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 March 31, 2017

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 office)**	**37203** **(zip code)**

(615) 732-6400
(Registrant’s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large Accelerated Filer	☐		Accelerated Filer	☐
Non-Accelerated Filer	☒	(Do not check if a smaller reporting company)	Smaller Reporting Company	☐
			Emerging Growth Company	☒

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

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

As of May 2, 2017, there were 11,223,536 shares of common stock, $1.00 par value per share, issued and outstanding.

CAPSTAR FINANCIAL HOLDINGS, INC.
QUARTERLY REPORT ON FORM 10-Q
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TERMINOLOGY

The terms “we,” “our,” “us,” “the Company,” “CSTR” and “CapStar” 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. The terms “CapStar Bank,” “the Bank” and “our Bank” that appear in this Report refer to CapStar Bank.

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, future events and our financial performance. 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,” “roadmap,” “achieve,” “estimate,” “intend,” “plan,” “project,” “projection,” “forecast,” “goal,” “target,” “would,” and “outlook,” or the negative version of those words or other comparable words of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. The inclusion of these forward-looking statements should not be regarded as a representation by us or any other person that such expectations, estimates and projections will be achieved. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date of this Report, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements. There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but are not limited to, the following:

Economic conditions (including interest rate environment, government economic and monetary policies, the strength of global financial markets and inflation and deflation) that impact the financial services industry as a whole and/or our business; the concentration of our business in the Nashville metropolitan statistical area (“MSA”) and the effect of changes in the economic, political and environmental conditions on this market; increased competition in the financial services industry, locally, regionally or nationally, which may adversely affect pricing and the other terms offered to our clients; our dependence on our management team and board of directors and changes in our management and board composition; our reputation in the community; our ability to execute our strategy and to achieve loan and deposit growth through organic growth and strategic acquisitions; credit risks related to the size of our borrowers and our ability to adequately identify, assess and limit our credit risk; our concentration of large loans to a small number of borrowers; the significant portion of our loan portfolio that originated during the past two years and therefore may less reliably predict future collectability than older loans; the adequacy of reserves (including our allowance for loan and lease losses) and the appropriateness of our methodology for calculating such reserves; non-performing loans and leases; non-performing assets; charge-offs, non-accruals, troubled-debt restructurings, impairments and other credit issues; adverse trends in the healthcare service industry, which is an integral component of our market’s economy; our management of risks inherent in our commercial real estate loan portfolio, and the risk of a prolonged downturn in the real estate market, which could impair the value of our collateral and our ability to sell collateral upon any foreclosure; governmental legislation and regulation, including changes in the nature and timing of the adoption and effectiveness of new requirements under the Dodd-Frank Act of 2010, as amended, Basel guidelines, capital requirements, accounting regulation or standards and other applicable laws and regulations; the loss of large depositor relationships, which could force us to fund our business through more expensive and less stable sources; operational and liquidity risks associated with our business, including liquidity risks inherent in correspondent banking; volatility in interest rates and our overall management of interest rate risk, including managing the sensitivity of our interest-earning assets and interest-bearing liabilities to interest rates, and the impact to our earnings from a change in interest rates; the potential for our Bank’s regulatory lending limits and other factors related to our size to restrict our growth and prevent us from effectively implementing our business strategy; strategic acquisitions we may undertake to achieve our goals; the sufficiency of our capital, including sources of capital and the extent to which we may be required to raise additional capital to meet our goals; fluctuations to the fair value of our investment securities that are beyond our control; deterioration in the fiscal position of the U.S. government and downgrades in Treasury and federal agency securities; potential exposure to fraud, negligence, computer theft and cyber-crime; the adequacy of our risk management framework; our dependence on our information technology and telecommunications systems and the potential for any systems failures or interruptions; our dependence upon outside third parties for the processing and handling of our records and data; our ability to adapt to technological change; the financial soundness of other financial institutions; our exposure to environmental liability risk associated with our lending activities; our engagement in derivative transactions; our involvement from time to time in legal proceedings and examinations and remedial actions by regulators; the susceptibility of our market to natural disasters and acts of God; and the effectiveness of our internal controls over financial reporting and our ability to remediate any future material weakness in our internal controls over financial reporting.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with those factors that are detailed from time to time in the Company's periodic and current reports filed with the Securities and Exchange Commission (the "SEC"), including those factors included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 under the heading "Item 1A. Risk Factors" and in the Company's Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. 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. Consolidated Financial Statements

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Balance Sheets

	March 31, 2017 (unaudited)	December 31, 2016
Assets		
Cash and due from banks	$ 8,635,982	$ 9,133,502
Interest-bearing deposits in financial institutions	49,992,644	54,322,823
Federal funds sold	1,410,000	16,654,481
Total cash and cash equivalents	60,038,626	80,110,806
Securities available for sale, at fair value	188,516,087	182,354,987
Securities held to maturity, fair value of $49,769,285, and $49,731,169 at March 31, 2017 and December 31, 2016, respectively	46,854,518	46,863,640
Loans held for sale	35,370,814	42,110,581
Loans and leases	1,003,433,910	935,250,703
Less allowance for loan and lease losses	(13,996,869)	(11,633,531)
Loans and leases, net	989,437,041	923,617,172
Premises and equipment, net	5,859,025	5,350,226
Restricted equity securities	6,544,250	6,031,700
Accrued interest receivable	4,012,367	3,941,609
Goodwill	6,218,867	6,218,867
Core deposit intangible	57,379	70,912
Deferred tax assets	13,461,531	12,956,059
Bank owned life insurance	22,044,193	21,900,465
Other assets	3,287,898	2,148,039
Total assets	$ 1,381,702,596	$ 1,333,675,063
Liabilities and Shareholders’ Equity		
Deposits:		
Non-interest-bearing	$ 223,449,870	$ 197,787,618
Interest-bearing	335,571,747	299,620,783
Savings and money market accounts	421,202,733	447,685,909
Time	177,770,839	183,627,943
Total deposits	1,157,995,189	1,128,722,253
Federal Home Loan Bank advances	75,000,000	55,000,000
Accrued interest payable	235,895	211,578
Other liabilities	8,260,090	10,533,836
Total liabilities	1,241,491,174	1,194,467,667
Shareholders’ equity:		
Series A convertible preferred stock, $1 par value; 5,000,000 shares authorized; 878,049 shares issued and outstanding at March 31, 2017 and December 31, 2016	878,049	878,049
Common stock, voting, $1 par value; 20,000,000 shares authorized; 11,218,328 and 11,204,515 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	11,218,328	11,204,515
Additional paid-in capital	116,263,244	116,142,894
Retained earnings	17,464,547	17,132,489
Accumulated other comprehensive loss, net of income tax	(5,612,746)	(6,150,551)
Total shareholders’ equity	140,211,422	139,207,396
Total liabilities and shareholders’ equity	$ 1,381,702,596	$ 1,333,675,063

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31,	
	2017	**2016**
Interest income:		
Loans, including fees	$ 10,466,758	$ 9,268,272
Securities:		
Taxable	1,002,896	898,038
Tax-exempt	325,916	282,244
Federal funds sold	2,305	4,138
Restricted equity securities	76,286	69,108
Interest-bearing deposits in financial institutions	104,791	76,378
Total interest income	11,978,952	10,598,178
Interest expense:		
Interest-bearing deposits	617,466	301,633
Savings and money market accounts	815,092	731,702
Time deposits	470,645	514,445
Federal funds purchased	3,910	2,083
Securities sold under agreements to repurchase	—	1,311
Federal Home Loan Bank advances	140,259	90,728
Total interest expense	2,047,372	1,641,902
Net interest income	9,931,580	8,956,276
Provision for loan and lease losses	3,404,799	937,216
Net interest income after provision for loan and lease losses	6,526,781	8,019,060
Noninterest income:		
Service charges on deposit accounts	328,585	225,427
Loan commitment fees	236,274	430,122
Net gain (loss) on sale of securities	(6,229)	38,961
Mortgage banking income	1,216,362	1,347,452
Other noninterest income	358,554	328,810
Total noninterest income	2,133,546	2,370,772
Noninterest expense:		
Salaries and employee benefits	5,086,451	5,217,755
Data processing and software	620,508	568,477
Professional fees	364,553	330,738
Occupancy	448,798	409,881
Equipment	496,196	406,571
Regulatory fees	307,060	227,260
Other operating	1,051,871	849,059
Total noninterest expense	8,375,437	8,009,741
Income before income taxes	284,890	2,380,091
Income tax expense (benefit)	(47,168)	796,245
Net income	$ 332,058	$ 1,583,846
Per share information:		
Basic net income per share of common stock	$ 0.03	$ 0.18
Diluted net income per share of common stock	$ 0.03	$ 0.15
Weighted average shares outstanding:		
Basic	11,210,948	8,628,683
Diluted	12,784,117	10,572,193

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended March 31,	
	2017	**2016**
Net income	$ 332,058	$ 1,583,846
Other comprehensive income:		
Unrealized gains on securities available for sale:		
Unrealized holding gains arising during the period	574,536	2,138,520
Reclassification adjustment for (gains) losses included in net income	6,229	(38,961)
Tax effect	(222,375)	(803,921)
Net of tax	358,390	1,295,638
Unrealized losses on securities transferred to held to maturity:		
Reclassification adjustment for losses included in net income	41,720	41,720
Tax effect	(15,975)	(15,975)
Net of tax	25,745	25,745
Unrealized gains (losses) on cash flow hedges:		
Unrealized holding losses arising during the period	(747)	(1,502,087)
Reclassification adjustment for losses included in net income	154,131	86,080
Tax effect	286	575,149
Net of tax	153,670	(840,858)
Other comprehensive income	537,805	480,525
Comprehensive income	$ 869,863	$ 2,064,371

See accompanying notes to consolidated financial statements (unaudited).

CAPSTAR FINANCIAL HOLDINGS, INC. & SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity
(Unaudited)

	Preferred stock	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total shareholders' equity
Balance December 31, 2015	$ 1,609,756	8,577,051	$ 8,577,051	$ 95,277,969	$ 8,035,711	$ (4,914,380)	$ 108,586,107
Issuance of restricted common stock, net of forfeitures and withholdings to satisfy employee tax obligations	—	99,851	99,851	(99,851)	—	—	—
Stock-based compensation expense	—	—	—	195,787	—	—	195,787
Excess tax benefit from stock compensation	—	—	—	2,539	—	—	2,539
Exercise of common stock warrants	—	1,000	1,000	9,000	—	—	10,000
Net income	—	—	—	—	1,583,846	—	1,583,846
Other comprehensive income	—	—	—	—	—	480,525	480,525
Balance March 31, 2016	$ 1,609,756	8,677,902	$ 8,677,902	$ 95,385,444	$ 9,619,557	$ (4,433,855)	$ 110,858,804
Balance December 31, 2016	$ 878,049	11,204,515	$ 11,204,515	$ 116,142,894	$ 17,132,489	$ (6,150,551)	$ 139,207,396
Issuance of restricted common stock, net of forfeitures and withholdings to satisfy employee tax obligations	—	(2,054)	(2,054)	(186,860)	—	—	(188,914)
Stock-based compensation expense	—	—	—	235,597	—	—	235,597
Exercise of employee common stock options	—	9,367	9,367	13,113	—	—	22,480
Exercise of common stock warrants	—	6,500	6,500	58,500	—	—	65,000
Net income	—	—	—	—	332,058	—	332,058
Other comprehensive income	—	—	—	—	—	537,805	537,805
Balance March 31, 2017	$ 878,049	11,218,328	$ 11,218,328	$ 116,263,244	$ 17,464,547	$ (5,612,746)	$ 140,211,422

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended March 31,	
	2017	2016
Cash flows from operating activities:		
Net income	$ 332,058	$ 1,583,846
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	3,404,799	937,216
Accretion of discounts on acquired loans and deferred fees	(159,331)	(440,249)
Depreciation and amortization	107,376	113,113
Net amortization of premiums on investment securities	358,327	286,011
Securities (gains) losses, net	6,229	(38,961)
Mortgage banking income	(1,216,362)	(1,347,452)
Net loss on disposal of premises and equipment	137,493	—
Net (gain) loss on sale of other real estate owned	—	(72,669)
Stock-based compensation	235,597	195,787
Excess tax benefit from stock compensation	—	(2,539)
Deferred income tax expense	(743,536)	33,697
Origination of loans held for sale	(93,162,136)	(85,107,642)
Proceeds from loans held for sale	101,118,265	92,654,273
Net increase in accrued interest receivable and other assets	(1,331,081)	(1,226,422)
Net increase in accrued interest payable and other liabilities	(2,120,362)	(1,449,958)
Net cash provided by operating activities	6,967,336	6,118,051
Cash flows from investing activities:		
Activities in securities available for sale:		
Purchases	(11,754,186)	(37,585,142)
Sales	644,983	18,750,334
Maturities, prepayments and calls	5,185,819	4,281,887
Activities in securities held to maturity:		
Maturities, prepayments and calls	29,335	162,709
Purchase of restricted equity securities	(512,550)	(4,550)
Net increase in loans	(69,065,337)	(29,624,468)
Purchase of premises and equipment	(742,375)	—
Proceeds from the sale of premises and equipment	3,293	—
Proceeds from sale of other real estate	—	288,923
Net cash used in investing activities	(76,211,018)	(43,730,307)
Cash flows from financing activities:		
Net increase in deposits	29,272,936	47,876,455
Proceeds from Federal Home Loan Bank advances	20,000,000	—
Payments on Federal Home Loan Bank advances	—	(30,000,000)
Exercise of common stock options and warrants, net of repurchase of restricted shares	(101,434)	10,000
Excess tax benefit from stock compensation	—	2,539
Net decrease in repurchase agreements	—	(3,755,000)
Net cash provided by financing activities	49,171,502	14,133,994
Net decrease in cash and cash equivalents	(20,072,180)	(23,478,262)
Cash and cash equivalents at beginning of period	80,110,806	100,184,841
Cash and cash equivalents at end of period	$ 60,038,626	$ 76,706,579
Supplemental disclosures of cash paid:		
Interest paid	$ 2,023,056	$ 1,620,198
Income taxes	—	807,369
Supplemental disclosures of noncash transactions:		
Loans charged off to the allowance for loan and lease losses	$ 1,124,350	$ 773,736

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 March 31, 2017 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. On February 5, 2016, CapStar Financial Holdings, Inc. acquired all of the Bank's issued and outstanding shares of common stock, preferred stock, common stock options and warrants, and the Bank became the wholly owned subsidiary of CapStar Financial Holdings, Inc.

The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and do not include all information and footnotes 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 Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Initial Public Offering

On September 21, 2016, the Securities and Exchange Commission ("SEC") declared effective our registration statement on Form S-1 registering the shares of our common stock. On September 27, 2016, we completed the initial public offering of 2,972,750 shares of our common stock. Of the 2,972,750 shares sold, 1,688,049 shares were sold by us and 1,284,701 shares were sold by certain selling shareholders. Of the 1,284,701 shares sold by certain selling shareholders, 731,707 were from preferred shares converted to common shares and 79,166 from the cashless exercise of 250,000 common share warrants. We received net proceeds of approximately $21.9 million from the offering, after deducting the underwriting discounts and commissions and estimated offering expenses. We did not receive any proceeds from the sale of shares by the selling shareholders.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses, determination of impairment of intangible assets, including goodwill, the valuation of our investment portfolio, deferred tax assets and estimated liabilities. There have been no significant changes to the Company's critical accounting policies as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Subsequent Events

Accounting Standards Codification ("ASC") 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company evaluated all events or transactions that occurred after March 31, 2017 through the date of the issued financial statements.

NOTE 2 – SECURITIES

The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2017 and December 31, 2016 are summarized as follows (in thousands):

	March 31, 2017				December 31, 2016			
	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	$ 11,531	$ —	$ (217)	$ 11,314	$ 9,517	$ —	$ (143)	$ 9,374
State and municipal securities	27,781	101	(542)	27,340	28,480	65	(632)	27,913
Mortgage-backed securities	131,232	3	(2,097)	129,138	126,637	17	(2,059)	124,595
Asset-backed securities	21,291	—	(567)	20,724	21,620	—	(1,147)	20,473
Total	$ 191,835	$ 104	$ (3,423)	$ 188,516	$ 186,254	$ 82	$ (3,981)	$ 182,355
Securities held to maturity:								
State and municipal securities	$ 36,865	$ 2,818	$ —	$ 39,683	$ 36,842	$ 2,784	$ —	$ 39,626
Mortgage-backed securities	4,657	63	—	4,720	4,687	79	—	4,766
Other debt securities	5,333	33	—	5,366	5,335	11	(7)	5,339
Total	$ 46,855	$ 2,914	$ —	$ 49,769	$ 46,864	$ 2,874	$ (7)	$ 49,731

Security fair values are established by an independent pricing service as of the dates indicated. The difference between amortized cost and fair value reflects current interest rates and represents the potential gain (loss) had the portfolio been liquidated on those dates. Security gains (losses) are realized only in the event of dispositions prior to maturity or other-than-temporary impairment. Securities with unrealized losses as of March 31, 2017 and December 31, 2016, and the length of time they were in continuous loss positions as of such dates are as follows (in thousands):

	Less than 12 months		12 months or more		Total	
March 31, 2017	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses
U. S. government agency securities	$ 9,297	$ (217)	$ —	$ —	$ 9,297	$ (217)
State and municipal securities	15,691	(542)	—	—	15,691	(542)
Mortgage-backed securities	114,688	(1,949)	8,720	(148)	123,408	(2,097)
Asset-backed securities	—	—	20,724	(567)	20,724	(567)
Total temporarily impaired securities	$ 139,676	$ (2,708)	$ 29,444	$ (715)	$ 169,120	$ (3,423)
December 31, 2016						
U. S. government agency securities	$ 9,374	$ (143)	$ —	$ —	$ 9,374	$ (143)
State and municipal securities	20,279	(632)	—	—	20,279	(632)
Mortgage-backed securities	110,563	(1,955)	4,150	(104)	114,713	(2,059)
Asset-backed securities	—	—	20,473	(1,147)	20,473	(1,147)
Other debt securities	2,029	(7)	—	—	2,029	(7)
Total temporarily impaired securities	$ 142,245	$ (2,737)	$ 24,623	$ (1,251)	$ 166,868	$ (3,988)

As noted in the table above, as of March 31, 2017, the Company had unrealized losses of $3.4 million in its investment securities portfolio. The unrealized losses associated with these investment securities are driven by changes in interest rates and are recorded as a component of equity. These investment securities will continue to be monitored as a part of our ongoing impairment analysis. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a charge to earnings and a new cost basis for the security will be established.

Because the Company currently does not intend to sell any investment securities that have an unrealized loss at March 31, 2017, and it is not more-likely-than-not that we will be required to sell these investment securities before recovery of their amortized cost bases, which may be at maturity, we do not consider these securities to be other-than-temporarily impaired at March 31, 2017.

Securities with a carrying value of $120.2 million at March 31, 2017 were pledged to collateralize public deposits, derivative positions and Federal Home Loan Bank advances.

The proceeds from sales and calls of securities and the associated gains and losses are listed below:

	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Proceeds	$ 5,860	$ 23,195
Gross gains	—	85
Gross losses	(6)	(46)

The amortized cost and fair value of securities at March 31, 2017, 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		Held-to-maturity	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due one to five years	$ 13,294	$ 13,304	$ 22,204	$ 23,436
Due five to ten years	20,526	20,220	14,562	15,548
Due beyond ten years	5,492	5,130	5,432	6,065
Mortgage-backed securities	131,232	129,138	4,657	4,720
Asset-backed securities	21,291	20,724	—	—
	$ 191,835	$ 188,516	$ 46,855	$ 49,769

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN AND LEASE LOSSES

A summary of the loan portfolio as of March 31, 2017 and December 31, 2016 follows (in thousands):

	March 31, 2017	December 31, 2016
Commercial real estate	$ 360,955	$ 302,322
Consumer real estate	99,952	97,015
Construction and land development	74,007	94,491
Commercial and industrial	420,825	379,620
Consumer	4,495	5,974
Other	43,984	56,796
Total	1,004,218	936,218
Less net unearned income	(784)	(967)
	1,003,434	935,251
Allowance for loan and lease losses	(13,997)	(11,634)
	$ 989,437	$ 923,617

The adequacy of the allowance for loan and lease losses (ALLL) is assessed at the end of each quarter. The ALLL includes a specific component related to loans that are individually evaluated for impairment and a general component related to loans that are segregated into homogenous pools and collectively evaluated for impairment. The ALLL factors applied to these pools are an estimate of probable incurred losses based on management's evaluation of historical net losses from loans with similar characteristics, which are adjusted by management to reflect current events, trends, and conditions. The adjustments include consideration of the following: changes in lending policies and procedures, economic conditions, nature and volume of the portfolio, experience of lending management, volume and severity of past due loans, quality of the loan review system, value of underlying collateral for collateral dependent loans, concentrations, and other external factors.

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, and consumer relationships with an outstanding balance greater than $500,000, individually and assigns each loan a risk rating. This analysis is performed on a continual basis by the relationship managers 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:

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.

Loans not falling into the criteria above are considered to be pass-rated loans. The Company utilizes six loan grades within the pass risk rating.

The following tables present the loan balances by category as well as risk rating (in thousands):

	Performing Loans					
March 31, 2017	**Pass/Watch**	**Special Mention**	**Substandard**	**Total Performing**	**Total Impaired Loans**	**Total**
Commercial real estate	$ 359,668	$ —	$ —	$ 359,668	$ 1,287	$ 360,955
Consumer real estate	99,661	—	291	99,952	—	99,952
Construction and land development	74,007	—	—	74,007	—	74,007
Commercial and industrial	385,188	16,288	7,012	408,488	12,337	420,825
Consumer	4,480	—	15	4,495	—	4,495
Other	43,984	—	—	43,984	—	43,984
Total	$ 966,988	$ 16,288	$ 7,318	$ 990,594	$ 13,624	$ 1,004,218
December 31, 2016						
Commercial real estate	$ 301,012	$ —	$ —	$ 301,012	$ 1,310	$ 302,322
Consumer real estate	96,722	—	293	97,015	—	97,015
Construction and land development	94,491	—	—	94,491	—	94,491
Commercial and industrial	349,857	11,035	16,419	377,311	2,309	379,620
Consumer	5,958	—	16	5,974	—	5,974
Other	56,796	—	—	56,796	—	56,796
Total	$ 904,836	$ 11,035	$ 16,728	$ 932,599	$ 3,619	$ 936,218

None of the Company's loans had a risk rating of "Doubtful" as of March 31, 2017 or December 31, 2016.

The following table details the changes in the ALLL for the three months ended March 31, 2017 and 2016 (in thousands):

	Commercial real estate	Consumer real estate	Construction and land development	Commercial and industrial	Consumer	Other	Total
Three Months Ended March 31, 2017							
Balance, beginning of year	$ 2,655	$ 1,013	$ 1,574	$ 5,618	$ 76	$ 698	$ 11,634
Charged-off loans	—	—	—	(1,124)	—	—	(1,124)
Recoveries	—	—	—	2	80	—	82
Provision for loan and lease losses	602	35	(484)	3,517	(96)	(169)	3,405
Balance, end of period	$ 3,257	$ 1,048	$ 1,090	$ 8,013	$ 60	$ 529	$ 13,997
Three Months Ended March 31, 2016							
Balance, beginning of year	$ 2,879	$ 968	$ 914	$ 4,693	$ 103	$ 575	$ 10,132
Charged-off loans	(350)	—	—	(300)	(124)	—	(774)
Recoveries	—	—	—	4	—	—	4
Provision for loan and lease losses	441	(5)	(115)	527	134	(45)	937
Balance, end of period	$ 2,970	$ 963	$ 799	$ 4,924	$ 113	$ 530	$ 10,299

A breakdown of the ALLL and the loan portfolio by loan category at March 31, 2017 and December 31, 2016 follows (in thousands):

	Commercial real estate	Consumer real estate	Construction and land development	Commercial and industrial	Consumer	Other	Total
March 31, 2017							
Allowance for Loan and Lease Losses:							
Collectively evaluated for impairment	$ 3,257	$ 1,048	$ 1,090	$ 5,401	$ 60	$ 529	$ 11,385
Individually evaluated for impairment	—	—	—	2,612	—	—	2,612
Balances, end of period	$ 3,257	$ 1,048	$ 1,090	$ 8,013	$ 60	$ 529	$ 13,997
Loans:							
Collectively evaluated for impairment	$ 359,668	$ 99,952	$ 74,007	$ 408,488	$ 4,495	$ 43,984	$ 990,594
Individually evaluated for impairment	1,287	—	—	12,337	—	—	13,624
Balances, end of period	$ 360,955	$ 99,952	$ 74,007	$ 420,825	$ 4,495	$ 43,984	$ 1,004,218
December 31, 2016							
Allowance for Loan and Lease Losses:							
Collectively evaluated for impairment	$ 2,655	$ 1,013	$ 1,574	$ 3,006	$ 76	$ 698	$ 9,022
Individually evaluated for impairment	—	—	—	2,612	—	—	2,612
Balances, end of period	$ 2,655	$ 1,013	$ 1,574	$ 5,618	$ 76	$ 698	$ 11,634
Loans:							
Collectively evaluated for impairment	$ 301,012	$ 97,015	$ 94,491	$ 377,311	$ 5,974	$ 56,796	$ 932,599
Individually evaluated for impairment	1,310	—	—	2,309	—	—	3,619
Balances, end of period	$ 302,322	$ 97,015	$ 94,491	$ 379,620	$ 5,974	$ 56,796	$ 936,218

The following table presents the allocation of the ALLL for each respective loan category with the corresponding percentage of the ALLL in each category to total loans, net of deferred fees as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017		December 31, 2016	
	Amount	Percent of total loans, net of deferred fees	Amount	Percent of total loans, net of deferred fees
Commercial real estate	$ 3,257	0.32%	$ 2,655	0.28%
Consumer real estate	1,048	0.10	1,013	0.11
Construction and land development	1,090	0.11	1,574	0.17
Commercial and industrial	8,013	0.80	5,618	0.60
Consumer	60	0.01	76	0.01
Other	529	0.05	698	0.07
Total allowance for loan and lease losses	$ 13,997	1.39%	$ 11,634	1.24%

The following table presents the Company's impaired loans that were evaluated for specific loss allowance as of March 31, 2017 and December 31, 2016 (in thousands):

	March 31, 2017			December 31, 2016		
	Recorded investment	Unpaid principal balance	Related allowance	Recorded investment	Unpaid principal balance	Related allowance
With no related allowance recorded:						
Commercial real estate	$ 1,287	$ 1,682	$ —	$ 1,310	$ 1,686	$ —
Consumer real estate	—	—	—	—	—	—
Construction and land development	—	—	—	—	—	—
Commercial and industrial	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	1,287	1,682	—	1,310	1,686	—
With an allowance recorded:						
Commercial real estate	—	—	—	—	—	—
Consumer real estate	—	—	—	—	—	—
Construction and land development	—	—	—	—	—	—
Commercial and industrial	12,337	14,237	2,612	2,309	2,921	500
Consumer	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	12,337	14,237	2,612	2,309	2,921	500
Total	$ 13,624	$ 15,919	$ 2,612	$ 3,619	$ 4,607	$ 500

The following presents information related to the average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2017 and 2016 (in thousands):

	Three Months Ended March 31, 2017		Three Months Ended March 31, 2016	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
With no related allowance recorded:				
Commercial real estate	$ 1,299	$ —	$ —	$ —
Consumer real estate	—	—	240	—
Construction and land development	—	—	—	—
Commercial and industrial	—	—	3,596	—
Consumer	—	—	—	—
Other	—	—	—	—
Subtotal	1,299	—	3,836	—
With an allowance recorded:				
Commercial real estate	—	—	1,944	—
Consumer real estate	—	—	—	—
Construction and land development	—	—	—	—
Commercial and industrial	13,106	—	—	—
Consumer	—	—	—	—
Other	—	—	—	—
Subtotal	13,106	—	1,944	—
Total	$ 14,405	$ —	$ 5,780	$ —

There was no interest income recognized on a cash basis for impaired loans for the three months ended March 31, 2017 or 2016.

The following table presents the aging of the recorded investment in past-due loans as of March 31, 2017 and December 31, 2016 by class of loans (in thousands):

March 31, 2017	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial real estate	$ —	$ —	$ —	$ —	$ 360,955	$ 360,955
Consumer real estate	143	—	—	143	99,809	99,952
Construction and land development	—	—	—	—	74,007	74,007
Commercial and industrial	8,948	—	—	8,948	411,877	420,825
Consumer	—	—	—	—	4,495	4,495
Other	90	—	—	90	43,894	43,984
Total	$ 9,181	$ —	$ —	$ 9,181	$ 995,037	$ 1,004,218
December 31, 2016						
Commercial real estate	$ —	$ —	$ —	$ —	$ 302,322	$ 302,322
Consumer real estate	81	282	—	363	96,652	97,015
Construction and land development	—	—	—	—	94,491	94,491
Commercial and industrial	—	—	—	—	379,620	379,620
Consumer	—	—	—	—	5,974	5,974
Other	—	—	—	—	56,796	56,796
Total	$ 81	$ 282	$ —	$ 363	$ 935,855	$ 936,218

The Company had no loans past due 90 days or more that were not on nonaccrual status as of March 31, 2017 and December 31, 2016.

The following table presents the recorded investment in non-accrual loans and troubled debt restructurings ("TDR") by class of loans as of March 31, 2017 and December 31, 2016 (in thousands):

	Non-Accrual		Troubled Debt Restructurings	
	March 31, 2017	December 31, 2016	March 31, 2017	December 31, 2016
Commercial real estate	$ 1,287	$ 1,310	$ 1,256	$ 1,272
Consumer real estate	—	—	—	—
Construction and land development	—	—	—	—
Commercial and industrial	12,337	2,309	—	—
Consumer	—	—	—	—
Other	—	—	—	—
Total	$ 13,624	$ 3,619	$ 1,256	$ 1,272

As of March 31, 2017 and December 31, 2016, all loans classified as nonperforming were deemed to be impaired.

As of March 31, 2017 and December 31, 2016, the Company had a recorded investment in TDR of $1.3 million and $1.3 million, respectively. The Company had no specific allowance for those loans at March 31, 2017 or December 31, 2016 and there were no commitments to lend additional amounts. Loans accounted for as TDR include modifications from original terms such as those due to bankruptcy proceedings, certain modifications of amortization periods or extended suspension of principal payments due to customer financial difficulties. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's loan policy. Loans accounted for as TDR are individually evaluated for impairment.

The following table presents loans by class modified as TDR that occurred during the three months ended March 31, 2016 (in thousands). There were no TDR identified during the three months ended March 31, 2017.

	Three Months Ended March 31,		
	Number of contracts	Pre modification outstanding recorded investment	Post modification outstanding recorded investment, net of related allowance
2016			
Commercial real estate	1	$ 1,948	$ 1,170
Consumer real estate	—	—	—
Construction and land development	—	—	—
Commercial and industrial	—	—	—
Consumer	—	—	—
Other	—	—	—
Total	1	$ 1,948	$ 1,170

The following table presents loans by class modified as TDR for which there was a payment default within twelve months following the modification during the three months ended March 31, 2016 (in thousands). There were no TDR for which there was a payment default within twelve months following the modification during the three months ended March 31, 2017.

	Three Months Ended March 31,	
	Number of contracts	Recorded investment
2016		
Commercial real estate	—	$ —
Consumer real estate	—	—
Construction and land development	—	—
Commercial and industrial	—	—
Consumer	1	124
Other	—	—
Total	1	$ 124

The consumer loan TDR that subsequently defaulted during the three months ended March 31, 2016 had no specific reserve in the allowance for loan and lease losses and resulted in a $0.1 million charge-off.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

NOTE 4 – FEDERAL HOME LOAN BANK ADVANCES

The Company had outstanding borrowings totaling of $75.0 million and $55.0 million at March 31, 2017 and December 31, 2016, respectively, via two separate advances. These advances are non-callable; interest payments are due monthly, with principal due at maturity.

The following is a summary of the contractual maturities and average effective rates of outstanding advances (dollars in thousands):

	March 31, 2017		December 31, 2016	
Year	Amount	Interest Rates	Amount	Interest Rates
2017	$ 75,000	0.96%	$ 55,000	0.80%
2018	—	—	—	—
2019	—	—	—	—
2020	—	—	—	—
2021	—	—	—	—
Thereafter	—	—	—	—
Total	$ 75,000	0.96%	$ 55,000	0.80%

Advances from the FHLB are collateralized by investment securities, FHLB stock and certain commercial and residential real estate mortgage loans totaling $400.2 million under a blanket mortgage collateral agreement. At March 31, 2017, the amount of available credit from the FHLB totaled $91.2 million.

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following were changes in accumulated other comprehensive income (loss) by component, net of tax, for the periods ended March 31, 2017 and 2016 (in thousands):

Three Months Ended March 31, 2017	Gains and Losses on Cash Flow Hedges	Unrealized Gains and Losses on Available for Sale Securities	Unrealized Losses on Securities Transferred to Held to Maturity	Total
Beginning Balance	$ (4,241)	$ (698)	$ (1,212)	$ (6,151)
Other comprehensive income (loss) before reclassification	—	354	—	354
Amounts reclassified from accumulated other comprehensive income (loss)	154	4	26	184
Net current period other comprehensive income (loss)	154	358	26	538
Ending Balance	$ (4,087)	$ (340)	$ (1,186)	$ (5,613)
Three Months Ended March 31, 2016				
Beginning Balance	$ (3,705)	$ 105	$ (1,315)	$ (4,915)
Other comprehensive income (loss) before reclassification	(927)	1,320	—	393
Amounts reclassified from accumulated other comprehensive income (loss)	86	(24)	26	88
Net current period other comprehensive income (loss)	(841)	1,296	26	481
Ending Balance	$ (4,546)	$ 1,401	$ (1,289)	$ (4,434)

The following were significant amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three months ended March 31, 2017 (in thousands):

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
Unrealized losses on cash flow hedges	$ 105	Interest expense - money market
	49	Interest expense - Federal Home Loan Bank advances
	$ 154	Net of tax
Unrealized gains and losses on available for sale securities	$ 6	Net loss on sale of securities
	(2)	Income tax expense (benefit)
	$ 4	Net of tax
Unrealized losses on securities transferred to held to maturity	$ 42	Interest income - securities
	(16)	Income tax expense (benefit)
	$ 26	Net of tax

The following were significant amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three months ended March 31, 2016 (in thousands):

Details about Accumulated Other Comprehensive Income Components		Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
Unrealized losses on cash flow hedges	$	37	Interest expense - money market
		49	Interest expense - Federal Home Loan Bank Advances
	$	86	Net of tax
Unrealized gains and losses on available for sale securities	$	(39)	Net gain on sale of securities
		15	Income tax expense (benefit)
	$	(24)	Net of tax
Unrealized losses on securities transferred to held to maturity	$	42	Interest income - securities
		(16)	Income tax expense (benefit)
	$	26	Net of tax

NOTE 6 – INCOME TAXES

The Company's effective tax rate for the three months ended March 31, 2017 was -16.6% compared to 33.5% for the three months ended March 31, 2016. In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions, including income tax consequences. In addition to other changes, the guidance changes the accounting for excess tax benefits and tax deficiencies from generally being recognized in additional paid-in capital to recognition as income tax expense or benefit in the period they occur. The Company adopted the new guidance in the first quarter of 2017. As a result, the Company's income tax expense was reduced by $145,000 for the period ended March 31, 2017.

The effective tax rate compared favorably to the statutory federal rate of 34% and Tennessee excise tax rate of 6.5% primarily due to investments in qualified municipal securities, 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.

NOTE 7 – 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 March 31, 2017 and December 31, 2016 (in thousands):

	Contract or notional amount			
		March 31, 2017		December 31, 2016
Financial instruments whose contract amounts represent credit risk:				
Unused commitments to extend credit	$	542,542	$	508,990
Standby letters of credit		11,401		10,886
Total	$	553,943	$	519,876

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 March 31, 2017, will not have a material impact on the financial statements of the Company.

NOTE 8 – 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 Designated as Cash Flow Hedges

Forward starting interest rate swaps with notional amounts totaling $20 million and $20 million as of March 31, 2017 and December 31, 2016, respectively, were designated as cash flow hedges of certain liabilities and were determined to be fully effective during all periods presented. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swaps is recorded in other assets (liabilities) with changes in fair value recorded in other comprehensive income (loss). The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedges no longer be considered effective. The Company expects the hedges to remain fully effective during the remaining terms of the swaps.

Summary information about the interest-rate swaps designated as cash flow hedges was as follows (dollars in thousands):

	March 31, 2017	December 31, 2016
Notional amounts	$ 20,000	$ 20,000
Weighted average pay rates	3.54%	3.54%
Weighted average receive rates	3 month LIBOR	3 month LIBOR
Weighted average maturity	6.2 years	6.5 years
Fair value	$ (1,535)	$ (1,535)
Amount of unrealized loss recognized in accumulated other comprehensive income, net of tax	$ (947)	$ (947)

Pursuant to its interest rate swap agreements, the Company pledged collateral to the counterparties in the form of investment securities with a carrying value of $2.3 million at March 31, 2017. There was no collateral posted from the counterparties to the Company as of March 31, 2017. It is possible that the Company may need to post additional collateral in the future or that the counterparties may be required to post collateral to the Company in the future.

Other Interest Rate Swaps

The Company also 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 risk to the Company. A summary of the Company's customer related interest rate swaps was as follows (in thousands):

	March 31, 2017		December 31, 2016	
	Notional amount	Estimated fair value	Notional amount	Estimated fair value
Interest rate swap agreements:				
Pay fixed/receive variable swaps	$ 41,703	$ 214	$ 41,254	$ 460
Pay variable/receive fixed swaps	41,703	(214)	41,254	(460)
Total	$ 83,406	$ —	$ 82,508	$ —

NOTE 9 - STOCK OPTIONS AND RESTRICTED SHARES

During 2008, the board of directors of the Bank approved the CapStar Bank 2008 Stock Incentive Plan (the Plan). The Plan was intended to provide incentives to certain officers, employees, and directors to stimulate their efforts toward the continued success of the Bank and to operate and manage the business in a manner that will provide for the long-term growth and profitability of the Bank. Additionally the Plan was intended to encourage stock ownership to align the interests of employees and shareholders and to provide a means of obtaining, rewarding and retaining officers, employees, and directors.

Following the formation of CapStar Financial Holdings, Inc. in 2016, and in connection with the Share Exchange, the outstanding awards of restricted stock and stock options under the CapStar Bank 2008 Stock Incentive Plan were exchanged for similar awards of restricted stock and stock options issued by CapStar Financial Holdings, Inc. under the CapStar Financial Holdings, Inc. Stock Incentive Plan, which the board of directors adopted in 2016. The Stock Incentive Plan provides for the grant of stock-based incentives, including stock options, restricted stock units, performance awards and restricted stock, to employees, directors and service providers that are subject to forfeiture until vesting conditions have been satisfied by the award recipient under the terms of the award. The Plan reserved 1,569,475 shares of stock for issuance of stock incentives. Stock incentives include both restricted share and stock option grants. Total shares issuable under the plan were 199,891 at March 31, 2017.

The Company has recognized stock-based compensation expense, within salaries and employee benefits for employees, and within other non-interest expense for directors, in the consolidated statements of income as follows (in thousands):

	Three Months Ended March 31,	
	2017	2016
Stock-based compensation expense before income taxes	$ 236	$ 196
Less: deferred tax benefit	(90)	(75)
Reduction of net income	$ 146	$ 121

Restricted Shares

Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at the issue date. The fair value of each restricted stock grant is based on valuations performed by independent consultants. The recipients have the right to vote and receive dividends but cannot sell, transfer, assign, pledge, hypothecate, or otherwise encumber the restricted stock until the shares have vested. Restricted shares fully vest on the third anniversary of the grant date. A summary of the changes in the Company's nonvested restricted shares for the three months ended March 31, 2017 follows:

Nonvested Shares	Restricted Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	199,641	$ 12.34
Granted	7,333	19.85
Vested	(43,002)	12.24
Forfeited	(1,500)	13.22
Nonvested at end of period	162,472	$ 12.70

As of March 31, 2017, there was $1.4 million of unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.9 years. The total fair value of shares vested during the three months ended March 31, 2017 and 2016 was $0.5 million and $0.2 million.

Stock Options

Option awards are generally granted with an exercise price equal to the fair value of the Company's common stock at the date of grant. Option awards generally have a three year vesting period and a ten year contractual term.

The fair value of each option grant is estimated on the date of grant using the Black Scholes option pricing model that uses the assumptions noted in the table below. Expected volatility is based on calculations performed by management using industry data. The Company's expected dividend yield is 0.00% because the Company has not paid dividends in the past. The expected term of options granted was calculated using the "simplified" method for plain vanilla options as permitted under authoritative literature. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no options granted in 2017.

The fair value of options granted was determined using the following weighted average assumptions as of the grant date:

	2017	2016
Dividend yield	—	—
Expected term (in years)	—	7.48
Expected stock price volatility	—	17.20%
Risk-free interest rate	—	1.66%
Pre-vest forfeiture rate	—	10.25%

A summary of the activity in stock options for the three months ended March 31, 2017 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)
Outstanding at beginning of period	1,006,000	$ 10.48	
Granted	—	—	
Exercised	(20,000)	10.00	
Forfeited or expired	—	—	
Outstanding at end of period	986,000	$ 10.49	2.9
Fully vested and expected to vest	978,308	$ 10.47	2.9
Exercisable at end of period	931,000	$ 10.39	2.6

Information related to stock options during each year follows:

	2017	2016
Intrinsic value of options exercised	$ 193,800	$ 53,756
Cash received from option exercises	200,000	96,306
Tax benefit realized from option exercises	74,206	20,583
Weighted average fair value of options granted	—	3.16

As of March 31, 2017, there was $0.1 million of unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2.3 years.

NOTE 10 – 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 final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of March 31, 2017, 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 March 31, 2017 and December 31, 2016 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 March 31, 2017:						
Total capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	$ 152,445	12.1%	$ 100,502	8.0%	N/A	N/A
CapStar Bank	129,571	10.3	100,483	8.0	$ 125,604	10.0
Tier I capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	138,375	11.0	75,377	6.0	N/A	N/A
CapStar Bank	115,501	9.2	75,362	6.0	100,483	8.0
Common equity Tier 1 capital to risk weighted assets:						
CapStar Financial Holdings, Inc.	129,685	10.3	56,533	4.5	N/A	N/A
CapStar Bank	99,311	7.9	56,522	4.5	81,643	6.5
Tier I capital to average assets:						
CapStar Financial Holdings, Inc.	138,375	10.4	53,396	4.0	N/A	N/A
CapStar Bank	115,501	8.7	53,394	4.0	66,742	5.0
At December 31, 2016:						
Total capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	$ 149,616	12.6%	$ 95,028	8.0%	N/A	N/A
CapStar Bank	126,718	10.7	95,028	8.0	$ 118,785	10.0
Tier I capital to risk-weighted assets:						
CapStar Financial Holdings, Inc.	137,909	11.6	71,271	6.0	N/A	N/A
CapStar Bank	115,011	9.7	71,271	6.0	95,028	8.0
Common equity Tier 1 capital to risk weighted assets:						
CapStar Financial Holdings, Inc.	129,528	10.9	53,453	4.5	N/A	N/A
CapStar Bank	99,130	8.3	53,453	4.5	77,210	6.5
Tier I capital to average assets:						
CapStar Financial Holdings, Inc.	137,909	10.5	52,727	4.0	N/A	N/A
CapStar Bank	115,011	8.7	52,727	4.0	65,909	5.0

(1) For the calendar year 2017, 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 1.25% 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 11 – EARNINGS PER SHARE

The following is a summary of the basic and diluted earnings per share calculation for the three months ended March 31, 2017 and 2016:

	Three Months Ended March 31,	
	2017	2016
Basic net income per share calculation:		
Numerator – Net income	$ 332,058	$ 1,583,846
Denominator – Average common shares outstanding	11,210,948	8,628,683
Basic net income per share	$ 0.03	$ 0.18
Diluted net income per share calculation:		
Numerator – Net income	$ 332,058	$ 1,583,846
Denominator – Average common shares outstanding	11,210,948	8,628,683
Dilutive shares contingently issuable	1,573,169	1,943,510
Average diluted common shares outstanding	12,784,117	10,572,193
Diluted net income per share	$ 0.03	$ 0.15

NOTE 12 – 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.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan and lease losses 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. Impaired 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 at March 31, 2017 or December 31, 2016.

Loans Held For Sale: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale 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). There were no loans held for sale carried at fair value at March 31, 2017 or December 31, 2016.

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

	Fair value measurements at March 31, 2017			
	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-sponsored agencies	$ 11,314	$ —	$ 11,314	$ —
Obligations of states and political subdivisions	27,340	—	27,340	—
Mortgage-backed securities-residential	129,138	—	129,138	—
Asset-backed securities	20,724	—	20,724	—
Total securities available for sale	$ 188,516	$ —	$ 188,516	$ —
Derivatives:				
Interest rate swaps - customer related	$ 328	$ —	$ 328	$ —
Liabilities:				
Derivatives:				
Interest rate swaps - customer related	$ (328)	$ —	$ (328)	$ —
Interest rate swaps - cash flow hedges	(1,535)	—	(1,535)	—
Total derivatives	$ (1,863)	$ —	$ (1,863)	$ —

	Fair value measurements at December 31, 2016			
	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-sponsored agencies	$ 9,374	$ —	$ 9,374	$ —
Obligations of states and political subdivisions	27,913	—	27,913	—
Mortgage-backed securities-residential	124,595	—	124,595	—
Asset-backed securities	20,473	—	20,473	—
Total securities available for sale	$ 182,355	$ —	$ 182,355	$ —
Derivatives:				
Interest rate swaps - customer related	$ 460	$ —	$ 460	$ —
Liabilities:				
Derivatives:				
Interest rate swaps - customer related	$ (460)	$ —	$ (460)	$ —
Interest rate swaps - cash flow hedges	(1,535)	—	(1,535)	—
Total derivatives	$ (1,995)	$ —	$ (1,995)	$ —

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

	Fair value measurements at March 31, 2017			
	Carrying Value	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Assets:				
Impaired loans:				
Commercial and industrial	$ 9,725	—	—	9,725

	Fair value measurements at December 31, 2016			
	Carrying Value	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Assets:				
Impaired loans:				
Commercial and industrial	$ 1,809	—	—	1,809

The following table presents quantitative information about Level 3 fair value measurements for assets measured at fair value on a non-recurring basis at March 31, 2017 and December 31, 2016 (dollars in thousands):

March 31, 2017	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted-Average)
Impaired loans:				
Commercial and industrial	$ 9,725	Sales comparison approach	Appraisal discounts	10 - 25%

December 31, 2016	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted-Average)
Impaired loans:				
Commercial and industrial	$ 1,809	Sales comparison approach	Appraisal discounts	25%

Fair Value of Financial Instruments

The carrying value and estimated fair values of the Bank's financial instruments at March 31, 2017 and December 31, 2016 were as follows (in thousands):

	March 31, 2017		December 31, 2016		
	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	$ 58,629	$ 58,629	$ 63,456	$ 63,456	Level 1
Federal funds sold	1,410	1,410	16,654	16,654	Level 1
Securities available for sale	188,516	188,516	182,355	182,355	Level 2
Securities held to maturity	46,855	49,769	46,864	49,731	Level 2
Loans held for sale	35,371	35,410	42,111	42,302	Level 2
Restricted equity securities	6,544	N/A	6,032	N/A	N/A
Loans, net	1,003,434	1,002,131	935,251	934,628	Level 3
Accrued interest receivable	4,012	4,012	3,942	3,942	Level 2
Bank owned life insurance	22,044	22,044	21,900	21,900	Level 2
Other assets	328	328	460	460	Level 2
Financial liabilities:					
Deposits	1,157,995	1,116,924	1,128,722	1,088,758	Level 3
Federal Home Loan Bank advances	75,000	74,993	55,000	54,989	Level 2
Accrued interest payable	236	236	212	212	Level 2
Other liabilities	3,789	3,789	5,349	5,349	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) *Federal Funds Sold*

Federal funds sold clear on a daily basis. For this reason, the carrying amount is a reasonable estimate of fair value.

(c) *Restricted Equity Securities*

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

(d) *Loans, net*

The fair value of the Bank's loan portfolio includes a credit risk assumption in the determination of the fair value of its loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Bank's loan portfolio is initially fair valued using a segmented approach. The Bank divides its loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk. For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(e) *Bank Owned Life Insurance*

For bank owned life insurance, the carrying amount is based on the cash surrender value and is a reasonable estimate of fair value.

(f) Other Assets

Included in other assets are certain interest rate swap agreements and the cash flow hedge relationships. The fair values of interest rate swap agreements and the cash flow hedge relationships are based on independent pricing services that utilize pricing models with observable market inputs.

(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

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

(i) Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value.

(j) Other Liabilities

Included in other liabilities are certain interest rate swap agreements, the cash flow hedge relationships and contingent consideration. The fair values of interest rate swap agreements and the cash flow hedge relationships are based on independent pricing services that utilize pricing models with observable market inputs. The fair value of contingent consideration is estimated by a discounted cash flow model that utilizes various unobservable inputs.

(k) 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.

(l) 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.

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

The following is a discussion of our financial condition at March 31, 2017 and December 31, 2016 and our results of operations for the three months ended March 31, 2017 and 2016. 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 included elsewhere in this Report and our Annual Report on Form 10-K for the year ended December 31, 2016. Annualized results for interim periods may not be indicative of results for the full year or future periods. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from our current expectations. Factors that could cause such differences are discussed in the section entitled "Cautionary Note Regarding Forward-Looking Statements" in this Report and the section entitled "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016. We assume no obligation to update any of these forward-looking statements except to the extent required by applicable law.

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 per share data or when otherwise specifically noted.

Overview

We completed the first three months of 2017 with net income of $0.3 million, or 79.0% less than the comparable period of 2016. The decrease in our profitability was primarily due to a higher provision for loan and lease losses. This decrease was partially offset by higher net interest income. Fully diluted net income per share of common stock for the first three months of 2017 was $0.03, compared with $0.15 for the first three months of 2016. Average loans for the first three months of 2017 were $974.4 million, an 18.5% increase over the comparable period of 2016. Average deposits for the first three months of 2017 were $1.1 billion, an 11.3% increase over the comparable period of 2016.

The Company's 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 increased $1.0 million, or 10.9%, for the first three months of 2017, compared with the same period in 2016. The positive effects of increased volumes of earning assets were partially offset by the negative effect of increasing deposit costs. Net interest margin declined to 3.12% for the first three months of 2017, compared with 3.18% for the same period of 2016.

In response to assessment of risk in the loan portfolio, including net loan growth, the Company recorded a $3.4 million provision for loan and lease losses in the first three months of 2017, compared with a $0.9 million provision in the first three months of 2016. The provision for loan and lease losses represents a charge to earnings necessary to establish an allowance for loan and lease losses that, in management's evaluation, is adequate to provide coverage for the inherent losses on outstanding loans.

Total non-interest income in the first three months of 2017 decreased $0.2 million, or 10.0%, compared with the same period in 2016, and comprised 15% of total revenues. The decrease was primarily the result of a decline in mortgage banking income and loan fees.

Total non-interest expense in the first three months of 2017 increased $0.4 million, or 4.6%, compared with the same period in 2016. Our efficiency ratio in the first three months of 2017 was 69.4% compared to 70.7% in the same period in 2016.

Our effective tax rate decreased to -16.6% for the first three months of 2017 from 33.5% for the same period in 2016. The decrease in the effective tax rate is largely the result of the effectiveness of ASU 2016-09, Compensation – Stock Compensation, which, among other things, amended existing guidance for the accounting of excess tax benefits from stock compensation.

Tangible common equity (TCE), a non-GAAP measure, is a measure of a company's capital which is useful in evaluating the quality and adequacy of capital. The ratio of tangible common equity to total tangible assets was 9.1% as of March 31, 2017, compared with 9.3% at December 31, 2016. The decrease is due to growth in our total tangible assets. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Non-GAAP Financial Measures" for details on reconciliations to the most directly comparable U.S. GAAP measures.

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

(a) Results of Operations

The following is a summary of our results of operations:

	Three months ended March 31,		2017 - 2016 Percent Increase (Decrease)
	2017	2016	
Interest income	$ 11,979	$ 10,598	*13.0%*
Interest expense	2,047	1,642	*24.7%*
Net interest income	9,932	8,956	*10.9%*
Provision for loan and lease losses	3,405	937	*263.3%*
Net interest income after provision for loan and lease losses	6,527	8,019	*(18.6)%*
Noninterest income	2,133	2,371	*(10.0)%*
Noninterest expense	8,375	8,010	*4.6%*
Net income before income taxes	285	2,380	*(88.0)%*
Income tax expense (benefit)	(47)	796	*(105.9)%*
Net income	$ 332	$ 1,584	*(79.0)%*
Basic net income per share of common stock	$ 0.03	$ 0.18	*(83.3)%*
Fully diluted net income per share of common stock	$ 0.03	$ 0.15	*(80.0)%*

We recorded net income of $0.3 million for the first quarter of 2017, a decrease of $1.3 million, or 79.0%, from $1.6 million for the first quarter of 2016. Basic net income per share of common stock was $0.03 and $0.18 for the first quarter of 2017 and 2016, respectively. Fully diluted net income per share of common stock was $0.03 and $0.15 for the first quarter of 2017 and 2016, respectively. We recorded a $3.4 million provision for loan and lease losses in the first quarter of 2017, compared with $0.9 million for the same period of 2016.

Annualized return on average assets and annualized return on average shareholders' equity were 0.10% and 0.95%, respectively, for the first quarter of 2017, compared with 0.54% and 5.75%, respectively, for the same period in 2016.

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 months ended March 31, 2017 and 2016:

	For the Three Months Ended March 31,					
	2017			2016		
	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate
Interest-Earning Assets						
Loans (1)	$ 974,350	$ 10,194	4.24%	$ 822,112	$ 8,976	4.39%
Loans held for sale	28,359	273	3.91%	29,799	292	3.94%
Securities:						
Taxable investment securities (2)	181,647	1,079	2.38%	177,563	968	2.18%
Investment securities exempt from federal income tax (3)	55,437	326	2.35%	42,719	282	2.64%
Total securities	237,084	1,405	2.37%	220,282	1,250	2.27%
Cash balances in other banks	48,041	105	0.88%	56,427	76	0.54%
Funds sold	1,729	2	0.54%	2,703	4	0.62%
Total interest-earning assets	1,289,563	11,979	3.77%	1,131,323	10,598	3.77%
Noninterest-earning assets	50,674			50,105		
Total assets	$ 1,340,237			$ 1,181,428		
Interest-Bearing Liabilities						
Interest-bearing deposits:						
Interest-bearing transaction accounts	$ 330,627	617	0.76%	$ 203,283	302	0.60%
Savings and money market deposits	434,375	815	0.76%	445,891	732	0.66%
Time deposits	168,326	471	1.13%	188,778	514	1.10%
Total interest-bearing deposits	933,328	1,903	0.83%	837,952	1,548	0.74%
Borrowings and repurchase agreements	45,115	144	1.30%	30,798	94	1.23%
Total interest-bearing liabilities	978,443	2,047	0.85%	868,750	1,642	0.76%
Noninterest-bearing deposits	210,308			189,505		
Total funding sources	1,188,751			1,058,255		
Noninterest-bearing liabilities	9,935			12,353		
Shareholders’ equity	141,551			110,820		
Total liabilities and shareholders’ equity	$ 1,340,237			$ 1,181,428		
Net interest spread (4)			2.92%			3.01%
Net interest income/margin (5)		$ 9,932	3.12%		$ 8,956	3.18%

(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) Balances for investment securities exempt from federal income tax are not calculated 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 net interest income divided by total average interest-earning assets and is presented in the table above on an annualized basis.

Our net interest margin on an annualized basis was 3.12% and 3.18% for the first quarter of 2017 and 2016, respectively. The decrease in net interest margin for the first quarter 2017 compared to 2016 was primarily due to declining loan yields and rising deposit costs.

For the first quarter of 2017 and 2016, average loan yields decreased from 4.39% to 4.24%. The decrease in loan yields was primarily due to two factors. First, during the first quarter of 2017, two loans were placed on non-accrual status, resulting in a nine basis point decrease in loan yields for the period. Second, there were lower loan rates on new loan production as compared to the average yield on the current loan portfolio, driven by continued competitive pricing pressures associated with securing the business of credit-worthy borrowers in the Nashville MSA. Average loans for the first three months of 2017 increased 18.5% compared to the same period in 2016 as a result of our continued focus on attracting new clients to our Company. For the first quarter of 2017 and 2016, average security yields increased from 2.24% to 2.37% primarily due to increases in the LIBOR rate on the variable rate portion of our securities portfolio. The resulting yield on average interest-earning assets remained at 3.77% for the first three months of 2017 and 2016 despite the decrease in loan yield.

We funded our growth in loans through an increase in our funding sources of 12.3%. For the first three months of 2017, average interest-bearing liabilities increased $109.7 million, or 12.6%, from the same period in 2016. The average rate paid on interest-bearing liabilities was 0.85% for the first three months of 2017, as compared to 0.76% for the same period in 2016. A portion of the increase was due to the increases in the Fed Funds rate in December 2016 and March 2017. We passed along a portion of these rate increases to our clients.

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 neutralize 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, market opportunities and customer requirements.

Interest Rate Simulation Sensitivity Analysis

The Company uses 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 new growth. Dynamic simulation models are also utilized that rely on detailed assumptions regarding changes in existing lines of business, new business, and changes in management and client behavior. 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 March 31, 2017, our EAR static simulation results indicated that our balance sheet is asset sensitive to parallel shifts in 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. 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 decay rates, 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 to determine the extent to which our net interest income over the next 12 months would change if prevailing interest rates increased or decreased by the specified amounts.

	Net interest income change
Increase 200bp	6.0%
Increase 100bp	2.6
Decrease 100bp	(5.0)
Decrease 200bp	(8.1)

Provision for Loan and Lease Losses

Our policy is to maintain an allowance for loan and lease losses at a level sufficient to absorb probable incurred losses inherent in the loan portfolio. The allowance is increased by a provision for loan and lease losses, which is a charge to earnings, is decreased by charge-offs and increased by loan recoveries. Our allowance for loan and lease losses as a percentage of total loans was 1.39% and 1.24% at March 31, 2017 and December 31, 2016, respectively.

The provision for loan and lease losses amounted to $3.4 million and $0.9 million for the three months ended March 31, 2017 and 2016, respectively. Provision expense is impacted by the absolute level of loans, loan growth, the credit quality of the loan portfolio and the amount of net charge-offs. Provision expense increased for the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to increased charge-offs of $0.4 million and increased specific reserves in our allowance for loan and lease losses of $2.1 million. These increases were caused primarily by deterioration in the credit quality of commercial and industrial loans to two borrowers. These loans experienced weakness due to each borrower's declining financial condition, which led to falling values of the collateral securing these loans. Our primary collateral for these loans are the enterprise values of the borrowers. As the financial condition of the borrower deteriorates, ultimate repayment becomes increasingly difficult. As a result, we have increased our allowance for loan and lease losses which has led to increased provision expense in 2017 compared to 2016.

Based upon our evaluation of the loan portfolio, we believe the allowance for loan and lease losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at March 31, 2017. While our policies and procedures used to estimate the allowance for loan and lease losses, as well as the resultant provision for loan and lease losses charged to operations, are considered adequate by management, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate markets, or particular industry or borrower-specific conditions, which may materially negatively impact our asset quality and the adequacy of our allowance for loan and lease losses and, thus, the resulting provision for loan and lease losses. See "Notes to Consolidated Financial Statements (Unaudited) — Note 3 — Loans and Allowance for Loan and Lease Losses" for additional information on our allowance for loan and lease losses.

Noninterest Income

In addition to net interest income, we generate other types of recurring noninterest income from our lines of business. Our banking operations generate revenue from service charges and fees on deposit accounts. We have a mortgage banking line of business that generates revenue from originating and selling mortgages, and we have a revenue-sharing relationship with a registered broker-dealer, which generates wealth management fees. In addition to these types of recurring noninterest income, we own insurance on several key employees and record income on 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 March 31,		2017-2016 Percent Increase (Decrease)
	2017	2016	
Noninterest income:			
Service charges on deposit accounts	$ 329	$ 225	*45.8%*
Loan commitment fees	236	430	*(45.1)%*
Net gain (loss) on sale of securities	(6)	39	*(116.0)%*
Mortgage banking income	1,216	1,347	*(9.7)%*
Other noninterest income	359	329	*9.0%*
Total noninterest income	$ 2,134	$ 2,370	*(10.0)%*

The increase in service charges on deposit accounts for the three months ended March 31, 2017 compared to the same period in 2016 is primarily related to increased analysis fees due to an increase in the volume of commercial accounts.

Loan commitment fees decreased 45.1% for the three months ended March 31, 2017 compared to the same period in 2016 due to one-time fees recognized during the three months ended March 31, 2016 that did not reoccur in 2017.

Mortgage banking income consists of mortgage fee income from the origination and sale of mortgage loans. These mortgage fees are for loans that we originated and that are subsequently sold to third-party investors. All of these loan sales transfer servicing rights to the buyer. Mortgage origination fees will fluctuate from quarter to quarter as the rate environment changes. Mortgage banking income decreased 9.7% for the three months ended March 31, 2017 compared to the similar period in 2016 due to declining margins on mortgage loans sold.

Noninterest Expense

Our total noninterest expense increase reflects expenses that we have incurred as we build the foundation to support our recent growth and enable us to execute our growth strategy. The following table presents the primary components of noninterest expense for the periods indicated.

	Three Months Ended March 31,		2017-2016 Percent Increase (Decrease)
	2017	2016	
Noninterest expense:			
Salaries and employee benefits	$ 5,086	$ 5,218	*(2.5)%*
Data processing and software	621	568	*9.2%*
Occupancy	365	331	*10.2%*
Equipment	449	410	*9.5%*
Professional fees	496	407	*22.0%*
Regulatory fees	307	227	*35.1%*
Other noninterest expense	1,052	849	*23.9%*
Total noninterest expense	$ 8,376	$ 8,010	*4.6%*

The largest increase between periods within noninterest expense was related to $137 thousand of one-time costs incurred during the three months ended March 31, 2017 related to the move of our corporate headquarters. This expense is recorded in other noninterest expense, which increased 23.9% for the three months ended 2017 compared to the same period in 2016.

Salaries and employee benefits decreased $132 thousand, or 2.5%, for the first quarter of 2017 compared with the same period of 2016. The decrease is primarily related to reduced incentive expense, offset by the addition of personnel associated with continued expansion in the Nashville MSA. The number of full-time employees increased from 163 at March 31, 2016 to 168 at March 31, 2017.

Professional fees expense increased $89 thousand, or 22.0%, in the first quarter of 2017 compared to the same period in 2016 largely due to additional expenses related to operating as a public company.

Regulatory fees expense increased $80 thousand, or 35.1%, in the first quarter of 2017 compared to the same period in 2016 due primarily to changes in the FDIC's assessment methodology.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 69.4% for the three months ended March 31, 2017 compared to 70.7% for the three months ended March 31, 2016. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue. The efficiency ratio for the period ended March 31, 2017 was positively impacted by growth in our net interest income that outpaced increases in our expenses. For the three months ended March 31, 2017 our revenue base (net interest income plus noninterest income) grew at rate of approximately 1.4 times our noninterest expense.

Income Tax Provision

During the three months ended March 31, 2017, we recorded an income tax benefit of $47 thousand compared to income tax expense of $0.8 million for the three months ended March 31, 2016. Our income tax (benefit) expense for the period ended March 31, 2017 reflects an effective income tax rate of (16.6)% compared to 33.5% for the period ended March 31, 2016. Our effective tax rate differs from the statutory tax rate by our investments in municipal securities, 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. In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions, including income tax consequences. In addition to other changes, the guidance changes the accounting for excess tax benefits and tax deficiencies from generally being recognized in additional paid-in capital to recognition as income tax expense or benefit in the period they occur. The Company adopted the new guidance in the first quarter of 2017. As a result, the Company's income tax expense was reduced by $145,000 for the period ended March 31, 2017.

(b) *Financial Condition*

Balance Sheet

Total assets increased $48.0 million, or 3.6%, from $1.33 billion on December 31, 2016 to $1.38 billion on March 31, 2017. Loans and leases grew $68.2 million, or 7.3%, in the first three months of 2017, offset by a decrease in cash of $20.1 million, or 25.1% for the same period. Loans held for sale decreased $6.7 million, or 16.0%, during the first three months of 2017.

Total liabilities increased $47.0 million, or 3.9%, from $1.19 billion on December 31, 2016 to $1.24 billion on March 31, 2017. Deposits increased $29.3 million, or 2.6%, due primarily to growth in our correspondent banking deposits. We increased our Federal Home Loan Bank advances $20.0 million during the first three months of 2017 to help fund our loan growth. Other liabilities decreased $2.3 million, or 21.6%, largely due to the scheduled payout of incentives and the earn-out related contingent liability.

Loans and Leases

The composition of loans and leases at March 31, 2017 and December 31, 2016 and the percentage of each classification to total loans are summarized as follows:

	March 31, 2017		December 31, 2016	
	Amount	Percent	Amount	Percent
Commercial real estate	$ 360,955	*35.9%*	$ 302,322	*32.3%*
Consumer real estate	99,952	*10.0%*	97,015	*10.4%*
Construction and land development	74,007	*7.4%*	94,491	*10.1%*
Commercial and industrial	420,825	*41.9%*	379,620	*40.5%*
Consumer	4,495	*0.4%*	5,974	*0.6%*
Other	43,984	*4.4%*	56,796	*6.1%*
Total loans	$ 1,004,218	*100.0%*	$ 936,218	*100.0%*

At March 31, 2017, our loan portfolio composition remained relatively consistent with the composition at December 31, 2016. The commercial real estate category includes owner-occupied commercial real estate loans which is similar in many ways to our commercial and industrial lending in that these loans are generally made to businesses on the basis of the cash flows of the business rather than on the valuation of the real estate. At March 31, 2017, approximately 26.0% of the outstanding principal balance of our commercial real estate loans was secured by owner-occupied properties. Growth in the commercial real estate segment reflects the development of the Nashville MSA in which we participate.

Non-Performing Loans and Assets

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

(Dollars in thousands)	March 31, 2017	December 31, 2016
Non-accrual loans	$ 13,624	$ 3,619
Troubled debt restructurings	1,256	1,272
Loans past due 90 days or more and still accruing	—	—
Non-performing loans	13,624	3,619
Foreclosed real estate	—	—
Non-performing assets	$ 13,624	$ 3,619
Non-performing loans as a percentage of total loans	1.36%	0.39%
Non-performing assets as a percentage of total assets	0.99%	0.27%

The increase in non-performing assets experienced during the three months ended March 31, 2017 is primarily related to loans made to two commercial and industrial borrowers. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Provision for Loan and Lease Losses" for more discussion regarding these loans.

The following table sets forth the major classifications of non-accrual loans:

	March 31, 2017	December 31, 2016
Commercial real estate	$ 1,287	$ 1,310
Consumer real estate	—	—
Construction and land development	—	—
Commercial and industrial	12,337	2,309
Consumer	—	—
Other	—	—
Total loans	$ 13,624	$ 3,619

(c) 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. To manage liquidity risk, management has established a comprehensive management 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 existing and potential future 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 available to us, and the ability to attract funds from external sources, principally deposits.

Our most liquid assets are comprised of cash and due from banks, available-for-sale marketable investment securities and federal funds sold. The fair value of the available-for-sale investment portfolio was $188.5 million at March 31, 2017. We pledge portions of our investment securities portfolio to secure public fund deposits, derivative positions and Federal Home Loan Bank advances, and securities sold under agreements to repurchase. At March 31, 2017, total investment securities pledged for these purposes comprised 50% of the estimated fair value of the entire investment portfolio, leaving $118.1 million of unpledged securities.

We have a large base of non-maturity customer deposits, defined as demand, savings, and money market deposit accounts. At March 31, 2017, such deposits totaled $980.2 million and represented 85% of our total deposits. Because these deposits are less volatile and are often tied to other products through long lasting relationships they do not put heavy pressure on liquidity.

Other sources of funds available to meet daily needs include FHLB advances. As a member of the FHLB of Cincinnati, the Company has access to credit products offered by the FHLB. The Company views these borrowings as a low cost alternative to other time deposits. At March 31, 2017, available credit from the FHLB totaled $91.2 million. Additionally, we had available federal funds purchased lines with correspondent banks totaling $110.0 million at March 31, 2017.

The Company's principal source of cash revenues is dividends paid to it as the sole shareholder of the Bank. At March 31, 2017, the Bank was able to pay up to $21.4 million in dividends to the Company without regulatory approval subject to the ongoing capital requirements of the Bank.

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

(d) Capital Resources

At March 31, 2017, shareholders' equity totaled $140.2 million, an increase of $1.0 million since December 31, 2016. Accordingly, as of March 31, 2017, the Company and the Bank were well-capitalized under the regulatory framework for prompt corrective action. See the Consolidated Statement of Changes in Shareholders' Equity and Note 10 of the consolidated financial statements for further detail of the changes in equity since the end of 2016.

Off-Balance Sheet Arrangements

In the normal course of business, we enter into various transactions that, in accordance with 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 probable 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 7 of the consolidated financial statements.

(e) *Non-GAAP Financial Measures*

This Report includes the following financial measures that have been prepared other than in accordance with generally accepted accounting principles in the United States ("non-GAAP financial measures"): tangible common equity, tangible common equity to total tangible assets and tangible common equity per share. 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 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 GAAP, and they are not necessarily comparable to non-GAAP financial measures that other companies use.

The following table presents a reconciliation of tangible common equity, tangible common equity to total tangible assets and tangible common equity per share to the most directly comparable GAAP financial measures.

(in thousands, except per share data)	March 31, 2017	December 31, 2016
Total equity	$ 140,211	$ 139,207
Less core deposit intangible	(57)	(71)
Less goodwill	(6,219)	(6,219)
Less preferred equity	(9,000)	(9,000)
Tangible common equity	$ 124,935	$ 123,917
Total assets	$ 1,381,703	$ 1,333,675
Less core deposit intangible	(57)	(71)
Less goodwill	(6,219)	(6,219)
Total tangible assets	$ 1,375,427	$ 1,327,385
Total shareholders' equity to total assets	10.15%	10.44%
Tangible common equity ratio	9.08%	9.34%
Total shares of common stock outstanding	11,218,328	11,204,515
Book value per share of common stock	$ 11.70	$ 11.62
Tangible book value per share of common stock	11.14	11.06

(f) *Recently Issued Accounting Pronouncements*

ASU 2014-09, Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, which outlines a single comprehensive model for use in accounting for revenue arising from contracts with customers, and supersedes most current revenue recognition guidance. The ASU was originally effective for fiscal years and interim periods beginning after December 15, 2016. In August 2015, FASB issued ASU 2015-14 which delays the effective date. The effective date will be annual reporting periods beginning after December 15, 2017, and the interim periods within that year. The Company is evaluating the potential impact of adoption of ASU 2014-09.

ASU 2016-02, Leases

In February 2016, the FASB issued guidance in the form of a FASB ASU, "Leases". The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain optional practical expedients available. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the impact of the pending adoption of the new standard on the Company's financial statements and disclosures.

ASU 2016-13, Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses, which outlines changes to replace the incurred loss impairment methodology currently in place with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate credit losses. The ASU is effective for fiscal years and interim periods beginning after December 15, 2019. The adoption of ASU 2016-13 is expected to have a significant impact on the Bank's operations and financial statements.

(g) 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.

Information required by this item is included in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Simulation Sensitivity Analysis."

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 Rules 13a-15(e) and 15d-15(e) under the Exchange Act) 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, as of the end of the period covered by this Report, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in the Company's filings under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting 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

From time to time, the Company is party to legal actions that are routine and incidental to its business. Given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to the Company's business, including laws and regulations governing consumer protection, fair lending, fair labor, privacy, information security and anti-money laundering and anti-terrorism laws, the Company, like all banking organizations, is subject to heightened legal and regulatory compliance and litigation risk. However, based upon available information and in consultation with legal counsel, management does not expect the ultimate disposition of any or a combination of these actions to have a material adverse effect on the Company's assets, business, cash flow, condition (financial or otherwise), liquidity, prospects and\or results of operations.

Item 1A. Risk Factors

In evaluating an investment in the Company's securities, investors should consider carefully, among other things, information under the heading "Cautionary Note Regarding Forward-Looking Statements" in this Report as well as those factors that are detailed from time to time in the Company's periodic and current reports filed with the SEC, including those factors included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 under the heading "Item 1A. Risk Factors" and in the Company's Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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

Unregistered Sales 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 March 31, 2017.

	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plan	Maximum number of shares that may yet be purchased under the plan
January 1 - January 31	6,633	$ 20.00	—	—
February 1 - February 28	3,907	19.98	—	—
March 1 - March 31	7,980	19.51	—	—
Total	18,520	$ 19.79	—	—

(1) Activity represents shares of stock withheld to pay taxes due upon vesting of restricted shares and exercise of stock options. This activity has no impact on the number of shares that may be purchased under a Board-approved plan.

Use of Proceeds

On September 27, 2016, the Company sold 1,688,049 shares of its common stock, including 387,750 shares purchased by the underwriters pursuant to the full exercise of their purchase option, in its initial public offering ("IPO"). In addition, certain selling shareholders participated in the IPO and sold an aggregate of 1,284,701 shares of the Company's common stock.

The shares were sold at a public offering price of $15.00 per share, resulting in aggregate gross proceeds of approximately $44.6 million. The aggregate offering price for the shares sold by the Company was approximately $25.3 million, and after deducting approximately $1.6 million for the underwriting discount and approximately $1.7 million of offering expenses paid to third parties, the Company received net proceeds of approximately $21.9 million. The aggregate offering price for the shares sold by the selling shareholders was approximately $19.3 million.

All of the shares were sold pursuant to our Registration Statement on Form S-1, as amended (File No. 333-213367), which was declared effective by the SEC on September 21, 2016. The offering did not terminate until all of the shares offered were sold. The Company made no payments to its directors, officers or persons owning ten percent or more of its common stock or to their associates, or to its affiliates in connection with the issuance and sale of the common stock. Keefe, Bruyette & Woods, Inc. and Sandler O'Neill & Partners, L.P. acted as lead book-running managers for the IPO. Our common stock is currently trading on the NASDAQ Global Select Market under the symbol "CSTR."

There has been no material change in the planned use of proceeds from our IPO as described in our prospectus filed with the SEC on September 23, 2016 pursuant to Rule 424(b)(4) under the Securities Act. Pending application of the IPO proceeds, we have invested the net proceeds in short-term investments.

Item 6. Exhibits

Exhibit Number	Description
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.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Document.*

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

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

SIGNATURES

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

CAPSTAR FINANCIAL HOLDINGS, INC.

By: /s/ Robert B. Anderson
Robert B. Anderson
Chief Financial Officer and Chief Administrative Officer

Date: May 3, 2017

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, Claire W. Tucker, 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: May 3, 2017

By: /s/ Claire W. Tucker
Claire W. Tucker
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, Robert B. Anderson, 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: May 3, 2017

By: /s/ Robert B. Anderson

Robert B. Anderson
Chief Financial Officer and
Chief Administrative 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 March 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Claire W. Tucker, 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:

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: May 3, 2017

By: /s/ Claire W. Tucker
Claire W. Tucker
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 March 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert B. Anderson, Chief Financial Officer and Chief Administrative 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:

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: May 3, 2017

By: /s/ Robert B. Anderson
Robert B. Anderson
Chief Financial Officer and
Chief Administrative Officer