Certification of Chief Executive Officer of CapStar Financial Holdings, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.
32.2	Certification of Chief Financial Officer of CapStar Financial Holdings, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.
101	Interactive data files for Capstar Financial Holdings, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2023, formatted in Inline XBRL: (i) the Consolidated Balance Sheets (unaudited); (ii) the Consolidated Statements of Income (unaudited); (iii) the Consolidated Statements of Comprehensive Income (unaudited); (iv) the Consolidated Statements of Changes in Shareholders' Equity (unaudited); (v) the Consolidated Statements of Cash Flows (unaudited); and (vi) the Notes to Consolidated Financial Statements (unaudited).
104	The cover page from Capstar Financial Holdings, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2023 (formatted in Inline XBRL and included in Exhibit 101)
*	Schedules have been omitted pursuant to Item 601(a)(5) of Regulation S-K.

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.

CAPSTAR FINANCIAL HOLDINGS, INC.

By: /s/ Michael J Fowler
Michael J. Fowler
Chief Financial Officer
(Principal Financial Officer)

Date: November 3, 2023

By: /s/ Alison L. Jefferson
Alison L. Jefferson
Controller
(Principal Accounting Officer)

Date: November 3, 2023

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Timothy K. Schools, certify that:

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

Date: November 3, 2023

By: /s/ Timothy K. Schools
Timothy K. Schools
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michael J. Fowler, certify that:

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

Date: November 3, 2023

By: /s/ Michael J. Fowler
Michael J. Fowler
Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER 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 CapStar Financial Holdings, Inc. (the “Company”) for the period ended September 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Timothy K. Schools, President and Chief Executive Officer of the Company, certify in my capacity as an officer of the Company, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities and 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 3, 2023

By: /s/ Timothy K. Schools
Timothy K. Schools
President and Chief Executive Officer

Exhibit 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER 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 CapStar Financial Holdings, Inc. (the “Company”) for the period ended September 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Michael J. Fowler, Chief Financial Officer of the Company, certify in my capacity as an officer of the Company, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities and 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 3, 2023

By: /s/ Michael J. Fowler
Michael J. Fowler
Chief Financial Officer