S&T BANCORP INC
Form 10-K
February 21, 2019
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 31, 2018
or
o 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 0-12508
S&T BANCORP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1434426
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
800 Philadelphia Street, Indiana, PA	15701
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (800) 325-2265
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $2.50 per share	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities registered pursuant to Section 12(g) of the Act: None
(Title of class)
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x
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 x No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this form 10-K. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer o

Non-accelerated filer o   Smaller reporting company o
Emerging growth company o

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. o

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Table of Contents

The aggregate estimated fair value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2018:
Common Stock, $2.50 par value – $1,473,398,806
The number of shares outstanding of each of the registrant's classes of common stock as of February 21, 2019:
Common Stock, $2.50 par value –34,616,337
DOCUMENTS INCORPORATED BY REFERENCE
Portions of the definitive Proxy Statement of S&T Bancorp, Inc., to be filed pursuant to Regulation 14A for the 2019 annual meeting of shareholders to be held May 20, 2019, are incorporated by reference into Part III of this Annual Report on Form 10-K.

Table of Contents

Table of Contents

PART I

Item 1. BUSINESS

General

S&T Bancorp, Inc. was incorporated on March 17, 1983 under the laws of the Commonwealth of Pennsylvania as a bank holding company and is registered with the Board of Governors of the Federal Reserve System, or the Federal Reserve Board, under the Bank Holding Company Act of 1956, as amended, or the BHCA, as a bank holding company and a financial holding company. S&T Bancorp, Inc. has three direct wholly-owned subsidiaries, S&T Bank, 9th Street Holdings, Inc. and STBA Capital Trust I, and also owns a 50 percent interest in Commonwealth Trust Credit Life Insurance Company, or CTCLIC. When used in this Report, “S&T”, “we”, “us” or “our” may refer to S&T Bancorp, Inc. individually, S&T Bancorp, Inc. and its consolidated subsidiaries, or certain of S&T Bancorp, Inc.’s subsidiaries or affiliates, depending on the context. As of December 31, 2018, we had approximately $7.3 billion in assets, $5.9 billion in loans, $5.7 billion in deposits and $935.8 million in shareholders’ equity.

S&T Bank is a full service bank, providing services to its customers through locations in Pennsylvania, Ohio and New York. S&T Bank deposits are insured by the Federal Deposit Insurance Corporation, or FDIC, to the maximum extent provided by law. S&T Bank has three wholly-owned operating subsidiaries: S&T Insurance Group, LLC, S&T Bancholdings, Inc. and Stewart Capital Advisors, LLC. Effective January 1, 2018, S&T Insurance Group, LLC, sold a majority interest in its previously wholly-owned subsidiary S&T-Evergreen Insurance, LLC.

Prior to 2017, we reported three operating segments: Community Banking, Wealth Management and Insurance. Effective January 1, 2017, we no longer report Wealth Management and Insurance segment information, as they do not meet the quantitative thresholds required for disclosure.

Through S&T Bank and our non-bank subsidiaries, we offer traditional banking services, which include accepting time and demand deposits and originating commercial and consumer loans, brokerage services and trust services including serving as executor and trustee under wills and deeds and as guardian and custodian of employee benefits. We also manage private investment accounts for individuals and institutions through our registered investment advisor. Total Wealth Management assets under administration were $1.8 billion at December 31, 2018.

The main office of both S&T Bancorp, Inc. and S&T Bank is located at 800 Philadelphia Street, Indiana, Pennsylvania, and its phone number is (800) 325-2265.

Employees

As of December 31, 2018, we had 1,040 full-time equivalent employees.

Access to United States Securities and Exchange Commission Filings

All of our reports filed electronically with the United States Securities and Exchange Commission, or the SEC, including this Annual Report on Form 10-K for the fiscal year ended December 31, 2018, our prior annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and our annual proxy statements, as well as any amendments to those reports, are accessible at no cost on our website at www.stbancorp.com under Financial Information, SEC Filings. These filings are also accessible on the SEC’s website at www.sec.gov. The charters of the Audit Committee, the Compensation and Benefits Committee, the Nominating and Corporate Governance Committee, the Executive Committee, the Credit Risk Committee and the Trust and Revenue Oversight Committee, as well as the Complaints Regarding Accounting, Internal Accounting Controls or Auditing Matters Policy, the Code of Conduct for the CEO and CFO, the General Code of Conduct, the Corporate Governance Guidelines and the Shareholder Communications Policy are also available at www.stbancorp.com under Corporate Governance.

Supervision and Regulation

General

S&T is extensively regulated under federal and state law. Regulation of bank holding companies and banks is intended primarily for the protection of consumers, depositors, borrowers, the Federal Deposit Insurance Fund, or DIF, and the banking system as a whole, and not for the protection of shareholders or creditors. The following describes certain aspects of that regulation and does not purport to be a complete description of all regulations that affect S&T or all aspects of any regulation discussed here. To the extent statutory or regulatory provisions are described, the description is qualified in its entirety by reference to the particular statutory or regulatory provisions.

3

The Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, enacted in July 2010, has had and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes addressing, among other things: (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; (v) enhanced corporate governance and executive compensation requirements and disclosures; and (vi) numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC. While certain requirements called for in the Dodd-Frank Act have been implemented, these regulations are subject to continuing interpretation and potential amendment, and a variety of the requirements remain to be implemented. Given the continued uncertainty associated with the ongoing implementation of the requirements of Dodd-Frank Act by the various regulatory agencies, including the manner in which the remaining provisions will be implemented and the interpretation of and potential amendments to existing regulations, the full extent of the impact of such requirements on financial institutions' operations is unclear. The continuing changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, increase our operating and compliance costs, or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

In addition, proposals to change the laws and regulations governing the banking industry are frequently raised in Congress, in state legislatures and before the various bank regulatory agencies that may impact S&T. Such initiatives to change the laws and regulations may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Any such legislation could change bank statutes and our operating environment in substantial and unpredictable ways. If enacted, such legislation could affect how S&T and S&T Bank operate and could significantly increase costs, impede the efficiency of internal business processes, limit our ability to pursue business opportunities in an efficient manner, or affect the competitive balance among banks, credit unions and other financial institutions, any of which could materially and adversely affect our business, financial condition and results of operations. The likelihood and timing of any changes and the impact such changes might have on S&T is impossible to determine with any certainty.

S&T

We are a bank holding company subject to regulation under the BHCA and the examination and reporting requirements of the Federal Reserve Board. Under the BHCA, a bank holding company may not directly or indirectly acquire ownership or control of more than five percent of the voting shares or substantially all of the assets of any additional bank, or merge or consolidate with another bank holding company, without the prior approval of the Federal Reserve Board.

As a bank holding company, we are expected under statutory and regulatory provisions to serve as a source of financial and managerial strength to our subsidiary bank. A bank holding company is also expected to commit resources, including capital and other funds, to support its subsidiary bank.

We elected to become a financial holding company under the BHCA in 2001 and thereby may engage in a broader range of financial activities than are permissible for traditional bank holding companies. In order to maintain our status as a financial holding company, we must remain "well-capitalized" and "well-managed" and the depository institutions controlled by us must remain "well-capitalized," "well-managed" (as defined in federal law) and have at least a "satisfactory" Community Reinvestment Act, or CRA, rating. Refer to Note 24 Regulatory Matters to the Consolidated

Financial Statements contained in Part II, Item 8 of this Report for information concerning the current capital ratios of S&T and S&T Bank. No prior regulatory approval is required for a financial holding company with total consolidated assets less than $50 billion to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board, unless the total consolidated assets to be acquired exceed $10 billion. The BHCA identifies several activities as "financial in nature" including, among others, securities underwriting; dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and sales agency; investment advisory activities; merchant banking activities and activities that the Federal Reserve Board has determined to be closely related to banking. Banks may also engage in, subject to limitations on investment, activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development and real estate investment, through a financial subsidiary of the bank, if the bank is "well-capitalized," "well-managed" and has at least a "satisfactory" CRA rating.

If S&T or S&T Bank ceases to be "well-capitalized" or "well-managed," we will not be in compliance with the requirements of the BHCA regarding financial holding companies or requirements regarding the operation of financial subsidiaries by insured banks.

If a financial holding company is notified by the Federal Reserve Board of such a change in the ratings of any of its subsidiary banks, it must take certain corrective actions within specified time frames. Furthermore, if S&T Bank was to receive a CRA rating of less than "satisfactory," then we would be prohibited from engaging in certain new activities or acquiring companies engaged in certain financial activities until the rating is raised to "satisfactory" or better.

We are presently engaged in nonbanking activities through the following five entities:

- 9th Street Holdings, Inc. was formed in June 1988 to hold and manage a group of investments previously owned by S&T Bank and to give us additional latitude to purchase other investments.
- S&T Bancholdings, Inc. was formed in August 2002 to hold and manage a group of investments previously owned by S&T Bank and to give us additional latitude to purchase other investments.
- CTCLIC is a joint venture with another financial institution, and acts as a reinsurer of credit life, accident and health insurance policies that were sold by S&T Bank and the other institution. S&T Bank and the other institution each have ownership interests of 50 percent in CTCLIC.
- S&T Insurance Group, LLC distributes life insurance and long-term disability income insurance products. During 2001, S&T Insurance Group, LLC and Attorneys Abstract Company, Inc. entered into an agreement to form S&T Settlement Services, LLC, or STSS, with respective ownership interests of 55 percent and 45 percent. STSS is a title insurance agency servicing commercial customers. During 2002, S&T Insurance Group, LLC expanded into the property and casualty insurance business with the acquisition of S&T-Evergreen Insurance, LLC. On January 1, 2018 we sold a 70 percent majority interest in the assets of our subsidiary, S&T-Evergreen Insurance, LLC. We transferred our remaining 30 percent share of net assets from S&T Evergreen Insurance, LLC to a new entity for a 30 percent partnership interest in a new insurance entity.
- Stewart Capital Advisors, LLC was formed in August 2005 and is a registered investment advisor that manages private investment accounts for individuals and institutions.

S&T Bank

As a Pennsylvania-chartered, FDIC-insured non-member commercial bank, S&T Bank is subject to the supervision and regulation of the Pennsylvania Department of Banking and Securities, or PADBS, and the FDIC. We are also subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types, amount and terms and conditions of loans that may be granted and limits on the types of other activities in which S&T Bank may engage and the investments it may make. In addition, pursuant to the federal Bank Merger Act, S&T Bank must obtain the prior approval of the FDIC before it can merge or consolidate with, or acquire the assets or assume the deposit liabilities of another bank.

S&T Bank is subject to affiliate transaction rules in Sections 23A and 23B of the Federal Reserve Act as implemented by the Federal Reserve Board's Regulation W, that limit the amount of transactions between itself and S&T or any other company or entity that controls or is under common control with any company or entity that controls S&T Bank, including for most purposes any financial or depository institution subsidiary of S&T Bank. Under these provisions, "covered" transactions, including making loans, purchasing assets, issuing guarantees and other similar transactions, between a bank and its parent company or any other affiliate, generally are limited to 10 percent of the bank subsidiary's capital and surplus, and with respect to all transactions with affiliates, are limited to 20 percent of the bank subsidiary's capital and surplus. Loans and extensions of credit from a bank to an affiliate generally are required to be secured by eligible collateral in specified amounts, and in general all affiliated transactions must be on terms consistent with safe and sound banking practices. The Dodd-Frank Act expanded the affiliate transaction rules to broaden the definition of affiliate to include as covered transactions securities borrowing or lending, repurchase or reverse repurchase agreements and derivatives activities, and to strengthen collateral requirements and limit Federal Reserve exemptive authority.

Federal law also constrains the types and amounts of loans that S&T Bank may make to its executive officers, directors and principal shareholders. Among other things, these loans are limited in amount, must be approved by the bank's board of directors in advance, and must be on terms and conditions as favorable to the bank as those available to an unrelated person. The Dodd-Frank Act strengthened restrictions on loans to insiders and expanded the types of transactions subject to the various limits to include credit exposure arising from a derivative transaction, a repurchase or reverse repurchase agreement and a securities lending or borrowing transaction. The Dodd-Frank Act also placed restrictions on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution's board of directors.

Insurance of Accounts; Depositor Preference

The deposits of S&T Bank are insured up to applicable limits per insured depositor by the Deposit Insurance Fund, or DIF, as administered by the FDIC. The Dodd-Frank Act codified FDIC deposit insurance coverage per separately insured depositor for all account types at $250,000.

Table of Contents

As an FDIC-insured bank, S&T Bank is subject to FDIC insurance assessments, which are imposed based upon the calculated risk the institution poses to the DIF. In July 2016, the FDIC Board of Directors adopted a revised final rule to refine the deposit insurance assessment system for small insured depository institutions (less than $10 billion in assets) that have been federally insured for at least five years by: revising the financial ratios method for determining assessment rates so that it is based on a statistical model estimating the probability of failure over three years; updating the financial measures used in the financial ratios method consistent with the statistical model; and eliminating risk categories for established small banks and using the financial ratios method to determine assessment rates for all such banks. The amended FDIC insurance assessment benefits many small institutions with a lower rate; we, however, have incurred a minimal increase to our base rate.

Under the current assessment system, for an institution with less than $10 billion in assets, assessment rates are determined based on a combination of financial ratios and CAMELS composite ratings. The assessment rate schedule can change from time to time, at the discretion of the FDIC, subject to certain limits. Under the current system, premiums are assessed quarterly. Assessments are calculated as a percentage of average consolidated total assets less average tangible equity during the assessment period. The current total base assessment rates on an annualized basis range from 1.5 basis points for certain "well-capitalized," "well-managed" banks, with the highest ratings, to 40 basis points for complex institutions posing the most risk to the DIF. The FDIC may raise or lower these assessment rates on a quarterly basis based on various factors designed to achieve a minimum designated reserve ratio of the DIF, which the Dodd-Frank Act has mandated to be no less than 1.35 percent of estimated insured deposits, subsequently set at two percent by the FDIC.

In addition to DIF assessments, the FDIC makes a special assessment to fund the repayment of debt obligations of the Financing Corporation, or FICO. FICO is a government-sponsored entity that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation in the 1990s. The FICO assessment rate for the first quarter of 2019 is 0.14 basis points on an annualized basis.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines after a hearing that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the Federal Reserve Board. It also may suspend deposit insurance temporarily during the hearing process if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of termination, less subsequent withdrawals, will continue to be insured for a period of six months to two years, as determined by the FDIC.

Under federal law, deposits and certain claims for administrative expenses and employee compensation against insured depository institutions are afforded a priority over other general unsecured claims against such an institution, including federal funds and letters of credit, in the liquidation or other resolution of such an institution by a receiver. Such priority creditors would include the FDIC.

Capital

The Federal Reserve Board and the FDIC have issued substantially similar minimum risk-based and leverage capital rules applicable to banking organizations they supervise. At December 31, 2018, both S&T and S&T Bank met the applicable minimum regulatory capital requirements.

The following table summarizes the leverage and risk-based capital ratios for S&T and S&T Bank:

	Actual	Minimum Regulatory Capital Requirements	To be Well Capitalized Under Prompt Corrective Action

(dollars in thousands)	Amount	Ratio	Amount	Ratio	Provisions Amount	Ratio
As of December 31, 2018						
Leverage Ratio						
S&T	$689,778	10.05%	$274,497	4.00 %	$343,121	5.00 %
S&T Bank	659,304	9.63 %	273,820	4.00 %	342,275	5.00 %
Common Equity Tier 1 (to Risk-Weighted Assets)						
S&T	669,778	11.38%	264,933	4.50 %	382,681	6.50 %
S&T Bank	659,304	11.23%	264,127	4.50 %	381,517	6.50 %
Tier 1 Capital (to Risk-Weighted Assets)						
S&T	689,778	11.72%	353,244	6.00 %	470,992	8.00 %
S&T Bank	659,304	11.23%	352,170	6.00 %	469,560	8.00 %
Total Capital (to Risk-Weighted Assets)						
S&T	777,913	13.21%	470,992	8.00 %	588,741	10.00%
S&T Bank	747,438	12.73%	469,560	8.00 %	586,950	10.00%

Table of Contents

In addition, the banking regulatory agencies may from time to time require that a banking organization maintain capital above the minimum prescribed levels, whether because of its financial condition or actual or anticipated growth.

The risk-based capital standards establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, takes off-balance sheet exposures explicitly into account in assessing capital adequacy and minimizes disincentives to holding liquid, low-risk assets. For purposes of the risk-based ratios, assets and specified off-balance sheet instruments are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The leverage ratio represents capital as a percentage of total average assets adjusted as specified in the guidelines.

In July 2013 the federal banking agencies issued final regulatory capital rules that replaced the then existing general risk-based capital and related rules, broadly revising the basic definitions and elements of regulatory capital and making substantial changes to the risk weightings for banking and trading book assets. The new regulatory capital rules are designed to implement Basel III (which were agreements reached in July 2010 by the international oversight body of the Basel Committee on Banking Supervision to require more and higher-quality capital) as well as the minimum leverage and risk-based capital requirements of the Dodd-Frank Act. These new capital standards apply to all banks, regardless of size, and to all bank holding companies with consolidated assets greater than $500 million, and became effective on January 1, 2015. For smaller banking organizations such as S&T and S&T Bank, the rules are subject to a transition period providing for full implementation as of January 1, 2019.

The required regulatory capital minimum ratios under the new capital standards as of December 31, 2018 are as follows:

- Common equity Tier 1 risk-based capital ratio (common equity Tier 1 capital to standardized total risk-weighted assets) of 4.50 percent;
- Tier 1 risk-based capital ratio (Tier 1 capital to standardized total risk-weighted assets) of 6.00 percent;
- Total risk-based capital ratio (total capital to standardized total risk-weighted assets) of 8.00 percent; and
- Leverage ratio (Tier 1 capital to average total consolidated assets less amounts deducted from Tier 1 capital) of 4.00 percent.

Generally, under the guidelines, common equity Tier 1 capital consists of common stock instruments that meet the eligibility criteria in the rule, retained earnings, accumulated other comprehensive income and common equity Tier 1 minority interest, less applicable regulatory adjustments and deductions including goodwill, intangible assets subject to limitation and certain deferred tax assets subject to limitation. Tier 1 capital is comprised of common equity Tier 1 capital plus generally non-cumulative perpetual preferred stock, Tier 1 minority interests and, for bank holding companies with less than $15 billion in consolidated assets at December 31, 2009, certain restricted capital instruments including qualifying cumulative perpetual preferred stock and grandfathered trust preferred securities, up to a limit of 25 percent of Tier 1 capital, less applicable regulatory adjustments and deductions. Tier 2, or supplementary, capital generally includes portions of trust preferred securities and cumulative perpetual preferred stock not otherwise counted in Tier 1 capital, as well as preferred stock, subordinated debt, total capital minority interests not included in Tier 1, and the allowance for loan losses in an amount not exceeding 1.25 percent of standardized risk-weighted assets, less applicable regulatory adjustments and deductions. Total capital is the sum of Tier 1 and Tier 2 capital.

The new regulatory capital rule also requires a banking organization to maintain a capital conservation buffer composed of common equity Tier 1 capital in an amount greater than 2.50 percent of total risk-weighted assets beginning in 2019. Beginning in 2016, the capital conservation buffer was phased in, beginning at 25 percent, increasing to 50 percent in 2017, 75 percent in 2018 and 100 percent in 2019 and beyond. As a result, starting in 2019, a banking organization must maintain a common equity Tier 1 risk-based capital ratio greater than 7.00 percent, a Tier 1 risk-based capital ratio greater than 8.50 percent and a Total risk-based capital ratio greater than 10.50 percent; otherwise, it will be subject to restrictions on capital distributions and discretionary bonus payments. By 2019, when the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the regulatory capital ratios required for an insured depository institution to be well-capitalized under prompt corrective action law, described below.

The new regulatory capital rule also revises the calculation of risk-weighted assets. It includes a new framework under which the risk weight will increase for most credit exposures that are 90 days or more past due or on nonaccrual, high-volatility commercial real estate loans, mortgage servicing and deferred tax assets that are not deducted from capital and certain equity exposures. It also includes changes to the credit conversion factors of off-balance sheet items, such as the unused portion of a loan commitment.

Federal regulators periodically propose amendments to the regulatory capital rules and the related regulatory framework and consider changes to the capital standards that could significantly increase the amount of capital needed to meet applicable standards. The timing of adoption, ultimate form and effect of any such proposed amendments cannot be predicted.

Payment of Dividends

S&T is a legal entity separate and distinct from its banking and other subsidiaries. A substantial portion of our revenues consist of dividend payments we receive from S&T Bank. The payment of common dividends by S&T is subject to certain requirements and limitations of Pennsylvania law. S&T Bank, in turn, is subject to federal and state laws and regulations that limit the amount of dividends it can pay to S&T. In addition, both S&T and S&T Bank are subject to various general regulatory policies relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The Federal Reserve Board has indicated that banking organizations should generally pay dividends only if (i) the organization’s net income available to common shareholders over the past year has been sufficient to fully fund the dividends and (ii) the prospective rate of earnings retention appears consistent with the organization’s capital needs, asset quality and overall financial condition. Thus, under certain circumstances based upon our financial condition, our ability to declare and pay quarterly dividends may require consultation with the Federal Reserve Board and may be prohibited by applicable Federal Reserve Board guidance.

Other Safety and Soundness Regulations

There are a number of obligations and restrictions imposed on bank holding companies such as us and our depository institution subsidiary by federal law and regulatory policy. These obligations and restrictions are designed to reduce potential loss exposure to the FDIC’s DIF in the event an insured depository institution becomes in danger of default or is in default. Under current federal law, for example, the federal banking agencies possess broad powers to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is “well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” as defined by the law. As of December 31, 2018, S&T Bank was classified as “well-capitalized.” New definitions of these categories, as set forth in the federal banking agencies’ final rule to implement Basel III and the minimum leverage and risk-based capital requirements of the Dodd-Frank Act, became effective as of January 1, 2015. To be well-capitalized, an insured depository institution must have a common equity Tier 1 risk-based capital ratio of at least 6.50 percent, a Tier 1 risk-based capital ratio of at least 8.00 percent, a total risk-based capital ratio of at least 10.00 percent and a leverage ratio of at least 5.00 percent, and the institution must not be subject to any written agreement, order, capital directive or prompt corrective action directive by its primary federal regulator. To be adequately capitalized, an insured depository institution must have a common equity Tier 1 risk-based capital ratio of at least 4.50 percent, a Tier 1 risk-based capital ratio of at least 6.00 percent, a total risk-based capital ratio of at least 8.00 percent and a leverage ratio of at least 4.00 percent. The classification of depository institutions is primarily for the purpose of applying the federal banking agencies’ prompt corrective action provisions and is not intended to be and should not be interpreted as a representation of overall financial condition or prospects of any financial institution.

The federal banking agencies’ prompt corrective action powers, which increase depending upon the degree to which an institution is undercapitalized, can include, among other things, requiring an insured depository institution to adopt a capital restoration plan, which cannot be approved unless guaranteed by the institution’s parent company; placing limits on asset growth and restrictions on activities, including restrictions on transactions with affiliates; restricting the interest rates the institution may pay on deposits; restricting the institution from accepting brokered deposits; prohibiting the payment of principal or interest on subordinated debt; prohibiting the holding company from making capital distributions, including payment of dividends, without prior regulatory approval; and, ultimately, appointing a receiver for the institution.

The federal banking agencies have also adopted guidelines prescribing safety and soundness standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, fees and compensation and benefits. In general, the guidelines require appropriate systems and practices to identify and manage specified risks and exposures. The guidelines prohibit excessive compensation as an unsafe and unsound practice and characterize compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies have adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not in compliance with any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an “undercapitalized” institution is subject under the prompt corrective action provisions described above.

Regulatory Enforcement Authority

The enforcement powers available to federal banking agencies are substantial and include, among other things and in addition to other powers described herein, the ability to assess civil money penalties and impose other civil and criminal penalties, to issue cease-and-desist or removal orders, to appoint a conservator to conserve the assets of an institution for the benefit of its depositors and creditors and to initiate injunctive actions against banks and bank holding companies and “institution affiliated parties,” as defined in the Federal Deposit Insurance Act. In general, these enforcement actions may be initiated for violations of laws and regulations, and engagement in unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

At the state level, the PADBS also has broad enforcement powers over S&T Bank, including the power to impose fines and other penalties and to appoint a conservator or receiver.

Interstate Banking and Branching

The BHCA currently permits bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including certain nationwide and state-imposed deposit concentration limits. In addition, because of changes to law made by the Dodd-Frank Act, S&T Bank may now establish de novo branches in any state to the same extent that a bank chartered in that state could establish a branch.

Community Reinvestment, Fair Lending and Consumer Protection Laws

In connection with its lending activities, S&T Bank is subject to a number of state and federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. The federal laws include, among others, the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Truth-in-Savings Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act and the CRA. In addition, federal rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent the disclosure of certain personal information to nonaffiliated third parties.

The CRA requires the appropriate federal banking agency, in connection with its examination of a bank, to assess the bank’s record in meeting the credit needs of the communities served by the bank, including low and moderate-income neighborhoods. Furthermore, such assessment is required of any bank that has applied, among other things, to merge or consolidate with or acquire the assets or assume the liabilities of an insured depository institution, or to open or relocate a branch office. In the case of a bank holding company, including a financial holding company, applying for approval to acquire a bank or bank holding company, the Federal Reserve Board will assess the record of each subsidiary bank of the applicant bank holding company in considering the application. Under the CRA, institutions are assigned a rating of “outstanding,” “satisfactory,” “needs to improve” or “unsatisfactory.” S&T Bank was rated “satisfactory” i its most recent CRA evaluation.

With respect to consumer protection, the Dodd-Frank Act created the Consumer Financial Protection Bureau, or the CFPB, which took over rulemaking responsibility on July 21, 2011 for the principal federal consumer financial protection laws, such as those identified above. Institutions that have assets of $10 billion or less, such as S&T Bank, are subject to the rules established by the CFPB but will continue to be supervised in this area by their state and primary federal regulators, which in the case of S&T Bank is the FDIC. The Dodd-Frank Act also gives the CFPB expanded data collection powers for fair lending purposes for both small business and mortgage loans, as well as expanded authority to prevent unfair, deceptive and abusive practices. The consumer complaint function also has been consolidated into the CFPB with respect to the institutions it supervises. The CFPB established an Office of Community Banks and Credit Unions, with a mission to ensure that the CFPB incorporates the perspectives of small depository institutions into the policy-making process, communicates relevant policy initiatives to community banks and credit unions, and works with community banks and credit unions to identify potential areas for regulatory simplification.

Fair lending laws prohibit discrimination in the provision of banking services, and the enforcement of these laws has been a focus for bank regulators. Fair lending laws include the Equal Credit Opportunity Act and the Fair Housing Act, which outlaw discrimination in credit transactions and residential real estate on the basis of prohibited factors including, among others, race, color, national origin, sex and religion. A lender may be liable for policies that result in a disparate treatment of or have a disparate impact on a protected class of applicants or borrowers. If a pattern or practice of lending discrimination is alleged by a regulator, then that agency may refer the matter to the U.S. Department of Justice, or DOJ, for investigation. In December of 2012, the DOJ and the CFPB entered into a Memorandum of Understanding under which the agencies have agreed to share information, coordinate investigations and have generally committed to strengthen their coordination efforts. S&T Bank is required to have a fair lending program that is of sufficient scope to monitor the inherent fair lending risk of the institution and that appropriately remediates issues which are identified.

Table of Contents

During 2013, the CFPB issued a series of final rules related to mortgage loan origination and mortgage loan servicing. In particular, on January 10, 2013, the CFPB issued a final rule implementing the ability-to-repay and qualified mortgage (QM) provisions of the Truth-in-Lending Act, as amended by the Dodd-Frank Act ("QM Rule"). The ability-to-repay provision requires creditors to make reasonable, good-faith determinations that borrowers are able to repay their mortgage loans before extending the credit, based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of "qualified mortgage" are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements, and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a QM incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43 percent debt-to-income ratio for borrowers if the loan is to meet the QM definition, though some mortgages that meet government-sponsored enterprise, or GSE, Federal Housing Administration, or FHA, and Veterans Affairs, or VA, underwriting guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43 percent debt-to-income limits. The QM Rule became effective on January 10, 2014. These rules did not have a material impact on our mortgage business.

In November 2013, the CFPB issued a final rule implementing the Dodd-Frank Act requirement to establish integrated disclosures in connection with mortgage origination, which incorporates disclosure requirements under the Real Estate Settlement Procedures Act and the Truth-in-Lending Act. The requirements of the final rule apply to all covered mortgage transactions for which S&T Bank receives a consumer application on or after October 3, 2015. The CFPB issued a final rule regarding the integrated disclosures in December 2013, and the disclosure requirement became effective in October 2015. These rules did not have a material impact on our mortgage business.

Anti-Money Laundering Rules

S&T Bank is subject to the Bank Secrecy Act, its implementing regulations and other anti-money laundering laws and regulations, including the USA Patriot Act of 2001. Among other things, these laws and regulations require S&T Bank to take steps to prevent the bank from being used to facilitate the flow of illegal or illicit money, to report large currency transactions and to file suspicious activity reports. S&T Bank is also required to develop and implement a comprehensive anti-money laundering compliance program. Banks must also have in place appropriate "know your customer" policies and procedures. Violations of these requirements can result in substantial civil and criminal sanctions. In addition, provisions of the USA Patriot Act of 2001 require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when considering applications for bank mergers and bank holding company acquisitions.

Other Dodd-Frank Provisions

In December 2013, federal regulators adopted final regulations regarding the Volcker Rule established in the Dodd-Frank Act. The Volcker Rule generally prohibits banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies generally covering hedge funds and private equity funds, subject to certain exemptions. Banking entities had until July 21, 2017 to conform their activities to the requirements of the rule. Because S&T generally does not engage in the activities prohibited by the Volcker Rule, the effectiveness of the rule has not had a material effect on S&T Bank or its affiliates.

In addition, the Dodd-Frank Act provides that the amount of any interchange fee charged for electronic debit transactions by debit card issuers having assets over $10 billion must be reasonable and proportional to the actual cost of a transaction to the issuer. The Federal Reserve Board has adopted a rule which limits the maximum permissible interchange fees that such issuers can receive for an electronic debit transaction. This rule, Regulation II, which was effective October 1, 2011, does not apply to a bank that, together with its affiliates, has less than $10 billion in assets, which includes S&T.

Competition

S&T Bank competes with other local, regional and national financial services providers, such as other financial holding companies, commercial banks, credit unions, finance companies and brokerage and insurance firms, including competitors that provide their products and services online and through mobile devices. Some of our competitors are not subject to the same level of regulation and oversight that is required of banks and bank holding companies, and are thus able to operate under lower cost structures. Our wealth management business competes with trust companies, mutual fund companies, investment advisory firms, law firms, brokerage firms and other financial services companies.

Changes in bank regulation, such as changes in the products and services banks can offer and permitted involvement in non-banking activities by bank holding companies, as well as bank mergers and acquisitions, can affect our ability to compete with other financial services providers. Our ability to do so will depend upon how successfully we can respond to the evolving competitive, regulatory, technological and demographic developments affecting our operations.

Our customers are primarily in Pennsylvania and the contiguous states of Ohio, West Virginia, New York, Maryland and Delaware. The majority of our commercial and consumer loans are made to businesses and individuals in these states resulting in a geographic concentration. Our market area has a high density of financial institutions, some of which are significantly larger institutions with greater financial resources than us, and many of which are our competitors to varying degrees. Our competition for loans comes principally from commercial banks, mortgage banking companies, credit unions and other financial service companies. Our most direct competition for deposits has historically come from commercial banks and credit unions. We face additional competition for deposits from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies. Because larger competitors have advantages in attracting business from larger corporations, we do not generally attempt to compete for that business. Instead, we concentrate our efforts on attracting the business of individuals, and small and medium-size businesses. We consider our competitive advantages to be customer service and responsiveness to customer needs, the convenience of banking offices and hours, access to electronic banking services and the availability and pricing of our products and services. We emphasize personalized banking and the advantage of local decision-making in our banking business.

The financial services industry is likely to become more competitive as further technological advances enable more companies to provide financial services on a more efficient and convenient basis. Technological innovations have lowered traditional barriers to entry and enabled many companies to compete in financial services markets. Many customers now expect a choice of banking options for the delivery of services, including traditional banking offices, telephone, internet, mobile, ATMs, self-service branches, in-store branches and/or digital and technology based solutions. These delivery channels are offered by traditional banks and savings associations, credit unions, brokerage firms, asset management groups, financial technology companies, finance and insurance companies, internet-based companies, and mortgage banking firms.

Table of Contents

Item 1A. RISK FACTORS

Investments in our common stock involve risk. The following discussion highlights the risks that we believe are material to S&T, but does not necessarily include all risks that we may face.

The market price of our common stock may fluctuate significantly in response to a number of factors.

Our quarterly and annual operating results have varied significantly in the past and could vary significantly in the future, which makes it difficult for us to predict our future operating results. Our operating results may fluctuate due to a variety of factors, many of which are outside of our control, including the changing U.S. economic environment and changes in the commercial and residential real estate market, any of which may cause our stock price to fluctuate. If our operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- volatility of stock market prices and volumes in general;
- changes in market valuations of similar companies;
- changes in the conditions of credit markets;
- changes in accounting policies or procedures as required by the Financial Accounting Standards Board, or FASB, or other regulatory agencies;
- legislative and regulatory actions, including the impact of the Dodd-Frank Act and related regulations, that may subject us to additional regulatory oversight which may result in increased compliance costs and/or require us to change our business model;
- government intervention in the U.S. financial system and the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- additions or departures of key members of management;
- fluctuations in our quarterly or annual operating results; and
- changes in analysts' estimates of our financial performance.

Risks Related to Credit

Our ability to assess the credit-worthiness of our customers may diminish, which may adversely affect our results of operations.

We incur credit risk by virtue of making loans and extending loan commitments and letters of credit. Credit risk is one of our most significant risks. Our exposure to credit risk is managed through the use of consistent underwriting standards that emphasize "in-market" lending while avoiding excessive industry and other concentrations. Our credit administration function employs risk management techniques to ensure that loans adhere to corporate policy and problem loans are promptly identified. There can be no assurance that such measures will be effective in avoiding undue credit risk. If the models and approaches that we use to select, manage and underwrite our consumer and commercial loan products become less predictive of future charge-offs, due to events adversely affecting our customers, including rapid changes in the economy, our credit losses may increase.

The value of the collateral used to secure our loans may not be sufficient to compensate for the amount of an unpaid loan and we may be unsuccessful in recovering the remaining balances from our customers.

Decreases in real estate values, particularly with respect to our commercial lending and mortgage activities, could adversely affect the value of property used as collateral for our loans and our customers' ability to repay these loans, which in turn could impact our profitability. Repayment of our commercial loans is often dependent on the cash flow of the borrower, which may become unpredictable. If the value of the assets, such as real estate, serving as collateral for the loan portfolio were to decline materially, a significant part of the loan portfolio could become under-collateralized. If the loans that are secured by real estate become troubled when real estate market conditions are declining or have declined, in the event of foreclosure, we may not be able to realize the amount of collateral that was anticipated at the time of originating the loan. This could result in higher charge-offs which could have a material adverse effect on our operating results and financial condition.

Changes in the overall credit quality of our portfolio can have a significant impact on our earnings.

Like other lenders, we face the risk that our customers will not repay their loans. We reserve for losses in our loan portfolio based on our assessment of inherent credit losses. This process, which is critical to our financial results and condition, requires complex judgment including our assessment of economic conditions, which are difficult to predict. Through a periodic review of the loan portfolio, management determines the amount of the allowance for loan losses, or ALL, by considering historical losses combined with qualitative factors including changes in lending policies and practices, economic conditions, changes in the loan portfolio, changes in lending management, results of internal loan reviews, asset quality trends, collateral values,

Table of Contents

concentrations of credit risk and other external factors. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control. Although we have policies and procedures in place to determine future losses, due to the subjective nature of this area, there can be no assurance that our management has accurately assessed the level of allowances reflected in our Consolidated Financial Statements. We may underestimate our inherent losses and fail to hold an ALL sufficient to account for these losses. Incorrect assumptions could lead to material underestimates of inherent losses and an inadequate ALL. As our assessment of inherent losses changes, we may need to increase or decrease our ALL, which could significantly impact our financial results and profitability.

Our loan portfolio is concentrated within our market area, and our lack of geographic diversification increases our risk profile.

The regional economic conditions within our market area affect the demand for our products and services as well as the ability of our customers to repay their loans and the value of the collateral securing these loans. We are less able than a larger institution to spread the risks of unfavorable local economic conditions across a large number of diversified economies. A significant decline in the regional economy caused by inflation, recession, unemployment or other factors could negatively affect our customers, the quality of our loan portfolio and the demand for our products and services. Any sustained period of increased payment delinquencies, foreclosures or losses caused by adverse market or economic conditions in our market area could adversely affect the value of our assets, revenues, results of operations and financial condition. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market area.

Our loan portfolio has a significant concentration of commercial real estate loans.

The majority of our loans are to commercial borrowers and 53 percent of our total loans are commercial real estate, or CRE, and construction loans with real estate as the primary collateral. The CRE segment of our loan portfolio typically involves higher loan principal amounts, and the repayment of these loans is generally dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Because payments on loans secured by CRE often depend upon the successful operation and management of the properties, repayment of these loans may be affected by factors outside the borrower’s control, including adverse conditions in the real estate market or the economy. Additionally, we have a number of significant credit exposures to commercial borrowers, and while the majority of these borrowers have numerous projects that make up the total aggregate exposure, if one or more of these borrowers default or have financial difficulties, we could experience higher credit losses, which could adversely impact our financial condition and results of operations. In December 2015, the FDIC and the other federal financial institution regulatory agencies released a new statement on prudent risk management for commercial real estate lending. In this statement, the agencies express concerns about easing commercial real estate underwriting standards, direct financial institutions to maintain underwriting discipline and exercise risk management practices to identify, measure and monitor lending risks, and indicate that they will continue to pay special attention to commercial real estate lending activities and concentrations going forward.

Risks Related to Our Operations

Failure to keep pace with technological changes could have a material adverse effect on our results of operations and financial condition.

The financial services industry is constantly undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better service customers and reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy their demands, as well as create additional efficiencies within our operations. Many of our large competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services quickly or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business, financial condition and results of operations.

13

Table of Contents

Item 1A. RISK FACTORS - continued

A failure in or breach of our operational or security systems or infrastructure, or those of third parties, could disrupt our businesses, and adversely impact our results of operations, liquidity and financial condition, as well as cause reputational harm.

Our operational and security systems, infrastructure, including our computer systems, data management, and internal processes, as well as those of third parties, are integral to our business. We rely on our employees and third parties in our day-to-day and ongoing operations, who may, as a result of human error, misconduct or malfeasance, or failure or breach of third- party systems or infrastructure, expose us to risk. We have taken measures to implement backup systems and other safeguards to support our operations, but our ability to conduct business may be adversely affected by any significant disruptions to us or to third parties with whom we interact. In addition, our ability to implement backup systems and other safeguards with respect to third-party systems is more limited than with our own systems.

We handle a substantial volume of customer and other financial transactions every day. Our financial, accounting, data processing, check processing, electronic funds transfer, loan processing, online and mobile banking, automated teller machines, or ATMs, backup or other operating or security systems and infrastructure may fail to operate properly or become disabled or damaged as a result of a number of factors including events that are wholly or partially beyond our control. This could adversely affect our ability to process these transactions or provide these services. There could be sudden increases in customer transaction volume, electrical, telecommunications or other major physical infrastructure outages, natural disasters, events arising from local or larger scale political or social matters, including terrorist acts, and cyber attacks. We continuously update these systems to support our operations and growth. This updating entails significant costs and creates risks associated with implementing new systems and integrating them with existing ones. Operational risk exposures could adversely impact our results of operations, liquidity and financial condition, and cause reputational harm.

A cyber attack, information or security breach, or a technology failure of ours or of a third-party could adversely affect our ability to conduct our business or manage our exposure to risk, result in the disclosure or misuse of confidential or proprietary information, increase our costs to maintain and update our operational and security systems and infrastructure, and adversely impact our results of operations, liquidity and financial condition, as well as cause reputational harm.

Our business is highly dependent on the security and efficacy of our infrastructure, computer and data management systems, as well as those of third parties with whom we interact. Cyber security risks for financial institutions have significantly increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties, including foreign state actors. Our operations rely on the secure processing, transmission, storage and retrieval of confidential, proprietary and other information in our computer and data management systems and networks, and in the computer and data management systems and networks of third parties. We rely on digital technologies, computer, database and email systems, software, and networks to conduct our operations. In addition, to access our network, products and services, our customers and third parties may use personal mobile devices or computing devices that are outside of our network environment.

Financial services institutions have been subject to, and are likely to continue to be the target of, cyber attacks, including computer viruses, malicious or destructive code, phishing attacks, denial of service or other security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of confidential, proprietary and other information of the institution, its employees or customers or of third parties, or otherwise materially disrupt network access or business operations. For example, denial of service attacks have been launched against a number of large financial institutions and several large retailers have disclosed substantial cyber security breaches affecting debit and credit card accounts of their customers. We have experienced cyber security incidents in the past, although not material, and we anticipate that, as a growing regional bank, we could experience further incidents. There can be no assurance that we will not suffer material losses or other material consequences relating to technology failure, cyber attacks or other information or security breaches.

In addition to external threats, insider threats also represent a risk to us. Insiders, having legitimate access to our systems and the information contained in them, have the opportunity to make inappropriate use of the systems and information. We have policies, procedures, and controls in place designed to prevent or limit this risk, but we cannot guarantee that these policies, procedures and controls fully mitigate this risk.

Item 1A. RISK FACTORS - continued

As cyber threats continue to evolve, we may be required to expend significant additional resources to continue to modify and enhance our protective measures or to investigate and remediate any information security vulnerabilities or incidents. Any of these matters could result in our loss of customers and business opportunities, significant disruption to our operations and business, misappropriation or destruction of our confidential information and/or that of our customers, or damage to our customers' and/or third parties' computers or systems, and could result in a violation of applicable privacy laws and other laws, litigation exposure, regulatory fines, penalties or intervention, loss of confidence in our security measures, reputational damage, reimbursement or other compensatory costs, and additional compliance costs. In addition, any of the matters described above could adversely impact our results of operations and financial condition.

We rely on third-party providers and other suppliers for a number of services that are important to our business. An interruption or cessation of an important service by any third-party could have a material adverse effect on our business.

We are dependent for the majority of our technology, including our core operating system, on third-party providers. If these companies were to discontinue providing services to us, we may experience significant disruption to our business. In addition, each of these third parties faces the risk of cyber attack, information breach or loss, or technology failure. If any of our third-party service providers experience such difficulties, or if there is any other disruption in our relationships with them, we may be required to find alternative sources of such services. We are dependent on these third-party providers securing their information systems, over which we have limited control, and a breach of their information systems could adversely affect our ability to process transactions, service our clients or manage our exposure to risk and could result in the disclosure of sensitive, personal customer information, which could have a material adverse impact on our business through damage to our reputation, loss of business, remedial costs, additional regulatory scrutiny or exposure to civil litigation and possible financial liability. Assurance cannot be provided that we could negotiate terms with alternative service sources that are as favorable or could obtain services with similar functionality as found in existing systems without the need to expend substantial resources, if at all, thereby resulting in a material adverse impact on our business and results of operations.

Risks Related to Interest Rates and Investments

Our net interest income could be negatively affected by interest rate changes which may adversely affect our financial condition.

Our results of operations are largely dependent on net interest income, which is the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Therefore, any change in general market interest rates, including changes resulting from the Federal Reserve Board's policies, can have a significant effect on our net interest income and total income. There may be mismatches between the maturity and repricing of our assets and liabilities that could cause the net interest rate spread to compress, depending on the level and type of changes in the interest rate environment. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and the policies of various governmental agencies. In addition, some of our customers often have the ability to prepay loans or redeem deposits with either no penalties, or penalties that are insufficient to compensate us for the lost income. A significant reduction in our net interest income will adversely affect our business and results of operations. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially harmed.

Declines in the value of investment securities held by us could require write-downs, which would reduce our earnings.

In order to diversify earnings and enhance liquidity, we own both debt and equity instruments of government agencies, municipalities and other companies. We may be required to record impairment charges on our debt securities if they suffer a decline in value that is considered other-than-temporary. Additionally, the value of these investments may fluctuate depending on the interest rate environment, general economic conditions and circumstances specific to the issuer. Volatile market conditions may detrimentally affect the value of these securities, such as through reduced valuations due to the perception of heightened credit or liquidity risks. Changes in the value of these instruments may result in a reduction to earnings and/or capital, which may adversely affect our results of operations and financial condition.

Table of Contents

Item 1A. RISK FACTORS - continued

Risks Related to Our Business Strategy

Our strategy includes growth plans through organic growth and by means of acquisitions. Our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a growth strategy through organic growth within our current footprint and through market expansion. We also actively evaluate acquisition opportunities as another source of growth. We cannot give assurance that we will be able to expand our existing market presence, or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations and could adversely affect our ability to successfully implement our business strategy.

Our failure to find suitable acquisition candidates, or successfully bid against other competitors for acquisitions, could adversely affect our ability to fully implement our business strategy. If we are successful in acquiring other entities, the process of integrating such entities will divert significant management time and resources. We may not be able to integrate efficiently or operate profitably any entity we may acquire. We may experience disruption and incur unexpected expenses in integrating acquisitions. These failures could adversely impact our future prospects and results of operation.

We are subject to competition from both banks and non-banking companies.

The financial services industry is highly competitive, and we encounter strong competition for deposits, loans and other financial services in our market area, including online providers of these products and services. Our principal competitors include other local, regional and national financial services providers, such as other financial holding companies, commercial banks, credit unions, finance companies and brokerage and insurance firms, including competitors that provide their products and services online. Many of our non-bank competitors are not subject to the same degree of regulation that we are and have advantages over us in providing certain services. Additionally, many of our competitors are significantly larger than we are and have greater access to capital and other resources. Failure to compete effectively for deposit, loan and other financial services customers in our markets could cause us to lose market share, slow our growth rate and have an adverse effect on our financial condition and results of operations.

We may be required to raise capital in the future, but that capital may not be available or may not be on acceptable terms when it is needed.

We are required by federal regulatory authorities to maintain adequate capital levels to support operations. While we believe we currently have sufficient capital, if we cannot raise additional capital when needed, we may not be able to meet these requirements. In addition, our ability to further expand our operations through organic growth, which includes growth within our current footprint and growth through market expansion, may be adversely affected by any inability to raise necessary capital. Our ability to raise additional capital at any given time is dependent on capital market conditions at that time and on our financial performance and outlook.

Risks Related to Regulatory Compliance and Legal Matters

We are subject to extensive governmental regulation and supervision.

We are subject to extensive state and federal regulation, supervision and legislation that govern nearly every aspect of our operations. The regulations are primarily intended to protect depositors, customers and the banking system as a whole, not shareholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or policies could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs of regulatory compliance and of doing business, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things, and could divert management's time from other business activities. Failure to comply with applicable laws, regulations, policies or supervisory guidance could lead to enforcement and other legal actions by federal or state authorities, including criminal or civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, and/or damage to our reputation. The ramifications and uncertainties of the level of government intervention in the U.S. financial system could also adversely affect us.

Table of Contents

Item 1A. RISK FACTORS - continued

Our controls and procedures may fail or be circumvented, which may result in a material adverse effect on our business, financial condition and results of operations.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

As previously disclosed in Part II, Item 9A “Controls and Procedures” of our Form 10-K for the period ended December 31, 2017, or Item 9A, a material weakness was identified in our internal control over financial reporting resulting from the inconsistent assessment of internally assigned risk weightings, which is one of several factors used to estimate the allowance for loan losses. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

The material weakness did not result in any misstatement of our Consolidated Financial Statements for any period presented. As previously disclosed, we have provided additional training internally and improved our documentation to strengthen the support for the judgments applied to risk rating conclusions by our internal Loan Review Department. Additionally, an independent third-party completed an engagement that encompassed a review of our loan review policies, procedures and processes, as well as an in-depth examination of judgments supporting risk rating conclusions. Based on the remediation performed by us and the conclusions reached by the independent third-party. Management has concluded that the material weakness was remediated as of September 30, 2018. However, we may in the future discover areas of our internal controls that need improvement. Failure to maintain effective controls or to timely implement any necessary improvement of our internal and disclosure controls could, among other things, result in losses from errors, harm our reputation, or cause investors to lose confidence in the reported financial information, all of which could have a material adverse effect on our results of operations and financial condition.

Negative public opinion could damage our reputation and adversely impact our earnings and liquidity.

Reputational risk, or the risk to our business, earnings, liquidity and capital from negative public opinion, is inherent in our operations. Negative public opinion could result from our actual or alleged conduct in a variety of areas, including legal and regulatory compliance, lending practices, corporate governance, litigation, ethical issues or inadequate protection of customer information. Financial companies are highly vulnerable to reputational damage when they are found to have harmed customers, particularly retail customers, through conduct that is illegal or viewed as unfair, deceptive, manipulative or otherwise wrongful. We are dependent on third-party providers for a number of services that are important to our business. Refer to the risk factor titled, “We rely on third-party providers and other suppliers for a number of services that are important to our business. An interruption or cessation of an important service by any third-party could have a material adverse effect on our business” for additional information. A failure by any of these third-party service providers could cause a disruption in our operations, which could result in negative public opinion about us or damage to our reputation. We expend significant resources to comply with regulatory requirements, and the failure to comply with such regulations could result in reputational harm or significant legal or remedial costs. Damage to our reputation could adversely affect our ability to retain and attract new customers and employees, expose us to litigation and regulatory action and adversely impact our earnings and liquidity.

We may be a defendant from time to time in a variety of litigation and other actions, which could have a material adverse effect on our financial condition and results of operations.

From time to time, customers and others make claims and take legal action pertaining to the performance of our responsibilities. Whether customer claims and legal action related to the performance of our responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant expenses, attention from management and financial liability. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

17

Item 1A. RISK FACTORS - continued

Risks Related to Liquidity

We rely on a stable core deposit base as our primary source of liquidity.

We are dependent for our funding on a stable base of core deposits. Our ability to maintain a stable core deposit base is a function of our financial performance, our reputation and the security provided by FDIC insurance, which combined, gives customers confidence in us. If any of these considerations deteriorates, the stability of our core deposits could be harmed. In addition, deposit levels may be affected by factors such as general interest rate levels, rates paid by competitors, returns available to customers on alternative investments and general economic conditions. Accordingly, we may be required from time to time to rely on other sources of liquidity to meet withdrawal demands or otherwise fund operations.

Our ability to meet contingency funding needs, in the event of a crisis that causes a disruption to our core deposit base, is dependent on access to wholesale markets, including funds provided by the FHLB of Pittsburgh.

We own stock in the Federal Home Loan Bank of Pittsburgh, or FHLB, in order to qualify for membership in the FHLB system, which enables us to borrow on our line of credit with the FHLB that is secured by a blanket lien on a significant portion of our loan portfolio. Changes or disruptions to the FHLB or the FHLB system in general may materially impact our ability to meet short and long-term liquidity needs or meet growth plans. Additionally, we cannot be assured that the FHLB will be able to provide funding to us when needed, nor can we be certain that the FHLB will provide funds specifically to us, should our financial condition and/or our regulators prevent access to our line of credit. The inability to access this source of funds could have a materially adverse effect on our ability to meet our customer’s needs. Our financial flexibility could be severely constrained if we were unable to maintain our access to funding or if adequate financing is not available at acceptable interest rates.

Risks Related to Owning Our Stock

Our ability to pay dividends on our common stock may be limited.

Holders of our common stock will be entitled to receive only such dividends as our Board of Directors may declare out of funds legally available for such payments. The payment of common dividends by S&T is subject to certain requirements and limitations of Pennsylvania law. Although we have historically declared cash dividends on our common stock, we are not required to do so and our Board of Directors could reduce, suspend or eliminate our dividend at any time. Substantial portions of our revenue consist of dividend payments we receive from S&T Bank. The payment of common dividends by S&T Bank is subject to certain requirements and limitations under federal and state laws and regulations that limit the amount of dividends it can pay to S&T. In addition, both S&T and S&T Bank are subject to various general regulatory policies relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. Any decrease to or elimination of the dividends on our common stock could adversely affect the market price of our common stock.

Item 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved SEC staff comments.

Item 2. PROPERTIES

We own a building in Indiana, Pennsylvania, located at 800 Philadelphia Street, which serves as our headquarters and executive and administrative offices and through which we offer community banking and wealth management services. In addition, we own a building in Indiana, Pennsylvania that serves as additional administrative offices. As of December 31, 2018, we lease two buildings in Indiana, Pennsylvania: one that houses both our data processing and technology center and one of our branches and one that houses our training center. We also offer our community banking services through 63 locations as of December 31, 2018, including 58 branches located in fifteen counties in Pennsylvania, of which 33 are owned and 30 are leased, including the aforementioned building that shares space with our data center. The other four community banking locations include two leased loan production offices in Ohio, a leased branch located in Ohio, and a leased loan production office in Upstate New York. We offer our wealth management services through two leased offices, one in Allegheny County, Pennsylvania and one in Westmoreland County, Pennsylvania, as well as through staff located within our banking offices to provide their services to our customers. Our operating leases and our two capital leases expire at various dates through the year 2055 and generally include options to renew. Management believes the terms of the various leases are consistent with market standards and were arrived at through arm's length bargaining. For additional information regarding the lease commitments, refer to Note 9 Premises and Equipment to the financial statements contained in Part II, Item 8 of this Report.

Table of Contents

Item 3. LEGAL PROCEEDINGS

The nature of our business generates a certain amount of litigation that arises in the ordinary course of business. However, in management's opinion, there are no proceedings pending that we are a party to or to which our property is subject that would be material in relation to our financial condition or results of operations. In addition, no material proceedings are pending nor are known to be threatened or contemplated against us by governmental authorities or other parties.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Stock Prices and Dividend Information

Our common stock is listed on the NASDAQ Global Select Market System, or NASDAQ, under the symbol STBA. The high and low sale prices of common stock for each quarter during 2018 and 2017 is detailed in the table below and is based upon information obtained from NASDAQ. As of the close of business on January 31, 2019, we had 2,645 shareholders of record. Dividends paid by S&T are primarily provided from S&T Bank's dividends to S&T. The payment of dividends by S&T Bank to S&T is subject to the restrictions described in Note 5 Dividend and Loan Restrictions of the Consolidated Financial Statements included in Part II, Item 8 of this Report. The cash dividends declared per share for each quarter during 2018 and 2017 are shown below.

	Price Range of Common Stock		Cash Dividends Declared
2018	Low	High	
Fourth quarter	$35.60	$44.59	$ 0.27
Third quarter	42.50	47.77	0.25
Second quarter	38.80	46.44	0.25
First quarter	37.79	42.93	0.22
2017			
Fourth quarter	$38.16	$43.17	$ 0.22
Third quarter	33.92	39.94	0.20
Second quarter	32.48	37.94	0.20
First quarter	31.72	39.84	0.20

Certain information relating to securities authorized for issuance under equity compensation plans is set forth under the heading Equity Compensation Plan Information in Part III, Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters of this Report.

Purchases of Equity Securities

The following table is a summary of our purchases of common stock during the fourth quarter of 2018:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan[(1)]	Approximate dollar value of shares that may yet be purchased under the plan
10/1/2018 - 10/31/2018				$50,000,000
11/1/2018 - 11/30/2018				50,000,000
12/1/2018 - 12/31/2018	321,731	$38.10	321,731	37,742,049
Total	321,731	38.10	321,731	$37,742,049

[(1)]On March 19, 2018, our Board of Directors authorized a $50 million share repurchase plan. This repurchase authorization, which is effective through August 31, 2019, permits us to repurchase from time to time up to $50 million in aggregate value of shares of our common stock through a combination of open market and privately negotiated repurchases. The specific timing, price and quantity of repurchases will be at our discretion and will depend on a variety of factors, including general market conditions, the trading price of the common stock, legal and contractual requirements and our financial performance. The repurchase plan does not obligate us to repurchase any particular number of shares. We expect to fund any repurchases from cash on hand and internally generated funds. As of December 2018, there were 321,731 common shares repurchased under this plan at a total cost of $12.3 million, or an average of $38.10 per share. Up to an additional $37.7 million of our common stock may be repurchased under this plan through August 31, 2019.

Table of Contents

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES - continued

Five-Year Cumulative Total Return

The following chart compares the cumulative total shareholder return on our common stock with the cumulative total shareholder return of the NASDAQ Composite Index[1] and the NASDAQ Bank Index[2] assuming a $100 investment in each on December 31, 2013 and the reinvestment of dividends.

	Period Ending					
Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
S&T Bancorp, Inc.	100.00	121.11	128.37	167.39	174.46	169.79
NASDAQ Composite	100.00	134.02	173.86	114.83	122.99	168.98
NASDAQ Bank	100.00	104.92	114.20	157.56	166.16	139.28

[1]The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on the Nasdaq Stock Market.

[2]The NASDAQ Bank Index contains securities of NASDAQ-listed companies classified according to the Industry Classification Benchmark as Banks. These companies include banks providing a broad range of financial services, including retail banking, loans and money transmissions.

Table of Contents

Item 6. SELECTED FINANCIAL DATA

The tables below summarize selected consolidated financial data as of the dates or for the periods presented and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 and the Consolidated Financial Statements and supplementary data in Part II, Item 8 of this Report. The below tables include the sale of a majority interest of insurance business on January 1, 2018, the effects of the enactment of the Tax Act in 2017 and the acquisition of Integrity Bancshares, Inc. beginning March 4, 2015.

CONSOLIDATED BALANCE SHEETS

	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Total assets	$7,252,221	$7,060,255	$6,943,053	$6,318,354	$4,964,686
Securities, at fair value	684,872	698,291	693,487	660,963	640,273
Loans held for sale	2,371	4,485	3,793	35,321	2,970
Portfolio loans, net of unearned income	5,946,648	5,761,449	5,611,419	5,027,612	3,868,746
Goodwill	287,446	291,670	291,670	291,764	175,820
Total deposits	5,673,922	5,427,891	5,272,377	4,876,611	3,908,842
Securities sold under repurchase agreements	18,383	50,161	50,832	62,086	30,605
Short-term borrowings	470,000	540,000	660,000	356,000	290,000
Long-term borrowings	70,314	47,301	14,713	117,043	19,442
Junior subordinated debt securities	45,619	45,619	45,619	45,619	45,619
Total shareholders' equity	935,761	884,031	841,956	792,237	608,389

CONSOLIDATED STATEMENTS OF NET INCOME

	Years Ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Interest income	$289,826	$260,642	$227,774	$203,548	$160,523
Interest expense	55,388	34,909	24,515	15,997	12,481
Provision for loan losses	14,995	13,883	17,965	10,388	1,715
Net Interest Income After Provision for Loan Losses	219,443	211,850	185,294	177,163	146,327
Noninterest income	49,181	55,462	54,635	51,033	46,338
Noninterest expense	145,445	147,907	143,232	136,717	117,240
Net Income Before Taxes	123,179	119,405	96,697	91,479	75,425
Provision for income taxes	17,845	46,437	25,305	24,398	17,515
Net Income	$105,334	$72,968	$71,392	$67,081	$57,910

Table of Contents

Item 6. SELECTED FINANCIAL DATA - continued

SELECTED PER SHARE DATA AND RATIOS

Refer to Explanation of Use of Non-GAAP Financial Measures below for a discussion of common tangible book value, common return on average tangible common equity and the ratio of tangible common equity to tangible assets as non-GAAP financial measures.

	December 31, 2018	2017	2016	2015	2014
Per Share Data					
Earnings per common share—basic	$3.03	$2.10	$2.06	$1.98	$1.95
Earnings per common share—diluted	$3.01	$2.09	$2.05	$1.98	$1.95
Dividends declared per common share	$0.99	$0.82	$0.77	$0.73	$0.68
Dividend payout ratio	32.79 %	39.15 %	37.52 %	36.47 %	34.89 %
Common book value	$26.98	$25.28	$24.12	$22.76	$20.42
Common tangible book value (non-GAAP)	$18.63	$16.87	$15.67	$14.26	$14.46
Profitability Ratios					
Common return on average assets	1.50 %	1.03 %	1.08 %	1.13 %	1.22 %
Common return on average equity	11.60 %	8.37 %	8.67 %	8.94 %	9.71 %
Common return on average tangible common equity (non-GAAP)	17.14 %	12.77 %	13.71 %	14.39 %	14.02 %
Capital Ratios					
Common equity/assets	12.90 %	12.52 %	12.13 %	12.54 %	12.25 %
Tangible common equity/tangible assets (non-GAAP)	9.28 %	8.72 %	8.23 %	8.24 %	9.00 %
Tier 1 leverage ratio	10.05 %	9.17 %	8.98 %	8.96 %	9.80 %
Common equity tier 1	11.38 %	10.71 %	10.04 %	9.77 %	11.81 %
Risk-based capital—tier 1	11.72 %	11.06 %	10.39 %	10.15 %	12.34 %
Risk-based capital—total	13.21 %	12.55 %	11.86 %	11.60 %	14.27 %
Asset Quality Ratios					
Nonaccrual loans/loans	0.77 %	0.42 %	0.76 %	0.70 %	0.32 %
Nonperforming assets/loans plus OREO	0.83 %	0.42 %	0.77 %	0.71 %	0.33 %
Allowance for loan losses/total portfolio loans	1.03 %	0.98 %	0.94 %	0.96 %	1.24 %
Allowance for loan losses/nonperforming loans	132 %	236 %	124 %	136 %	385 %
Net loan charge-offs/average loans	0.18 %	0.18 %	0.25 %	0.22 %	0.00 %

Explanation of Use of Non-GAAP Financial Measures

In addition to traditional measures presented in accordance with GAAP, our management uses, and this Report contains or references, certain non-GAAP financial measures identified below. We believe these non-GAAP financial measures provide information useful to investors in understanding our underlying operational performance and our business and performance trends as they facilitate comparisons with the performance of other companies in the financial services industry. Although we believe that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP or considered to be more important than financial results determined in accordance with GAAP, nor are they necessarily comparable with non-GAAP measures which may be presented by other companies.

We believe the presentation of net interest income on a FTE basis ensures comparability of net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Interest income per the Consolidated Statements of Net Income is reconciled to net interest income adjusted to a FTE basis in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Report.

The efficiency ratio is noninterest expense divided by noninterest income plus net interest income, on a FTE basis, which ensures comparability of net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice.

23

Table of Contents

Item 6. SELECTED FINANCIAL DATA - continued

Common tangible book value, common return on average tangible common equity and the ratio of tangible common equity to tangible assets exclude goodwill and other intangible assets in order to show the significance of the tangible elements of our assets and common equity. Total assets and total average assets are reconciled to total tangible assets and total tangible average assets. Total shareholders' equity and total average shareholders' equity are also reconciled to total tangible common equity and total tangible average common equity. These measures are consistent with industry practice.

RECONCILIATIONS OF GAAP TO NON-GAAP RATIOS

	December 31				
(dollars in thousands)	2018	2017	2016	2015	2014
Common tangible book value (non-GAAP)					
Total shareholders' equity	$935,761	$884,031	$841,956	$792,237	$608,389
Less: goodwill and other intangible assets	(290,047)	(295,347)	(296,580)	(298,289)	(178,451)
Tax effect of other intangible assets	546	1,287	1,719	2,284	921
Tangible common equity (non-GAAP)	646,260	589,971	547,095	496,232	430,859
Common shares outstanding	34,684	34,972	34,913	34,810	29,796
Common tangible book value (non-GAAP)	$18.63	$16.87	$15.67	$14.26	$14.46
Common return on average tangible common shareholders' equity (non-GAAP)					
Net income	$105,334	$72,968	$71,392	$67,081	$57,910
Plus: amortization of intangibles	861	1,233	1,615	1,818	1,129
Tax effect of amortization of intangibles	(181)	(432)	(565)	(636)	(395)
Net income before amortization of intangibles	106,014	73,769	72,442	68,263	58,644
Total average shareholders’ equity (GAAP Basis)	908,355	872,130	823,607	750,069	596,155
Less: average goodwill and average other intangible assets	(290,380)	(295,937)	(297,377)	(278,130)	(178,990)
Tax effect of other intangible assets	614	1,493	1,992	2,283	1,109
Tangible average common shareholders' equity (non-GAAP)	$618,589	$577,686	$528,222	$474,222	$418,274
Common return on average tangible common shareholders' equity (non-GAAP)	17.14%	12.77%	13.71%	14.39%	14.02%
Efficiency Ratio (non-GAAP)					
Noninterest expense	145,445	147,907	143,232	136,717	117,240
Net interest income per Consolidated Statements of Net Income	234,438	225,733	203,259	187,551	148,042
Plus: taxable equivalent adjustment	3,804	7,493	7,043	6,123	5,461
Noninterest income	49,181	55,462	54,635	51,033	46,338
Less: securities (gains) losses, net	—	(3,000)	—	34	(41)
Net interest income (FTE) (non-GAAP) plus noninterest income	287,423	285,688	264,938	244,742	199,801
Efficiency ratio (non-GAAP)	50.60%	51.77%	54.06%	55.86%	58.68%
Tangible common equity (non-GAAP)					
Total shareholders' equity (GAAP basis)	$935,761	$884,031	$841,956	$792,237	$608,389
Less: goodwill and other intangible assets	(290,047)	(295,347)	(296,580)	(298,289)	(178,451)
Tax effect of other intangible assets	546	1,287	1,719	2,284	921

Tangible common equity (non-GAAP)	646,260	589,971	547,095	496,232	430,859
Total assets (GAAP basis)	7,252,221	7,060,255	6,943,053	6,318,354	4,964,686
Less: goodwill and other intangible assets	(290,047)	(295,347)	(296,580)	(298,289)	(178,451)
Tax effect of other intangible assets	546	1,287	1,719	2,284	921
Tangible assets (non-GAAP)	$6,962,720	$6,766,195	$6,648,192	$6,022,349	$4,787,156
Tangible common shareholders' equity/tangible assets (non-GAAP)	9.28 %	8.72 %	8.23 %	8.24 %	9.00 %

Table of Contents

Item 6. SELECTED FINANCIAL DATA - continued

On December 22, 2017, H.R.1, originally known as the Tax Cuts and Jobs Act, or Tax Act, was signed into law. We made certain tax adjustments to reflect the impact of the Tax Act in our 2017 income tax expense for the year ended December 31, 2017. An adjustment of $13.4 million was made for the re-measurement of our deferred tax assets and liabilities as a result of the new corporate rate of 21 percent, rather than the pre-enactment rate of 35 percent. We believe the $13.4 million non-cash tax expense impacts comparability to prior year financial measurements and results and therefore present certain non-GAAP financial measures excluding the impact of this amount. These non-GAAP measures exclude the net deferred tax asset, or DTA, re-measurement and are reconciled to the GAAP measures below:

(dollars in thousands)	2017
Diluted Earnings Per Share	
Net Income	$72,968
Plus: DTA re-measurement	13,433
Adjusted net Income (non-GAAP)	$86,401
Average shares outstanding - diluted	34,955
Diluted adjusted earnings per share (non-GAAP)	$2.47

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section reviews our financial condition for each of the past two years and results of operations for each of the past three years. Certain reclassifications have been made to prior periods to place them on a basis comparable with the current period presentation. Some tables may include additional time periods to illustrate trends within our Consolidated Financial Statements. The results of operations reported in the accompanying Consolidated Financial Statements are not necessarily indicative of results to be expected in future periods.

Important Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains or incorporates statements that we believe are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements generally relate to our financial condition, results of operations, plans, objectives, outlook for earnings, revenues, expenses, capital and liquidity levels and ratios, asset levels, asset quality, financial position, and other matters regarding or affecting S&T and its future business and operations. Forward looking statements are typically identified by words or phrases such as "will likely result", "expect", "anticipate", "estimate", "forecast", "project", "intend", " believe", "assume", "st "trend", "plan", "outlook", "outcome", "continue", "remain", "potential", "opportunity", "believe", "comfortable", "current", " "maintain", "sustain", "seek", "achieve" and variations of such words and similar expressions, or future or conditional verbs such as will, would, should, could or may. Although we believe the assumptions upon which these forward-looking statements are based are reasonable, any of these assumptions could prove to be inaccurate and the forward-looking statements based on these assumptions could be incorrect. The matters discussed in these forward-looking statements are subject to various risks, uncertainties and other factors that could cause actual results and trends to differ materially from those made, projected, or implied in or by the forward-looking statements depending on a variety of uncertainties or other factors including, but not limited to: credit losses; cyber-security concerns; rapid technological developments and changes; sensitivity to the interest rate environment including a prolonged period of low interest rates, a rapid increase in interest rates or a change in the shape of the yield curve; a change in spreads on interest-earning assets and interest-bearing liabilities; regulatory supervision and oversight; legislation affecting the financial services industry as a whole, and S&T, in particular; the outcome of pending and future litigation and governmental proceedings; increasing price and product/service competition; the ability to continue to introduce competitive new products and services on a timely, cost-effective basis; managing our internal growth and acquisitions; the possibility that the anticipated benefits from acquisitions cannot be fully realized in a timely manner or at all, or that integrating the acquired operations will be more difficult, disruptive or costly than anticipated; containing costs and expenses; reliance on significant customer relationships; general economic or business conditions; deterioration of the housing market and reduced demand for mortgages; deterioration in the overall macroeconomic conditions or the state of the banking industry that could warrant further analysis of the carrying value of goodwill and could result in an adjustment to its carrying value resulting in a non-cash charge to net income; re-emergence of turbulence in significant portions of the global financial and real estate markets that could impact our performance, both directly, by affecting our revenues and the value of our assets and liabilities, and indirectly, by affecting the economy generally and access to capital in the amounts, at the times and on the terms required to support our future businesses. Many of these factors, as well as other factors, are described elsewhere in this report, including Part I, Item 1A, Risk Factors and any of our subsequent filings with the SEC. Forward-looking statements are based on beliefs and assumptions using information available at the time the statements are made. We caution you not to unduly rely on forward-looking statements because the assumptions, beliefs, expectations and projections about future events may, and often do, differ materially from actual results. Any forward-looking statement speaks only as to the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect developments occurring after the statement is made.

Critical Accounting Policies and Estimates

Our Consolidated Financial Statements are prepared in accordance with U.S. generally accepted accounting principles, or GAAP. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. These estimates, assumptions and judgments are based on information available as of the date of the Consolidated Financial

Statements; accordingly, as this information changes, the Consolidated Financial Statements could reflect different estimates, assumptions and judgments. Certain policies are based to a greater extent on estimates, assumptions and judgments of management and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Our most significant accounting policies are presented in Note 1 Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Report. These policies, along with the disclosures presented in the Notes to Consolidated Financial Statements, provide information on how significant assets and liabilities are valued in the Consolidated Financial Statements and how those values are determined.

We view critical accounting policies to be those which are highly dependent on subjective or complex estimates, assumptions and judgments and where changes in those estimates and assumptions could have a significant impact on the Consolidated Financial Statements. We currently view the determination of the ALL and goodwill and other intangible assets to be critical accounting policies. During 2018, we did not significantly change the manner in which we applied our critical accounting policies or developed related assumptions or estimates. We have reviewed these critical accounting estimates and related disclosures with the Audit Committee.

Allowance for Loan Losses

Our loan portfolio is our largest category of assets on our Consolidated Balance Sheets. We have designed a systematic ALL methodology which is used to determine our provision for loan losses and ALL on a quarterly basis. The ALL represents management's estimate of probable losses inherent in the loan portfolio at the balance sheet date and is presented as a reserve against loans in the Consolidated Balance Sheets. The ALL is increased by a provision charged to expense and reduced by charge-offs, net of recoveries. Determination of an adequate ALL is inherently subjective and may be subject to significant changes from period to period.

The methodology for determining the ALL has two main components: evaluation and impairment tests of individual loans and evaluation and impairment tests of certain groups of homogeneous loans with similar risk characteristics. We individually evaluate all substandard and nonaccrual commercial loans greater than $0.5 million for impairment. A loan is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the original contractual terms of the loan agreement. For all troubled debt restructurings, or TDRs, regardless of size, as well as all other impaired loans, we conduct further analysis to determine the probable loss and assign a specific reserve to the loan if deemed appropriate. Specific reserves are established based upon the following three impairment methods: 1) the present value of expected future cash flows discounted at the loan's effective interest rate, 2) the loan's observable market price or 3) the estimated fair value of the collateral if the loan is collateral dependent. These analyses involve a high degree of judgment in estimating the amount of loss associated with specific impaired loans, including estimating the amount and timing of future cash flows, the current estimated fair value of the loan and collateral values. Our impairment evaluations consist primarily of the fair value of collateral method because most of our loans are collateral dependent. We obtain appraisals annually on impaired loans greater than $0.5 million.

The ALL methodology for groups of homogeneous loans, or the reserve for loans collectively evaluated for impairment, is comprised of both a quantitative and qualitative analysis. We first apply historical loss rates to pools of loans, with similar risk characteristics, using a migration analysis where losses in each pool are aggregated over the loss emergence period, or LEP. The LEP is an estimate of the average amount of time from when an event happens that causes the borrower to be unable to pay on a loan until the loss is confirmed through a loan charge-off.

In conjunction with our annual review of the ALL assumptions, we have updated our analysis of LEPs for our Commercial and Consumer loan portfolio segments using our loan charge-off history. No changes were made to our LEP assumptions in 2018. We estimate an LEP of 3 years for CRE, 4 years for construction and 1.25 years for C&I. We estimate an LEP of 2.75 years for Consumer Real Estate and 1.25 years for Other Consumer.

Another key assumption is the look-back period, or LBP, which represents the historical period utilized to calculate loss rates. We used 9.5 years for our LBP for all portfolio segments which encompasses our loss experience during the 2008 - 2010 Financial Crisis, and our more recent improved loss experience.

After consideration of the historic loss calculations, management applies additional qualitative adjustments so that the ALL is reflective of the inherent losses that exist in the loan portfolio at the balance sheet date. Qualitative adjustments are made based upon changes in lending policies and practices, economic conditions, changes in the loan portfolio, changes in lending management, results of internal loan reviews, asset quality trends, collateral values, concentrations of credit risk and other external factors. The evaluation of the various components of the ALL requires considerable judgment in order to estimate inherent loss exposures.

Acquired loans are recorded at fair value on the date of acquisition with no carryover of the related ALL. Determining the fair value of acquired loans involves estimating the principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest. In estimating the fair value of our acquired loans, we considered a number of factors including the loan term, internal risk rating, delinquency status, prepayment rates, recovery periods, estimated value of the underlying collateral and the current interest rate environment.

Loans acquired with evidence of credit deterioration were evaluated and not considered to be significant. The premium or discount estimated through the loan fair value calculation is recognized into interest income on a level yield or straight-line basis over the remaining contractual life of the loans. Additional credit deterioration on acquired loans, in excess of the original credit discount embedded in the fair value determination on the date of acquisition, will be recognized in the ALL through the provision for loan losses.

Our ALL Committee meets at least quarterly to verify the overall adequacy of the ALL. Additionally, on an annual basis, the ALL Committee meets to validate our ALL methodology. This validation includes reviewing the loan segmentation, LEP, LBP and the qualitative framework. As a result of this ongoing monitoring process, we may make changes to our ALL to be responsive to the economic environment.

Although we believe our process for determining the ALL adequately considers all of the factors that would likely result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual losses are higher than management estimates, additional provisions for loan losses could be required and could adversely affect our earnings or financial position in future periods.

Goodwill and Other Intangible Assets

As a result of acquisitions, we have recorded goodwill and identifiable intangible assets in our Consolidated Balance Sheets. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. We account for business combinations using the acquisition method of accounting.

We have three reporting units: Community Banking, Insurance and Wealth Management. Existing goodwill relates to value inherent in the Community Banking reporting unit and that value is dependent upon our ability to provide quality, cost-effective services in the face of competition from other market participants. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is supported ultimately by profitability that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective services over sustained periods can lead to impairment of goodwill, which could adversely impact our earnings in future periods

The carrying value of goodwill is tested annually for impairment each October 1st or more frequently if it is determined that a triggering event has occurred. We first assess qualitatively whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Our qualitative assessment considers such factors as macroeconomic conditions, market conditions specifically related to the banking industry, our overall financial performance and various other factors. If we determine that it is more likely than not that the fair value is less than the carrying amount, we proceed to test for impairment. The evaluation for impairment involves comparing the current estimated fair value of each reporting unit to its carrying value, including goodwill. If the current estimated fair value of a reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. If the estimated fair value of a reporting unit is less than the carrying value, further valuation procedures are performed that could result in impairment of goodwill being recorded. Further valuation procedures would include allocating the estimated fair value to all assets and liabilities of the reporting unit to determine an implied goodwill value. If the implied value of goodwill of a reporting unit is less than the carrying amount of that goodwill, an impairment loss is recognized in an amount equal to that excess. We completed the annual goodwill impairment assessment as required in 2018, 2017 and 2016; the results indicated that the fair value of each reporting unit exceeded the carrying value.

We determine the amount of identifiable intangible assets based upon independent core deposit and insurance contract valuations at the time of acquisition. Intangible assets with finite useful lives, consisting primarily of core deposit and customer list intangibles, are amortized using straight-line or accelerated methods over their estimated weighted average useful lives, ranging from 10 to 20 years. Intangible assets with finite useful lives are evaluated for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. No such events or changes in circumstances occurred during the years ended December 31, 2018, 2017 and 2016.

The financial services industry and securities markets can be adversely affected by declining values. If economic conditions result in a prolonged period of economic weakness in the future, our business may be adversely affected. In the event that we determine that either our goodwill is impaired, recognition of an impairment charge could have a significant adverse impact on our financial position or results of operations in the period in which the impairment occurs.

Recent Accounting Pronouncements and Developments

Note 1 Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements, which is included in Part II, Item 8 of this Report, discusses new accounting pronouncements that we have adopted and the expected impact of accounting pronouncements recently issued or proposed, but not yet required to be adopted.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Executive Overview

We are a $7.3 billion bank holding company that is headquartered in Indiana, Pennsylvania and trades on the NASDAQ Global Select Market under the symbol STBA. Our principal subsidiary, S&T Bank, a full-service financial institution, was established in 1902, and operates in five markets including Western Pennsylvania, Central Pennsylvania, Northeast Ohio, Central Ohio, and Upstate New York. We employ a geographic market based strategy in order to drive organic growth. Each of our five markets is lead by a Market President who is responsible for developing strategic initiatives specific to each market. We acknowledge that each of our five markets are in different stages of development and that our market based strategy will allow us to customize our approach to each market given its developmental stage and unique characteristics. We provide a full range of financial services with retail and commercial banking products, cash management services, trust and brokerage services.

We earn revenue primarily from interest on loans and securities and fees charged for financial services provided to our customers. We incur expenses for the cost of deposits and other funding sources, provision for loan losses and other operating costs such as salaries and employee benefits, data processing, occupancy and tax expense.

Our mission is to become the financial services provider of choice within the markets that we serve. We strive to do this by delivering exceptional service and value, one customer at a time. Our strategic plan focuses on organic growth, which includes both growth within our current footprint and growth through market expansion. We also actively evaluate acquisition opportunities as another source of growth. Our strategic plan includes a collaborative model that combines expertise from all areas of our business and focuses on satisfying each customer's individual financial objectives.

Our major accomplishments during 2018 included:

- We had record net income for 2018 of $105.3 million, or $3.01 per diluted share, surpassing our 2017 net income of $73.0 million, or $2.09 per diluted share.
- Return on average assets was 1.50 percent, return on average equity was 11.60 percent and return on tangible shareholders' equity (non-GAAP) was 17.14 percent for 2018.
- Net interest income increased $8.7 million, or 3.9 percent, and net interest margin (FTE) (non-GAAP) increased eight basis points to 3.64 percent compared to 3.56 percent in 2017.
- Our expenses were well controlled during 2018 with an improved efficiency ratio (non-GAAP) of 50.60 percent compared to 51.77 percent for 2017.
- We were recognized by Forbes as one of the Best-In-State Banks and Credit Unions, naming S&T Bank as the second highest-rated bank in Pennsylvania – further confirming our ability to fulfill our mission of creating value for our customers and shareholders through consistent and outstanding financial performance.

Our focus continues to be on organic loan and deposit growth and implementing opportunities to increase fee income while closely monitoring our operating expenses and asset quality. We are focused on executing our strategy to successfully build our brand and grow our business in all of our markets. We have benefited from recent increases in short-term interest rates from the Tax Cuts and Jobs Act (Tax Act) which lowered the federal corporate tax rate from 35 percent to 21 percent effective January 1, 2018.

On November 9, 2017, we entered into an asset purchase agreement to sell a 70 percent ownership interest in the assets of our subsidiary, S&T Evergreen Insurance, LLC. At the date of the sale, January 1, 2018, we ceased to have a controlling financial interest, therefore we deconsolidated the subsidiary and recognized a gain of $1.9 million. We transferred our remaining 30 percent share of net assets from S&T Evergreen Insurance, LLC to a new entity for a 30 percent partnership interest in a new insurance entity.

Return on tangible shareholders' equity and the efficiency ratio are non-GAAP measures. Refer to Explanation of Use of Non-GAAP Financial Measures in Part II, Item 6 Selected Financial Data of this Report for a reconciliation to the most directly comparable GAAP measures. Net interest margin (FTE) is a non-GAAP measure and is reconciled to the comparable GAAP measure in the "Net Interest Income" section of this Management's Discussion and Analysis of

Financial Condition and Results of Operations, or MD&A, below.

Results of Operations

Year Ended December 31, 2018

Earnings Summary

Net income increased $32.3 million, or 44.4 percent, to $105.3 million, or $3.01 per diluted share, in 2018 compared to $73.0 million, or $2.09 per diluted share, in 2017. As a result of the Tax Act, additional tax expense of $13.4 million was recognized to re-measure the net deferred tax asset (DTA) in the fourth quarter 2017. Excluding the net DTA re-measurement, net income was $86.4 million (non-GAAP) and diluted earnings per share was $2.47 (non-GAAP). Net income and diluted earnings per share adjusted to exclude the net DTA remeasurement are non-GAAP measures. Refer to Explanation of Use of

Table of Contents

Non-GAAP Financial Measures in Part II, Item 6 Selected Financial Data of this Report for a reconciliation to the comparable GAAP measures.

The increase in net income was primarily due to decreases in the provision for income taxes of $28.6 million and noninterest expense of $2.5 million, an increase in net interest income of $8.7 million offset by a decrease of $6.3 million in noninterest income.

Net interest income increased $8.7 million, or 3.9 percent, to $234.4 million compared to $225.7 million in 2017. Average interest-earning assets were unchanged from 2017 at $6.5 billion. Average interest-bearing liabilities decreased $115.6 million due to decreases in average interest-bearing deposits and short-term borrowings. Average interest-bearing deposits decreased $25.1 million and average short-term borrowings decreased $119.7 million for 2018. Net interest margin, on a fully taxable-equivalent, or FTE, basis (non-GAAP), increased eight basis points to 3.64 percent in 2018 compared to 3.56 percent for 2017. The increases in short-term interest rates over the past year positively impacted both net interest income and net interest margin. Net interest margin is reconciled to net interest income adjusted to a FTE basis below in the "Net Interest Income" section of this MD&A.

The provision for loan losses increased $1.1 million, or 8.0 percent, to $15.0 million during 2018 compared to $13.9 million in 2017. The provision for loan losses increased due to increases in substandard loans and impaired loans with specific reserves. Commercial substandard loans increased $110.5 million to $181.2 million at December 31, 2018 compared to $70.7 million at December 31, 2017. The increase in substandard loans from December 31, 2017 was mainly due to the receipt of updated financial information from our borrowers that resulted in the loans being downgraded. Impaired loans increased $22.7 million with an increase in specific reserves of $1.7 million compared to 2017. Net loan charge-offs were consistent at $10.4 million, or 0.18 percent of average loans, for 2018 compared to $10.3 million, or 0.18 percent of average loans, in 2017.

Total noninterest income decreased $6.3 million to $49.2 million compared to $55.5 million in 2017. Insurance income decreased $4.9 million compared to 2017 due to the sale of a majority interest in our insurance business on January 1, 2018. A gain of $1.9 million was recognized in 2018 related to this sale. Further decreasing noninterest income were security gains of $3.0 million recognized in 2017 compared to no gains in 2018. Other income decreased $1.7 million due to a bank owned life insurance, or BOLI, claim of $0.7 million and a $1.0 million gain on a branch sale both during 2017.

Expenses were well controlled during 2018. Total noninterest expense decreased $2.5 million to $145.4 million for 2018 compared to $147.9 million for 2017. The decrease was mainly due to a decrease in salaries and employee benefits of $4.7 million due to lower incentives and commission costs and fewer employees due to the sale of our insurance business on January 1, 2018. FDIC insurance decreased $1.3 million due to improvements in the components used to determine the assessment. Offsetting these improvements was an increase of $1.7 million for other taxes related to a state sales tax assessment. Data processing and information technology, or IT, increased $1.8 million mainly due to a recent outsourcing arrangement for certain components of our IT function.

The provision for income taxes decreased $28.6 million to $17.8 million compared to $46.4 million in 2017. Our effective tax rate was 14.5 percent for 2018 compared to 38.9 percent for 2017. The decrease was primarily due to the enactment of the Tax Act which lowered the federal corporate tax rate from 35 percent to 21 percent effective January 1, 2018. The comparison between the 2018 and the 2017 tax provision was also affected by the increased tax expense in 2017 for the non-cash tax adjustment of $13.4 million for the re-measurement of our deferred tax assets and liabilities.

Net Interest Income

Our principal source of revenue is net interest income. Net interest income represents the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Net interest income is affected by changes in the average balance of interest-earning assets and interest-bearing liabilities and changes in interest rates and spreads. The level and mix of interest-earning assets and interest-bearing liabilities is managed by our Asset and Liability Committee, or ALCO, in order to mitigate interest rate and liquidity risks of the balance sheet. A variety of ALCO strategies were implemented, within prescribed ALCO risk parameters, to produce what we believe is an acceptable level of net interest income.

The interest income on interest-earning assets and the net interest margin are presented on a FTE basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and securities and the dividend-received deduction for equity securities using the federal statutory tax rate of 21 percent for 2018 and 35 percent for 2017 and 2016. We believe this to be the preferred industry measurement of net interest income that provides a relevant comparison between taxable and non-taxable sources of interest income.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following table reconciles interest income per the Consolidated Statements of Net Income to net interest income and rates on a FTE basis for the periods presented:

	Years Ended December 31,		
(dollars in thousands)	2018	2017	2016
Total interest income	$289,826	$260,642	$227,774
Total interest expense	55,388	34,909	24,515
Net interest income per Consolidated Statements of Net Income	234,438	225,733	203,259
Adjustment to FTE basis	3,803	7,493	7,043
Net Interest Income (FTE) (non-GAAP)	$238,241	$233,226	$210,302
Net interest margin	3.58 %	3.45 %	3.35 %
Adjustment to FTE basis	0.06	0.11	0.12
Net Interest Margin (FTE) (non-GAAP)	3.64 %	3.56 %	3.47 %

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Average Balance Sheet and Net Interest Income Analysis

The following table provides information regarding the average balances, interest and rates earned on interest-earning assets and the average balances, interest and rates paid on interest-bearing liabilities for the years ended December 31:

	2018			2017			2016		
(dollars in thousands)	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
ASSETS									
Interest-bearing deposits with banks	$56,210	$1,042	1.85 %	$56,344	$578	1.03 %	$41,810	$207	0.50 %
Securities at fair value[(2)(3)]	682,806	17,860	2.62 %	698,460	17,320	2.48 %	676,696	16,306	2.41 %
Loans held for sale	1,515	85	5.60 %	14,607	581	3.98 %	14,255	814	5.71 %
Commercial real estate	2,779,096	132,139	4.75 %	2,638,766	114,484	4.34 %	2,344,050	96,814	4.13 %
Commercial and industrial	1,441,560	67,770	4.70 %	1,425,421	61,976	4.35 %	1,348,287	53,629	3.98 %
Commercial construction	314,265	15,067	4.79 %	426,574	17,384	4.08 %	400,997	14,788	3.69 %
Total commercial loans	4,534,921	214,976	4.74 %	4,490,761	193,844	4.32 %	4,093,334	165,231	4.04 %
Residential mortgage	696,849	29,772	4.27 %	699,843	28,741	4.11 %	668,236	27,544	4.12 %
Home equity	474,538	22,981	4.84 %	484,023	20,866	4.31 %	477,011	19,213	4.03 %
Installment and other consumer	67,047	4,594	6.85 %	69,163	4,521	6.54 %	64,960	4,136	6.37 %
Consumer construction	5,336	267	5.00 %	4,631	201	4.35 %	7,038	287	4.08 %
Total consumer loans	1,243,770	57,614	4.63 %	1,257,660	54,329	4.32 %	1,217,245	51,180	4.20 %
Total portfolio loans	5,778,691	272,590	4.72 %	5,748,421	248,173	4.32 %	5,310,579	216,411	4.08 %
Total Loans[(1)(2)]	$5,780,206	$272,675	4.72 %	$5,763,028	$248,754	4.32 %	$5,324,834	$217,225	4.08 %
Federal Home Loan Bank and other restricted stock	30,457	2,052	6.74 %	31,989	1,483	4.64 %	23,811	1,079	4.53 %
Total Interest-earning Assets	6,549,679	293,629	4.48 %	6,549,821	268,135	4.09 %	6,067,151	234,817	3.87 %
Noninterest-earning assets	494,149			510,411			521,104		
Total Assets	$7,043,828			$7,060,232			$6,588,255		
LIABILITIES AND SHAREHOLDERS’ EQUITY									
Interest-bearing demand	$570,459	$1,883	0.33 %	$637,526	$1,418	0.22 %	$651,118	$1,088	0.17 %
Money market	1,299,185	18,228	1.40 %	994,783	7,853	0.79 %	735,159	3,222	0.44 %
Savings	836,747	1,773	0.21 %	988,504	2,081	0.21 %	1,039,664	2,002	0.19 %
Certificates of deposit	1,328,985	18,972	1.43 %	1,439,711	13,978	0.97 %	1,472,613	13,380	0.91 %
Total Interest-bearing deposits	4,035,376	40,856	1.01 %	4,060,524	25,330	0.62 %	3,898,554	19,692	0.51 %
Securities sold under repurchase agreements	45,992	221	0.48 %	46,662	54	0.12 %	51,021	5	0.01 %
Short-term borrowings	525,172	11,082	2.11 %	644,864	7,399	1.15 %	414,426	2,713	0.65 %
Long-term borrowings	47,986	1,129	2.35 %	18,057	463	2.57 %	50,257	670	1.33 %

Junior subordinated debt securities	45,619	2,100	4.60 %	45,619	1,663	3.65 %	45,619	1,435	3.14 %
Total borrowings	664,769	14,532	2.19 %	755,202	9,579	1.27 %	561,323	4,823	0.86 %
Total Interest-bearing Liabilities	4,700,145	55,388	1.18 %	4,815,726	34,909	0.72 %	4,459,877	24,515	0.55 %
Noninterest-bearing liabilities	1,435,328			1,372,376			1,304,771		
Shareholders’ equity	908,355			872,130			823,607		
Total Liabilities and Shareholders’ Equity	$7,043,828			$7,060,232			$6,588,255		
Net Interest Income (2)(3)		$238,241			$233,226			$210,302	
Net Interest Margin (2)(3)			3.64 %			3.56 %			3.47 %

(1)Nonaccruing loans are included in the daily average loan amounts outstanding.
(2)Tax-exempt income is on a FTE basis using the statutory federal corporate income tax rate of 21 percent for 2018 and 35 percent for 2017 and 2016.
(3)Taxable investment income is adjusted for the dividend-received deduction for equity securities.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following table sets forth for the periods presented a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

	2018 Compared to 2017 Increase (Decrease) Due to			2017 Compared to 2016 Increase (Decrease) Due to		
(dollars in thousands)	Volume[4]	Rate[4]	Net	Volume[4]	Rate[4]	Net
Interest earned on:						
Interest-bearing deposits with banks	$(1)	$465	$464	$72	$299	$371
Securities at fair value[2][3]	(388)	928	540	524	490	1,014
Loans held for sale	(521)	25	(496)	20	(253)	(233)
Commercial real estate	6,088	11,567	17,655	12,172	5,498	17,670
Commercial and industrial	702	5,092	5,794	3,068	5,279	8,347
Commercial construction	(4,577)	2,260	(2,317)	943	1,653	2,596
Total commercial loans	2,213	18,919	21,132	16,183	12,430	28,613
Residential mortgage	(123)	1,154	1,031	1,303	(106)	1,197
Home equity	(409)	2,524	2,115	282	1,371	1,653
Installment and other consumer	(138)	211	73	268	117	385
Consumer construction	31	35	66	(98)	12	(86)
Total consumer loans	(639)	3,924	3,285	1,755	1,394	3,149
Total portfolio loans	1,574	22,843	24,417	17,938	13,824	31,762
Total loans [1][2]	1,053	22,868	23,921	17,958	13,571	31,529
Federal Home Loan Bank and other restricted stock	(71)	640	569	371	33	404
Change in Interest Earned on Interest-earning Assets	$593	$24,901	$25,494	$18,925	$14,393	$33,318
Interest paid on:						
Interest-bearing demand	$(149)	$614	$465	$(23)	$353	$330
Money market	2,403	7,972	10,375	1,138	3,493	4,631
Savings	(319)	11	(308)	(99)	178	79
Certificates of deposit	(1,075)	6,069	4,994	(299)	897	598
Total interest-bearing deposits	860	14,666	15,526	717	4,921	5,638
Securities sold under repurchase agreements	(1)	168	167	—	49	49
Short-term borrowings	(1,373)	5,056	3,683	1,509	3,177	4,686
Long-term borrowings	767	(101)	666	(429)	222	(207)
Junior subordinated debt securities	—	437	437	—	228	228
Total borrowings	(607)	5,560	4,953	1,080	3,676	4,756
Change in Interest Paid on Interest-bearing Liabilities	$253	$20,226	$20,479	$1,797	$8,597	$10,394
Change in Net Interest Income	$340	$4,675	$5,015	$17,128	$5,796	$22,924

[1]Nonaccruing loans are included in the daily average loan amounts outstanding.
[2]Tax-exempt income is on a FTE basis using the statutory federal corporate income tax rate of 21 percent for 2018 and 35 percent for 2017 and 2016.
[3]Taxable investment income is adjusted for the dividend-received deduction for equity securities.
[4]Changes to rate/volume are allocated to both rate and volume on a proportionate dollar basis.

Net interest income on a FTE basis increased $5.0 million, or 2.2 percent, compared to 2017. The net interest margin on a FTE basis increased eight basis points compared to 2017. These increases were primarily due to higher short-term interest rates offset by the decrease in the federal corporate tax rate effective January 1, 2018, which negatively impacted the net interest margin on a FTE basis by six basis points or $3.0 million, compared to 2017.

Interest income on a FTE basis increased $25.5 million, or 9.5 percent, compared to 2017. The increase was primarily due to higher short-term interest rates. Average interest-bearing deposits with banks, which is primarily cash at the Federal Reserve, remained relatively flat and the average rate earned increased 82 basis points due to higher short-term interest rates. Average securities decreased $15.7 million due to a decline in the market value of our bond portfolio and the average rate earned increased 14 basis points. Average loan balances increased $17.2 million and the average rate earned on loans increased 40 basis points due to higher short-term interest rates. The average rate earned on the FHLB and other restricted stock improved due to an increase in the FHLB's quarterly dividend in 2018. Overall, the FTE rate on interest-earning assets increased 39 basis points compared to 2017.

Table of Contents

Interest expense increased $20.5 million compared to 2017. The increase was primarily due to higher short-term interest rates. Average interest-bearing deposits decreased $25.1 million. Average money market balances increased $304.4 million and the average rate paid increased 61 basis points due to higher short-term interest rates. The increase in average money market balances was partially attributable to a shift in deposit mix with decreases in average interest-bearing demand, savings, and certificates of deposit balances. The overall decline in interest-bearing deposits is favorably offset by increased average noninterest-bearing demand balances of $65.5 million. Average borrowings decreased $90.4 million. Short-term borrowings decreased $119.7 million and the average rate paid increased 96 basis points due to higher short-term interest rates. Long-term borrowings increased $29.9 million and the average rate paid decreased 22 basis points due to the addition of a long-term variable rate borrowing in November 2017. Overall, the cost of interest-bearing liabilities increased 46 basis points compared to 2017.

Provision for Loan Losses

The provision for loan losses is the adjustment to the ALL after net loan charge-offs have been deducted to bring the ALL to a level determined to be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses increased $1.1 million, or 8.0 percent, to $15.0 million for 2018 compared to $13.9 million for 2017. The provision for loan losses increased primarily due to increases in substandard loans and impaired loans with specific reserves.

Commercial special mention and substandard loans increased $67.7 million to $268.5 million compared to $200.8 million at December 31, 2017, with an increase of $110.5 million in substandard offset by a decrease of $42.8 million in special mention. The increase in substandard loans from December 31, 2017 was mainly due to the receipt of updated financial information from our borrowers that resulted in the loans being downgraded.

Impaired loan balances increased $22.7 million, or 84.6 percent, to $49.5 million at December 31, 2018 compared to $26.8 million at December 31, 2017 with an increase in specific reserves of $1.7 million compared to December 31, 2017. The increase in specific reserves related to an $11.3 million commercial construction loan that had a specific reserve of $1.3 million at December 31, 2018.

Net charge-offs increased $0.1 million to $10.4 million, or 0.18 percent of average loans in 2018, compared to $10.3 million, or 0.18 percent of average loans in 2017. Significantly impacting net loan charge-offs during 2018 was a $5.2 million loan charge-off in the second quarter of 2018 for a commercial customer arising from a participation loan agreement with a lead bank and other participating banks. The loss resulted from fraudulent activities believed to be perpetrated by one or more executives employed by the borrower and its related entities. S&T's total exposure consisted of the participation loan of $4.9 million and a direct exposure of $950 thousand which was secured by vehicles and equipment liens. Subsequent to the loan charge-off in the second quarter, we received $0.4 million of recovery on this relationship.

Total nonperforming loans increased $22.2 million to $46.1 million, or 0.77 percent of total loans at December 31, 2018, compared to $23.9 million, or 0.42 percent of total loans at December 31, 2017.

The ALL at December 31, 2018, was $61.0 million, or 1.03 percent of total portfolio loans, compared to $56.4 million, or 0.98 percent of total portfolio loans at December 31, 2017. The increase in the level of the reserve is due to portfolio loan growth of $185.2 million and the increase in substandard loans during 2018. Refer to the Allowance for Loan Losses section of this MD&A for further details.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Noninterest Income

	Years Ended December 31,			
(dollars in thousands)	2018	2017	$ Change	% Change
Securities gains, net	$—	$3,000	$(3,000)	NM
Service charges on deposit accounts	13,096	12,458	638	5.1 %
Debit and credit card	12,679	12,029	650	5.4 %
Wealth management	10,084	9,758	326	3.3 %
Insurance	505	5,371	(4,866)	(90.6)%
Mortgage banking	2,762	2,915	(153)	(5.2)%
Gain on sale of a majority interest of insurance business	1,873	—	1,873	NM
Other Income:				
Bank owned life insurance	2,041	2,755	(714)	(25.9)%
Letter of credit origination	1,064	1,018	46	4.5 %
Interest rate swap	1,225	503	722	143.5 %
Other	3,852	5,655	(1,803)	(31.9)%
Total Other Noninterest Income	8,182	9,931	(1,749)	(17.6)%
Total Noninterest Income	$49,181	$55,462	$(6,281)	(11.3)%

NM- percentage change not meaningful

Noninterest income decreased $6.3 million, or 11.3 percent, in 2018 compared to 2017. The decrease was primarily related to gains on the sales of securities of $3.0 million in 2017, a $1.0 million gain from the sale of a branch in the fourth quarter of 2017 in other income and the sale of a majority interest in S&T Evergreen Insurance, LLC in the first quarter of 2018. As a result of this sale in 2018, insurance income decreased $4.9 million. A gain of $1.9 million was recognized related to this sale during 2018. The decrease in BOLI income related to a $0.7 million claim during the third quarter of 2017. Interest rate swap fees from our commercial customers increased $0.7 million compared to the prior year due to an increase in customer demand for this product. Debit and credit card fees increased $0.6 million compared to the prior year due to increased debit card usage. Service charges on deposit accounts also increased $0.6 million due to increases in fees.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Noninterest Expense

	Years Ended December 31,			
(dollars in thousands)	2018	2017	$ Change	% Change
Salaries and employee benefits	$76,108	$80,776	$(4,668)	(5.8)%
Net occupancy	11,097	10,994	103	0.9%
Data processing and information technology	10,633	8,801	1,832	20.8%
Furniture, equipment and software	8,083	7,946	137	1.7%
FDIC insurance	3,238	4,543	(1,305)	(28.7)%
Other taxes	6,183	4,509	1,674	37.1%
Professional services and legal	4,132	4,096	36	0.9%
Marketing	4,192	3,659	533	14.6%
Other expenses:				
Joint venture amortization	2,701	3,048	(347)	(11.4)%
Telecommunications	2,500	2,572	(72)	(2.8)%
Loan related expenses	2,268	2,547	(279)	(11.0)%
Amortization of intangibles	846	1,247	(401)	(32.2)%
Supplies	1,080	1,233	(153)	(12.4)%
Postage	1,077	1,128	(51)	(4.5)%
Other	11,307	10,808	499	4.6%
Total Other Noninterest Expense	21,779	22,583	(804)	(3.6)%
Total Noninterest Expense	$145,445	$147,907	$(2,462)	(1.7)%

NM - percentage not meaningful

Noninterest expense decreased $2.5 million, or 1.7 percent, to $145.4 million in 2018 compared to 2017. Salaries and employee benefits decreased $4.7 million during 2018 primarily due to lower restricted stock, incentive and commission costs and fewer employees mainly due to the sale of a majority of our insurance business in the first quarter 2018 and the sale of a branch office in the fourth quarter of 2017. FDIC insurance decreased $1.3 million due to improvements in the components used to determine the assessment. The increase of $1.8 million in data processing expense compared to 2017 was mainly due to the annual increase with our third-party data processor and recent outsourcing arrangement for certain components of our IT function. Other taxes increased $1.7 million due to a state sales tax assessment.

Our efficiency ratio (non-GAAP), which measures noninterest expense as a percent of noninterest income plus net interest income, on a FTE basis, excluding security gains/losses, was 50.60 percent for 2018 and 51.77 percent for 2017. Refer to Explanation of Use of Non-GAAP Financial Measures in Part II, Item 6 Selected Financial Data in this Report for a discussion of this non-GAAP financial measure.

Federal Income Taxes

Our federal income tax provision decreased $28.6 million to $17.8 million in 2018 compared to $46.4 million in 2017. The decrease in our 2018 income tax provision was primarily due to the corporate income tax rate reduction from 35 percent to 21 percent. Our 2017 income tax provision was calculated at the 35 percent corporate income tax rate and further increased by $13.4 million due to the re-measurement of our deferred tax assets and liabilities at the new corporate income tax rate of 21 percent enacted as part of the Tax Act on December 22, 2017.

The effective tax rate, which is total tax expense as a percentage of pretax income, decreased to 14.5 percent in 2018 compared to 38.9 percent in 2017. Historically, we have generated an annual effective tax rate that is less than the statutory rates of 21 percent for 2018 and 35 percent for 2017 due to benefits resulting from tax-exempt interest, excludable dividend income, tax-exempt income on BOLI and tax benefits associated with Low Income Housing Tax

Credits, or LIHTC. However, due to the 2017 enactment of the Tax Act, our net DTA re-measurement of $13.4 million increased our effective tax rate by 11.3 percent in 2017.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Results of Operations
Year Ended December 31, 2017
Earnings Summary
On December 22, 2017, the Tax Act was signed into law. At the date of enactment, we were required to re-measure our deferred tax assets and liabilities, or net DTA, at the new lower corporate tax rate of 21 percent. We made a tax adjustment to re-measure our deferred tax assets and liabilities for the impact of the Tax Act that decreased 2017 net income by $13.4 million, or $0.38 per diluted share. The tax adjustment was recognized as an increase to our income tax expense in the fourth quarter of 2017. The new corporate tax rate of 21 percent is effective for tax years beginning January 1, 2018.
Net income increased $1.6 million, or 2.2 percent, to $73.0 million, or $2.09 per diluted share, in 2017 compared to $71.4 million or $2.05 per diluted share in 2016. The increase in net income was primarily due to an increase in net interest income of $22.5 million, or 11.1 percent, a decrease in the provision for loan losses of $4.1 million, or 22.7 percent, and an increase in security gains of $3.0 million. This was offset by increases of $4.7 million in noninterest expense and $21.1 million in the provision for income taxes.
Net interest income increased $22.5 million, or 11.1 percent, to $226 million compared to $203 million in 2016. The increases in short-term interest rates in 2017 positively impacted both net interest income and net interest margin during 2017. The increase in net interest income was primarily due to an increase in average interest-earning assets of $483 million, or 8.0 percent, offset by an increase in average interest-bearing liabilities of $356 million, or 8.0 percent, compared to 2016. The increase in average interest-earning assets primarily related to organic growth with average loans increasing $438 million, or 8.2 percent, during 2017. Most of this growth was in our commercial loan portfolio. The increases in average interest-bearing liabilities were mainly due to deposit growth and an increase in short-term borrowings. Average deposits increased $162 million, or 4.2 percent, and average borrowings increased $194 million, or 34.5 percent, for 2017. Net interest margin, on a fully taxable-equivalent, or FTE, basis (non-GAAP), increased nine basis points to 3.56 percent in 2017 compared to 3.47 percent for 2016.
The provision for loan losses decreased $4.1 million, or 22.7 percent, to $13.9 million during 2017 compared to $18.0 million in 2016. The lower provision for loan losses was due to decreases in net loan charge-offs and nonperforming loans and a decline in impaired loan balances and the related specific reserves. Net loan charge-offs decreased $3.0 million to $10.3 million, or 0.18 percent of average loans, for 2017 compared to $13.3 million, or 0.25 percent of average loans, in 2016. Impaired loans decreased $15.1 million, or 36 percent, with a decline in specific reserves of $0.7 million compared to 2016.
Total noninterest income increased $0.9 million to $55.5 million compared to $54.6 million in 2016. The increase in noninterest income was primarily due security gains of $3.0 million, a bank owned life insurance, or BOLI, claim of $0.7 million and a $1.0 million gain on a branch sale during 2017, compared to a gain of $2.1 million on the sale of our credit card portfolio and a $1.0 million pension curtailment gain in 2016.
Total noninterest expense increased $4.7 million to $148 million for 2017 compared to $143 million for 2016. The increase was mainly due to an increase in salaries and employee benefits of $3.5 million primarily due to annual merit increases, higher incentive costs and higher medical costs offset by lower pension expense.
The provision for income taxes increased $21.1 million to $46.4 million compared to $25.3 million in 2016. The increase was primarily due to the non-cash tax adjustment of $13.4 million for the re-measurement of our deferred tax assets and liabilities as a result of the corporate rate reduction, which was recorded as an increase to income tax expense and higher pre-tax income in 2017 compared to 2016.
Net Interest Income
Our principal source of revenue is net interest income. Net interest income represents the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Net interest income is affected by changes in the average balance of interest-earning assets and interest-bearing liabilities and

changes in interest rates and spreads. The level and mix of interest-earning assets and interest-bearing liabilities is managed by our Asset and Liability Committee, or ALCO, in order to mitigate interest rate and liquidity risks of the balance sheet. A variety of ALCO strategies were implemented, within prescribed ALCO risk parameters, to produce what we believe is an acceptable level of net interest income.

The interest income on interest-earning assets and the net interest margin are presented on a FTE basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and securities using the federal statutory tax rate of 35 percent for each period and the dividend-received deduction for equity securities. We believe this to be the preferred industry measurement of net interest income that provides a relevant comparison between taxable and non-taxable sources of interest income.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following table reconciles interest income per the Consolidated Statements of Net Income to net interest income and rates on a FTE basis for the periods presented:

	Years Ended December 31,		
(dollars in thousands)	2017	2016	2015
Total interest income	$260,642	$227,774	$203,548
Total interest expense	34,909	24,515	15,997
Net interest income per Consolidated Statements of Net Income	225,733	203,259	187,551
Adjustment to FTE basis	7,493	7,043	6,123
Net Interest Income (FTE) (non-GAAP)	$233,226	$210,302	$193,674
Net interest margin	3.45 %	3.35 %	3.45 %
Adjustment to FTE basis	0.11	0.12	0.11
Net Interest Margin (FTE) (non-GAAP)	3.56 %	3.47 %	3.56 %

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Average Balance Sheet and Net Interest Income Analysis

The following table provides information regarding the average balances, interest and rates earned on interest-earning assets and the average balances, interest and rates paid on interest-bearing liabilities for the years ended December 31:

	2017			2016			2015		
(dollars in thousands)	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
ASSETS									
Interest-bearing deposits with banks	$56,344	$578	1.03 %	$41,810	$207	0.50 %	$66,101	$165	0.25 %
Securities available-for-sale, at fair value	698,460	17,320	2.48 %	676,696	16,306	2.41 %	654,655	16,246	2.48 %
Loans held for sale	14,607	581	3.98 %	14,255	814	5.71 %	8,272	349	4.22 %
Commercial real estate	2,638,766	114,484	4.34 %	2,344,050	96,814	4.13 %	2,026,206	83,469	4.12 %
Commercial and industrial	1,425,421	61,976	4.35 %	1,348,287	53,629	3.98 %	1,209,020	46,175	3.82 %
Commercial construction	426,574	17,384	4.08 %	400,997	14,788	3.69 %	330,821	13,249	4.00 %
Total commercial loans	4,490,761	193,844	4.32 %	4,093,334	165,231	4.04 %	3,566,047	142,893	4.01 %
Residential mortgage	699,843	28,741	4.11 %	668,236	27,544	4.12 %	577,294	24,458	4.24 %
Home equity	484,023	20,866	4.31 %	477,011	19,213	4.03 %	451,755	18,139	4.02 %
Installment and other consumer	69,163	4,521	6.54 %	64,960	4,136	6.37 %	82,972	5,764	6.95 %
Consumer construction	4,631	201	4.35 %	7,038	287	4.08 %	6,092	256	4.21 %
Total consumer loans	1,257,660	54,329	4.32 %	1,217,245	51,180	4.20 %	1,118,113	48,617	4.35 %
Total portfolio loans	5,748,421	248,173	4.32 %	5,310,579	216,411	4.08 %	4,684,160	191,510	4.09 %
Total Loans	$5,763,028	$248,754	4.32 %	$5,324,834	$217,225	4.08 %	$4,692,432	$191,859	4.09 %
Federal Home Loan Bank and other restricted stock	31,989	1,483	4.64 %	23,811	1,079	4.53 %	19,672	1,401	7.12 %
Total Interest-earning Assets	6,549,821	268,135	4.09 %	6,067,151	234,817	3.87 %	5,432,860	209,671	3.86 %
Noninterest-earning assets	510,411			521,104			509,236		
Total Assets	$7,060,232			$6,588,255			$5,942,096		
LIABILITIES AND SHAREHOLDERS’ EQUITY									
Interest-bearing demand	$637,526	$1,418	0.22 %	$651,118	$1,088	0.17 %	$623,232	$888	0.14 %
Money market	994,783	7,853	0.79 %	735,159	3,222	0.44 %	574,102	1,229	0.21 %
Savings	988,504	2,081	0.21 %	1,039,664	2,002	0.19 %	1,072,683	1,712	0.16 %
Certificates of deposit	1,439,711	13,978	0.97 %	1,472,613	13,380	0.91 %	1,252,798	9,115	0.73 %
Total Interest-bearing deposits	4,060,524	25,330	0.62 %	3,898,554	19,692	0.51 %	3,522,815	12,944	0.37 %
Securities sold under repurchase agreements	46,662	54	0.12 %	51,021	5	0.01 %	44,394	4	0.01 %
Short-term borrowings	644,864	7,399	1.15 %	414,426	2,713	0.65 %	257,117	932	0.36 %

Long-term borrowings	18,057	463	2.57 %	50,257	670	1.33 %	83,648	790	0.94 %
Junior subordinated debt securities	45,619	1,663	3.65 %	45,619	1,435	3.14 %	47,071	1,327	2.82 %
Total borrowings	755,202	9,579	1.27 %	561,323	4,823	0.86 %	432,230	3,053	0.71 %
Total Interest-bearing Liabilities	4,815,726	34,909	0.72 %	4,459,877	24,515	0.55 %	3,955,045	15,997	0.40 %
Noninterest-bearing liabilities	1,372,376			1,304,771			1,236,984		
Shareholders' equity	872,130			823,607			750,069		
Total Liabilities and Shareholders' Equity	$7,060,232	34,909		$6,588,255			$5,942,098		
Net Interest Income (2)(3)		$233,226			$210,302			$193,674	
Net Interest Margin (2)(3)			3.56 %			3.47 %			3.56 %

(1)Nonaccruing loans are included in the daily average loan amounts outstanding.
(2)Tax-exempt income is on a FTE basis using the statutory federal corporate income tax rate of 35 percent for 2017, 2016 and 2015.
(3)Taxable investment income is adjusted for the dividend-received deduction for equity securities.

39

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following table sets forth for the periods presented a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

	2017 Compared to 2016 Increase (Decrease) Due to			2016 Compared to 2015 Increase (Decrease) Due to		
(dollars in thousands)	Volume[4]	Rate[4]	Net	Volume[4]	Rate[4]	Net
Interest earned on:						
Interest-bearing deposits with banks	$72	$299	$371	$(61)	$103	$42
Securities available-for-sale, at fair value[2][3]	524	490	1,014	547	(487)	60
Loans held for sale	20	(253)	(233)	252	213	465
Commercial real estate	12,172	5,498	17,670	13,093	252	13,345
Commercial and industrial	3,068	5,279	8,347	5,319	2,135	7,454
Commercial construction	943	1,653	2,596	2,810	(1,271)	1,539
Total commercial loans	16,183	12,430	28,613	21,222	1,116	22,338
Residential mortgage	1,303	(106)	1,197	3,853	(767)	3,086
Home equity	282	1,371	1,653	1,014	60	1,074
Installment and other consumer	268	117	385	(1,251)	(377)	(1,628)
Consumer construction	(98)	12	(86)	40	(9)	31
Total consumer loans	1,755	1,394	3,149	3,656	(1,093)	2,563
Total portfolio loans	17,938	13,824	31,762	24,878	23	24,901
Total loans [1][2]	17,958	13,571	31,529	25,130	236	25,366
Federal Home Loan Bank and other restricted stock	371	33	404	295	(617)	(322)
Change in Interest Earned on Interest-earning Assets	$18,925	$14,393	$33,318	$25,911	$(765)	$25,146
Interest paid on:						
Interest-bearing demand	$(23)	$353	$330	$40	$160	$200
Money market	1,138	3,493	4,631	345	1,648	1,993
Savings	(99)	178	79	(53)	343	290
Certificates of deposit	(299)	897	598	1,599	2,666	4,265
Total interest-bearing deposits	717	4,921	5,638	1,931	4,817	6,748
Securities sold under repurchase agreements	—	49	49	1	—	1
Short-term borrowings	1,509	3,177	4,686	570	1,211	1,781
Long-term borrowings	(429)	222	(207)	(315)	195	(120)
Junior subordinated debt securities	—	228	228	(41)	149	108
Total borrowings	1,080	3,676	4,756	215	1,555	1,770
Change in Interest Paid on Interest-bearing Liabilities	$1,797	$8,597	$10,394	$2,146	$6,372	$8,518
Change in Net Interest Income	$17,128	$5,796	$22,924	$23,765	$(7,137)	$16,628

[1]Nonaccruing loans are included in the daily average loan amounts outstanding.
[2]Tax-exempt income is on a FTE basis using the statutory federal corporate income tax rate of 35 percent for 2017, 2016 and 2015.
[3]Taxable investment income is adjusted for the dividend-received deduction for equity securities.
[4]Changes to rate/volume are allocated to both rate and volume on a proportionate dollar basis.

Net interest income on a FTE basis increased $22.9 million, or 10.9 percent, compared to 2016. The increase was primarily due to organic loan growth and higher short-term interest rates. The net interest margin on a FTE basis increased nine basis points to 3.56 percent compared to 3.47 percent for 2016.

Interest income on a FTE basis increased $33.3 million, or 14.2 percent, compared to 2016. The increase is primarily due to an increase in average interest-earning assets of $483 million and higher short-term interest rates. Average loan balances increased $438 million due to organic growth, primarily in the commercial loan portfolio. The average rate earned on loans increased 24 basis points primarily due to higher short-term interest rates. Average interest-bearing deposits with banks, which is primarily cash at the Federal Reserve increased $14.5 million and the average rate earned increased 53 basis points due to higher short-term interest rates. Average securities increased $21.8 million with no significant change to the rate. Overall, the FTE rate on interest-earning assets increased 22 basis points compared to 2016.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Interest expense increased $10.4 million compared to 2016. The increase was primarily due to an increase in average interest-bearing liabilities of $356 million and higher short-term interest rates. Average interest-bearing deposits increased $162 million due to sales efforts and rate promotions. Average money market account balances increased $260 million and the average rate paid increased 35 basis points due to higher short-term interest rates. Average total borrowings increased $194 million to provide funding for loan growth. Short-term borrowings increased $230 million and the average rate paid increased 50 basis points due to higher short-term interest rates. Overall, the cost of interest-bearing liabilities increased 17 basis points compared to 2016.

Provision for Loan Losses

The provision for loan losses is the amount to be added to the ALL after net loan charge-offs have been deducted to bring the ALL to a level determined to be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses decreased $4.1 million, or 22.7 percent, to $13.9 million for 2017 compared to $18.0 million for 2016. This decrease in the provision for loan losses is primarily related to decreases in net loan charge-offs and nonperforming loans and lower impaired loan balances and the related specific reserves.

Net charge-offs decreased $3.0 million, or 23 percent, to $10.3 million, or 0.18 percent of average loans in 2017, compared to $13.3 million, or 0.25 percent of average loans in 2016. Total nonperforming loans decreased $18.7 million to $23.9 million, or 0.42 percent of total loans at December 31, 2017, compared to $42.6 million, or 0.76 percent of total loans at December 31, 2016. Impaired loan balances decreased $15.1 million, or 36 percent, to $26.8 million at December 31, 2017 compared to $41.9 million at December 31, 2016 with a decrease in specific reserves of $0.7 million compared to December 31, 2016. The decrease primarily related to two large commercial nonperforming, impaired loans that paid off during 2017 that totaled $10.5 million. The $0.7 million decrease in specific reserves was primarily related to the release of reserve related to a C&I loan.

The ALL at December 31, 2017, was $56.4 million, or 0.98 percent of total portfolio loans, compared to $52.8 million, or 0.94 percent of total portfolio loans at December 31, 2016. The increase in the level of the reserve is partly due to portfolio loan growth of $150 million during 2017. Refer to the Allowance for Loan Losses section of this MD&A for further details.

Noninterest Income

	Years Ended December 31,			
(dollars in thousands)	2017	2016	$ Change	% Change
Securities gains, net	$3,000	$—	$3,000	NM
Service charges on deposit accounts	12,458	12,512	(54)	(0.4)%
Debit and credit card	12,029	11,943	86	0.7%
Wealth management	9,758	10,456	(698)	(6.7)%
Insurance	5,418	5,253	165	3.1%
Mortgage banking	2,915	2,879	36	1.3%
Bank owned life insurance	2,756	2,122	634	29.9%
Gain on sale of credit card portfolio	—	2,066	(2,066)	NM
Other Income:				
Letter of credit origination	1,018	1,154	(136)	(11.8)%
Interest rate swap	503	977	(474)	(48.5)%
Curtailment gain	—	1,017	(1,017)	NM
Other	5,607	4,256	1,351	31.7%
Total Other Noninterest Income	7,128	7,404	(276)	(3.7)%
Total Noninterest Income	$55,462	$54,635	$827	1.5%

NM- percentage change not meaningful

Noninterest income increased $0.8 million, or 1.5 percent, in 2017 compared to 2016. Net gains on the sale of securities and a $1.0 million gain from the sale of a branch in 2017 were mostly offset by a $2.1 million decrease related to the gain on the sale of our credit card portfolio and a $1.0 million defined benefit plan curtailment gain in 2016. The curtailment gain was due to an amendment to freeze benefit accruals under the qualified and nonqualified defined benefit pension plans effective March 31, 2016.

The decrease in wealth management fees of $0.7 million is primarily due to a decline in advisory fees related to the dissolution of the mutual fund, compared to the prior year. The increase in BOLI income related to a $0.7 million claim during the third quarter of 2017. Interest rate swap fees from our commercial customers decreased $0.5 million compared to the prior year due to a decrease in customer demand for this product.

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

On January 1, 2018, we sold a majority interest in S&T Evergreen Insurance, LLC, a subsidiary of S&T Insurance Group. Our insurances fees will decrease in future periods along with a corresponding decrease in operating expenses.

Noninterest Expense

	Years Ended December 31,			
(dollars in thousands)	2017	2016	$ Change	% Change
Salaries and employee benefits	$80,776	$77,325	$3,451	4.5 %
Net occupancy	10,994	11,057	(63)	(0.6)%
Data processing	8,801	8,837	(36)	(0.4)%
Furniture, equipment and software	7,946	7,290	656	9.0 %
FDIC insurance	4,543	3,984	559	14.0 %
Other taxes	4,509	4,050	459	11.3 %
Professional services and legal	4,096	3,466	630	18.2 %
Marketing	3,659	3,713	(54)	(1.5)%
Other expenses:				
Joint venture amortization	3,048	3,283	(235)	(7.2)%
Telecommunications	2,572	2,693	(121)	(4.5)%
Loan related expenses	2,547	1,752	795	45.4 %
Amortization of intangibles	1,247	1,615	(368)	(22.8)%
Supplies	1,233	1,350	(117)	(8.7)%
Postage	1,128	1,118	10	0.9 %
Other	10,808	11,699	(891)	(7.6)%
Total Other Noninterest Expense	22,583	23,510	(927)	(3.9)%
Total Noninterest Expense	$147,907	$143,232	$4,675	3.3 %

NM - percentage not meaningful

Noninterest expense increased $4.7 million, or 3.3 percent, to $148 million in 2017 compared to 2016. Salaries and employee benefits increased $3.5 million during 2017 primarily due to annual merit increases, higher incentive costs and higher medical claims. Incentive expense increased $3.0 million due to a higher number of participants and strong performance in 2017. Medical expense increased $0.4 million primarily due to higher claims. These increases were offset by a decrease in pension expense of $1.7 million related to the amendment in 2016 to freeze benefit accruals for all participants in our defined benefit pension plans.

The increase of $0.7 million in furniture and equipment expense compared to 2016 was mainly due to technology upgrades. Professional services and legal expense increased $0.6 million mainly related to the sale of our subsidiary, S&T Evergreen Insurance, effective January 1, 2018 and a branch sale during 2017. FDIC insurance increased $0.6 million due to growth and other taxes increased $0.5 million due to higher sales tax. Loan related expense increased $0.8 million due to expense recoveries during 2016 on impaired loans. Other noninterest expense decreased $0.9 million primarily related to lower processing charges for credit cards due to the sale of the credit card portfolio in 2016.

Our efficiency ratio (non-GAAP), which measures noninterest expense as a percent of noninterest income plus net interest income, on a FTE basis, excluding security gains/losses, was 51.77 percent for 2017 and 54.06 percent for 2016. Refer to Explanation of Use of Non-GAAP Financial Measures in Item 6 Selected Financial Data in this Report for a discussion of this non-GAAP financial measure.

Federal Income Taxes

We recorded a federal income tax provision of $46.4 million in 2017 compared to $25.3 million in 2016, an increase of $21.1 million. Our 2017 income tax provision increased by $13.4 million due to the re-measurement of our deferred tax assets and liabilities at the new corporate income tax rate of 21 percent enacted as part of the Tax Act on

December 22, 2017. The remainder of the increase in tax provision was primarily due to higher pretax earnings.

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The effective tax rate, which is total tax expense as a percentage of pretax income, increased to 38.9 percent in 2017 compared to 26.2 percent in 2016. Historically, we have generated an annual effective tax rate that is less than the pre-tax reform statutory rate of 35 percent due to benefits resulting from tax-exempt interest, excludable dividend income, tax-exempt income on bank owned life insurance, or BOLI, and tax benefits associated with LIHTC. However, due to the 2017 enactment of the Tax Act, our net DTA re-measurement of $13.4 million increased our effective tax rate by 11.3 percent in 2017. In 2018, our annual effective tax rate is anticipated to be less than the new corporate rate of 21 percent due to similar tax benefits listed above.

Financial Condition
December 31, 2018
Total assets increased $192.0 million, or 2.7 percent, to $7.3 billion at December 31, 2018 compared to $7.1 billion at December 31, 2017. Total portfolio loans increased $185.2 million, or 3.2 percent with increases primarily in the commercial loan portfolio. CRE increased by $235.8 million, or 8.8 percent, and Commercial Industrial, or C&I, increased $60.2 million, or 4.2 percent, offset by a decrease in commercial construction loans of $127.1 million compared to a year ago. The commercial portfolio was impacted by higher loan payoffs through the third quarter of 2018 and an increasingly competitive market throughout the year. Consumer loans increased $16.3 million with growth primarily in our residential mortgages portfolio of $27.9 million. Securities decreased $13.4 million to $684.9 million at December 31, 2018 from $698.3 million at December 31, 2017 primarily due to an increase in the unrealized loss on the bond portfolio related to an increase in interest rates.
Our deposits increased $246.0 million, or 4.5 percent, with total deposits of $5.7 billion at December 31, 2018 compared to $5.4 billion at December 31, 2017. Customer deposits increased $165.4 million with growth in money market of $297.7 million, or 33.8 percent, and in noninterest-bearing demand accounts of $33.4 million which was offset by declines in interest-bearing demand, savings and certificates of deposit. Total brokered deposits increased $80.6 million at December 31, 2018 compared to December 31, 2017.
Total borrowings decreased $78.8 million, or 11.5 percent, compared to 2017 due to a decrease in funding needs. Short-term borrowings decreased by $101.8 million, or 17.2 percent, and long-term borrowings increased $23.0 million.
Total shareholders’ equity increased by $51.7 million, or 5.9 percent, to $935.8 million at December 31, 2018 compared to $884.0 million at December 31, 2017. The increase was primarily due to net income of $105.3 million offset partially by dividends of $34.5 million and share repurchases of $12.3 million.
Securities Activity
The balances and average rates of our securities portfolio are presented below as of December 31:

	2018			2017			2016		
(dollars in thousands)	Balance	Weighted-Average Yield		Balance	Weighted-Average Yield		Balance	Weighted-Average Yield	
U.S. Treasury securities	$9,736	1.87	%	$19,789	1.57	%	$24,811	1.49	%
Obligations of U.S. government corporations and agencies	128,261	2.30	%	162,193	2.09	%	232,179	1.68	%
Collateralized mortgage obligations of U.S. government	148,659	2.71	%	108,688	2.25	%	129,777	2.24	%

corporations and agencies								
Residential mortgage-backed securities of U.S. government corporations and agencies	24,350	3.43 %	32,854	3.52 %	37,358	2.64 %
Commercial mortgage-backed securities of U.S. government corporations and agencies	246,784	2.38 %	242,221	2.34 %	125,604	2.06 %
Obligations of states and political subdivisions [1]	122,266	3.43 %	127,402	4.06 %	132,509	4.10 %
Marketable equity securities	4,816	3.02 %	5,144	2.78 %	11,249	3.38 %
Total Securities	$684,872	2.65 %	$698,291	2.62 %	$693,487	2.39 %

[1] Weighted-average yields are calculated on a taxable-equivalent basis using the federal statutory tax rate of 21 percent for 2018 and 35 percent for 2017 and 2016.

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

We invest in various securities in order to maintain a source of liquidity, to satisfy various pledging requirements, to increase net interest income, and as a tool of ALCO to reposition the balance sheet for interest rate risk purposes. Securities are subject to market risks that could negatively affect the level of liquidity available to us. Security purchases are subject to an investment policy approved annually by our Board of Directors and administered through ALCO and our treasury function. Securities decreased $13.4 million, or 1.9 percent, to $684.9 million at December 31, 2018 compared to $698.3 million at December 31, 2017. The decrease is primarily due to an increase in the unrealized loss on the bond portfolio.

At December 31, 2018, our bond portfolio was in a net unrealized loss position of $5.1 million, compared to a net unrealized gain position of $1.7 million at December 31, 2017. At December 31, 2018, total gross unrealized gains were $3.5 million offset by total gross unrealized losses of $8.6 million, compared to total gross unrealized gains of $5.6 million offset by total gross unrealized losses of $3.9 million at December 31, 2017. The decrease in the net unrealized gain position of our securities portfolio was due to the increase in interest rates during 2018.

Management evaluates the bond portfolio for other than temporary impairment, or OTTI, on a quarterly basis. The unrealized losses on debt securities were primarily attributable to changes in interest rates and not related to the credit quality of these securities. All debt securities were determined to be investment grade and paying principal and interest according to the contractual terms of the security at December 31, 2018. We do not intend to sell and it is more likely than not that we will not be required to sell any of the securities in an unrealized loss position before recovery of their amortized cost. We did not record any OTTI in 2018, 2017 or 2016. The performance of the debt securities markets could generate impairments in future periods requiring realized losses to be reported.

The following table sets forth the maturities of securities at December 31, 2018 and the weighted average yields of such securities. Taxable-equivalent adjustments for 2018 have been made in calculating yields on obligations of state and political subdivisions.

	Maturing									
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		No Fixed Maturity	
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available-for-Sale										
U.S. Treasury securities	$9,736	1.87 %	$—	— %	$—	— %	$—	— %	$—	— %
Obligations of U.S. government corporations and agencies	997	1.34 %	104,255	2.26 %	23,009	2.51 %	—	— %	—	—%
Collateralized mortgage obligations of U.S. government corporations and agencies	—	— %	—	— %	66,847	2.57 %	81,812	2.83 %	—	—%
Residential mortgage-backed securities of U.S. government corporations and agencies	9	4.50 %	429	5.18 %	10,087	2.95 %	13,825	3.72 %	—	—%
Commercial mortgage-backed securities of U.S. government corporations and agencies	28,105	1.76 %	99,400	2.31 %	119,279	2.58 %	—	—	—	—%
Obligations of states and political subdivisions (1)	10,158	3.06 %	43,930	3.41 %	39,008	3.34 %	29,170	3.70 %	—	—%

Marketable equity securities	—	— %	—	— %	—	— %	—	— %	4,816	3.02%
Total	$49,005		$248,014		$258,230		$124,807		$4,816	
Weighted Average Yield		2.04 %		2.49 %		2.70 %		3.13 %		3.02%

(1) Weighted-average yields are calculated on a taxable-equivalent basis using the federal statutory tax rate of 21 percent for 2018.

44

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Lending Activity

The following table summarizes our loan portfolio as of December 31:

	2018		2017		2016		2015		2014	
(dollars in thousands)	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commercial										
Commercial real estate	$2,921,832	49.13 %	$2,685,994	44.53 %	$2,498,476	44.53 %	$2,166,603	43.09 %	$1,682,236	43.48 %
Commercial and industrial	1,493,416	25.11 %	1,433,266	24.88 %	1,401,035	24.97 %	1,256,830	25.00 %	994,138	25.70 %
Commercial construction	257,197	4.33 %	384,334	6.67 %	455,884	8.12 %	413,444	8.22 %	216,148	5.59 %
Total Commercial Loans	4,672,445	78.57 %	4,503,594	78.17 %	4,355,395	77.62 %	3,836,877	76.31 %	2,892,522	74.77 %
Consumer										
Residential mortgage	726,679	12.22 %	698,774	12.13 %	701,982	12.51 %	639,372	12.72 %	489,586	12.66 %
Home equity	471,562	7.93 %	487,326	8.46 %	482,284	8.59 %	470,845	9.37 %	418,563	10.82 %
Installment and other consumer	67,546	1.13 %	67,204	1.17 %	65,852	1.17 %	73,939	1.47 %	65,567	1.69 %
Consumer construction	8,416	0.14 %	4,551	0.08 %	5,906	0.11 %	6,579	0.13 %	2,508	0.06 %
Total Consumer Loans	1,274,203	21.43 %	1,257,855	21.83 %	1,256,024	22.38 %	1,190,735	23.69 %	976,224	25.23 %
Total Portfolio Loans	$5,946,648	100.00%	$5,761,449	100.00%	$5,611,419	100.00%	$5,027,612	100.00%	$3,868,746	100.00%

The loan portfolio represents the most significant source of interest income for us. The risk that borrowers will be unable to pay such obligations is inherent in the loan portfolio. Other conditions such as downturns in the borrower's industry or the overall economic climate can significantly impact the borrower's ability to pay.

We maintain a General Lending Policy to control the quality of our loan portfolio. The policy delegates the authority to extend loans under specific guidelines and underwriting standards. The General Lending Policy is formulated by management and reviewed and ratified annually by the Board of Directors.

Total portfolio loans increased $185.2 million, or 3.2 percent, to $5.9 billion at December 31, 2018 compared to $5.8 billion at December 31, 2017. CRE increased $235.8 million, or 8.8 percent, and C&I increased $60.2 million, or 4.2 percent, offset by a decrease in commercial construction loans of $127.1 million compared 2017. The commercial portfolio was impacted by higher loan payoffs through the third quarter of 2018 and an increasingly competitive market throughout the year. New construction loan activity was outpaced by loan payoffs and transfers to CRE upon completion of the construction period.

Commercial loans, including CRE, C&I and Commercial Construction, comprised 79 percent of total portfolio loans at December 31, 2018 and 78 percent at December 31, 2017. Although commercial loans can have a relatively higher risk profile, management believes these risks are mitigated through active portfolio management, conservative underwriting standards and continuous portfolio review. The loan-to-value, or LTV, policy guidelines for CRE loans are generally 65-80 percent. At December 31, 2018, variable rate commercial loans represented 74 percent of total commercial loans compared to 75 percent in 2017.

Consumer loans represent 21 percent of our loan portfolio at December 31, 2018 compared to 22 percent at December 31, 2017. Consumer loans increased $16.3 million with growth primarily in our residential mortgage portfolio of $27.9 million.

Residential mortgage lending continues to be a focus through a centralized mortgage origination department, secondary market activities and the utilization of commission compensated originators. Management believes that continued adherence to our conservative mortgage lending policies for portfolio mortgage loans will be as important in a growing economy as it was during the downturn in recent years. The LTV policy guideline is 80 percent for residential first lien mortgages. Higher LTV loans may be approved with the appropriate private mortgage insurance coverage. We primarily limit our fixed rate portfolio mortgage loans to a maximum term of 20 years for traditional mortgages, 30 year fixed rate construction loans and adjustable rate mortgages with a maximum amortization term of 30 years. We may originate home equity loans with a lien position that is second to unrelated third party lenders, but normally only to the extent that the combined LTV considering both the first and second liens does not exceed 100 percent of the fair value of the property. Combo mortgage loans consisting of a residential first mortgage and a home equity second mortgage are also available.

We originate and sell loans into the secondary market, primarily to Fannie Mae. We sell these loans in order to mitigate interest-rate risk associated with holding lower rate, long-term residential mortgages in the loan portfolio and to generate fee revenue from sales and servicing of the loans. During 2018 and 2017, we sold $79.3 million and $78.8 million of 1-4 family mortgages to Fannie Mae. In addition, at December 31, 2018, we were servicing $473.2 million of mortgage loans that we had originated and sold into the secondary market, compared to $441.0 million at December 31, 2017.

Table of Contents

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

We also offer a variety of unsecured and secured consumer loan products. LTV guidelines for direct loans are generally 90-100 percent of invoice for new automobiles and 80-90 percent of National Automobile Dealer Association value for used automobiles.

The following table presents the maturity of consumer and commercial loans outstanding as of December 31, 2018:

	Maturity			
(dollars in thousands)	Within One Year	After One But Within Five Years	After Five Years	Total
Fixed interest rates	$198,578	$626,954	$387,519	$1,213,051
Variable interest rates	935,982	1,089,286	1,434,126	3,459,394
Total Commercial Loans	$1,134,560	$1,716,240	$1,821,645	$4,672,445
Fixed interest rates	61,677	195,617	303,966	561,260
Variable interest rates	365,912	62,403	284,628	712,943
Total Consumer Loans	$427,589	$258,020	$588,594	$1,274,203
Total Portfolio Loans	$1,562,149	$1,974,260	$2,410,239	$5,946,648

Credit Quality

On a quarterly basis, a criticized asset meeting is held to monitor all special mention and substandard loans greater than $1.5 million. These loans typically represent the highest risk of loss to us. Action plans are established and these loans are monitored through regular contact with the borrower, review of current financial information and other documentation, review of all loan or potential loan restructures or modifications and the regular re-evaluation of assets held as collateral.

Additional credit risk management practices include periodic review and update of our lending policies and procedures to support sound underwriting practices and portfolio management through portfolio stress testing. During 2018, we strengthened our portfolio monitoring process to include an annual review of all commercial loans greater than $1.5 million. Commercial loans less than $1.5 million are monitored through portfolio management software that identifies credit risk indicators. Our Loan Review process serves to independently monitor credit quality and assess the effectiveness of credit risk management practices to provide oversight of all corporate lending activities. The Loan Review function has the primary responsibility for assessing commercial credit administration and credit decision functions of consumer and mortgage underwriting, as well as providing input to the loan risk rating process.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Nonperforming assets, or NPAs, consist of nonaccrual loans, nonaccrual TDRs and OREO. The following represents NPAs as of December 31:

(dollars in thousands)	2018	2017	2016	2015	2014
Nonperforming Loans					
Commercial real estate	$10,913	$2,501	$15,526	$5,171	$2,255
Commercial and industrial	2,314	2,449	3,578	7,709	1,266
Commercial construction	13,787	1,460	4,497	7,488	105
Residential mortgage	5,585	3,580	4,850	4,964	1,877
Home equity	2,349	2,736	2,485	2,379	1,497
Installment and other consumer	37	62	101	12	21
Consumer construction	—	—	—	—	—
Total Nonperforming Loans	34,985	12,788	31,037	27,723	7,021
Nonperforming Troubled Debt Restructurings					
Commercial real estate	1,139	967	646	3,548	2,180
Commercial and industrial	6,646	3,197	4,493	1,570	356
Commercial construction	406	2,413	430	1,265	1,869
Residential mortgage	1,543	3,585	5,068	665	459
Home Equity	1,349	979	954	523	562
Installment and other consumer	5	9	7	88	10
Total Nonperforming Troubled Debt Restructurings	11,088	11,150	11,598	7,659	5,436
Total Nonperforming Loans	46,073	23,938	42,635	35,382	12,457
OREO	3,092	469	679	354	166
Total Nonperforming Assets	$49,165	$24,407	$43,314	$35,736	$12,623
Nonperforming loans as a percent of total loans	0.77 %	0.42 %	0.76 %	0.70 %	0.32 %
Nonperforming assets as a percent of total loans plus OREO	0.83 %	0.42 %	0.77 %	0.71 %	0.33 %

Our policy is to place loans in all categories in nonaccrual status when collection of interest or principal is doubtful, or generally when interest or principal payments are 90 days or more past due. There were no loans 90 days or more past due and still accruing at December 31, 2018 or December 31, 2017.

NPAs increased $24.8 million to $49.2 million at December 31, 2018 compared to $24.4 million at December 31, 2017. New nonperforming loan formation was $28.4 million for 2018 compared to $1.2 million for 2017. The increase in nonperforming loans related mainly to the reclassification of loans in the fourth quarter of 2018 including an $11.5 construction loan, a $7.7 million CRE loan and a $4.4 million C&I loan. OREO increased $2.6 million related to two land lots that are no longer intended to be future branch locations.

TDRs are loans where we, for economic or legal reasons related to a borrower's financial difficulties, grant a concession to the borrower that we would not otherwise grant. We strive to identify borrowers in financial difficulty early and work with them to modify the terms before their loan reaches nonaccrual status. These modified terms generally include extensions of maturity dates at a stated interest rate lower than the current market rate for a new loan with similar risk characteristics, reductions in contractual interest rates or principal deferment. While unusual, there may be instances of principal forgiveness. These modifications are generally for longer term periods that would not be considered insignificant. Additionally, we classify loans where the debt obligation has been discharged through a Chapter 7 bankruptcy and not reaffirmed by the borrower as TDRs.

An accruing loan that is modified into a TDR can remain in accrual status if, based on a current credit analysis, collection of principal and interest in accordance with the modified terms is reasonably assured, and the borrower has demonstrated sustained historical repayment performance for a reasonable period before the modification. All TDRs are considered to be impaired loans and will be reported as impaired loans for their remaining lives, unless the restructuring agreement specifies an interest rate equal to or greater than the rate that would be accepted at the time of the restructuring for a new loan with comparable risk and we fully expect that the remaining principal and interest will be collected according to the restructured agreement. For all TDRs, regardless of size, as well as all other impaired loans, we conduct further analysis to determine the probable loss and assign a specific reserve to the loan if deemed appropriate. Further, all impaired loans are reported as nonaccrual loans unless the loan is a TDR that has met the requirements to be returned to accruing status. TDRs can be returned to accruing status if the ultimate collectability of all contractual amounts due, according to the restructured agreement, is not in doubt and there is a period of a minimum of six months of satisfactory payment performance by the borrower either immediately before or after the restructuring.

As an example, consider a substandard commercial construction loan that is currently 90 days past due where the loan is restructured to extend the maturity date for a period longer than would be considered an insignificant period of time. The post-modification interest rate given to the borrower is considered to be lower than the current market rate for new debt with similar risk and all other terms remain the same according to the original loan agreement. This loan will be considered a TDR as the borrower is experiencing financial difficulty and a concession has been granted due to the long extension, resulting in payment delay as well as the rate being lower than the current market rate for new debt with similar risk. The loan will be reported as nonaccrual TDR and an impaired loan. In addition, the loan could be charged down to the fair value of the collateral if a confirmed loss exists. If the loan subsequently performs, by means of making on-time principal and interest payments according to the newly restructured terms for a period of six months, and it is expected that all remaining principal and interest will be collected according to the terms of the restructured agreement, the loan will be returned to accrual status and reported as an accruing TDR. The loan will remain an impaired loan for the remaining life of the loan because the interest rate was not adjusted to be equal to or greater than the rate that would be accepted at the time of the restructuring for a new loan with comparable risk.

TDRs increased $1.8 million to $27.9 million at December 31, 2018 compared to $26.1 million at December 31, 2017. The $27.9 million of TDRs at December 31, 2018 included $16.8 million of TDRS that were performing and $11.1 million that were nonperforming. This is an increase from December 31, 2017 when we had $26.1 million in TDRs, including $14.9 million that were performing and $11.2 million that were nonperforming. The increase is primarily due to new TDRs totaling $11.4 million, which were offset by principal reductions and charge-offs.

Loan modifications resulting in new TDRs during 2018 included 46 modifications for $12.7 million compared to 36 modifications for $5.8 million of new TDRs in 2017. Included in the 2018 new TDRs were 29 loans totaling $1.2 million related to Chapter 7 bankruptcy filings that were not reaffirmed, thus resulting in discharged debt, which compares to 26 loans totaling $0.8 million in 2017.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following represents delinquency as of December 31:

	2018			2017			2016			2015			2014		
(dollars in thousands)	Amount	% of Loans		Amount	% of Loans		Amount	% of Loans		Amount	% of Loans		Amount	% of Loans	
90 days or more:															
Commercial real estate	$12,052	0.41	%	$3,468	0.13	%	$16,172	0.65	%	$8,719	0.40	%	$4,435	0.26	%
Commercial and Industrial	8,960	0.60	%	5,646	0.39	%	8,071	0.58	%	9,279	0.74	%	1,622	0.16	%
Commercial construction	14,193	5.52	%	3,873	1.01	%	4,927	1.08	%	8,753	2.12	%	1,974	0.91	%
Residential mortgage	7,128	0.98	%	7,165	1.03	%	9,918	1.41	%	5,629	0.88	%	2,336	0.48	%
Home equity	3,698	0.78	%	3,715	0.76	%	3,439	0.71	%	2,902	0.62	%	2,059	0.49	%
Installment and other consumer	42	0.06	%	71	0.11	%	108	0.16	%	100	0.14	%	31	0.05	%
Consumer construction	—	—	%	—	—	%	—	—	%	—	—	%	—	—	%
Total Loans	$46,073	0.77	%	$23,938	0.42	%	$42,635	0.74	%	$35,382	0.61	%	$12,457	0.22	%
30 to 89 days:															
Commercial real estate	$5,783	0.20	%	$1,131	0.04	%	$2,791	0.11	%	$12,229	0.56	%	$2,871	0.17	%
Commercial and industrial	1,983	0.13	%	866	0.06	%	1,488	0.11	%	2,749	0.22	%	1,380	0.14	%
Commercial construction	—	—	%	2,493	0.65	%	547	0.12	%	3,607	0.87	%	—	—	%
Residential mortgage	2,104	0.29	%	4,414	0.63	%	2,429	0.35	%	2,658	0.42	%	1,785	0.36	%
Home equity	2,712	0.58	%	2,655	0.54	%	1,979	0.41	%	2,888	0.61	%	2,201	0.53	%
Installment and other consumer	223	0.33	%	363	0.54	%	220	0.33	%	352	0.48	%	425	0.65	%
Consumer construction	—	—	%	—	—	%	—	—	%	—	—	%	—	—	%
Loans held for sale	—	—	%	—	—	%	—	—	%	143	—	%	—	—	%
Total Loans	$12,805	0.22	%	$11,922	0.21	%	$9,454	0.16	%	$24,626	0.43	%	$—	0.15	%

Closed-end installment loans, amortizing loans secured by real estate and any other loans with payments scheduled monthly are reported past due when the borrower is in arrears two or more monthly payments. Other multi-payment obligations with payments scheduled other than monthly are reported past due when one scheduled payment is due and unpaid for 30 days or more. We monitor delinquency on a monthly basis, including early stage delinquencies of 30 to 89 days past due for early identification of potential problem loans.

Loans past due 90 days or more increased $22.1 million compared to December 31, 2017 and represented 0.77 percent of total loans at December 31, 2018. The increase related mainly to new loans in the fourth quarter of 2018 including an $11.5 construction loan, a $7.7 million CRE loan and a $4.4 million C&I loan. Loans past due by 30 to 89 days increased $0.9 million and represented 0.22 percent of total loans at December 31, 2018.

Allowance for Loan Losses

We maintain an ALL at a level determined to be adequate to absorb estimated probable credit losses inherent within the loan portfolio as of the balance sheet date, and it is presented as a reserve against loans in the Consolidated Balance Sheets. Determination of an adequate ALL is inherently subjective and may be subject to significant changes from period to period. The methodology for determining the ALL has two main components: evaluation and impairment tests of individual loans and evaluation and impairment tests of certain groups of homogeneous loans with similar risk characteristics.

Our charge-off policy for commercial loans requires that loans and other obligations that are not collectible be promptly charged-off when the loss becomes probable, regardless of the delinquency status of the loan. We may elect to recognize a partial charge-off when management has determined that the value of collateral is less than the remaining investment in the loan. A loan or obligation does not need to be charged-off, regardless of delinquency status, if (i) management has determined there exists sufficient collateral to protect the remaining loan balance and (ii) there exists a strategy to liquidate the collateral. Management may also consider a number of other factors to determine when a charge-off is appropriate. These factors may include, but are not limited to:

- The status of a bankruptcy proceeding;
- The value of collateral and probability of successful liquidation; and/or
- The status of adverse proceedings or litigation that may result in collection.

Consumer unsecured loans and secured loans are evaluated for charge-off after the loan becomes 90 days past due. Unsecured loans are fully charged-off and secured loans are charged-off to the estimated fair value of the collateral less the cost to sell.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The following summarizes our loan charge-off experience for each of the five years presented below:

	Years Ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
ALL Balance at Beginning of Year:	$56,390	$52,775	$48,147	$47,911	$46,255
Charge-offs:					
Commercial real estate	(372)	(2,304)	(3,114)	(2,787)	(2,041)
Commercial and industrial	(8,574)	(4,709)	(6,810)	(5,463)	(1,267)
Commercial construction	(2,630)	(2,571)	(1,877)	(3,321)	(712)
Consumer real estate	(1,319)	(2,274)	(1,657)	(2,167)	(1,200)
Other consumer	(1,694)	(1,638)	(2,103)	(1,528)	(1,133)
Total	(14,589)	(13,496)	(15,561)	(15,266)	(6,353)
Recoveries:					
Commercial real estate	309	810	692	3,545	1,798
Commercial and industrial	1,723	654	722	605	3,647
Commercial construction	1,135	851	21	143	146
Consumer real estate	541	342	433	495	350
Other consumer	492	571	356	326	353
Total	4,200	3,228	2,224	5,114	6,294
Net Charge-offs	(10,389)	(10,268)	(13,337)	(10,152)	(59)
Provision for loan losses	14,995	13,883	17,965	10,388	1,715
ALL Balance at End of Year:	$60,996	$56,390	$52,775	$48,147	$47,911

Net loan charge-offs for 2018 were $10.4 million, or 0.18 percent of average loans, compared to $10.3 million, or 0.18 percent of average loans for 2017. Net loan charge-offs in 2018 were significantly impacted by a $5.2 million loan charge-off in the second quarter of 2018 for a commercial C&I customer arising from a participation loan agreement with a lead bank and other participating banks. The loss resulted from fraudulent activities believed to be perpetrated by one or more executives employed by the borrower and its related entities. During the fourth quarter of 2018, we had an increase in nonperforming loans with an $11.5 construction loan, a $7.7 million CRE loan and a $4.4 million C&I loan. The construction nonperforming loan resulted in a $2.4 million loan charge-off and the CRE loan had a $1.3 million specific reserve for the fourth quarter ended December 31, 2018. Net loan charge-offs for 2017 of $10.3 million included $8.4 million of acquired loan charge-offs and $2.1 million for two originated C&I relationships.

The following table summarizes net charge-offs as a percentage of average loans for the years presented

	2018	2017	2016	2015	2014
Commercial real estate	— %	0.06 %	0.10 %	(0.04)%	0.01 %
Commercial and industrial	0.48 %	0.28 %	0.45 %	0.40 %	(0.26)%
Commercial construction	0.48 %	0.40 %	0.46 %	0.96 %	0.32 %
Consumer real estate	0.07 %	0.16 %	0.11 %	0.17 %	0.09 %
Other consumer	1.79 %	1.54 %	2.69 %	1.37 %	1.19 %
Net charge-offs to average loans outstanding	0.18 %	0.18 %	0.25 %	0.22 %	— %
Allowance for loan losses as a percentage of total portfolio loans	1.03 %	0.98 %	0.94 %	0.96 %	1.24 %
Allowance for loan losses to total nonperforming loans	132 %	236 %	124 %	136 %	385 %
Provision for loan losses as a percentage of net loan charge-offs	144 %	135 %	135 %	102 %	NM

NM - percentage not meaningful

An inherent risk to the loan portfolio as a whole is the condition of the economy in our markets. In addition, each loan segment carries with it risks specific to the segment. We develop and document a systematic ALL methodology based on the following portfolio segments: 1) CRE, 2) C&I, 3) Commercial Construction, 4) Consumer Real Estate and 5)

Other Consumer.
CRE loans are secured by commercial purpose real estate, including both owner-occupied properties and investment properties for various purposes such as hotels, strip malls and apartments. Operations of the individual projects as well as global cash flows of the debtors are the primary sources of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the collateral type as well as the business prospects of the lessee, if the project is not owner-occupied.

C&I loans are made to operating companies or manufacturers for the purpose of production, operating capacity, accounts receivable, inventory or equipment financing. Cash flow from the operations of the company is the primary source of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the industry of the company. Collateral for these types of loans often does not have sufficient value in a distressed or liquidation scenario to satisfy the outstanding debt.

Commercial construction loans are made to finance construction of buildings or other structures, as well as to finance the acquisition and development of raw land for various purposes. While the risk of these loans is generally confined to the construction period, if there are problems, the project may not be completed, and as such, may not provide sufficient cash flow on its own to service the debt or have sufficient value in a liquidation to cover the outstanding principal. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the type of project and the experience and resources of the developer.

Consumer real estate loans are secured by first and second liens such as home equity loans, home equity lines of credit and 1-4 family residential mortgages, including purchase money mortgages. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk of this segment. The state of the local housing markets can also have a significant impact on this segment because low demand and/or declining home values can limit the ability of borrowers to sell a property and satisfy the debt.

Other consumer loans are made to individuals and may be secured by assets other than 1-4 family residences, as well as unsecured loans. This segment includes auto loans, unsecured loans and lines and credit cards. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk for this segment. The value of the collateral, if there is any, is less likely to be a source of repayment due to less certain collateral values.

The following is the ALL balance by portfolio segment as of December 31:

	2018			2017			2016			2015			2014		
(dollars in thousands)	Amount	% of Total		Amount	% of Total		Amount	% of Total		Amount	% of Total		Amount	% of Total	
Commercial real estate	$33,707	55	%	$27,235	48	%	$19,976	38	%	$15,043	31	%	$20,164	42	%
Commercial and industrial	11,596	19	%	8,966	16	%	10,810	20	%	10,853	23	%	13,668	28	%
Commercial construction	7,983	13	%	13,167	23	%	13,999	26	%	12,625	26	%	6,093	13	%
Consumer real estate	6,187	10	%	5,479	10	%	6,095	12	%	8,400	17	%	6,333	13	%
Other consumer	1,523	3	%	1,543	3	%	1,895	4	%	1,226	3	%	1,653	4	%
Total	$60,996	100	%	$56,390	100	%	$52,775	100	%	$48,147	100	%	$47,911	100	%

Significant to our ALL is a higher concentration of commercial loans. The ability of borrowers to repay commercial loans is dependent upon the success of their business and general economic conditions. Due to the greater potential for loss within our commercial portfolio, we monitor the commercial loan portfolio through an internal risk rating system. Loan risk ratings are assigned based upon the creditworthiness of the borrower and are reviewed on an ongoing basis according to our internal policies. Loans rated special mention or substandard have potential or well-defined weaknesses not generally found in high quality, performing loans, and require attention from management to limit loss.

The following table summarizes the ALL balance as of December 31:

(dollars in thousands)	2018	2017	2016	2015	2014
Collectively Evaluated for Impairment	$59,233	$56,313	$51,977	$48,110	$47,857
Individually Evaluated for Impairment	1,763	77	798	37	54
Total Allowance for Loan Losses	$60,996	$56,390	$52,775	$48,147	$47,911

51

The ALL was $61.0 million, or 1.03 percent of total portfolio loans, at December 31, 2018, compared to $56.4 million, or 0.98 percent of total portfolio loans, at December 31, 2017. The increase in the ALL of $4.6 million was primarily due to a $2.9 million increase in the reserve for loans collectively evaluated for impairment and an increase of $1.7 million in specific reserves for loans individually evaluated for impairment at December 31, 2018 compared to December 31, 2017. The increase in loans collectively evaluated for impairment was due to loan downgrades during 2018. Commercial special mention and substandard loans increased $67.7 million to $268.5 million compared to $200.8 million at December 31, 2017, with an increase of $110.5 million in substandard offset by a decrease of $42.8 million in special mention. The increase in substandard loans from December 31, 2017 was mainly due to the receipt of updated financial information from our borrowers that resulted in the loans being downgraded. The increase in specific reserves related to a $1.3 million reserve established for a CRE loan. Impaired loans increased $22.7 million from December 31, 2017 due to three large commercial nonperforming, impaired loans totaling $23.6 million. As of December 31, 2018, we had $49.5 million of impaired loans compared to $26.8 million at December 31, 2017.

Federal Home Loan Bank and Other Restricted Stock

At December 31, 2018 and 2017, we held FHLB of Pittsburgh stock of $28.6 million and $28.4 million. This investment is carried at cost and evaluated for impairment based on the ultimate recoverability of the par value. We hold FHLB stock because we are a member of the FHLB of Pittsburgh. The FHLB requires members to purchase and hold a specified level of FHLB stock based upon on the members' asset values, level of borrowings and participation in other programs offered. Stock in the FHLB is non-marketable and is redeemable at the discretion of the FHLB. Members do not purchase stock in the FHLB for the same reasons that traditional equity investors acquire stock in an investor-owned enterprise. Rather, members purchase stock to obtain access to the products and services offered by the FHLB. Unlike equity securities of traditional for-profit enterprises, the stock of the FHLB does not provide its holders with an opportunity for capital appreciation because, by regulation, FHLB stock can only be purchased, redeemed and transferred at par value. We reviewed and evaluated the FHLB capital stock for OTTI at December 31, 2018. The FHLB reported improved earnings throughout 2018 and 2017 and continues to exceed all capital ratios required. Additionally, we considered that the FHLB has been paying dividends and actively redeeming stock throughout 2018 and 2017. Accordingly, we believe sufficient evidence exists to conclude that no OTTI exists at December 31, 2018.

Atlantic Community Bankers' Bank, or ACBB, stock is carried at cost and evaluated for impairment based on the ultimate recoverability of the carrying value. We do not currently use their membership products and services. We acquired ACBB stock through various mergers of banks that were ACBB members. ACBB stock is evaluated for OTTI on a quarterly basis.

Deposits

The following table presents the composition of deposits at December 31:

(dollars in thousands)	2018	2017	$ Change
Customer deposits			
Noninterest-bearing demand	$1,421,156	$1,387,712	$33,444
Interest-bearing demand	567,492	599,986	(32,494)
Money market	1,178,212	880,330	297,882
Savings	784,970	893,119	(108,149)
Certificates of deposit	1,261,704	1,286,988	(25,284)
Total customer deposits	5,213,533	5,048,135	165,399
Brokered deposits			
Interest-bearing demand	6,201	3,155	3,046
Money market	303,854	265,826	38,028

Certificates of deposit	150,334	110,775	39,559
Total brokered deposits	$460,389	$379,756	$80,633
Total Deposits	$5,673,922	$5,427,891	$246,032

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Deposits are our primary source of funds. We believe that our deposit base is stable and that we have the ability to attract new deposits. Total deposits at December 31, 2018 increased $246.0 million, or 4.5 percent, from December 31, 2017. Total customer deposits increased $165.4 million from December 31, 2017. Noninterest-bearing demand deposits increased $33.4 million and money market increased $297.9 million. The increase in money market deposits is related to a competitively-priced, indexed product. These increases were offset by declines in interest-bearing demand deposits of $32.5 million, savings deposits of $108.1 million, and certificates of deposits of $25.3 million. These decreases were a mainly a result of migration into the indexed money market product. Total brokered deposits increased $80.6 million from December 31, 2017. Brokered deposits are an additional source of funds utilized by ALCO as a way to diversify funding sources, as well as manage our funding costs and structure.
The daily average balance of deposits and rates paid on deposits are summarized in the following table for the years ended December 31:

	2018		2017		2016	
(dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing demand	$1,376,329		$1,310,814		$1,232,633	
Interest-bearing demand	565,273	0.31 %	630,418	0.21 %	638,461	0.16