

ITC Holdings Corp.  
Form 10-Q  
August 07, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**(Mark One)**

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

**For the Quarterly Period Ended June 30, 2008**

**OR**

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

**Commission File Number: 001-32576  
ITC HOLDINGS CORP.**

(Exact Name of Registrant as Specified in Its Charter)

**Michigan**

(State or Other Jurisdiction of  
Incorporation or Organization)

**32-0058047**

(I.R.S. Employer Identification No.)

**27175 Energy Way  
Novi, MI 48377**

(Address Of Principal Executive Offices, Including Zip Code)

**(248) 946-3000**

(Registrant's Telephone Number, Including Area Code)

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

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

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

The number of shares of the Registrant's Common Stock, without par value, outstanding as of August 1, 2008 was 49,471,125.

**ITC Holdings Corp.**  
**Form 10-Q for the Quarterly Period Ended June 30, 2008**  
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**DEFINITIONS**

Unless otherwise noted or the context requires, all references in this report to:

*ITC Holdings Corp. and its subsidiaries*

ITC Grid Development are references to ITC Grid Development, LLC, a wholly-owned subsidiary of ITC Holdings;

ITC Holdings are references to ITC Holdings Corp. and not any of its subsidiaries;

ITC Midwest are references to ITC Midwest LLC, a wholly-owned subsidiary of ITC Holdings;

ITCTransmission are references to International Transmission Company, a wholly-owned subsidiary of ITC Holdings;

METC are references to Michigan Electric Transmission Company, LLC, an indirect, wholly-owned subsidiary of ITC Holdings;

Regulated Operating Subsidiaries are references to ITCTransmission, METC, and ITC Midwest together; and

We, our and us are references to ITC Holdings together with all of its subsidiaries.

*Other definitions*

Consumers Energy are references to Consumers Energy Company, a wholly-owned subsidiary of CMS Energy Corporation;

Detroit Edison are references to The Detroit Edison Company, a wholly-owned subsidiary of DTE Energy Company;

FERC are references to the Federal Energy Regulatory Commission;

IP&L are references to Interstate Power and Light Company, an Alliant Energy Corporation subsidiary;

IUB are references to the Iowa Utilities Board;

kV are references to kilovolts (one kilovolt equaling 1,000 volts);

kW are references to kilowatts (one kilowatt equaling 1,000 watts);

MISO are references to the Midwest Independent Transmission System Operator, Inc., a FERC-approved regional transmission organization, which oversees the operation of the bulk power transmission system for a substantial portion of the Midwestern United States and Manitoba, Canada, and of which ITCTransmission, METC and ITC Midwest are members;

MW are references to megawatts (one megawatt equaling 1,000,000 watts); and

NERC are references to the North American Electric Reliability Corporation.

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ITC HOLDINGS CORP. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)**

(in thousands, except share data)	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 13,400	\$ 2,616
Accounts receivable	55,854	40,919
Inventory	22,786	26,315
Deferred income taxes	12,910	2,689
Other	5,876	3,518
Total current assets	110,826	76,057
<b>Property, plant and equipment</b> (net of accumulated depreciation and amortization of \$898,729 and \$879,843, respectively)	2,114,617	1,960,433
<b>Other assets</b>		
Goodwill	960,071	959,042
Intangible assets (net of accumulated amortization of \$4,537 and \$3,025, respectively)	53,870	55,382
Regulatory assets- acquisition adjustments	83,359	86,054
Regulatory assets- Attachment O revenue accrual (including accrued interest of \$1,141 and \$552, respectively)	72,492	20,537
Other regulatory assets	29,732	29,449
Deferred financing fees (net of accumulated amortization of \$6,981 and \$5,138, respectively)	20,656	14,201
Other	21,441	12,142
Total other assets	1,241,621	1,176,807
<b>TOTAL ASSETS</b>	<b>\$ 3,467,064</b>	<b>\$ 3,213,297</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 63,493	\$ 47,627
Accrued payroll	7,915	8,928
Accrued interest	37,970	23,088
Accrued taxes	22,647	15,065
ITC Midwest's asset acquisition additional purchase price accrual	4,960	5,402
Refundable deposits from generators for transmission network upgrades	9,902	2,352
Other	3,811	3,965
Total current liabilities	150,698	106,427
<b>Accrued pension and postretirement liabilities</b>	<b>16,515</b>	<b>13,934</b>
<b>Deferred income taxes</b>	<b>135,917</b>	<b>90,617</b>
<b>Regulatory liabilities</b>	<b>193,500</b>	<b>189,727</b>

<b>Other</b>	4,490	6,093
<b>Long-term debt</b>	2,065,652	2,243,424
<b>STOCKHOLDERS EQUITY</b>		
Common stock, without par value, 100,000,000 shares authorized, 49,463,885 and 42,916,852 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	843,777	532,103
Retained earnings	57,375	31,864
Accumulated other comprehensive loss	(860)	(892)
Total stockholders equity	900,292	563,075
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,467,064</b>	<b>\$ 3,213,297</b>

See notes to condensed consolidated financial statements (unaudited).

**Table of Contents****ITC HOLDINGS CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

(in thousands, except share and per share data)	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
<b>OPERATING REVENUES</b>	\$ 160,616	\$ 106,303	\$ 302,530	\$ 207,577
<b>OPERATING EXPENSES</b>				
Operation and maintenance	32,902	21,503	54,357	40,043
General and administrative	21,361	12,203	39,343	27,226
Depreciation and amortization	23,446	16,711	45,770	32,833
Taxes other than income taxes	10,313	8,066	21,198	16,836
Gain on sale of asset	(1,445)		(1,445)	
Total operating expenses	86,577	58,483	159,223	116,938
<b>OPERATING INCOME</b>	74,039	47,820	143,307	90,639
<b>OTHER EXPENSES (INCOME)</b>				
Interest expense	29,946	19,940	60,716	39,072
Allowance for equity funds used during construction	(2,284)	(1,613)	(5,380)	(2,853)
Loss on extinguishment of debt				349
Other income	(552)	(1,018)	(1,062)	(1,720)
Other expense	597	336	1,434	669
Total other expenses (income)	27,707	17,645	55,708	35,517
<b>INCOME BEFORE INCOME TAXES</b>	46,332	30,175	87,599	55,122
<b>INCOME TAX PROVISION</b>	17,671	10,176	33,417	18,268
<b>NET INCOME</b>	\$ 28,661	\$ 19,999	\$ 54,182	\$ 36,854
Basic earnings per share	\$ 0.58	\$ 0.47	\$ 1.13	\$ 0.87
Diluted earnings per share	\$ 0.57	\$ 0.46	\$ 1.10	\$ 0.85
Weighted-average basic shares	49,002,365	42,269,646	48,153,011	42,180,993
Weighted-average diluted shares	50,205,625	43,424,029	49,355,024	43,432,526
Dividends declared per common share	\$ 0.290	\$ 0.275	\$ 0.580	\$ 0.550

See notes to condensed consolidated financial statements (unaudited).

**Table of Contents****ITC HOLDINGS CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

<b>(in thousands)</b>	<b>Six months ended</b>	
	<b>2008</b>	<b>June 30, 2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 54,182	\$ 36,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	45,770	32,833
Attachment O revenue accrual including accrued interest	(51,946)	(23,541)
Deferred income tax expense	32,564	18,268
Allowance for equity funds used during construction	(5,380)	(2,853)
Stock-based compensation expense	3,220	1,622
Amortization of loss on reacquired debt, deferred financing fees and debt discounts	3,075	2,190
Other	(1,435)	(76)
Changes in assets and liabilities, exclusive of changes shown separately:		
Accounts receivable	(13,623)	(14,703)
Inventory	1,783	(10,256)
Other current assets	(2,358)	5,893
Accounts payable	15,969	14,922
Accrued interest	14,882	727
Accrued taxes	7,582	1,513
Other current liabilities	(1,502)	(5,599)
Non-current assets and liabilities, net	(1,639)	1,288
Net cash provided by operating activities	101,144	59,082
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(193,793)	(148,162)
ITC Midwest's asset acquisition direct fees	(981)	(1,459)
Other	1,445	926
Net cash used in investing activities	(193,329)	(148,695)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of long-term debt	657,782	
Borrowings under ITC Holdings' Term Loan Agreement		25,000
Repayment of long-term debt	(765,000)	
Borrowings under revolving credit agreements	282,500	293,300
Repayments of revolving credit agreements	(353,200)	(209,600)
Issuance of common stock	309,427	1,759
Common stock issuance costs	(755)	(5)
Dividends on common stock	(28,662)	(23,363)
Repurchase and retirement of common stock		(1,841)
Debt issuance costs	(5,409)	(565)
Refundable deposits from generators for transmission network upgrades	6,286	
Net cash provided by financing activities	102,969	84,685
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>10,784</b>	<b>(4,928)</b>
<b>CASH AND CASH EQUIVALENTS Beginning of period</b>	<b>2,616</b>	<b>13,426</b>



<b>CASH AND CASH EQUIVALENTS</b>	<b>End of period</b>	\$ 13,400	\$ 8,498
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See notes to condensed consolidated financial statements (unaudited).

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**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****1. GENERAL**

These condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements as of and for the period ended December 31, 2007 included in ITC Holdings Form 10-K for such period.

The accompanying condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America ( GAAP ) and with the instructions to Form 10-Q and Rule 10-01 of Securities and Exchange Commission ( SEC ) Regulation S-X as they apply to interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These accounting principles require us to use estimates and assumptions that impact the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from our estimates.

The condensed consolidated financial statements are unaudited, but in our opinion include all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the results for the interim period. The interim financial results are not necessarily indicative of results that may be expected for any other interim period or the fiscal year.

**Supplementary Cash Flows Information**

<b>(in thousands)</b>	<b>Six months ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
Supplementary cash flows information:		
Interest paid (excluding interest capitalized)	\$42,758	\$36,505
Income taxes paid	1,314	2,058
Supplementary noncash investing and financing activities:		
Additions to property, plant and equipment (a)	35,772	26,472
Allowance for equity funds used during construction	5,380	2,853

(a) Amounts consist primarily of current liabilities for construction labor and materials that have not been included in investing activities. These amounts have not been paid for as of June 30, 2008 or 2007, respectively, but have been or will be included as a cash outflow from

investing  
activities for  
expenditures for  
property, plant  
and equipment  
when paid.

### Comprehensive Income

Comprehensive income is the change in stockholders' equity during a period from transactions and other events and circumstances from non-owner sources.

Comprehensive income includes the following components:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Net income	\$ 28,661	\$ 19,999	\$ 54,182	\$ 36,854
Amortization of interest rate lock cash flow hedges, net of tax of \$9 for the three months ended June 30, 2008 and 2007, respectively, and net of tax of \$17 for the six months ended June 30, 2008 and 2007, respectively	16	16	32	32
Comprehensive income	\$ 28,677	\$ 20,015	\$ 54,214	\$ 36,886

**Table of Contents****2. RECENT ACCOUNTING PRONOUNCEMENTS****FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities**

In June 2008, the Financial Accounting Standards Board (the FASB) issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities as defined in EITF 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128*, and therefore should be included in computing earnings per share using the two-class method. According to FSP EITF 03-6-1, a share-based payment award is a participating security when the award includes non-forfeitable rights to dividends or dividend equivalents. The rights result in a non-contingent transfer of value each time an entity declares a dividend or dividend equivalent during the award's vesting period. FSP EITF 03-6-1 is effective for us beginning January 1, 2009. Upon adoption, FSP EITF 03-6-1 requires an entity to retroactively adjust all prior period earnings-per-share computations to reflect the FSP's provisions. We have share-based payment awards that include non-forfeitable rights to dividends and we are evaluating the future impact of FSP EITF 03-6-1 on our earnings-per-share computations.

**Statement of Financial Accounting Standards No. 141(R), Business Combinations**

Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (SFAS 141(R)) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of SFAS 141(R) will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration), exclude transaction costs from acquisition accounting and require expense recognition for these costs and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS 141(R) is effective for us for business combinations occurring beginning January 1, 2009 and for adjustments to an acquired entity's deferred tax asset and liability balances occurring beginning January 1, 2009. We are evaluating the future impact of SFAS 141(R).

**Statement of Financial Accounting Standards No. 157, Fair Value Measurements**

Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. We have adopted SFAS 157 and FASB Staff Position FAS157-2: *Effective Date of FASB Statement No. 157* effective January 1, 2008. The adoption of SFAS 157 for financial instruments as required at January 1, 2008 did not have a material effect on our consolidated financial statements; however, we are required to provide additional disclosure as part of our consolidated financial statements. We will adopt SFAS 157 for non-financial assets and non-financial liabilities, such as goodwill and other intangible assets held by us and measured annually for impairment testing purposes only, on January 1, 2009 as required and do not expect the provisions to have a material effect on our consolidated financial statements.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of June 30, 2008, we held certain assets that are required to be measured at fair value on a recurring basis. These consist of investments recorded within other long-term assets, including investments held in trust associated with our nonqualified, noncontributory, supplemental retirement benefit plans for selected management and employees that are classified as trading securities under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investments consist primarily of mutual funds and debt and equity securities that are publicly traded and for which market prices are readily available.

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Our assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at June 30, 2008, were as follows:

	Fair Value Measurements at Reporting Date Using		
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(in thousands)			
Trading securities	\$ 6,285	\$	\$

**Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)**

Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ( SFAS 158 ), requires the recognition of the funded status of a defined benefit plan in the statement of financial position as other comprehensive income. Additionally, SFAS 158 requires that changes in the funded status be recognized through comprehensive income, requires the measurement date for defined benefit plan assets and obligations to be the entity's fiscal year-end and expands disclosures. Upon adoption of SFAS 158 we applied the provisions of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* and the amounts that otherwise would have been charged and or credited to accumulated other comprehensive income associated with Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions* ( SFAS 87 ), and Statement of Financial Accounting Standards No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* ( SFAS 106 ), are recorded as a regulatory asset or liability because as the unrecognized amounts recorded to this regulatory asset are recognized through SFAS 87 and SFAS 106 expenses, under forward-looking Attachment O, they will be recovered from customers in future rates.

Under the provisions of SFAS 158, we recognized the funded status of our defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of the SFAS 158 funded status recognition and disclosure provisions did not have an impact on our condensed consolidated results of operations or cash flows.

Under the measurement date requirements of SFAS 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position. Historically, we have measured our plan assets and obligations as of a date three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. In 2008, we are required to adopt the change in measurement date by allocating as an adjustment to retained earnings three-fifteenths of net periodic benefit cost as determined for the period from September 30, 2007 to December 31, 2008, pursuant to the transition requirements of SFAS 158. We expect this to result in a decrease in other long-term assets of \$0.3 million, an increase in total liabilities of \$0.5 million (consisting of a \$0.9 million increase in accrued pension and postretirement liabilities offset by a \$0.4 million decrease in deferred income tax liabilities) and a \$0.8 million (net of tax of a \$0.4 million) decrease in retained earnings, which we expect to record in the fourth quarter of 2008. The remaining twelve-fifteenths of net periodic benefit cost of \$4.6 million will be recognized during the fiscal year ending December 31, 2008.

**Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities**

Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ), was issued in February 2007. SFAS 159 allows entities to measure at fair value many financial instruments and certain other assets and liabilities that are not otherwise required to be measured at fair value. SFAS 159 was effective for us beginning January 1, 2008. The adoption of this statement did not have a

material effect on our consolidated financial statements.

**Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133**

Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* ( SFAS 161 ) amends and expands the disclosure requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ), by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an

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entity's financial position, financial performance, and cash flows. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 will be effective for us as of January 1, 2009. The adoption of this standard will not have a material impact on our consolidated financial statements because SFAS 161 provides only for disclosure requirements.

**Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles**

Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162), was issued in May 2008. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS 162 will become effective for us 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The adoption of this standard is not expected to have a material impact on our consolidated financial statements.

**3. ACQUISITIONS, GOODWILL AND INTANGIBLE ASSETS****ITC Midwest's Acquisition of IP&L Transmission Assets**

On December 20, 2007, ITC Midwest acquired the electric transmission assets of IP&L, for \$783.1 million, excluding fees, expenses and purchase price adjustments, pursuant to an asset sale agreement, dated January 18, 2007, with IP&L (the *Asset Sale Agreement*). The purchase price is subject to several purchase price adjustment provisions relating to liabilities actually assumed by ITC Midwest and the actual rate base, construction work in progress and other asset or liability balances actually transferred to ITC Midwest by IP&L on December 20, 2007.

ITC Midwest's asset acquisition was accounted for as an acquisition of a group of assets that constitutes a business under the provisions of Statement of Financial Accounting Standards No. 141, *Business Combinations*. As of June 30, 2008, the purchase price and purchase price allocation has not been finalized. At June 30, 2008, ITC Midwest has recorded \$5.0 million in current liabilities for additional purchase price estimated to be paid relating to certain revisions to the original estimated assets acquired and liabilities assumed. We had recorded an estimate of \$5.4 million in current liabilities for additional purchase price to be paid at December 31, 2007.

ITC Midwest also incurred \$12.3 million for professional services and other direct acquisition costs in connection with the acquisition, resulting in an aggregate estimated purchase price of \$800.4 million as of June 30, 2008. ITC Midwest had recorded an estimate of \$11.7 million of professional services and other direct acquisition costs at December 31, 2007. The additional \$0.6 million of direct acquisition costs recorded during the six months ended June 30, 2008 are included in the aggregate purchase price and resulted in an increase in goodwill.

In addition, as a condition of the *Asset Sale Agreement* we assumed \$1.7 million of prior service obligations for participants who transferred from IP&L to us for postretirement benefits. As of December 31, 2007, we had not recorded a liability for these obligations as they were expected to be fully funded by IP&L. However, during the first quarter of 2008, IP&L only paid us \$1.3 million associated with these obligations based on their obligations under the *Asset Sale Agreement*. The difference of \$0.4 million resulted in an increase to goodwill during the six months ended June 30, 2008.

**Intangible Assets**

We have identified intangible assets with finite lives as a result of the METC acquisition in 2006. During both the six months ended June 30, 2008 and 2007, we recognized \$1.5 million of amortization expense of our intangible assets and we expect to amortize \$3.0 million of our intangible assets per year over the five years from 2008 through 2012, and \$40.4 million thereafter.

**Table of Contents****4. REGULATORY MATTERS****Attachment O Network Transmission Rates**

Attachment O is a FERC-approved cost of service formula rate template that is completed annually by most transmission owning members of MISO, including each of our Regulated Operating Subsidiaries. Rates are generally set annually under Attachment O and remain in effect for a one-year period. Rates derived using Attachment O are posted on the MISO Open Access Same-Time Information System each year. The information used to complete the Attachment O template is subject to verification by MISO. By completing the Attachment O template on an annual basis, our Regulated Operating Subsidiaries are able to adjust their transmission rates to reflect changing operational data and financial performance, including the amount of network load on their transmission systems, operating expenses and additions to property, plant and equipment when placed in service, among other items.

Because Attachment O is a FERC-approved formula rate, no further action or FERC filings are required for the calculated rates to go into effect, although the rate is subject to legal challenge at the FERC. Attachment O will be used by our Regulated Operating Subsidiaries to calculate their respective annual revenue requirements until and unless it is determined by the FERC to be unjust and unreasonable or another mechanism is determined by the FERC to be just and reasonable.

***Forward-Looking Attachment O***

On July 14, 2006 and December 21, 2006, the FERC authorized ITCTransmission and METC, respectively, to modify the implementation of their Attachment O formula rates so that, beginning January 1, 2007, ITCTransmission and METC recover expenses and earn a return on and recover investments in property, plant and equipment on a current rather than a lagging basis. As part of the FERC order dated December 3, 2007 approving ITC Midwest's asset acquisition, the FERC approved ITC Midwest's request for the use of a forward-looking Attachment O. The compliance filing we made for ITC Midwest's forward-looking Attachment O is pending at FERC.

Under the forward-looking Attachment O formula, our Regulated Operating Subsidiaries use forecasted expenses, additions to in-service property, plant and equipment, point-to-point revenues, network load and other items for the upcoming calendar year to establish rates for service on their systems from January 1 to December 31 of that year. The forward-looking Attachment O formula includes a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual net revenue requirements to their billed revenues for each year.

The true-up mechanism under forward-looking Attachment O meets the requirements of Emerging Issues Task Force Issue No. 92-7, *Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs*, ( EITF 92-7 ). Accordingly, revenue is recognized for services provided during each reporting period based on actual net revenue requirements calculated using forward-looking Attachment O. Beginning January 1, 2007, ITCTransmission and METC accrued or deferred revenues to the extent that the actual net revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. The true-up amount is automatically reflected in customer bills within two years under the provisions of forward-looking Attachment O.

For the period from December 20, 2007 through December 31, 2007, ITC Midwest's Attachment O method in effect did not contain a true-up mechanism, and there was no adjustment recognized for billed amounts that differed from actual net revenue requirement. Beginning January 1, 2008, under forward-looking Attachment O, ITC Midwest recovers its expenses and earns a return on and recovers investments in transmission property, plant and equipment on a current rather than a lagging basis and includes a true-up mechanism.

**Long Term Pricing**

In November 2004, in FERC Docket No. EL02-111 et al., the FERC approved a pricing structure to facilitate seamless trading of electricity between MISO and PJM Interconnection, a Regional Transmission Organization that borders MISO. The order establishes a Seams Elimination Cost Adjustment ( SECA ), as set forth in previous FERC orders, that took effect December 1, 2004, and remained in effect until March 31, 2006 as a transitional pricing mechanism. Prior to December 1, 2004, ITCTransmission and METC earned revenues for transmission of electricity between MISO and PJM Interconnection based on a regional through-and-out rate administered by MISO.



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From December 1, 2004 through March 31, 2006, we recorded \$2.5 million of gross SECA revenue based on an allocation of these revenues by MISO as a result of the FERC order approving this transitional pricing mechanism. Subsequent to the first quarter of 2006, we no longer earn SECA revenues. The SECA revenues were subject to refund as described in the FERC order and this matter was litigated in a contested hearing before the FERC that concluded on May 18, 2006. An initial decision was issued by the Administrative Law Judge presiding over the hearings on August 10, 2006, which generally indicated that the SECA revenues resulted from unfair, unjust and preferential rates. The judge's decision is subject to the FERC's final ruling on the matter, which could differ from the initial decision. Notwithstanding the judge's initial decision, ITC Transmission, METC and other transmission owners who collected SECA amounts and certain counterparties that paid SECA amounts have filed settlement agreements with the FERC. As of June 30, 2008, ITC Transmission and METC have reserves recorded of \$0.6 million and \$0.4 million, respectively, as estimates of the amounts to be refunded to the counterparties that have filed settlement agreements with the FERC. For the counterparties who have not filed settlements with the FERC, we are not able to estimate whether any refunds of amounts earned by ITC Transmission or METC will result from this hearing or whether this matter will otherwise be settled, but we do not expect the resolution of this matter to have a material impact on our consolidated financial statements. We have not accrued any refund amounts relating to these counterparties who have not filed settlements with the FERC.

**5. LONG-TERM DEBT****ITC Midwest's Asset Acquisition Debt Financing*****ITC Holdings Bridge Facility***

ITC Holdings received a commitment letter, dated January 18, 2007, from a bank (the *Lead Arranger*) to provide to ITC Holdings, subject to the terms and conditions therein, financing in an aggregate amount of up to \$765.0 million in the form of a 364-day senior unsecured bridge facility (the *Bridge Facility*). Among other fees paid on the Bridge Facility, ITC Holdings paid a funding fee equal to 0.375% of the aggregate amount of the loans borrowed (the *Funding Fee*). The Funding Fee was rebated in full in January 2008 as a result of the Bridge Facility being refinanced with the Lead Arranger within the specified time period, and was applied as a reduction to the issuance costs of ITC Midwest's asset acquisition financings. The borrowings under the Bridge Facility accrued interest at 5.56% and total interest expense recognized in 2008 was \$2.7 million. The proceeds from the Bridge Facility were used to finance a significant portion of ITC Midwest's asset acquisition.

In January 2008, we repaid in full all amounts outstanding under the Bridge Facility using the proceeds of ITC Holdings' \$385.0 million Senior Notes, ITC Midwest's \$175.0 million First Mortgage Bonds, Series A and the issuance of 6,420,737 shares of ITC Holdings' common stock for proceeds of \$308.3 million, net of underwriting discount. The terms of the ITC Holdings Senior Notes and ITC Midwest First Mortgage Bonds are discussed below.

***ITC Holdings Senior Notes***

On January 24, 2008, ITC Holdings issued \$385.0 million aggregate principal amount of its 6.050% Senior Notes due January 31, 2018 under its first mortgage indenture, dated as of December 10, 2003 in a private placement in reliance on exemptions from registration under the Securities Act of 1933. The senior notes were sold by ITC Holdings to various initial purchasers pursuant to a purchase agreement dated January 15, 2008. The proceeds were used to partially pay off the balance of the Bridge Facility.

***ITC Midwest First Mortgage Bonds***

On January 24, 2008, ITC Midwest issued \$175.0 million aggregate principal amount of its 6.150% First Mortgage Bonds, Series A, due January 31, 2038 (*Series A Bonds*).

The Series A Bonds are secured by a first mortgage lien on substantially all of ITC Midwest's real and tangible personal property equally with all other securities issued in the future under its First Mortgage and Deed of Trust, with such exceptions as described in, and such releases as permitted by, the indenture. The proceeds were used to partially pay off the balance of the Bridge Facility.

**Table of Contents****ITCTransmission First Mortgage Bonds**

On April 1, 2008, ITCTransmission issued \$100.0 million aggregate principal amount of its 5.75% First Mortgage Bonds, Series D, due April 18, 2018 ( Series D Bonds ). The Series D Bonds are issued under ITCTransmission's First Mortgage and Deed of Trust, and therefore have the benefit of a first mortgage lien on substantially all of ITCTransmission's property. The proceeds were primarily used to pay off amounts outstanding under the ITCTransmission/METC Revolving Credit Agreement.

**Revolving Credit Agreements*****ITC Holdings Revolving Credit Agreement***

At June 30, 2008, ITC Holdings had no amounts outstanding under the ITC Holdings Revolving Credit Agreement.

***ITCTransmission/METC Revolving Credit Agreement***

At June 30, 2008, ITCTransmission and METC had \$8.9 million and \$40.5 million, respectively, outstanding under the ITCTransmission/METC Revolving Credit Agreement and the weighted-average interest rates of borrowings outstanding under the agreement at June 30, 2008 were 2.8% and 3.0%, respectively. On April 1, 2008, we repaid the outstanding balance of \$91.1 million at ITCTransmission using the proceeds from the Series D Bonds issuance.

***ITC Midwest Revolving Credit Agreement***

At June 30, 2008, ITC Midwest had \$22.4 million outstanding under the ITC Midwest Revolving Credit Agreement and the weighted-average interest rate of borrowings outstanding under the facility at June 30, 2008 was 3.0%.

**6. EQUITY****ITC Holdings Sales Agency Financing Agreement**

On June 27, 2008, ITC Holdings entered into a Sales Agency Financing Agreement (the SAFE Agreement ) with BNY Mellon Capital Markets, LLC ( BNYMCM ). Under the terms of the SAFE Agreement, ITC Holdings may issue and sell shares of common stock, without par value, from time to time, up to an aggregate sales price of \$150.0 million. The terms of the SAFE Agreement will be for a period of up to three years subject to continued approval from the FERC authorizing ITC Holdings to issue equity. BNYMCM will act as ITC Holdings' agent in connections with any offerings of shares under the SAFE Agreement. The shares of common stock may be offered in one or more selling periods, none of which will exceed 20 trading days. Any shares of common stock sold under the SAFE Agreement will be offered at market prices prevailing at the time of sale. Moreover, ITC Holdings will specify to BNYMCM (i) the aggregate selling price of the shares of common stock to be sold during each selling period, which may not exceed \$40.0 million without BNYMCM's prior written consent and (ii) the minimum price below which sales may not be made, which may not be less than \$10.00 per share without BNYMCM's prior written consent. ITC Holdings will pay BNYMCM a commission equal to 1% of the sales price of all shares of common stock sold through it as agent under the SAFE Agreement plus expenses. The shares will be issued pursuant to ITC Holdings' automatic shelf registration statement on Form S-3 (File No. 333-140026) filed on January 17, 2007 with the SEC.

**Public Securities Offering**

On January 24, 2008, ITC Holdings completed an underwritten public offering of its common stock. ITC Holdings sold 6,420,737 newly-issued common shares in the offering, which resulted in proceeds of \$308.3 million (net of underwriting discount of \$13.7 million and before issuance costs of \$0.8 million). The proceeds from this offering were used to partially finance ITC Midwest's asset acquisition described in Note 3.

**Options**

We issued 92,072 and 351,172 shares of our common stock during the six months ended June 30, 2008 and the year ended December 31, 2007, respectively, due to the exercise of stock options.

**7. EARNINGS PER SHARE**

We report both basic and diluted earnings per share. Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share assumes the issuance of

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potentially dilutive shares of common stock during the period resulting from the exercise of common stock options and vesting of restricted stock awards. A reconciliation of both calculations for the three and six months ended June 30, 2008 and 2007 is presented in the following table:

(in thousands, except share and per share data)	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Basic earnings per share:				
Net income	\$ 28,661	\$ 19,999	\$ 54,182	\$ 36,854
Weighted-average shares outstanding	49,002,365	42,269,646	48,153,011	42,180,993
Basic earnings per share	\$ 0.58	\$ 0.47	\$ 1.13	\$ 0.87
Diluted earnings per share:				
Net income	\$ 28,661	\$ 19,999	\$ 54,182	\$ 36,854
Weighted-average shares outstanding	49,002,365	42,269,646	48,153,011	42,180,993
Incremental shares of stock-based awards	1,203,260	1,154,383	1,202,013	1,251,533
Weighted-average dilutive shares outstanding	50,205,625	43,424,029	49,355,024	43,432,526
Diluted earnings per share	\$ 0.57	\$ 0.46	\$ 1.10	\$ 0.85

Basic earnings per share excludes 464,666 and 261,473 shares of restricted common stock at June 30, 2008 and 2007, respectively, that were issued and outstanding, but had not yet vested as of such dates.

During the three and six months ended June 30, 2008 and 2007, there were 31,459 and 22,354 potential shares of common stock, respectively, that were excluded from the diluted per share calculation relating to stock option and restricted stock awards, because the effect of including these potential shares was anti-dilutive.

**8. TAXES****Michigan Business Tax**

On July 12, 2007, a Michigan law was enacted to replace the Michigan Single Business Tax effective January 1, 2008. Key features of the new tax include a business income tax at a rate of 4.95% and a modified gross receipts tax at a rate of 0.80%, with credits for certain activities. In December 2007, a 21.99% surcharge was added to both the business income tax and modified gross receipts tax, resulting in total rates of 6.04% and 0.98%, respectively. The surcharge expires no earlier than January 1, 2017. The Michigan Single Business Tax that was in effect through December 31, 2007 was accounted for as a tax other than income tax. The new tax is accounted for as an income tax under the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS 109"). The new tax resulted in a state income tax provision recorded for the six months ended June 30, 2008 of \$4.0 million. For the six months ended June 30, 2007, we had recorded \$1.0 million in tax other than income tax for the Michigan Single Business Tax.

**9. RETIREMENT BENEFITS AND ASSETS HELD IN TRUST****Retirement Plan Benefits**

We have a retirement plan for eligible employees, comprised of a traditional final average pay plan and a cash balance plan. The retirement plan is noncontributory, covers substantially all employees, and provides retirement benefits based on the employees' years of benefit service, average final compensation and age at retirement. The cash balance plan benefits are based on eligible compensation and interest credits. While we are obligated to fund the retirement plan by contributing the minimum amount required by the Employee Retirement Income Security Act of 1974, it is our practice to contribute the maximum allowable amount as defined by section 404 of the Internal Revenue Code. We contributed \$2.1 million to the retirement plan relating to 2007 during the six months ended June 30, 2008 although we had no minimum funding requirement relating to 2007.

We have also established two supplemental nonqualified, noncontributory, retirement benefit plans for selected management employees. The plans provide for benefits that supplement those provided by our other retirement plans.

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Net pension cost includes the following components:

(in thousands)	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Service cost	\$ 498	\$ 347	\$ 981	\$ 747
Interest cost	293	248	577	498
Expected return on plan assets	(261)	(175)	(517)	(325)
Amortization of prior service cost	(232)	(276)	(453)	(551)
Amortization of unrecognized loss	455	526	890	976
Net pension cost	\$ 753	\$ 670	\$ 1,478	\$ 1,345

**Other Postretirement Benefits**

We provide certain postretirement health care, dental, and life insurance benefits for employees who may become eligible for these benefits. During the six months ended June 30, 2008 we made contributions of \$0.4 million to the plan.

Net postretirement cost includes the following components:

(in thousands)	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Service cost	\$ 406	\$ 191	\$ 819	\$ 491
Interest cost	167	65	337	165
Expected return on plan assets	(54)	(47)	(109)	(47)
Amortization of prior service cost	145	18	292	118
Amortization of unrecognized actuarial loss		(47)		(47)
Net postretirement cost	\$ 664	\$ 180	\$ 1,339	\$ 680

**Defined Contribution Plans**

We also sponsor a defined contribution retirement savings plan. Participation in this plan is available to substantially all employees. We match employee contributions up to certain predefined limits based upon eligible compensation and the employee's contribution rate. The cost of this plan was \$0.3 million and \$0.3 million for the three months ended June 30, 2008 and 2007, respectively, and \$0.9 million and \$0.8 million for the six months ended June 30, 2008 and 2007, respectively.

**10. CONTINGENCIES****Litigation**

We are involved in certain legal proceedings before various courts, governmental agencies, and mediation panels concerning matters arising in the ordinary course of business. These proceedings include certain contract disputes, regulatory matters, and pending judicial matters. We cannot predict the final disposition of such proceedings. We regularly review legal matters and record provisions for claims that are considered probable of loss. The resolution of pending proceedings is not expected to have a material effect on our operations or consolidated financial statements in the period in which they are resolved.

**CSX Transportation, Inc.**

On August 2, 2006, CSX Transportation, Inc. ( CSX ) filed a lawsuit in the United States District Court for the Eastern District of Michigan alleging that ITC Transmission caused damage to equipment owned by CSX and further claiming mitigation costs to protect against future damage. In January 2007, ITC Transmission received a notice from its insurance provider that it reserves its rights as to the insurance policy, asserting that damage claims of CSX arising

from the contractual liability of ITCTransmission are not covered under insurance. In July 2008, ITCTransmission, by and through its insurer, reached a settlement agreement with CSX and the court entered an order of dismissal. Additionally, ITCTransmission has settled with its insurer the amount to be covered by insurance for this matter. During the year ended December 31, 2007, we recorded an accrual of \$0.2 million for this matter in general and administrative expenses which was sufficient to cover the settlement.

**Table of Contents****11. SEGMENT INFORMATION**

We identify reportable segments based on the criteria of Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*. We determine our reportable segments based primarily on the regulatory environment of our subsidiaries and the business activities performed to earn revenues and incur expenses. There have been no changes in the basis of segmentation or the way segment profit or loss were measured during the six months ended June 30, 2008. The following tables show our financial information by reportable segment:

<b>OPERATING REVENUES:</b> <b>(in thousands)</b>	<b>Three months ended</b> <b>June 30,</b>		<b>Six months ended</b> <b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Regulated Operating Subsidiaries	\$ 160,641	\$ 106,303	\$ 302,555	\$ 207,577
ITC Holdings and other	69	58	139	58
Intercompany eliminations	(94)	(58)	(164)	(58)
Total Operating Revenues	\$ 160,616	\$ 106,303	\$ 302,530	\$ 207,577
<b>INCOME BEFORE INCOME TAXES:</b> <b>(in thousands)</b>	<b>Three months ended</b> <b>June 30,</b>		<b>Six months ended</b> <b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Regulated Operating Subsidiaries	\$ 67,587	\$ 44,645	\$ 131,925	\$ 84,028
ITC Holdings and other	(21,255)	(14,470)	(44,326)	(28,906)
Total Income Before Income Taxes	\$ 46,332	\$ 30,175	\$ 87,599	\$ 55,122
<b>NET INCOME:</b> <b>(in thousands)</b>	<b>Three months ended</b> <b>June 30,</b>		<b>Six months ended</b> <b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Regulated Operating Subsidiaries (a)	\$ 46,650	\$ 34,961	\$ 91,908	\$ 65,326
ITC Holdings and other	28,661	19,999	54,182	36,854
Intercompany eliminations	(46,650)	(34,961)	(91,908)	(65,326)
Total Net Income	\$ 28,661	\$ 19,999	\$ 54,182	\$ 36,854
<b>ASSETS:</b> <b>(in thousands)</b>	<b>June 30,</b>		<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Regulated Operating Subsidiaries	\$ 3,416,058	\$ 3,177,561		
ITC Holdings and other	2,257,205	2,313,701		
Reconciliations(b)	89	(540)		
Intercompany eliminations	(2,206,288)	(2,277,425)		
Total Assets	\$ 3,467,064	\$ 3,213,297		

(a) Net income for our Regulated Operating Subsidiaries does not include any allocation of

federal taxes for METC, as METC is organized as a multiple-member LLC and is exempt from federal taxation for the periods presented. METC does include an allowance for income taxes for ratemaking purposes.

- (b) Reconciliations of total assets result primarily from differences in the netting of deferred tax assets and liabilities under the provisions of SFAS 109 at our Regulated Operating Subsidiaries as compared to the classification in our consolidated statement of financial position.



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

Our reports, filings and other public announcements contain certain statements that describe our management's beliefs concerning future business conditions and prospects, growth opportunities and the outlook for our business and the electricity transmission industry based upon information currently available. Such statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Wherever possible, we have identified these forward-looking statements by words such as will, may, anticipates, believes, intends, estimate, expects, projects and similar phrases. These forward-looking statements are based upon assumptions our management believes are reasonable. Such forward-looking statements are subject to risks and uncertainties which could cause our actual results, performance and achievements to differ materially from those expressed in or implied by these statements, including, among others, the risks and uncertainties listed in Part I, Item 1A Risk Factors of our Form 10-K for the fiscal year ended December 31, 2007 (as revised in Part II, Item 1A of this Form 10-Q) and the following:

unless we receive dividends or other payments from our Regulated Operating Subsidiaries, we will be unable to pay dividends to our stockholders and fulfill our cash obligations;

certain elements of our Regulated Operating Subsidiaries' cost recovery through rates can be challenged, which could result in lowered rates and/or refunds of amounts previously collected and thus have an adverse effect on our business, financial condition, results of operations and cash flows. We have also made certain commitments to federal and state regulators with respect to, among other things, our rates in connection with recent acquisitions (including ITC Midwest's asset acquisition) that could have an adverse effect on our business, financial condition, results of operations and cash flows;

approval of ITC Midwest's asset acquisition by state regulatory authorities in Iowa has been appealed. If such proceedings are decided in a manner that is unfavorable to us, all or part of the orders approving ITC Midwest's asset acquisition in Iowa could be reversed, which could have a material adverse effect on our business, financial condition, results of operations and cash flows;

our Regulated Operating Subsidiaries' actual capital expenditures may be lower than planned, which would decrease their respective expected rate bases and therefore our revenues;

the regulations to which we are subject may limit our ability to raise capital and/or pursue acquisitions or development opportunities or other transactions or may subject us to liabilities;

our Regulated Operating Subsidiaries are subject to various regulatory requirements. Violations of these requirements, whether intentional or unintentional, may result in penalties that, under some circumstances, could have a material adverse effect on our results of operations, financial condition and cash flows;

changes in federal energy laws, regulations or policies could reduce the dividends we may be able to pay our stockholders;

adverse changes in interest rates or our credit ratings may negatively affect us;

hazards associated with high-voltage electricity transmission, such as explosions, fires, inclement weather, natural disasters, mechanical failure and related matters, may result in suspension of our Regulated Operating Subsidiaries' operations or the imposition of civil or criminal penalties;

if the network load or point-to-point transmission service on our Regulated Operating Subsidiaries' transmission systems is lower than expected, the timing of collection of our revenues would be delayed.

each of our Regulated Operating Subsidiaries depends on its primary customer for a substantial portion of its revenues (Detroit Edison for ITC Transmission, Consumers Energy for METC and IP&L for ITC Midwest), and any material failure by those primary customers to make payments for transmission services would adversely affect our revenues and our ability to service our debt obligations;

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METC does not own the majority of the land on which its transmission assets are located. A significant amount of the land on which ITC Transmission's and ITC Midwest's assets are located is subject to easements, mineral rights and other similar encumbrances and a significant amount of ITC Transmission and ITC Midwest's other property consists of easements. As a result each of our Regulated Operating Subsidiaries must comply with the provisions of various easements, mineral rights and other similar encumbrances, which may adversely impact their ability to complete construction projects in a timely manner;

deregulation and/or increased competition may adversely affect customers of our Regulated Operating Subsidiaries, or customers of Detroit Edison, Consumers Energy or IP&L, which may affect our ability to collect revenues;

we are subject to environmental regulations and to laws that can give rise to substantial liabilities from environmental contamination;

acts of war, terrorist attacks and threats or the escalation of military activity in response to such attacks or otherwise may negatively affect our business, financial condition and results of operations;

the purchase price for ITC Midwest's asset acquisition remains subject to adjustment and, therefore, the final purchase price cannot be determined at this time;

we may encounter difficulties consolidating IP&L's electric transmission assets into our business and may not fully attain or retain, or achieve within a reasonable time frame, expected strategic objectives and other expected benefits of ITC Midwest's asset acquisition;

if one or both of ITC Midwest's operating agreements with IP&L and American Transmission Company, LLC were terminated early, ITC Midwest may face a shortage of labor or replacement contractors to provide the services formerly provided by IP&L and American Transmission Company, LLC;

we are highly leveraged and our dependence on debt may limit our ability to fulfill our debt obligations, pay dividends and/or obtain additional financing;

certain provisions in our debt instruments may limit our financial flexibility;

we have limitations on the amount of federal income tax net operating loss carryforwards that we may use to reduce our tax liability in a given period;

provisions in our Articles of Incorporation and bylaws, Michigan corporate law and our debt agreements may impede efforts by our shareholders to change the direction or management of our company;

provisions in our Articles of Incorporation restrict market participants from voting or owning 5% or more of the outstanding shares of our capital stock;

future sales of our shares could depress the market price of our common stock;

our Regulated Operating Subsidiaries ability to raise capital may be restricted which may, in turn, restrict our ability to make capital expenditures or pay dividends to our stockholders; and

other risk factors discussed herein and listed from time to time in our public filings with the Securities and Exchange Commission ( SEC ).

Because our forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond our control or are subject to change, actual results could be materially different and any or all of our forward-looking statements may turn out to be wrong. Forward-looking statements speak only as of the date made and can be affected by assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this report will be important in determining future results. Consequently, we cannot assure you that our

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expectations or forecasts expressed in such forward-looking statements will be achieved. Actual future results may vary materially. Except as required by law, we undertake no obligation to publicly update any of our forward-looking or other statements, whether as a result of new information, future events, or otherwise.

**OVERVIEW**

Through our Regulated Operating Subsidiaries, we are engaged in the transmission of electricity in the United States. Our business strategy is to operate, maintain and invest in our transmission infrastructure in order to enhance system integrity and reliability and to reduce transmission constraints. By pursuing this strategy, we strive to lower the delivered cost of electricity and improve accessibility to generation sources of choice, including renewable sources. We operate contiguous, high-voltage systems in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois and Missouri that transmit electricity from generating stations to local distribution facilities connected to our systems.

As electric transmission utilities with rates regulated by the FERC, our Regulated Operating Subsidiaries earn revenues through tariff rates charged for the use of their electricity transmission systems by our customers, which include investor-owned utilities, municipalities, co-operatives, power marketers and alternative energy suppliers. As independent transmission companies, our Regulated Operating Subsidiaries are subject to rate regulation only by the FERC. The rates charged by our Regulated Operating Subsidiaries are established using Attachment O, as discussed in Note 4 to the condensed consolidated financial statements.

Our Regulated Operating Subsidiaries' primary operating responsibilities include maintaining, improving and expanding their transmission systems to meet their customers' ongoing needs, scheduling outages on system elements to allow for maintenance and construction, balancing electricity generation and demand, maintaining appropriate system voltages and monitoring flows over transmission lines and other facilities to ensure physical limits are not exceeded.

We derive nearly all of our revenues from providing network transmission service, point-to-point transmission service and other related services over our Regulated Operating Subsidiaries' transmission systems to Detroit Edison, Consumers Energy, IP&L and to other entities such as alternative electricity suppliers, power marketers and other wholesale customers that provide electricity to end-use consumers and from transaction-based capacity reservations on our transmission systems. Substantially all of our operating expenses and assets support our transmission operations.

**Recent Developments**

Significant recent events that influenced our financial position and results of operations and cash flows for the three and six months ended June 30, 2008 or may affect future results include:

Capital investment of \$72.3 million, \$54.1 million and \$49.6 million at ICTTransmission, METC and ITC Midwest, respectively, for the six months ended June 30, 2008, resulting from our focus on improving system reliability;

ITC Midwest's acquisition of the transmission assets of IP&L on December 20, 2007 and the related financing activities (described in Notes 3, 5 and 6 to the condensed consolidated financial statements);

Lower than expected monthly peak loads at ICTTransmission and METC and the resulting effect on operating cash flows; and

Debt issuances and borrowings under our revolving credit agreements in 2007 and 2008 to fund capital investment at our Regulated Operating Subsidiaries, resulting in higher interest expense.

These items are discussed in more detail throughout Management's Discussion and Analysis of Financial Condition and Results of Operations.

In addition, as a result of the flooding in Iowa in June of 2008, ITC Midwest suffered damage at three substations located in Cedar Rapids and Mason City, Iowa and was forced to relocate its headquarters in Cedar Rapids to temporary office facilities. The damage caused ITC Midwest to make capital investments estimated at approximately \$2 million to replace certain property, plant and equipment and perform various maintenance activities estimated at \$1.1 million during the three months ended June 30, 2008. We have an insurance policy that covers ITC Holdings and

its subsidiaries (including ITC Midwest) with a \$1 million deductible that is

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expected to cover most of the damage. We have not yet finalized the amount of damages incurred or filed any claims under our insurance policy associated with the matter but do not anticipate that the flooding will have a material impact on our results of operations, financial position or liquidity.

**Trends and Seasonality****Network Revenues**

We expect a general trend of increases in network transmission rates and revenues for our Regulated Operating Subsidiaries, although we cannot predict a specific year-to-year trend due to the variability of factors beyond our control. The primary factor that is expected to continue to increase our rates and our actual net revenue requirements in future years is our anticipated capital investment in excess of depreciation as a result of the long-term capital investment programs for our Regulated Operating Subsidiaries. Investments in property, plant and equipment, when placed in service upon completion of a capital project, are added to rate base. Our Regulated Operating Subsidiaries strive for high reliability of their systems, low delivered costs of electricity and accessibility to generation sources of choice, including renewable sources. On August 8, 2005, the Energy Policy Act was enacted, which requires the FERC to implement mandatory electricity transmission reliability standards to be enforced by an Electric Reliability Organization. Effective June 2007, the FERC approved mandatory adoption of certain reliability standards and approved enforcement actions for the violators, including fines of up to \$1.0 million per day. The NERC was assigned the responsibility of developing and enforcing these mandatory reliability standards. We continually assess our transmission systems against standards established by the NERC, as well as ReliabilityFirst Corporation (for ITCTransmission and METC) and Midwest Reliability Organization (for ITC Midwest), which are regional entities under the NERC that have been delegated certain authority for the purpose of proposing and enforcing reliability standards. We believe we meet the applicable standards in all material respects, although further investment in our transmission systems is needed to maintain compliance and improve reliability. Analysis of the transmission systems against these reliability standards has become more focused and rigorous in recent years. We also assess our transmission systems against our own planning criteria that are filed annually with the FERC.

Based on our planning studies, we see needs to make capital investments to (1) rebuild existing property, plant and equipment; (2) upgrade the systems to address demographic changes that have impacted transmission load and the changing role that transmission plays in meeting the needs of the wholesale market, including accommodating the siting of new generation or to increase import capacity to meet changes in peak electrical demand; and (3) relieve congestion in the transmission systems. The following table shows our expected and actual capital investment for each of our Regulated Operating Subsidiaries:

Regulated Operating Subsidiary	Period	Long-Term Capital Investment Program		2008 Capital Investment	
		Expectation	Amounts through June 30, 2008	Expected in 2008	Six Months Ended June 30, 2008 (a)
ITCTransmission	January 1, 2005			\$95 million	
	December 31, 2011	\$1 billion	\$572.3 million	\$110 million	\$72.3 million
METC	January 1, 2007	\$600 million		\$130 million	
	December 31, 2013		\$129.6 million	\$105 million	\$54.1 million
ITC Midwest	Seven- to ten-year period beginning January 1, 2008	\$1 billion (b)	\$49.6 million	\$85 million	
				\$100 million	\$49.6 million

- (a) Capital investment amounts differ from cash expenditures for property, plant and equipment included in our consolidated statements of cash flows due in part to differences in construction costs incurred compared to cash paid during that period, as well as payments for major equipment inventory that are included in cash expenditures but not included in capital investment until transferred to construction work in progress, among other factors.
- (b) As part of the regulatory proceedings approving ITC Midwest's asset acquisition, ITC Midwest has made several investment commitments relating to our transmission systems, including completing projects



anticipated to cost at least approximately \$100 million over the next five years dedicated to reducing transmission constraints as well as investing at least an additional \$250 million in other projects over the next five years.

Investments in property, plant and equipment could vary due to, among other things, the impact of weather conditions, union strikes, labor shortages, material and equipment prices and availability, our ability to obtain financing for such expenditures, if necessary, limitations on the amount of construction that can be undertaken on our systems at any one time, regulatory approvals for

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reasons relating to environmental, siting or regional planning issues or as a result of legal proceedings and variances between estimated and actual costs of construction contracts awarded.

We assess our performance based in part on the levels of prudent and necessary capital investment and maintenance spending on our transmission systems.

**Seasonality and Attachment O Revenue Accrual**

Prior to the implementation of forward-looking Attachment O effective January 1, 2007 for ITC Transmission and METC and January 1, 2008 for ITC Midwest, the revenues recognized by our Regulated Operating Subsidiaries were dependent on monthly peak loads. Revenues and net income varied between periods based on monthly peak loads, among other factors. To the extent that actual conditions during an annual period varied from the data on which the Attachment O rate was based, our Regulated Operating Subsidiaries earned more or less revenue during that annual period and therefore recovered more or less than their respective net revenue requirements.

Under forward-looking Attachment O, although the monthly peak loads continue to be used for billing network revenues and continue to affect operating cash flows, our Regulated Operating Subsidiaries accrue or defer revenues to the extent that their actual net revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. This results in more consistent net income for each quarterly period within a given year, compared to the historical Attachment O method that applied to ITC Transmission and METC prior to January 1, 2007 and ITC Midwest prior to January 1, 2008.

ITC Transmission's monthly peak loads for the three and six months ended June 30, 2008 were down 14.7% and 9.3%, respectively, compared to the corresponding total for 2007 as shown in the table below. METC's monthly peak loads for the three and six months ended June 30, 2008 were down 15.2% and 8.4%, respectively, compared to the corresponding total for 2007 as shown in the table below. The monthly peak load is affected by many factors, but is generally higher in the summer months when cooling demand is higher.

**Monthly Peak Load (in MW) (a)**

	2008			2007			2006	
	ITC Midwest	METC ITC Transmission	ITC Midwest	METC ITC Transmission	METC ITC Transmission	METC ITC Transmission	ITC Transmission	
<b>January</b>	2,974	6,215	7,889	6,051	7,876		7,754	
<b>February</b>	2,890	6,139	7,713	6,227	8,170		7,667	
<b>March</b>	2,733	5,797	7,511	6,006	7,739		7,554	
<b>April</b>	2,455	5,223	6,926	5,473	7,141		7,035	
<b>May</b>	2,431	5,320	7,039	6,981	9,927		10,902	
<b>June</b>	2,888	7,243	10,624	8,511	11,761		9,752	
<b>July</b>				8,672	11,706		12,392	
<b>August</b>				8,955	12,087		12,745	
<b>September</b>				7,908	11,033		8,415	
<b>October</b>				7,524	10,365	5,642	7,302	
<b>November</b>				6,200	7,812	6,103	7,724	
<b>December</b>			2,244	6,215	8,022	6,527	8,257	
<b>Total</b>			2,244	84,723	113,639	18,272	107,499	

(a) Each of our Regulated Operating Subsidiaries is part of a joint rate zone. The

load data presented is for all transmission owners in the respective joint rate zone and is used for billing network revenues. Each of our Regulated Operating Subsidiaries makes up the significant portion of billed network revenues within their respective joint rate zone.

The monthly peak loads at ITC Transmission and METC thus far in 2008 are lower than what had been forecasted in developing the transmission network rates applicable for 2008. The lower monthly peak loads are due to cooler than normal weather as well as unfavorable economic factors in Michigan. An unfavorable economy in Michigan would continue to negatively impact our operating cash flows from network revenues for the remainder of 2008.

Transmission network rates in 2010 at each of our Regulated Operating Subsidiaries will include the Attachment O revenue accrual relating to 2008, including interest.

The Attachment O revenue accrual at our Regulated Operating Subsidiaries discussed in Note 4 to the condensed consolidated financial statements resulted from actual net revenue requirement for the six months ended June 30, 2008 that exceeded network revenues billed for the six months ended June 30, 2008.

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The table below illustrates the calculation of the total Attachment O revenue accrual for the six months ended June 30, 2008.

(in  
thousands)

Line	Item	ITCTransmission	METC	ITC Midwest	Total
1	Estimated net revenue requirement	\$ 127,404	\$ 85,512	\$ 60,700	
2	Network revenues billed (a)	111,541	70,853	39,857	
3	Six months ended June 30, 2008 Attachment O revenue accrual (line 1 line 2)	\$ 15,863	\$ 14,659	\$ 20,843	\$ 51,365

(a) Network revenues billed at our Regulated Operating Subsidiaries is calculated based on the joint zone monthly network peak load multiplied by our effective monthly network rates of \$2.350 per kW/month, \$1.985 per kW/month and \$2.446 per kW/month applicable to ITCTransmission, METC and ITC Midwest, respectively, adjusted for the actual number of days in the month.

**RESULTS OF OPERATIONS**

Our results of operations for the three and six months ended June 30, 2008 include revenues and expenses at ITC Midwest that resulted from the December 2007 asset acquisition by ITC Midwest, for which no revenues or expenses were included in our results of operations for the comparable periods in 2007.

**Results of Operations and Variances**

(in thousands)	Three months ended		Percentage Increase (decrease)	Six months ended		Percentage Increase (decrease)
	June 30, 2008	2007		June 30, 2008	2007	

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OPERATING REVENUES	\$	160,616	\$ 106,303	\$ 54,313	51.1%	\$ 302,530	\$ 207,577	\$ 94,953	45.7%
OPERATING EXPENSES									
Operation and maintenance		32,902	21,503	11,399	53.0%	54,357	40,043	14,314	35.7%
General and administrative		21,361	12,203	9,158	75.0%	39,343	27,226	12,117	44.5%
Depreciation and amortization		23,446	16,711	6,735	40.3%	45,770	32,833	12,937	39.4%
Taxes other than income taxes		10,313	8,066	2,247	27.9%	21,198	16,836	4,362	25.9%
Gain on sale of asset		(1,445)		(1,445)	n/a	(1,445)		(1,445)	n/a
Total operating expenses		86,577	58,483	28,094	48.0%	159,223	116,938	42,285	36.2%
OPERATING INCOME		74,039	47,820	26,219	54.8%	143,307	90,639	52,668	58.1%
OTHER EXPENSES (INCOME)									
Interest expense		29,946	19,940	10,006	50.2%	60,716	39,072	21,644	55.4%
Allowance for equity funds used during construction		(2,284)	(1,613)	(671)	41.6%	(5,380)	(2,853)	(2,527)	88.6%
Loss on extinguishment of debt					n/a		349	(349)	(100.0)%
Other income		(552)	(1,018)	466	(45.8)%	(1,062)	(1,720)	658	(38.3)%
Other expense		597	336	261	77.7%	1,434	669	765	114.3%
Total other expenses (income)									
		166,158							
		149,723							

Income before income taxes  
29,484

30,546

100,733

85,009

Income taxes  
4,722

8,434

16,607

23,598

Net income  
\$  
24,762

\$  
22,112

\$  
84,126

\$  
61,411

Earnings per Common Share:

Basic  
\$  
1.58

\$  
1.45

\$  
5.46

\$  
4.01

Diluted  
\$  
1.56

\$  
1.44

\$  
5.41

\$

3.99

Weighted average common shares outstanding

Basic

15,686,542

15,287,974

15,420,135

15,299,039

Diluted

15,832,734

15,351,590

15,560,666

15,394,199



Cash dividends declared

\$

0.96

\$

0.94

\$

3.11

\$

2.82

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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## PARK NATIONAL CORPORATION AND SUBSIDIARIES

## Consolidated Condensed Statements of Comprehensive Income (Unaudited)

(in thousands)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
Net income	\$24,762	\$22,112	\$84,126	\$61,411
Other comprehensive (loss) income, net of tax:				
Net loss realized on sale of securities, net of income tax benefit of \$538 for the nine months ended September 30, 2018	—	—	2,024	—
Unrealized net holding (loss) gain on debt securities available-for-sale, net of federal income tax effect of \$(1,364) and \$380 for the three months ended September 30, 2018 and 2017, and \$(8,217) and \$2,551 for the nine months ended September 30, 2018 and 2017, respectively	(5,141 )	707	(30,919 )	4,740
Other comprehensive (loss) income	\$(5,141 )	\$707	\$(28,895)	\$4,740
Comprehensive income	\$19,621	\$22,819	\$55,231	\$66,151

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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## PARK NATIONAL CORPORATION AND SUBSIDIARIES

## Consolidated Condensed Statements of Changes in Shareholders' Equity (Unaudited)

(in thousands, except share and per share data)

	Preferred Shares	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive (Loss) Income
Balance at January 1, 2017	\$	—\$305,826	\$535,631	\$(81,472)	\$ (17,745 )
Net income			61,411		
Other comprehensive income, net of tax					4,740
Dividends on common shares at \$2.82 per share			(43,411 )		
Cash payment for fractional common shares in dividend reinvestment plan		(4 )			
Issuance of 9,674 common shares under share-based compensation awards, net of 3,293 common shares withheld to pay employee income taxes		(795 )	(197 )	\$645	
Repurchase of 70,000 common shares to be held as treasury shares				\$(7,378 )	
Share-based compensation expense		2,116			
Balance at September 30, 2017	\$	—\$307,143	\$553,434	\$(88,205)	\$ (13,005 )
Balance at January 1, 2018, as previously presented	\$	—\$307,726	\$561,908	\$(87,079)	\$ (26,454 )
Cumulative effect of change in accounting principle for marketable equity securities, net of tax			1,917		(995 )
Balance at January 1, 2018, as adjusted	—	307,726	563,825	(87,079 )	(27,449 )
Reclassification of disproportionate income tax effects			3,806		(3,806 )
Net income			84,126		
Other comprehensive loss, net of tax					(28,895 )
Dividends on common shares at \$3.11 per share			(48,349 )		
Cash payment for fractional common shares in dividend reinvestment plan		(3 )			
Issuance of 435,457 common shares for the acquisition of New Dominion Bank		48,519			
Issuance of 18,800 common shares under share-based compensation awards, net of 5,879 common shares withheld to pay employee income taxes		(1,597 )	(317 )	1,304	
Repurchase of 50,000 common shares to be held as treasury shares				(5,784 )	
Share-based compensation expense		3,064			
Balance at September 30, 2018	\$	—\$357,709	\$603,091	\$(91,559)	\$ (60,150 )

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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PARK NATIONAL CORPORATION AND SUBSIDIARIES  
 Consolidated Condensed Statements of Cash Flows (Unaudited)  
 (in thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net income	\$84,126	\$61,411
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,586	8,740
Amortization of loan fees and costs, net	(4,631 )	(4,352 )
Increase in prepaid dealer premiums	(1,399 )	(4,313 )
Provision for depreciation	6,446	6,463
Amortization of investment securities, net	932	1,013
Realized net investment securities losses	2,271	—
Gain on equity securities, net	(3,467 )	—
Amortization of prepayment penalty on long-term debt	—	4,711
Loan originations to be sold in secondary market	(153,093)	(168,255 )
Proceeds from sale of loans in secondary market	154,544	170,703
Gain on sale of loans in secondary market	(3,604 )	(3,431 )
Share-based compensation expense	3,064	2,116
OREO valuation adjustments	398	367
Gain on sale of OREO, net	(4,093 )	(204 )
Bank owned life insurance income	(4,625 )	(3,790 )
Investment in qualified affordable housing tax credits amortization	5,553	5,592
Changes in assets and liabilities:		
Decrease (increase) in other assets	6,575	(5,603 )
Increase (decrease) in other liabilities	4,536	(4,502 )
Net cash provided by operating activities	\$98,119	\$66,666
Investing activities:		
Proceeds from the redemption/repurchase of Federal Home Loan Bank stock	\$7,004	\$—
Proceeds from sales of securities	244,399	—
Proceeds from calls and maturities of:		
Available-for-sale debt securities	151,860	128,736
Held-to-maturity debt securities	10,102	12,264
Purchases of:		
Available-for-sale debt securities	(373,372)	(29,684 )
Held-to-maturity debt securities	(4,946 )	(96,293 )
Equity securities	(2,590 )	—
Net loan paydowns (originations), portfolio loans	12,027	(95,808 )
Proceeds from the sale of OREO	11,919	2,363
Life insurance death benefits	4,028	1,037
Purchases of premises and equipment	(7,145 )	(4,995 )
Cash received from acquisitions, net	12,270	—
Net cash provided by (used in) investing activities	\$65,556	\$(82,380)



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## PARK NATIONAL CORPORATION AND SUBSIDIARIES

## Consolidated Condensed Statements of Cash Flows (Unaudited) (Continued)

(in thousands)

	Nine Months Ended September 30,	
	2018	2017
Financing activities:		
Net increase in deposits	\$177,626	\$452,366
Net decrease in short-term borrowings	(211,471 )	(201,899 )
Proceeds from issuance of long-term debt	25,000	150,000
Repayment of subordinated notes	—	(30,000 )
Repayment of long-term debt	(125,000 )	—
Value of common shares withheld to pay employee income taxes	(610 )	(347 )
Repurchase of common shares to be held as treasury shares	(5,784 )	(7,378 )
Cash dividends paid	(47,944 )	(43,122 )
Net cash (used in) provided by financing activities	\$(188,183)	\$319,620
 (Decrease) increase in cash and cash equivalents	 (24,508 )	 303,906
 Cash and cash equivalents at beginning of year	 169,112	 146,446
 Cash and cash equivalents at end of period	 \$144,604	 \$450,352
 Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	\$30,424	\$31,743
Income taxes	\$5,525	\$18,690
Non-cash items:		
Loans transferred to OREO	\$1,037	\$2,991
Loans transferred to repossessed assets	\$11,379	\$—
New commitments in affordable housing tax credit investments	\$8,000	\$7,000

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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PARK NATIONAL CORPORATION  
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation

The accompanying unaudited consolidated condensed financial statements included in this report have been prepared for Park National Corporation (sometimes also referred to as the “Registrant”) and its subsidiaries. Unless the context otherwise requires, references to “Park”, the “Corporation” or the “Company” and similar terms mean Park National Corporation and its subsidiaries. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the results of operations for the interim periods included herein have been made. The results of operations for the three-month and nine-month periods ended September 30, 2018 are not necessarily indicative of the operating results to be anticipated for the fiscal year ending December 31, 2018.

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and footnotes necessary for a fair presentation of the condensed balance sheets, condensed statements of income, condensed statements of comprehensive income, condensed statements of changes in shareholders’ equity and condensed statements of cash flows in conformity with United States (“U.S.”) generally accepted accounting principles (“U.S. GAAP”). These financial statements should be read in conjunction with the consolidated financial statements incorporated by reference in the Annual Report on Form 10-K of Park for the fiscal year ended December 31, 2017 from Park’s 2017 Annual Report to Shareholders (“Park’s 2017 Annual Report”). Prior period financial statements reflect the retrospective application of Accounting Standards Update (“ASU”) 2017-07 - Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This change in classification had no effect on reported net income.

Park’s significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in Park’s 2017 Annual Report. For interim reporting purposes, Park follows the same basic accounting policies, as updated by the information contained in this report, and considers each interim period an integral part of an annual period.

Note 2 - Adoption of New Accounting Pronouncements and Issued But Not Yet Effective Accounting Standards

The following is a summary of new accounting pronouncements impacting Park's consolidated financial statements, and issued but not yet effective accounting standards:

Adoption of New Accounting Pronouncements

ASU 2014-09 - Revenue from Contracts with Customers (Topic 606): In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. Certain services that

fall within the scope of ASC 606 are presented within Other Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include income from fiduciary activities, service charges on deposit accounts, other service income, checkcard fee income, ATM fees, and gain (loss) on sale of OREO, net. The adoption of this guidance on January 1, 2018 did not have a material impact on Park's consolidated financial statements. However, the adoption of this standard resulted in additional disclosures beginning with the first quarter 2018 Form 10-Q. Reference Note 20 - Revenue from Contracts with Customers, for further discussion on the Company's accounting policies for revenue sources within the scope of ASC 606.

ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. In January 2016, the FASB issued ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Changes reflected in the current U.S. GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, this ASU clarifies guidance related to the



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valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale ("AFS") securities. The new guidance is effective for annual reporting periods and interim reporting periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance on January 1, 2018 resulted in an \$1.9 million increase to beginning retained earnings and a \$995,000 increase to beginning accumulated other comprehensive loss. Additional income of \$3.2 million, \$1.3 million and \$89,000 was recorded in the first, second and third quarters of 2018, respectively, as a result of changes to the accounting for equity investments. Further, beginning with the first quarter of 2018, Park's fair value disclosures in Note 16 - Fair Value, have incorporated the revised disclosure requirements for financial investments.

ASU 2016-15 - Statement of Cash Flows (Topic 203): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force): In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 203): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). This ASU provides guidance on eight specific cash flow issues where then current GAAP was either unclear or did not include specific guidance. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance on January 1, 2018 did not have an impact on Park's consolidated financial statements. As such transactions arise, management will utilize the updated guidance in providing disclosures within Park's consolidated condensed statements of cash flows.

ASU 2017-07 - Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost: In March 2017, the FASB issued ASU 2017-07 - Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. As a result of the adoption of this guidance on January 1, 2018, all prior periods have been recast to separately record the service cost component and other components of net benefit cost. For all periods presented, this resulted in an increase in other income and an offsetting increase in other expense with no change to net income. See Note 14 - Benefit Plans, for further details.

ASU 2017-09 - Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting: In May 2017, the FASB issued ASU 2017-09 - Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU amends the guidance concerning which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance on January 1, 2018 did not impact Park's consolidated financial statements.

ASU 2017-12 - Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities: In August 2017, the FASB issued ASU 2017-12 - Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU amends the current guidance with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU amends the current guidance to simplify the application of the hedge accounting guidance. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted for interim or annual periods. The early adoption of this guidance on July 1, 2018 did not have an impact on Park's consolidated financial statements. Park will apply this guidance to future transactions.

ASU 2018-02 - Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income: In February 2018, the FASB issued ASU 2018-02 - Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects, resulting from the federal corporate income tax rate enacted under the Tax Cuts and Jobs Act. The amount of the reclassification is the difference between the historical federal corporate income tax rate and the newly-enacted 21% federal corporate income tax rate. The guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted for interim or annual periods. The early adoption of this guidance effective January 1, 2018 resulted in a \$3.8 million increase to Park's accumulated other comprehensive loss and a \$3.8 million increase to retained earnings.

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ASU 2018-03 - Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. In February 2018, the FASB issued ASU 2018-03 - Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This ASU includes amendments that clarify certain aspects of the guidance issued in ASU 2016-01. Park considered this clarification in determining the appropriate adoption of ASU 2016-01 effective as of January 1, 2018.

Issued But Not Yet Effective Accounting Standards

ASU 2016-02 - Leases (Topic 842): In February 2016, the FASB issued ASU 2016-02 - Leases (Topic 842). This ASU will require all organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Additional qualitative and quantitative disclosures will be required so that users can understand more about the nature of an entity's leasing activities. The new guidance is effective for annual reporting periods and interim reporting periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. Management is currently analyzing data on leased assets and is in the process of implementing a software solution to assist in the adoption of this ASU. The adoption of this guidance is expected to increase both assets and liabilities, but is not expected to have a material impact on Park's consolidated statement of income.

ASU 2016-13 - Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments: In June 2016, FASB issued ASU 2016-13 - Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new guidance replaces the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity ("HTM") debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. The CECL model requires an entity to estimate credit losses over the life of an asset or off-balance sheet exposure. The new guidance is effective for annual reporting periods and interim reporting periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted for annual reporting periods and interim reporting periods within those annual periods, beginning after December 15, 2018.

Management is currently evaluating the impact of the adoption of this guidance on Park's consolidated financial statements. We anticipate that the adoption of the CECL model will result in a material increase to Park's allowance for loan losses. Management has established a committee to oversee the implementation of the CECL model and is currently in the process of implementing a software solution to assist in the adoption of this ASU. Management plans to run our current allowance model and a CECL model concurrently for 12 months prior to the adoption of this guidance on January 1, 2020.

ASU 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities: In March 2017, the FASB issued ASU 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This ASU amends the amortization period for certain purchased callable debt securities held at a premium. It shortens the amortization period for the premium to the earliest call date. Under current U.S. GAAP, premiums on callable debt securities generally are amortized to the maturity date. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted for interim or annual periods. The adoption of this guidance is not expected to have a material impact on Park's consolidated financial statements.

ASU 2018-10 - Codification Improvements to Topic 842, Leases: In July 2018, the FASB issued ASU 2018-10 - Codification Improvements to Topic 842, Leases. This ASU includes amendments that clarify certain aspects of the guidance issued in ASU 2016-02. Park will consider this clarification in determining the appropriate adoption of ASU 2016-02, effective for annual and interim reporting periods within those annual periods, beginning after December 15, 2018.

ASU 2018-11 - Leases (Topic 842): Targeted Improvements: In July 2018, the FASB issued ASU 2018-11 - Leases (Topic 842): Targeted Improvements. This ASU amends the guidance in ASU 2016-02 which is not yet effective. The amendments in the ASU provide entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings for the period of adoption. Additionally, this amendment provides lessors with a practical expedient, by class of asset, to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component if certain criteria are met. Park will consider this clarification in determining the appropriate adoption of ASU 2016-02, effective for annual and interim reporting periods within those annual periods, beginning after December 15, 2018.

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ASU 2018-13 - Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement: In August 2018, the FASB issued ASU 2018-13 - Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement by removing, modifying and adding certain requirements. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted upon issuance of this ASU. An entity is permitted to early adopt and remove or modify disclosures upon issuance of the ASU and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not have an impact on Park's consolidated financial statements, but will impact disclosures.

ASU 2018-14 - Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans: In August 2018, the FASB issued ASU 2018-14 - Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. This amendments in this ASU modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans by removing disclosures that are no longer considered cost beneficial, clarifying the specific requirements of disclosures and adding disclosure requirements identified as relevant. The amendments in this ASU are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The adoption of this guidance will not have an impact on Park's consolidated financial statements, but will impact disclosures.

Note 3 - Business Combinations

On July 1, 2018, NewDominion Bank, a North Carolina state-chartered bank ("NewDominion"), merged with and into The Park National Bank, the national bank subsidiary of Park ("PNB"), with PNB continuing as the surviving entity pursuant to the Agreement and Plan of Merger and Reorganization (the "Merger Agreement"), dated as of January 22, 2018, by and among Park, PNB, and NewDominion. In accordance with the Merger Agreement, NewDominion shareholders were permitted to make an election to receive for their shares of NewDominion common stock either \$1.08 in cash without interest (the cash consideration) or 0.01023 of a Park common share, plus cash in lieu of any fractional Park common share (the stock consideration). Based on the terms of the Merger Agreement, the aggregate consideration to be paid in the merger was subject to proration and allocation procedures to ensure that 60 percent of the shares of NewDominion common stock outstanding immediately prior to the completion of the merger were exchanged for the stock consideration and that the remaining 40 percent of the shares of NewDominion common stock outstanding immediately prior to the completion of the merger were to be exchanged for the cash consideration, including, in each case, shares of NewDominion common stock subject to NewDominion options and restricted stock awards.

Purchase consideration consisted of 435,457 Park common shares, valued at \$48.5 million, and \$30.7 million in cash to acquire 91.45% of NewDominion outstanding common shares. The remaining 8.55% of NewDominion's outstanding common shares were previously held by Park. Park recognized a gain of \$3.5 million as a result of remeasuring to fair value its 8.55% equity interest in NewDominion held before the business combination. The gain is included in "(Loss) gain on equity securities, net" in the consolidated condensed statements of income. The acquisition is expected to provide additional revenue growth and geographic diversification.

NewDominion's results of operations were included in Park's results beginning July 1, 2018. For the nine months ended September 30, 2018, Park recorded merger-related expenses of \$3.6 million associated with the NewDominion acquisition. Of this \$3.6 million in expense, \$1.8 million is included within "Professional fees and services", \$1.6 million is included within "Salaries", \$78,000 is included within "Employee benefits", and \$197,000 is included within "Miscellaneous", in each case within "Other expense" on the consolidated condensed statements of income.

Goodwill of \$40.4 million arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the PNB and NewDominion. The goodwill is not deductible for income tax purposes as the transaction was accounted for as a tax-free exchange.

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The following table summarizes the consideration paid for NewDominion and the amounts of the assets acquired and liabilities assumed at their fair value:

(in thousands)

Consideration

Cash	\$30,684
Equity instruments	48,519
Previous 8.55% investment in NewDominion	7,000
Fair value of total consideration transferred	\$86,203

Recognized amounts of identifiable assets acquired and liabilities assumed

Cash and cash equivalents	\$42,954
Securities	1,954
Loans	272,753
Premises and equipment	940
Core deposit intangibles	6,249
Trade name intangible	1,300
Other assets	6,133
Total assets acquired	\$332,283

Deposits	284,231
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Other liabilities	2,254
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Total liabilities assumed	286,485
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Net identifiable assets	45,798
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Goodwill	\$40,405
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Park accounted for the NewDominion acquisition using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date, in accordance with FASB ASC Topic 805, Business Combinations. The fair value measurements of assets acquired and liabilities assumed are subject to refinement for up to one year after the closing date of the acquisition as additional information relative to closing date fair values becomes available. Park continues to finalize the fair values of loans, intangible assets, and deferred taxes. As a result, the fair value adjustments are preliminary and may change as information becomes available. Fair value adjustments will be finalized no later than July 2019.

The fair value of net assets acquired includes fair value adjustments to loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. However, Park believes that all contractual cash flows related to these loans will be collected. As such, these loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. Loans acquired that were not subject to these requirements included non-impaired loans with a fair value and gross contractual amounts receivable of \$267.9 million and \$272.9 million, respectively, on the date of acquisition.

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The table below presents information with respect to the fair value of acquired loans as well as their book balance at the acquisition date.

(in thousands)	Book Balance	Fair Value
Commercial, financial and agricultural	\$19,246	\$19,138
Commercial real estate	119,434	117,638
Construction real estate:		
Commercial	22,494	22,235
Mortgage	8,391	8,111
Residential real estate:		
Commercial	14,798	14,797
Mortgage	50,295	48,714
HELOC	37,651	36,688
Consumer	541	539
Purchased credit impaired	5,069	4,893
Total loans	\$277,919	\$272,753

The following table presents supplemental pro forma information as if the acquisition had occurred at the beginning of 2017. The unaudited pro forma information includes adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the transaction, depreciation expense on property acquired, interest expense on deposits acquired, and the related tax effects. The pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been effected on the assumed dates.

	Nine months ended September 30,	
(dollars in thousands, except per share data)	2018	2017
Net interest income	204,074	190,461
Net income	88,102	62,775
Basic earnings per share	5.61	3.99
Diluted earnings per share	5.51	3.97



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## Note 4 – Loans

The composition of the loan portfolio, by class of loan, as of September 30, 2018 and December 31, 2017 was as follows:

(In thousands)	September 30, 2018			December 31, 2017		
	Loan Balance	Accrued Interest Receivable	Recorded Investment	Loan Balance	Accrued Interest Receivable	Recorded Investment
Commercial, financial and agricultural *	\$ 1,031,500	\$ 5,606	\$ 1,037,106	\$ 1,053,453	\$ 4,413	\$ 1,057,866
Commercial real estate *	1,302,630	5,169	1,307,799	1,167,607	4,283	1,171,890
Construction real estate:						
Commercial	151,757	474	152,231	125,389	401	125,790
Mortgage	65,842	158	66,000	52,203	133	52,336
Installment	2,597	8	2,605	3,878	13	3,891
Residential real estate:						
Commercial	403,147	1,156	404,303	393,094	1,029	394,123
Mortgage	1,140,648	1,719	1,142,367	1,110,426	1,516	1,111,942
HELOC	221,632	964	222,596	203,178	974	204,152
Installment	15,556	43	15,599	18,526	53	18,579
Consumer	1,287,382	3,773	1,291,155	1,241,736	3,808	1,245,544
Leases	2,632	40	2,672	2,993	36	3,029
Total loans	\$ 5,625,323	\$ 19,110	\$ 5,644,433	\$ 5,372,483	\$ 16,659	\$ 5,389,142

\* Included within each of commercial, financial and agricultural loans and commercial real estate loans is an immaterial amount of consumer loans that are not broken out by class.

Loans are shown net of deferred origination fees, costs and unearned income of \$12.4 million at September 30, 2018 and \$12.2 million at December 31, 2017, which represented a net deferred income position in both periods. At September 30, 2018, loans included a purchase accounting adjustment of \$5.1 million, which represented a net deferred income position. This fair market value adjustment is expected to be recognized into interest income on a level yield basis over the remaining expected life of the loans.

Overdrawn deposit accounts of \$1.1 million and \$1.9 million had been reclassified to loans at September 30, 2018 and December 31, 2017, respectively, and are included in the commercial, financial and agricultural loan class above.

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## Credit Quality

The following tables present the recorded investment in nonaccrual loans, accruing troubled debt restructurings ("TDRs"), and loans past due 90 days or more and still accruing by class of loan as of September 30, 2018 and December 31, 2017:

(In thousands)	September 30, 2018			
	Nonaccrual Loans	Accruing TDRs	Loans Past Due 90 Days or More and Accruing	Total Nonperforming Loans
Commercial, financial and agricultural	\$ 15,837	\$ 264	\$ 16	\$ 16,117
Commercial real estate	22,806	2,999	—	25,805
Construction real estate:				
Commercial	2,016	—	—	2,016
Mortgage	16	16	—	32
Installment	21	12	—	33
Residential real estate:				
Commercial	2,786	127	—	2,913
Mortgage	17,411	8,175	720	26,306
HELOC	1,901	1,251	144	3,296
Installment	410	1,074	—	1,484
Consumer	3,450	789	1,203	5,442
Total loans	\$66,654	\$ 14,707	\$ 2,083	\$ 83,444

(In thousands)	December 31, 2017			
	Nonaccrual Loans	Accruing TDRs	Loans Past Due 90 Days or More and Accruing	Total Nonperforming Loans
Commercial, financial and agricultural	\$ 16,773	\$ 1,291	\$ —	\$ 18,064
Commercial real estate	12,979	5,163	—	18,142
Construction real estate:				
Commercial	986	338	—	1,324
Mortgage	8	92	—	100
Installment	52	—	—	52
Residential real estate:				
Commercial	18,835	224	—	19,059
Mortgage	16,841	10,766	568	28,175
HELOC	1,593	1,025	14	2,632
Installment	586	616	7	1,209
Consumer	3,403	662	1,256	5,321
Total loans	\$72,056	\$ 20,177	\$ 1,845	\$ 94,078



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The following table provides additional information regarding those nonaccrual loans and accruing TDR loans that were individually evaluated for impairment and those collectively evaluated for impairment, as of September 30, 2018 and December 31, 2017.

(In thousands)	September 30, 2018			December 31, 2017		
	Nonaccruals and Accruing TDRs	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Nonaccruals and Accruing TDRs	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment
Commercial, financial and agricultural	\$16,101	\$ 16,026	\$ 75	\$18,064	\$ 18,039	\$ 25
Commercial real estate	25,805	25,805	—	18,142	18,142	—
Construction real estate:						
Commercial	2,016	2,016	—	1,324	1,324	—
Mortgage	32	—	32	100	—	100
Installment	33	—	33	52	—	52
Residential real estate:						
Commercial	2,913	2,913	—	19,059	19,059	—
Mortgage	25,586	—	25,586	27,607	—	27,607
HELOC	3,152	—	3,152	2,618	—	2,618
Installment	1,484	—	1,484	1,202	—	1,202
Consumer	4,239	—	4,239	4,065	—	4,065
Total loans	\$81,361	\$ 46,760	\$ 34,601	\$92,233	\$ 56,564	\$ 35,669

All of the loans individually evaluated for impairment were evaluated using the fair value of the underlying collateral or the present value of expected future cash flows as the measurement method.

The following table presents loans individually evaluated for impairment by class of loan, together with the related allowance recorded, as of September 30, 2018 and December 31, 2017.

(In thousands)	September 30, 2018			December 31, 2017		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:						
Commercial, financial and agricultural	\$18,067	\$ 12,801	\$ —	\$19,899	\$ 14,704	\$ —
Commercial real estate	24,518	24,004	—	18,974	18,060	—
Construction real estate:						
Commercial	4,829	2,016	—	2,788	1,324	—
Residential real estate:						
Commercial	3,004	2,716	—	19,346	19,012	—
With an allowance recorded:						
Commercial, financial and agricultural	5,317	3,225	1,716	5,394	3,335	681
Commercial real estate	1,832	1,801	71	137	82	2
Construction real estate:						
Commercial	—	—	—	—	—	—
Residential real estate:						
Commercial	200	197	59	47	47	1

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Consumer	—	—	—	—	—	—
Total	\$57,767	\$ 46,760	\$ 1,846	\$66,585	\$ 56,564	\$ 684

Management's general practice is to proactively charge down loans individually evaluated for impairment to the fair value of the underlying collateral. At September 30, 2018 and December 31, 2017, there were \$8.9 million and \$7.9 million, respectively, of partial charge-offs on loans individually evaluated for impairment with no related allowance recorded. At both September 30, 2018 and December 31, 2017, there were \$2.1 million of partial charge-offs on loans individually evaluated for impairment that also had a specific reserve allocated.

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The allowance for loan losses included specific reserves related to loans individually evaluated for impairment at September 30, 2018 and December 31, 2017 of \$1.8 million and \$0.7 million, respectively. These loans with specific reserves had a recorded investment of \$5.2 million and \$3.5 million as of September 30, 2018 and December 31, 2017, respectively.

Interest income on nonaccrual loans individually evaluated for impairment is recognized on a cash basis only when Park expects to receive the entire recorded investment of the loan. Interest income on accruing TDRs individually evaluated for impairment continues to be recorded on an accrual basis. The following table presents the average recorded investment and interest income recognized subsequent to impairment on loans individually evaluated for impairment as of and for the three and nine months ended September 30, 2018 and September 30, 2017:

(In thousands)	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017		
	Recorded Investment as of September 30, 2018	Average Recorded Investment	Interest Income Recognized	Recorded Investment as of September 30, 2017	Average Recorded Investment	Interest Income Recognized
Commercial, financial and agricultural	\$16,026	\$ 23,247	\$ 187	\$29,848	\$ 28,412	\$ 398
Commercial real estate	25,805	26,428	268	22,995	22,241	192
Construction real estate:						
Commercial	2,016	2,246	4	1,460	1,554	18
Residential real estate:						
Commercial	2,913	2,758	26	19,298	20,365	46
Consumer	—	—	—	8	8	—
Total	\$46,760	\$ 54,679	\$ 485	\$73,609	\$ 72,580	\$ 654
(In thousands)	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Recorded Investment as of September 30, 2018	Average Recorded Investment	Interest Income Recognized	Recorded Investment as of September 30, 2017	Average Recorded Investment	Interest Income Recognized
Commercial, financial and agricultural	\$16,026	\$ 22,686	\$ 506	\$29,848	\$ 23,770	\$ 738
Commercial real estate	25,805	21,582	671	22,995	22,470	663
Construction real estate:						
Commercial	2,016	1,661	31	1,460	1,830	49
Residential real estate:						
Commercial	2,913	6,086	84	19,298	20,876	452
Consumer	—	—	—	8	7	—
Total	\$46,760	\$ 52,015	\$ 1,292	\$73,609	\$ 68,953	\$ 1,902

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The following tables present the aging of the recorded investment in past due loans as of September 30, 2018 and December 31, 2017 by class of loan.

(In thousands)	September 30, 2018		Total Past Due	Total Current (2)	Total Recorded Investment
	Accruing Past Due Days	Past Due Nonaccrual Loans and Loans Past Due 90 Days or More and Accruing (1)			
Commercial, financial and agricultural	\$2,769	\$ 1,817	\$ 4,586	\$ 1,032,520	\$ 1,037,106
Commercial real estate	96	1,425	1,521	1,306,278	1,307,799
Construction real estate:					
Commercial	—	1,837	1,837	150,394	152,231
Mortgage	241	—	241	65,759	66,000
Installment	179	21	200	2,405	2,605
Residential real estate:					
Commercial	79	1,268	1,347	402,956	404,303
Mortgage	13,669	8,241	21,910	1,120,457	1,142,367
HELOC	749	1,089	1,838	220,758	222,596
Installment	273	212	485	15,114	15,599
Consumer	10,221	2,251	12,472	1,278,683	1,291,155
Leases	—	—	—	2,672	2,672
Total loans	\$28,276	\$ 18,161	\$ 46,437	\$ 5,597,996	\$ 5,644,433

(1) Includes \$2.1 million of loans past due 90 days or more and accruing. The remaining loans were past due nonaccrual loans.

(2) Includes \$50.1 million of nonaccrual loans which were current in regards to contractual principal and interest payments.

(in thousands)	December 31, 2017		Total Past Due	Total Current (2)	Total Recorded Investment
	Accruing Past Due Days	Past Due Nonaccrual Loans and Loans Past Due 90 Days or More and Accruing (1)			
Commercial, financial and agricultural	\$145	\$ 1,043	\$ 1,188	\$ 1,056,678	\$ 1,057,866
Commercial real estate	856	2,360	3,216	1,168,674	1,171,890
Construction real estate:					
Commercial	29	—	29	125,761	125,790
Mortgage	256	—	256	52,080	52,336
Installment	54	19	73	3,818	3,891
Residential real estate:					
Commercial	16	1,586	1,602	392,521	394,123
Mortgage	11,515	9,232	20,747	1,091,195	1,111,942
HELOC	616	876	1,492	202,660	204,152
Installment	239	253	492	18,087	18,579
Consumer	11,515	2,407	13,922	1,231,622	1,245,544
Leases	—	—	—	3,029	3,029

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Total loans	\$25,241	\$ 17,776	\$ 43,017	\$ 5,346,125	\$ 5,389,142
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(1) Includes \$1.8 million of loans past due 90 days or more and accruing. The remaining loans were past due nonaccrual loans.

(2) Includes \$56.1 million of nonaccrual loans which were current in regards to contractual principal and interest payments.



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## Credit Quality Indicators

Management utilizes past due information as a credit quality indicator across the loan portfolio. Past due information as of September 30, 2018 and December 31, 2017 is included in the tables above. The past due information is the primary credit quality indicator within the following classes of loans: (1) mortgage loans and installment loans in the construction real estate segment; (2) mortgage loans, HELOC and installment loans in the residential real estate segment; and (3) consumer loans. The primary credit indicator for commercial loans is based on an internal grading system that grades commercial loans on a scale from 1 to 8. Credit grades are continuously monitored by the responsible loan officer and adjustments are made when appropriate. A grade of 1 indicates little or no credit risk and a grade of 8 is considered a loss. Commercial loans that are pass-rated (graded an 1 through a 4) are considered to be of acceptable credit risk. Commercial loans graded a 5 (special mention) are considered to be watch list credits and a higher loan loss reserve percentage is allocated to these loans. Loans classified as special mention have potential weaknesses that require management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of Park's credit position at some future date. Commercial loans graded a 6 (substandard), also considered to be watch list credits, are considered to represent higher credit risk and, as a result, a higher loan loss reserve percentage is allocated to these loans. Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or the value of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that Park will sustain some loss if the deficiencies are not corrected. Commercial loans that are graded a 7 (doubtful) are shown as nonaccrual and Park generally charges these loans down to their fair value by taking a partial charge-off or recording a specific reserve. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Certain 6-rated loans and all 7-rated loans are placed on nonaccrual status and included within the impaired category. A loan is deemed impaired when management determines the borrower's ability to perform in accordance with the contractual loan agreement is in doubt. Any commercial loan graded an 8 (loss) is completely charged off.

The tables below present the recorded investment by loan grade at September 30, 2018 and December 31, 2017 for all commercial loans:

(In thousands)	September 30, 2018					
	5 Rated	6 Rated	Nonaccrual and Accruing TDRs	Purchase Credit Impaired	Pass-Rated	Recorded Investment
Commercial, financial and agricultural *	\$980	\$ 451	\$ 16,101	\$ 405	\$1,019,169	\$1,037,106
Commercial real estate *	2,147	—	25,805	3,546	1,276,301	1,307,799
Construction real estate:						
Commercial	1,588	—	2,016	499	148,128	152,231
Residential real estate:						
Commercial	195	44	2,913	44	401,107	404,303
Leases	—	—	—	—	2,672	2,672
Total commercial loans	\$4,910	\$ 495	\$ 46,835	\$ 4,494	\$2,847,377	\$2,904,111

\* Included within each of commercial, financial and agricultural loans and commercial real estate loans is an immaterial amount of consumer loans that are not broken out by class.



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(In thousands)	December 31, 2017					
	5 Rated	6 Rated	Nonaccrual and Accruing TDRs	Purchase Credit Impaired	Pass-Rated	Recorded Investment
Commercial, financial and agricultural *	\$17,272	\$ 153	\$ 18,064	\$ —	—\$1,022,377	\$1,057,866
Commercial real estate *	5,322	457	18,142	—	1,147,969	1,171,890
Construction real estate:						
Commercial	278	—	1,324	—	124,188	125,790
Residential real estate:						
Commercial	216	1	19,059	—	374,847	394,123
Leases	—	—	—	—	3,029	3,029
Total Commercial Loans	\$23,088	\$ 611	\$ 56,589	\$ —	—\$2,672,410	\$2,752,698

\* Included within each of commercial, financial and agricultural loans and commercial real estate loans is an immaterial amount of consumer loans that are not broken out by class.

## Purchase Credit Impaired ("PCI") Loans

In conjunction with the NewDominion acquisition, Park acquired loans with a book value of \$277.9 million as of July 1, 2018. These loans were recorded at the preliminary fair value of \$272.8 million.

Loans acquired with deteriorated credit quality with a book value of \$5.1 million were recorded at the preliminary fair value of \$4.9 million. The carrying amount of loans acquired with deteriorated credit quality at September 30, 2018 was \$4.5 million, while the outstanding customer balance was \$4.7 million. At September 30, 2018, no allowance for loan losses had been recognized related to the acquired impaired loans.

The following table provides changes in accretable discount for loans acquired with deteriorated credit quality:

(in thousands)	For the Nine Months Ended September	
	30, 2018	30, 2017
Balance at the beginning of the period	\$ —	\$ —
Acquisitions	176	—
Reductions due to change in projected cash flows	—	—
Reclass from non-accretable difference	—	—
Transfers out	11	—
Accretion	—	—
Balance at end of period	\$ 165	\$ —

## Troubled Debt Restructurings ("TDRs")

Management classifies loans as TDRs when a borrower is experiencing financial difficulties and Park has granted a concession to the borrower as part of a modification or in the loan renewal process. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of the borrower's debt in the foreseeable future without the modification. This evaluation is performed in accordance with the Company's internal underwriting policy. Management's policy is to modify loans by extending the term or by granting a temporary or permanent contractual interest rate below the market rate, not by forgiving debt. A court's discharge of a borrower's debt in a Chapter 7 bankruptcy is considered a concession when the

borrower does not reaffirm the discharged debt.

Certain loans which were modified during the three-month periods ended September 30, 2018 and September 30, 2017 did not meet the definition of a TDR as the modification was a delay in a payment that was considered to be insignificant. Management considers a forbearance period of up to three months or a delay in payment of up to 30 days to be insignificant. TDRs may be classified as accruing if the borrower has been current for a period of at least six months with respect to loan payments and management expects that the borrower will be able to continue to make payments in accordance with the terms of the restructured note. Management reviews all accruing TDRs quarterly to ensure payments continue to be made in accordance with the modified terms.

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Quarterly, management reviews renewals/modifications of loans previously identified as TDRs to consider if it is appropriate to remove the TDR classification. If the borrower is no longer experiencing financial difficulty and the renewal/modification did not contain a concessionary interest rate or other concessionary terms, management considers the potential removal of the TDR classification. If deemed appropriate, the TDR classification is removed if the borrower has complied with the terms of the loan at the date of the renewal/modification and there was a reasonable expectation that the borrower would continue to comply with the terms of the loan subsequent to the date of the renewal/modification. The majority of these TDRs were originally considered restructurings in a prior year as a result of a renewal/modification with an interest rate that was not commensurate with the risk of the underlying loan at the time of the renewal/modification. The TDR classification was removed on \$0.2 million of loans during the three-month period ended September 30, 2018 and on \$2.4 million of loans during the nine-month period ended September 30, 2018. There were no TDR classifications removed during the three-month or nine-month periods ended September 30, 2017.

At September 30, 2018 and December 31, 2017, there were \$25.2 million and \$38.5 million, respectively, of TDRs included in the nonaccrual loan totals. At September 30, 2018 and December 31, 2017, \$19.4 million and \$32.4 million, respectively, of these nonaccrual TDRs were performing in accordance with the terms of the restructured note. As of September 30, 2018 and December 31, 2017, loans with a recorded investment of \$14.7 million and \$20.2 million, respectively, were included in accruing TDR loan totals. Management will continue to review the restructured loans and may determine it is appropriate to move certain nonaccrual TDRs to accrual status in the future.

At September 30, 2018 and December 31, 2017, Park had commitments to lend \$0.2 million and \$1.3 million, respectively, of additional funds to borrowers whose outstanding loan terms had been modified in a TDR.

At September 30, 2018 and December 31, 2017, there were \$0.9 million and \$0.5 million of specific reserves related to TDRs. Modifications made in 2017 and 2018 were largely the result of renewals and extending the maturity date of the loans at terms consistent with the original notes. These modifications were deemed to be TDRs primarily due to Park's conclusion that the borrower would likely not have qualified for similar terms through another lender. Many of the modifications deemed to be TDRs were previously identified as impaired loans, and thus were also previously evaluated for impairment under Accounting Standards Codification (ASC) 310. Additional specific reserves of \$150,000 were recorded during the three-month period ended September 30, 2018 as a result of TDRs identified in the period. There were no additional specific reserves recorded during the three-month period ended September 30, 2017 as a result of TDRs identified in the period. Additional specific reserves of \$160,000 and \$290,000 were recorded during the nine-month periods ended September 30, 2018 and September 30, 2017, respectively, as a result of TDRs identified in the respective periods.

The terms of certain other loans were modified during the three-month and nine-month periods ended September 30, 2018 and September 30, 2017 that did not meet the definition of a TDR. There were no substandard commercial loans modified during the three-month period ended September 30, 2018 which did not meet the definition of a TDR. Substandard commercial loans modified during the nine-month period ended September 30, 2018 which did not meet the definition of a TDR had a total recorded investment of \$0.2 million. Substandard commercial loans modified during the three-month and nine-month periods ended September 30, 2017 which did not meet the definition of a TDR had a total recorded investment of \$0.9 million and \$1.0 million, respectively. The renewal/modification of these loans: (1) resulted in a delay in a payment that was considered to be insignificant, or (2) resulted in Park obtaining additional collateral or guarantees that improved the likelihood of the ultimate collection of the loans such that each modification was deemed to be at market terms. Consumer loans modified during the three-month and nine-month periods ended September 30, 2018 which did not meet the definition of a TDR had a total recorded investment of \$6.6 million and \$17.0 million, respectively. Consumer loans with a recorded investment of \$3.1 million and \$6.7 million were modified during the three-month and nine-month periods ended September 30, 2017, respectively, and did not meet the definition of a TDR. Many of these loans were to borrowers who were not experiencing financial difficulties

but who were looking to reduce their cost of funds.

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The following tables detail the number of contracts modified as TDRs during the three-month periods ended September 30, 2018 and September 30, 2017, as well as the recorded investment of these contracts at September 30, 2018 and September 30, 2017. The recorded investment pre- and post-modification is generally the same due to the fact that Park does not typically forgive principal.

(In thousands)	Three Months Ended September 30, 2018			
	Number of Contracts	Accruing	Nonaccrual	Total Recorded Investment
Commercial, financial and agricultural	8	\$ 22	\$ 552	\$ 574
Commercial real estate	3	—	1,154	1,154
Construction real estate:				
Commercial	—	—	—	—
Mortgage	—	—	—	—
Installment	—	—	—	—
Residential real estate:				
Commercial	2	55	249	304
Mortgage	4	—	246	246
HELOC	10	453	16	469
Installment	8	336	—	336
Consumer	71	31	590	621
Total loans	106	\$ 897	\$ 2,807	\$ 3,704

(In thousands)	Three Months Ended September 30, 2017			
	Number of Contracts	Accruing	Nonaccrual	Total Recorded Investment
Commercial, financial and agricultural	14	\$ 400	\$ 1,015	\$ 1,415
Commercial real estate	3	974	481	1,455
Construction real estate:				
Commercial	—	—	—	—
Mortgage	—	—	—	—
Installment	—	—	—	—
Residential real estate:				
Commercial	10	144	354	498
Mortgage	5	211	206	417
HELOC	4	123	45	168
Installment	4	110	41	151
Consumer	99	99	735	834
Total loans	139	\$ 2,061	\$ 2,877	\$ 4,938

Of those loans which were modified and determined to be a TDR during the three-month period ended September 30, 2018, \$0.1 million were on nonaccrual status as of December 31, 2017. Of those loans which were modified and determined to be a TDR during the three-month period ended September 30, 2017, \$0.5 million were on nonaccrual status as of December 31, 2016.





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(In thousands)	Nine Months Ended September 30, 2018			Total Recorded Investment
	Number of Contracts	Accruing	Nonaccrual	
Commercial, financial and agricultural	16	\$ 208	\$ 592	\$ 800
Commercial real estate	10	447	1,412	1,859
Construction real estate:				
Commercial	1	—	—	—
Mortgage	—	—	—	—
Installment	2	12	—	12
Residential real estate:				
Commercial	2	55	249	304
Mortgage	17	90	972	1,062
HELOC	18	735	125	860
Installment	17	437	16	453
Consumer	206	59	1,157	1,216
Total loans	289	\$ 2,043	\$ 4,523	\$ 6,566

(In thousands)	Nine Months Ended September 30, 2017			Total Recorded Investment
	Number of Contracts	Accruing	Nonaccrual	
Commercial, financial and agricultural	25	\$ 400	\$ 3,769	\$ 4,169
Commercial real estate	9	1,525	795	2,320
Construction real estate:				
Commercial	—	—	—	—
Mortgage	1	—	8	8
Installment	—	—	—	—
Residential real estate:				
Commercial	15	144	558	702
Mortgage	24	746	923	1,669
HELOC	16	478	51	529
Installment	7	175	41	216
Consumer	228	140	1,012	1,152
Total loans	325	\$ 3,608	\$ 7,157	\$ 10,765

Of those loans which were modified and determined to be a TDR during the nine-month period ended September 30, 2018, \$0.5 million were on nonaccrual status as of December 31, 2017. Of those loans which were modified and determined to be a TDR during the nine-month period ended September 30, 2017, \$3.0 million were on nonaccrual status as of December 31, 2016.

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The following table presents the recorded investment in loans which were modified as TDRs within the previous 12 months and for which there was a payment default during the three-month and nine-month periods ended September 30, 2018 and September 30, 2017, respectively. For this table, a loan is considered to be in default when it becomes 30 days contractually past due under the modified terms. The additional allowance for loan loss resulting from the defaults on TDR loans was immaterial.

(In thousands)	Three Months Ended September 30, 2018		Three Months Ended September 30, 2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial, financial and agricultural	1	\$ 1	1	\$ 20
Commercial real estate	—	—	1	72
Construction real estate:				
Commercial	—	—	—	—
Mortgage	—	—	—	—
Installment	—	—	—	—
Residential real estate:				
Commercial	—	—	1	17
Mortgage	8	688	6	427
HELOC	3	108	2	27
Installment	—	—	—	—
Consumer	40	315	33	262
Leases	—	—	—	—
Total loans	52	\$ 1,112	44	\$ 825

Of the \$1.1 million in modified TDRs which defaulted during the three-month period ended September 30, 2018, \$67,000 were accruing loans and \$1.0 million were nonaccrual loans. Of the \$0.8 million in modified TDRs which defaulted during the three-month period ended September 30, 2017, all were nonaccrual loans.

(In thousands)	Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial, financial and agricultural	1	\$ 1	1	\$ 20
Commercial real estate	—	—	2	248
Construction real estate:				
Commercial	—	—	—	—
Mortgage	—	—	—	—
Installment	—	—	—	—
Residential real estate:				
Commercial	—	—	1	17
Mortgage	9	789	6	426
HELOC	3	108	3	32
Installment	—	—	—	—
Consumer	50	392	45	345

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Leases	—	—	—	—
Total loans	63	\$ 1,290	58	\$ 1,088

Of the \$1.3 million in modified TDRs which defaulted during the nine-month period ended September 30, 2018, \$67,000 were accruing loans and \$1.2 million were nonaccrual loans. Of the \$1.1 million in modified TDRs which defaulted during the nine-month period ended September 30, 2017, \$2,000 were accruing loans and \$1.1 million were nonaccrual loans.

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Note 5 – Allowance for Loan Losses

The allowance for loan losses ("ALLL") is that amount management believes is adequate to absorb probable incurred credit losses in the loan portfolio based on management's evaluation of various factors including overall growth in the loan portfolio, an analysis of individual loans, prior and current loss experience, and current economic conditions. A provision for loan losses is charged to operations based on management's periodic evaluation of these and other pertinent factors as discussed within Note 1 of the Notes to Consolidated Financial Statements included in Park's 2017 Annual Report.

Loss factors are reviewed quarterly and updated at least annually to reflect recent loan loss history and incorporate current risks and trends which may not be recognized in historical data. The following are factors management reviews on a quarterly or annual basis.

**Historical Loss Factor:** Management updated the historical loss calculation during the fourth quarter of 2017, incorporating net charge-offs plus changes in specific reserves through December 31, 2017. With the addition of 2017 historical losses, management extended the historical loss period to 96 months from 84 months. The 96-month historical loss period captures all annual periods subsequent to June 2009, the end of the most recent recession, thus encompassing the full economic cycle to date.

**Loss Emergence Period Factor:** At least annually, management calculates the loss emergence period for each commercial loan segment. The loss emergence period is calculated based upon the average period of time it takes from the probable occurrence of a loss event to the credit being moved to nonaccrual. If the loss emergence period for any commercial loan segment is greater than one year, management applies additional general reserves to all performing loans within that segment of the commercial loan portfolio. The loss emergence period was last updated in the fourth quarter of 2017.

**Loss Migration Factor:** Park's commercial loans are individually risk graded. If loan downgrades occur, the probability of default increases, and accordingly, management allocates a higher percentage reserve to those accruing commercial loans graded special mention and substandard. Annually, management calculates a loss migration factor for each commercial loan segment for special mention and substandard credits based on a review of losses over the period of time a loan takes to migrate from pass-rated to impaired. The loss migration factor was last updated in the fourth quarter of 2017.

**Environmental Loss Factor:** Management has identified certain macroeconomic factors that trend in accordance with losses in Park's commercial loan portfolio. These macroeconomic factors are reviewed quarterly and the adjustments made to the environmental loss factor impacting each segment in the performing commercial loan portfolio correlate to changes in the macroeconomic environment. There was no change to the environmental loss factor during the third quarter of 2018.

Loans acquired as part of the acquisition of NewDominion were recorded at fair value on the date of acquisition, July 1, 2018. An allowance is only established on these NewDominion loans as a result of credit deterioration post acquisition. As of September 30, 2018, there was no allowance related to acquired NewDominion loans.

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The activity in the allowance for loan losses for the three-month and nine-month periods ended September 30, 2018 and September 30, 2017 is summarized in the following tables.

(In thousands)	Three Months Ended September 30, 2018						Total
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	
Allowance for loan losses:							
Beginning balance	\$14,478	\$ 9,406	\$ 4,652	\$ 9,245	\$ 11,671	\$ —	\$49,452
Charge-offs	993	23	26	61	2,371	—	3,474
Recoveries	136	27	156	130	875	4	1,328
Net charge-offs/(recoveries)	857	(4 )	(130 )	(69 )	1,496	(4 )	2,146
Provision/(recovery)	1,394	337	(187 )	(212 )	1,612	(4 )	2,940
Ending balance	\$15,015	\$ 9,747	\$ 4,595	\$ 9,102	\$ 11,787	\$ —	\$50,246

(In thousands)	Three Months Ended September 30, 2017						Total
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	
Allowance for loan losses:							
Beginning balance	\$16,746	\$ 10,451	\$ 4,677	\$ 10,319	\$ 11,629	\$ —	\$53,822
Charge-offs	626	628	78	217	2,828	—	4,377
Recoveries	115	13	303	1,061	1,011	1	2,504
Net charge-offs/(recoveries)	511	615	(225 )	(844 )	1,817	(1 )	1,873
Provision/(recovery)	1,742	336	499	(1,078 )	1,785	(1 )	3,283
Ending balance	\$17,977	\$ 10,172	\$ 5,401	\$ 10,085	\$ 11,597	\$ —	\$55,232

(In thousands)	Nine Months Ended September 30, 2018						Total
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	
Allowance for loan losses:							
Beginning balance	\$15,022	\$ 9,601	\$ 4,430	\$ 9,321	\$ 11,614	\$ —	\$49,988
Charge-offs	1,929	252	57	279	7,123	—	9,640
Recoveries	994	203	435	734	2,942	4	5,312
Net charge-offs/(recoveries)	935	49	(378 )	(455 )	4,181	(4 )	4,328
Provision/(recovery)	928	195	(213 )	(674 )	4,354	(4 )	4,586
Ending balance	\$15,015	\$ 9,747	\$ 4,595	\$ 9,102	\$ 11,787	\$ —	\$50,246

(In thousands)	Nine Months Ended September 30, 2017						Total
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	
Allowance for loan losses:							

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Beginning balance	\$13,434	\$ 10,432	\$ 5,247	\$ 10,958	\$ 10,553	\$ —	\$50,624
Charge-offs	1,283	1,050	105	987	7,706	—	11,131
Recoveries	647	368	686	1,688	3,609	1	6,999
Net charge-offs/(recoveries)	636	682	(581)	(701)	4,097	(1)	4,132
Provision/(recovery)	5,179	422	(427)	(1,574)	5,141	(1)	8,740
Ending balance	\$17,977	\$ 10,172	\$ 5,401	\$ 10,085	\$ 11,597	\$ —	\$55,232

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Loans collectively evaluated for impairment in the following tables include all performing loans at September 30, 2018 and December 31, 2017, as well as nonperforming loans internally classified as consumer loans. Nonperforming consumer loans are not typically individually evaluated for impairment, but receive a portion of the statistical allocation of the allowance for loan losses. Loans individually evaluated for impairment include all impaired loans internally classified as commercial loans at September 30, 2018 and December 31, 2017, which are evaluated for impairment in accordance with U.S. GAAP (see Note 1 of the Notes to Consolidated Financial Statements included in Park's 2017 Annual Report).

The composition of the allowance for loan losses at September 30, 2018 and December 31, 2017 was as follows:

(In thousands)	September 30, 2018							
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	Total	
Allowance for loan losses:								
Ending allowance balance attributed to loans:								
Individually evaluated for impairment	\$ 1,716	\$ 71	\$ —	\$ 59	\$ —	\$ —	\$ 1,846	
Collectively evaluated for impairment	13,299	9,676	4,595	9,043	11,787	—	48,400	
Acquired with deteriorated credit quality	—	—	—	—	—	—	—	
Total ending allowance balance	\$ 15,015	\$ 9,747	\$ 4,595	\$ 9,102	\$ 11,787	\$ —	\$ 50,246	
Loan balance:								
Loans individually evaluated for impairment	\$ 16,023	\$ 25,747	\$ 2,016	\$ 2,912	\$ —	\$ —	\$ 46,698	
Loans collectively evaluated for impairment	1,015,072	1,273,337	217,681	1,778,027	1,287,382	2,632	5,574,131	
Loans acquired with deteriorated credit quality	405	3,546	499	44	—	—	4,494	
Total ending loan balance	\$ 1,031,500	\$ 1,302,630	\$ 220,196	\$ 1,780,983	\$ 1,287,382	\$ 2,632	\$ 5,625,323	
Allowance for loan losses as a percentage of loan balance:	10.71	% 0.28	% —	% 2.03	% —	% —	% 3.95	%

Loans individually evaluated for impairment								
Loans collectively evaluated for impairment	1.31	% 0.76	% 2.11	% 0.51	% 0.92	% —	% 0.87	%
Loans acquired with deteriorated credit quality	—	% —	% —	% —	% —	% —	% —	%
Total	1.46	% 0.75	% 2.09	% 0.51	% 0.92	% —	% 0.89	%

Recorded investment:								
Loans individually evaluated for impairment	\$ 16,026	\$ 25,805	\$ 2,016	\$ 2,913	\$—	\$—	\$ 46,760	
Loans collectively evaluated for impairment	1,020,675	1,278,448	218,321	1,781,908	1,291,155	2,672	5,593,179	
Loans acquired with deteriorated credit quality	405	3,546	499	44	—	—	4,494	
Total ending recorded investment	\$ 1,037,106	\$ 1,307,799	\$ 220,836	\$ 1,784,865	\$ 1,291,155	\$ 2,672	\$ 5,644,433	



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(In thousands)	December 31, 2017							
	Commercial, financial and agricultural	Commercial real estate	Construction real estate	Residential real estate	Consumer	Leases	Total	
Allowance for loan losses:								
Ending allowance balance attributed to loans:								
Individually evaluated for impairment	\$ 681	\$ 2	\$ —	\$ 1	\$ —	\$ —	\$ 684	
Collectively evaluated for impairment	14,341	9,599	4,430	9,320	11,614	—	49,304	
Total ending allowance balance	\$ 15,022	\$ 9,601	\$ 4,430	\$ 9,321	\$ 11,614	\$ —	\$ 49,988	
Loan balance:								
Loans individually evaluated for impairment	\$ 18,034	\$ 18,131	\$ 1,322	\$ 19,058	\$ —	\$ —	\$ 56,545	
Loans collectively evaluated for impairment	1,035,419	1,149,476	180,148	1,706,166	1,241,736	2,993	5,315,938	
Total ending loan balance	\$ 1,053,453	\$ 1,167,607	\$ 181,470	\$ 1,725,224	\$ 1,241,736	\$ 2,993	\$ 5,372,483	
Allowance for loan losses as a percentage of loan balance:								
Loans individually evaluated for impairment	3.78	% 0.01	% —	% 0.01	% —	% —	% 1.21	%
Loans collectively evaluated for impairment	1.39	% 0.84	% 2.46	% 0.55	% 0.94	% —	% 0.93	%
Total	1.43	% 0.82	% 2.44	% 0.54	% 0.94	% —	% 0.93	%
Recorded investment:								
Loans individually evaluated for impairment	\$ 18,039	\$ 18,142	\$ 1,324	\$ 19,059	\$ —	\$ —	\$ 56,564	
Loans collectively evaluated for impairment	1,039,827	1,153,748	180,693	1,709,737	1,245,544	3,029	5,332,578	
	\$ 1,057,866	\$ 1,171,890	\$ 182,017	\$ 1,728,796	\$ 1,245,544	\$ 3,029	\$ 5,389,142	

Total ending  
recorded  
investment

Note 6 – Foreclosed and Repossessed Assets

Park typically transfers a loan to other real estate owned ("OREO") at the time that Park takes deed/title to the asset. The carrying amounts of foreclosed properties held at September 30, 2018 and December 31, 2017 are listed below, as well as the recorded investment of loans secured by residential real estate properties for which formal foreclosure proceedings were in process at those dates.

(in thousands)	September 30, 2018	December 31, 2017
OREO:		
Commercial real estate	\$ 2,359	\$ 7,888
Construction real estate	2,191	4,852
Residential real estate	726	1,450
Total OREO	\$ 5,276	\$ 14,190
Loans in process of foreclosure:		
Residential real estate	\$ 2,743	\$ 2,948

In addition to real estate, Park may also repossess different types of collateral. As of September 30, 2018, Park had \$7.2 million in other repossessed assets which are included in other assets on the consolidated condensed balance sheet. These assets consisted of aircraft acquired as part of a loan workout. There were no other repossessed assets as of September 30, 2017.

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## Note 7 – Earnings Per Common Share

The following table sets forth the computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2018 and 2017.

(In thousands, except share and per common share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	\$24,762	\$ 22,112	\$84,126	\$ 61,411
Denominator:				
Weighted-average common shares outstanding	15,686,542	15,287,974	15,420,135	15,299,039
Effect of dilutive restricted stock units	146,192	63,616	140,531	95,160
Weighted-average common shares outstanding adjusted for the effect of dilutive restricted stock units	15,832,734	15,351,590	15,560,666	15,394,199
Earnings per common share:				
Basic earnings per common share	\$1.58	\$ 1.45	\$5.46	\$ 4.01
Diluted earnings per common share	\$1.56	\$ 1.44	\$5.41	\$ 3.99

Park awarded 48,053 and 45,788 performance based restricted stock units ("PBRsUs") to certain employees during the nine months ended September 30, 2018 and 2017, respectively. No PBRsUs were awarded during the three months ended either September 30, 2018 or 2017.

On July 1, 2018, Park issued 435,457 common shares to complete its acquisition of NewDominion and granted 13,637 restricted stock units ("RSUs") to NewDominion employees. These common shares are included in average common shares outstanding beginning on that date.

Park repurchased 50,000 common shares during the nine months ended September 30, 2018 to fund the PBRsUs, RSUs and common shares to be awarded to directors of Park and to directors of Park's subsidiary PNB (and its divisions). No common shares were repurchased during the three months ended September 30, 2018. Park repurchased 20,000 common shares during the three months ended September 30, 2017, and repurchased 70,000 common shares during the nine months ended September 30, 2017 to fund the PBRsUs and common shares to be awarded to directors of Park and to directors of Park's subsidiary PNB (and its divisions).

## Note 8 – Segment Information

The Corporation is a financial holding company headquartered in Newark, Ohio. The operating segments for the Corporation are its chartered national bank subsidiary, PNB (headquartered in Newark, Ohio), SE Property Holdings, LLC ("SEPH"), and Guardian Financial Services Company ("GFSC").

Management is required to disclose information about the different types of business activities in which a company engages and also information on the different economic environments in which a company operates, so that the users of the financial statements can better understand the company's performance, better understand the potential for future cash flows, and make more informed judgments about the company as a whole. Park has three operating segments, as: (i) discrete financial information is available for each operating segment and (ii) the segments are aligned with internal reporting to Park's Chief Executive Officer and President, who is the chief operating decision maker.



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September 30, 2018

(In thousands)	PNB	GFSC	SEPH	All Other	Total
Net interest income	\$66,195	\$1,252	\$119	\$110	\$67,676
Provision for (recovery of) loan losses	2,935	183	(178)	—	2,940
Other income (loss)	22,559	63	(99)	1,541	24,064
Other expense	51,982	810	563	5,961	59,316
Income (loss) before income taxes	\$33,837	\$322	\$(365)	\$(4,310)	\$29,484
Income tax expense (benefit)	5,981	68	(76)	(1,251)	4,722
Net income (loss)	\$27,856	\$254	\$(289)	\$(3,059)	\$24,762
Assets (as of September 30, 2018)	\$7,707,474	\$28,551	\$7,475	\$12,991	\$7,756,491

Operating Results for the three months ended  
September 30, 2017

(In thousands)	PNB	GFSC	SEPH	All Other	Total
Net interest income	\$59,415	\$1,455	\$401	\$280	\$61,551
Provision for (recovery of) loan losses	3,820	609	(1,146)	—	3,283
Other income	21,770	34	440	1,293	23,537
Other expense	47,390	750	1,025	2,094	51,259
Income (loss) before income taxes	\$29,975	\$130	\$962	\$(521)	\$30,546
Income tax expense (benefit)	8,678	46	336	(626)	8,434
Net income	\$21,297	\$84	\$626	\$105	\$22,112
Assets (as of September 30, 2017)	\$7,788,248	\$33,260	\$25,377	\$15,810	\$7,862,695

Operating Results for the nine months ended  
September 30, 2018

(In thousands)	PNB	GFSC	SEPH	All Other	Total
Net interest income	\$190,319	\$3,818	\$2,612	\$519	\$197,268
Provision for (recovery of) loan losses	4,491	773	(678)	—	4,586
Other income	64,544	135	3,559	5,971	74,209
Other expense	149,152	2,412	3,445	11,149	166,158
Income (loss) before income taxes	\$101,220	\$768	\$3,404	\$(4,659)	\$100,733
Income tax expense (benefit)	17,822	162	715	(2,092)	16,607
Net income (loss)	\$83,398	\$606	\$2,689	\$(2,567)	\$84,126

Operating Results for the nine months ended  
September 30, 2017

(In thousands)	PNB	GFSC	SEPH	All Other	Total
Net interest income	\$174,717	\$4,424	\$884	\$256	\$180,281
Provision for (recovery of) loan losses	9,114	1,419	(1,793)	—	8,740
Other income	61,466	58	477	1,190	63,191
Other expense	137,876	2,343	3,097	6,407	149,723
Income (loss) before income taxes	\$89,193	\$720	\$57	\$(4,961)	\$85,009
Income tax expense (benefit)	26,247	252	20	(2,921)	23,598
Net income (loss)	\$62,946	\$468	\$37	\$(2,040)	\$61,411

The operating results of the Parent Company in the “All Other” column are used to reconcile the segment totals to the consolidated condensed statements of income for the three-month and nine-month periods ended September 30, 2018 and 2017. The reconciling amounts for consolidated total assets for the periods ended September 30, 2018 and 2017 consisted of the elimination of intersegment borrowings and the assets of the Parent Company which were not eliminated.

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## Note 9 – Loans Held For Sale

Mortgage loans held for sale are carried at their fair value. At September 30, 2018 and December 31, 2017, respectively, Park had approximately \$6.4 million and \$4.1 million in mortgage loans held for sale. These amounts are included in loans on the consolidated condensed balance sheets and in the residential real estate loan segments in Note 4 - Loans, and Note 5 - Allowance for Loan Losses. The contractual balance was \$6.4 million and \$4.1 million at September 30, 2018 and December 31, 2017, respectively. The gain expected upon sale was \$75,000 and \$55,000 at September 30, 2018 and December 31, 2017, respectively. None of these loans were 90 days or more past due or on nonaccrual status as of September 30, 2018 or December 31, 2017.

## Note 10 – Investment Securities

The amortized cost and fair value of investment securities are shown in the following tables. Management performs a quarterly evaluation of investment securities for any other-than-temporary impairment. For the three-month and nine-month periods ended September 30, 2018 and 2017, there were no investment securities deemed to be other-than-temporarily impaired.

Investment securities at September 30, 2018, were as follows:

Debt Securities Available-for-Sale (In thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
U.S. Government sponsored entities' asset-backed securities	\$1,074,605	\$ 229	\$ 42,569	\$1,032,265
Total	\$1,074,605	\$ 229	\$ 42,569	\$1,032,265

Debt Securities Held-to-Maturity (In thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
U.S. Government sponsored entities' asset-backed securities	\$46,974	\$ 41	\$ 1,386	\$45,629
Obligations of states and political subdivisions	303,668	1,096	\$ 6,052	298,712
Total	\$350,642	\$ 1,137	\$ 7,438	\$344,341

Investment securities with unrealized/unrecognized losses at September 30, 2018, were as follows:

(In thousands)	Unrealized/unrecognized loss position for less than 12 months	Unrealized/unrecognized loss position for 12 months or longer	Total
	Fair value	Unrealized/unrecognized losses	Fair value
Debt Securities Available-for-Sale			
U.S. Government sponsored entities' asset-backed securities	\$ 547,752	\$ 12,583	\$ 450,284
Total	\$ 547,752	\$ 12,583	\$ 450,284
Debt Securities Held-to-Maturity			
U.S. Government sponsored entities' asset-backed securities	\$ 32,704	\$ 1,165	\$ 6,944
	152,074	\$ 3,041	69,429
			3,011
			\$221,503
			6,052

Obligations of states and political  
subdivisions

Total	\$ 184,778	\$ 4,206	\$ 76,373	\$ 3,232	\$ 261,151	\$ 7,438
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Investment securities at December 31, 2017, were as follows:

Debt Securities Available-for-Sale (In thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Obligations of U.S. Treasury and other U.S. Government sponsored entities	\$245,000	\$ —	\$ 2,280	\$242,720
U.S. Government sponsored entities' asset-backed securities	852,645	4,645	8,129	849,161
Total	\$1,097,645	\$ 4,645	\$ 10,409	\$1,091,881

Debt Securities Held-to-Maturity (In thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Obligations of states and political subdivisions	\$ 300,412	\$ 6,575	\$ 713	\$ 306,274
U.S. Government sponsored entities' asset-backed securities	56,785	758	38	57,505
Total	\$ 357,197	\$ 7,333	\$ 751	\$ 363,779

Investment securities with unrealized/unrecognized losses at December 31, 2017, were as follows:

(In thousands)	Unrealized/unrecognized loss position for less than 12 months	Unrealized/unrecognized loss position for 12 months or longer	Total
Fair value	Unrealized/unrecognized losses	Unrealized/unrecognized losses	Unrealized/unrecognized losses
Debt Securities Available-for-Sale			
Obligations of U.S. Treasury and other U.S. Government sponsored entities	\$ 24,931	\$ 70	\$ 242,720
U.S. Government sponsored entities' asset-backed securities	236,924	2,786	555,721
Total	\$ 261,855	\$ 2,856	\$ 798,441
Debt Securities Held-to-Maturity			
Obligations of states and political subdivisions	\$ 26,644	\$ 194	\$ 72,142
U.S. Government sponsored entities' asset-backed securities	7,331	38	7,331
Total	\$ 33,975	\$ 232	\$ 79,473

Management does not believe any of the unrealized/unrecognized losses at September 30, 2018 or December 31, 2017 represented other-than-temporary impairment. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized within net income in the period the other-than-temporary impairment is identified.

Park's U.S. Government sponsored entities' asset-backed securities consist primarily of 15-year residential mortgage-backed securities and collateralized mortgage obligations.



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The amortized cost and estimated fair value of investments in debt securities at September 30, 2018, are shown in the following table by contractual maturity, except for asset-backed securities, which are shown as a single total, due to the unpredictability of the timing of principal repayments.

Securities Available-for-Sale (In thousands)	Amortized cost	Fair value	Tax equivalent yield	
U.S. Government sponsored entities' asset-backed securities	\$ 1,074,605	\$ 1,032,265	2.35	%
Securities Held-to-Maturity (In thousands)	Amortized cost	Fair value	Tax equivalent yield <sup>(1)</sup>	
Obligations of state and political subdivisions:				
Due five through ten years	\$ 2,430	\$ 2,385	2.97	%
Due over ten years	301,238	296,327	3.68	%
Total <sup>(1)</sup>	\$ 303,668	\$ 298,712	3.67	%
U.S. Government sponsored entities' asset-backed securities	\$ 46,974	\$ 45,629	2.83	%

(1) The tax equivalent yield for obligations of state and political subdivisions includes the effects of a taxable equivalent adjustment using a 21% federal corporate income tax rate.

The remaining average life of the entire investment portfolio is estimated to be 4.8 years.

There were no sales of investment securities during the three-month period ended September 30, 2018. During the nine-month period ended September 30, 2018, Park sold certain AFS debt securities with a book value of \$247.0 million at a loss of \$2.6 million. Additionally, during the nine-month period ended September 30, 2018, Park sold certain HTM debt securities with a book value of \$7.4 million at a gain of \$291,000. These HTM securities had been paid down by 96.3% of the principal outstanding at acquisition. There were no sales of investment securities during the three-month or nine-month periods ended September 30, 2017.

Investment securities having a book value of \$564 million and \$557 million at September 30, 2018 and December 31, 2017, respectively, were pledged to collateralize government and trust department deposits in accordance with federal and state requirements, to secure repurchase agreements sold and as collateral for Federal Home Loan Bank ("FHLB") advance borrowings.

#### Note 11 – Other Investment Securities

Other investment securities consist of stock investments in the FHLB, the Federal Reserve Bank ("FRB"), and equity securities. The FHLB and FRB restricted stock investments are carried at their redemption value. Equity securities with a readily determinable fair value are carried at fair value. Beginning on January 1, 2018, with the adoption of ASU 2016-01, changes in fair value are included in other income on the consolidated condensed statement of income as opposed to in accumulated other comprehensive loss on the consolidated condensed balance sheet. Equity securities without a readily determinable fair value are recorded at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions ("modified cost").

The carrying amount of other investment securities at September 30, 2018 and December 31, 2017 was as follows:

(In thousands)	September 30, 2018	December 31, 2017
FHLB stock	\$ 43,388	\$ 50,086
FRB stock	8,225	8,225

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Equity investments carried at fair value	1,902	1,935
Equity investments carried at cost/modified cost <sup>(1)</sup>	2,589	3,500
Total other investment securities	\$ 56,104	\$ 63,746

<sup>(1)</sup> There have been no impairments, downward adjustments, or upward adjustments made to equity investments carried at modified cost.

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During the three and nine months ended September 30, 2018, \$326,000 and \$33,000, respectively, of unrealized losses were recorded within "(Loss) gain on equity securities, net" on the consolidated condensed statements of income. An additional \$3.5 million gain recorded within "(Loss) gain on equity securities, net" on the consolidated condensed statement of income for the nine months ended September 30, 2018 relates to an investment security which was no longer held at September 30, 2018.

## Note 12 – Goodwill and Other Intangibles

The following table shows the activity in goodwill and other intangibles for the first nine months of 2018.

(in thousands)	Goodwill	Other Intangibles	Total
December 31, 2017	\$72,334	\$ —	\$72,334
Acquired goodwill and other intangibles	40,405	7,549	47,954
Amortization	—	289	289
September 30, 2018	\$112,739	\$ 7,260	\$119,999

Park evaluates goodwill for impairment on April 1 of each year, with financial data as of March 31. Based on the analysis performed as of April 1, 2018, the Company determined that goodwill for Park's national bank subsidiary (PNB) was not impaired. There have been no subsequent circumstances or events triggering an additional evaluation.

## Acquired Intangible Assets

The following table shows the balance of acquired intangible assets as of September 30, 2018. Park had no other intangible assets as of December 31, 2017.

(in thousands)	2018 Gross Carrying Amount	Accumulated Amortization
Other intangible assets:		
Core deposit intangibles	\$6,249	\$ 289
Trade name intangible	1,300	—
Total	\$7,549	\$ 289

Core deposit intangibles are being amortized, on an accelerated basis, over a period of ten years. The trade name intangible is an indefinite life asset and is not amortized, but rather is assessed, at least annually, for impairment. Aggregate amortization expense was \$289,000 for both the three months and nine months ended September 30, 2018. There was no amortization expense during 2017.

Estimated amortization expense for each of the periods listed below follows:

(in thousands)	Total
Three months ending December 31, 2018	\$ 289
2019	1,234
2020	1,149
2021	869
2022	629

Note 13 - Share-Based Compensation

The Park National Corporation 2013 Long-Term Incentive Plan (the "2013 Incentive Plan") was adopted by the Board of Directors of Park on January 28, 2013 and was approved by Park's shareholders at the Annual Meeting of Shareholders on April 22, 2013. The 2013 Incentive Plan made equity-based awards and cash-based awards available for grant to participants in the form of incentive stock options, nonqualified stock options, stock appreciation rights ("SARs"), restricted common shares

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("Restricted Stock"), restricted stock unit awards that may be settled in common shares, cash or a combination of the two ("Restricted Stock Units"), unrestricted common shares ("Other Stock-Based Awards") and cash-based awards. Under the 2013 Incentive Plan, 600,000 common shares were authorized to be delivered in connection with grants under the 2013 Incentive Plan. The common shares to be delivered under the 2013 Incentive Plan are to consist of either common shares currently held or common shares subsequently acquired by Park as treasury shares, including common shares purchased in the open market or in private transactions. As of September 30, 2018, there were 92,404 common shares subject to performance-based Restricted Stock Units ("PBRsUs") issued under the 2013 Incentive Plan, which represented the only awards outstanding under the 2013 Incentive Plan.

The Park National Corporation 2017 Long-Term Incentive Plan for Employees (the "2017 Employees LTIP") was adopted by the Board of Directors of Park on January 23, 2017 and was approved by Park's shareholders at the Annual Meeting of Shareholders on April 24, 2017. The 2017 Employees LTIP makes equity-based awards and cash-based awards available for grant to participants in the form of incentive stock options, nonqualified stock options, SARs, Restricted Stock, Restricted Stock Units, Other Stock-Based Awards and cash-based awards. Under the 2017 Employees LTIP, 750,000 common shares are authorized to be delivered in connection with grants under the 2017 Employees LTIP. The common shares to be delivered under the 2017 Employees LTIP are to consist of either common shares currently held or common shares subsequently acquired by Park as treasury shares, including common shares purchased in the open market or in private transactions. At September 30, 2018, 689,773 common shares were available for future grants under the 2017 Employees LTIP.

The Park National Corporation 2017 Long-Term Incentive Plan for Non-Employee Directors (the "2017 Non-Employee Directors LTIP") was adopted by the Board of Directors of Park on January 23, 2017 and was approved by Park's shareholders at the Annual Meeting of Shareholders on April 24, 2017. The 2017 Non-Employee Directors LTIP makes equity-based awards and cash-based awards available for grant to participants in the form of nonqualified stock options, SARs, Restricted Stock, Restricted Stock Units, Other Stock-Based Awards, and cash-based awards. Under the 2017 Non-Employee Directors LTIP, 150,000 common shares are authorized to be delivered in connection with grants under the 2017 Non-Employee Directors LTIP. The common shares to be delivered under the 2017 Non-Employee Directors LTIP are to consist of either common shares currently held or common shares subsequently acquired by Park as treasury shares, including common shares purchased in the open market or in private transactions. At September 30, 2018, 138,850 common shares were available for future grants under the 2017 Non-Employee Director LTIP.

The 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP have replaced the provisions of the 2013 Incentive Plan with respect to the grant of future awards. As a result of the approval of the 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP, Park has not granted and will not grant any additional awards under the 2013 Incentive Plan after April 24, 2017. Awards made under the 2013 Incentive Plan prior to April 24, 2017 will remain in effect in accordance with their respective terms.

During the nine months ended September 30, 2018, the Compensation Committee of the Board of Directors of Park granted awards of PBRsUs, under the 2017 Employees LTIP, covering an aggregate of 48,053 common shares to certain employees of Park and its subsidiaries. Additionally, on July 1, 2018, Park granted 13,637 RSUs to NewDominion employees. During the nine months ended September 30, 2017, the Compensation Committee of the Board of Directors of Park granted awards of PBRsUs, under the 2013 Incentive Plan, covering an aggregate of 45,788 common shares to certain employees of Park and its subsidiaries. There were no awards granted during the three months ended September 30, 2017. The number of PBRsUs earned or settled will depend on the level of achievement with respect to certain performance criteria and are also subject to subsequent service-based vesting. The number of RSUs earned or settled are subject to subsequent service-based vesting.





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A summary of changes in the common shares subject to nonvested PBRsUs and RSUs for the nine months ended September 30, 2018 follows:

	Common shares subject to PBRsUs and RSUs
Nonvested at January 1, 2018	116,716
Granted	61,690
Vested	(18,800 )
Forfeited	(4,655 )
Adjustment for performance conditions of PBRsUs <sup>(1)</sup>	(2,320 )
Nonvested at September 30, 2018	152,631

(1) The number of PBRsUs earned depends on the level of achievement with respect to certain performance criteria. Adjustment herein represents the difference between the maximum number of common shares which could be earned and the actual number earned for those PBRsUs as to which the performance period was completed.

On March 31, 2018, an aggregate of 18,800 of the PBRsUs granted in 2014 and 2015 vested in full due to the level of achievement with respect to certain performance criteria and the satisfaction of the service-based vesting requirement. A total of 5,879 common shares were withheld to satisfy employee income tax withholding obligations. This resulted in a net amount of 12,921 common shares being issued to employees of Park. On March 31, 2017, 9,674 of the PBRsUs granted in 2014 vested in full due to the level of achievement with respect to certain performance criteria and the satisfaction of the service-based vesting requirement. A total of 3,293 common shares were withheld to satisfy employee income tax withholding obligations. This resulted in a net amount of 6,381 common shares being issued to employees of Park.

Share-based compensation expense of \$1.0 million and \$0.7 million was recognized for the three-month periods ended September 30, 2018 and 2017, respectively, and of \$3.1 million and \$2.1 million was recognized for the nine-month periods ended September 30, 2018 and 2017, respectively.

The following table details expected additional share-based compensation expense related to PBRsUs and RSUs outstanding as of September 30, 2018:

(In thousands)	
Three months ending December 31, 2018	\$ 1,047
2019	3,653
2020	2,440
2021	1,030
2022	226
Total	\$8,396

## Note 14 – Benefit Plans

Park has a noncontributory defined benefit pension plan (the "Pension Plan") covering substantially all of its employees. The Pension Plan provides benefits based on an employee's years of service and compensation.

There were no Pension Plan contributions for the three-month and nine-month periods ended September 30, 2018 and 2017.

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The following table shows the components of net periodic pension benefit income:

(In thousands)	Three Months Ended		Nine Months Ended		Affected Line Item in the Consolidated Condensed Statements of Income
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017	
Service cost	\$1,637	\$1,317	\$4,911	\$3,951	Employee benefits
Interest cost	1,309	1,271	3,927	3,813	Other components of net periodic pension benefit income
Expected return on plan assets	(3,354 )	(2,863 )	(10,062)	(8,589 )	Other components of net periodic pension benefit income
Amortization of prior service cost	—	—	—	—	Other components of net periodic pension benefit income
Recognized net actuarial loss	340	144	1,020	432	Other components of net periodic pension benefit income
Net periodic pension benefit income	\$(68 )	\$(131 )	\$(204 )	\$(393 )	

Park has entered into Supplemental Executive Retirement Plan Agreements (the "SERP Agreements") with certain key officers of the Corporation and its subsidiaries which provide defined pension benefits in excess of limits imposed by federal tax law. The expense for the Corporation related to the SERP Agreements for the three months and nine months ended September 30, 2018 and 2017 was as follows:

(In thousands)	Three Months Ended		Nine Months Ended		Affected Line Item in the Consolidated Condensed Statement of Income
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017	
Service cost	\$157	\$185	\$635	\$555	Employee benefits
Interest cost	188	161	349	483	Miscellaneous expense
Total SERP expense	\$345	\$346	\$984	\$1,038	

Previously, the net periodic benefit income/expense related to Park's Pension Plan and the expense related to the SERP Agreements had been recorded within the "Employee benefits" line item. During the first quarter of 2018, Park adopted ASU 2017-07 - Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement. This ASU requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. This ASU is required to be applied retrospectively to all periods presented. For all periods presented, this resulted in an increase in other income and an offsetting increase in other expense with no change to net income. As a practical expedient, Park used the amounts disclosed in "Note 12 - Pension Plan" of the Notes to Unaudited Consolidated Condensed Financial Statements, included under Item 1 of Part I of Park's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2017 as the estimation basis for applying the retrospective presentation requirements.

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The following table summarizes the impact of retrospective application of this ASU to the consolidated condensed statement of income for the three and nine months ended September 30, 2017.

(in thousands)	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
Other components of net periodic pension benefit income		
As previously reported	\$ —	\$ —
As reported under new guidance	1,448	4,344
 Total other income		
As previously reported	\$ 22,089	\$ 58,847
As reported under new guidance	23,537	63,191
 Employee benefits expense		
As previously reported	\$ 4,656	\$ 14,756
As reported under new guidance	5,943	18,617
 Miscellaneous expense		
As previously reported	\$ 2,764	\$ 5,847
As reported under new guidance	2,925	6,330
 Total other expense		
As previously reported	\$ 49,811	\$ 145,379
As reported under new guidance	51,259	149,723

## Note 15 – Loan Servicing

Park serviced sold mortgage loans of \$1.38 billion at September 30, 2018, \$1.37 billion at December 31, 2017 and \$1.36 billion at September 30, 2017. At September 30, 2018, \$2.6 million of the sold mortgage loans were sold with recourse, compared to \$3.0 million at December 31, 2017 and \$3.2 million at September 30, 2017. Management closely monitors the delinquency rates on the mortgage loans sold with recourse. At September 30, 2018 and December 31, 2017, management had established reserves of \$49,000 and \$270,000, respectively, to account for expected losses on loan repurchases.

When Park sells mortgage loans with servicing rights retained, these servicing rights are initially recorded at fair value. Park selected the “amortization method” as permissible within U.S. GAAP, whereby the servicing rights capitalized are amortized in proportion to and over the period of estimated future servicing income with respect to the underlying loan. At the end of each reporting period, the carrying value of mortgage servicing rights (“MSRs”) is assessed for impairment with a comparison to fair value. MSRs are carried at the lower of their amortized cost or fair value. The amortization of MSRs is included within other service income in the consolidated condensed statements of income.

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Activity for MSR's and the related valuation allowance follows:

(In thousands)	Three Months		Nine Months	
	Ended September 30, 2018	2017	Ended September 30, 2018	2017
<b>Mortgage servicing rights:</b>				
Carrying amount, net, beginning of period	\$10,077	\$9,476	\$9,688	\$9,266
Additions	432	559	1,208	1,434
Amortization	(387 )	(448 )	(1,156 )	(1,213 )
Changes in valuation allowance	(26 )	(108 )	356	(8 )
Carrying amount, net, end of period	\$10,096	\$9,479	\$10,096	\$9,479
<b>Valuation allowance:</b>				
Beginning of period	\$248	\$635	\$630	\$735
Changes in valuation allowance	26	108	(356 )	8
End of period	\$274	\$743	\$274	\$743

Servicing fees included in other service income were \$0.9 million and \$0.8 million for the three months ended September 30, 2018 and 2017, respectively, and were \$2.7 million and \$2.6 million for the nine months ended September 30, 2018 and 2017, respectively.

#### Note 16 – Fair Value

The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that Park uses to measure fair value are as follows:

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

Level 2: Level 1 inputs for assets or liabilities that are not actively traded. Also consists of an observable market price for a similar asset or liability. This includes the use of “matrix pricing” to value debt securities absent the exclusive use of quoted prices.

Level 3: Consists of unobservable inputs that are used to measure fair value when observable market inputs are not available. This could include the use of internally developed models, financial forecasting and similar inputs.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the balance sheet date. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to observable market data for similar assets and liabilities. However, certain assets and liabilities are not traded in observable markets and Park must use other valuation methods to develop a fair value. The fair value of impaired loans is typically based on the fair value of the underlying collateral, which is estimated through third-party appraisals in accordance with Park's valuation requirements under its commercial and real estate loan policies.

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## Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The following table presents assets and liabilities measured at fair value on a recurring basis:

## Fair Value Measurements at September 30, 2018 using:

(In thousands)	Level 1	Level 2	Level 3	Balance at September 30, 2018
Assets				
Investment securities:				
U.S. Government sponsored entities' asset-backed securities	\$	-\$1,032,265	\$—	\$1,032,265
Equity securities	1,478	—	424	1,902
Mortgage loans held for sale	—	6,441	—	6,441
Mortgage IRLCs	—	128	—	128
Liabilities				
Fair value swap	\$	-\$—	\$226	\$226

## Fair Value Measurements at December 31, 2017 using:

(In thousands)	Level 1	Level 2	Level 3	Balance at December 31, 2017
Assets				
Investment securities:				
Obligations of U.S. Treasury and other U.S. Government sponsored entities	\$	-\$242,720	\$—	\$242,720
U.S. Government sponsored entities' asset-backed securities	—	849,161	—	849,161
Equity securities	1,518	—	417	1,935
Mortgage loans held for sale	—	4,148	—	4,148
Mortgage IRLCs	—	94	—	94
Liabilities				
Fair value swap	\$	-\$—	\$226	\$226

There were no transfers between Level 1 and Level 2 during either of the three-month periods ended September 30, 2018 or 2017. Management's policy is to transfer assets or liabilities from one level to another when the methodology to obtain the fair value changes such that there are more or fewer unobservable inputs as of the end of the reporting period.

The following methods and assumptions were used by the Company in determining the fair value of the financial assets and liabilities discussed above:

**Investment securities:** Fair values for investment securities are based on quoted market prices, where available (Level 1). If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows (Level 3).

**Fair value swap:** The fair value of the swap agreement entered into with the purchaser of the Visa Class B shares represents an internally developed estimate of the exposure based upon probability-weighted potential Visa litigation losses.

Mortgage Interest Rate Lock Commitments (IRLCs): Mortgage IRLCs are based on current secondary market pricing and are classified as Level 2.

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Mortgage loans held for sale: Mortgage loans held for sale are carried at their fair value. Mortgage loans held for sale are estimated using security prices for similar product types and, therefore, are classified in Level 2.

The table below presents a reconciliation of the beginning and ending balances of the Level 3 inputs for the three and six months ended September 30, 2018 and 2017, for financial instruments measured on a recurring basis and classified as Level 3:

## Level 3 Fair Value Measurements

Three months ended September 30, 2018 and 2017

(In thousands)	Equity Securities	Fair value swap
Balance at July 1, 2018	\$ 420	\$(226)
Total gains/(losses)		
Included in other income	4	—
Balance at September 30, 2018	\$ 424	\$(226)
Balance at July 1, 2017	\$ 458	\$(226)
Total gains/(losses)		
Included in other comprehensive income	37	—
Balance at September 30, 2017	\$ 495	\$(226)

## Level 3 Fair Value Measurements

Nine months ended September 30, 2018 and 2017

(In thousands)	Equity Securities	Fair value swap
Balance at January 1, 2018	\$ 417	\$(226)
Total gains/(losses)		
Included in other income	7	—
Balance at September 30, 2018	\$ 424	\$(226)
Balance at January 1, 2017	\$ 790	\$(226)
Total gains/(losses)		
Transfers out of Level 3 <sup>(1)</sup>	(346 )	—
Included in other comprehensive income	51	—
Balance at September 30, 2017	\$ 495	\$(226)

<sup>(1)</sup> Transferred from Level 3 to Level 1 as the result of a quoted market price becoming available.

## Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

The following methods and assumptions were used by the Company in determining the fair value of assets and liabilities measured at fair value on a nonrecurring basis described below:

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Collateral dependent impaired loans carried at fair value have been partially charged-off or receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is generally based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including the comparable sales



approach and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments result in a Level 3 classification of the inputs for determining fair value. Collateral is then adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. Additionally, updated independent valuations are obtained annually for all impaired loans in accordance with Company policy.

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Other Real Estate Owned ("OREO"): Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value less costs to sell when acquired. The carrying value of OREO is not re-measured to fair value on a recurring basis, but is subject to fair value adjustments when the carrying value exceeds the fair value, less estimated selling costs. Fair value is based on recent real estate appraisals and is updated at least annually. These appraisals may utilize a single valuation approach or a combination of approaches including the comparable sales approach and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral dependent impaired loans and OREO are performed by licensed appraisers. Appraisals are generally obtained to support the fair value of collateral. In general, there are three types of appraisals received by the Company: real estate appraisals, income approach appraisals, and lot development loan appraisals. These are discussed below:

Real estate appraisals typically incorporate measures such as recent sales prices for comparable properties. Appraisers may make adjustments to the sales prices of the comparable properties as deemed appropriate based on the age, condition or general characteristics of the subject property. Management generally applies a 15% discount to real estate appraised values which management expects will cover all disposition costs (including selling costs). This 15% discount is based on historical discounts to appraised values on sold OREO properties.

Income approach appraisals typically incorporate the annual net operating income of the business divided by an appropriate capitalization rate, as determined by the appraiser. Management generally applies a 15% discount to income approach appraised values which management expects will cover all disposition costs (including selling costs).

Lot development loan appraisals are typically performed using a discounted cash flow analysis. Appraisers determine an anticipated absorption period and a discount rate that takes into account an investor's required rate of return based on recent comparable sales. Management generally applies a 6% discount to lot development appraised values, which is an additional discount above the net present value calculation included in the appraisal, to account for selling costs.

Other repossessed assets: Other repossessed assets are initially recorded at fair value less costs to sell when acquired. The carrying value of other repossessed assets is not re-measured to fair value on a recurring basis, but is subject to fair value adjustments when the carrying value exceeds the fair value, less estimated selling costs. As of September 30, 2018, other repossessed assets consisted of aircraft acquired as part of a loan workout. Fair value is based on Aircraft Bluebook and VREF Aircraft Value Reference values based on the model of aircraft and adjustments for flight hours, features and other variables. Such adjustments result in a Level 3 classification of the inputs for determining fair value.

MSRs: MSRs are carried at the lower of cost or fair value. MSRs do not trade in active, open markets with readily observable prices. For example, sales of MSRs do occur, but precise terms and conditions typically are not readily available. As such, management, with the assistance of a third-party specialist, determines fair value based on the discounted value of the future cash flows estimated to be received. Significant inputs include the discount rate and assumed prepayment speeds. The calculated fair value is then compared to market values where possible to ascertain the reasonableness of the valuation in relation to current market expectations for similar products. Accordingly, MSRs are classified as Level 2.

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The following tables present assets and liabilities measured at fair value on a nonrecurring basis. Collateral dependent impaired loans are carried at fair value if they have been charged down to fair value or if a specific valuation allowance has been established. As of September 30, 2018, there were no PCI loans considered impaired. A new cost basis is established at the time a property is initially recorded in OREO. OREO properties are carried at fair value if a devaluation has been taken to the property's value subsequent to the initial measurement.

## Fair Value Measurements at September 30, 2018 using:

(In thousands)	Level 1	Level 2	Level 3	Balance at September 30, 2018
Impaired loans recorded at fair value:				
Commercial real estate	\$ —	\$ —	\$4,020	\$ 4,020
Construction real estate	—	—	1,635	1,635
Residential real estate	—	—	592	592
Total impaired loans recorded at fair value	\$ —	\$ —	\$6,247	\$ 6,247
Mortgage servicing rights	\$ —	\$1,457	\$ —	\$ 1,457
OREO:				
Commercial real estate	—	—	2,295	2,295
Construction real estate	—	—	889	889
Residential real estate	—	—	679	679
Total OREO recorded at fair value	\$ —	\$ —	\$3,863	\$ 3,863
Other repossessed assets	\$ —	\$ —	\$7,170	\$ 7,170

## Fair Value Measurements at December 31, 2017 using:

(In thousands)	Level 1	Level 2	Level 3	Balance at December 31, 2017
Impaired loans recorded at fair value:				
Commercial real estate	\$ —	\$ —	\$2,735	\$ 2,735
Construction real estate	—	—	127	127
Residential real estate	—	—	712	712
Total impaired loans recorded at fair value	\$ —	\$ —	\$3,574	\$ 3,574
Mortgage servicing rights	\$ —	\$7,316	\$ —	\$ 7,316
OREO:				
Commercial real estate	—	—	2,295	2,295
Construction real estate	—	—	3,204	3,204
Residential real estate	—	—	1,021	1,021
Total OREO recorded at fair value	\$ —	\$ —	\$6,520	\$ 6,520

The table below provides additional detail on those impaired loans which are recorded at fair value as well as the remaining impaired loan portfolio not included above. The remaining impaired loans consist of loans which are not collateral dependent as well as loans carried at cost as the fair value of the underlying collateral or the present value of expected future cash flows on each of the loans exceeded the book value for each respective credit.



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	September 30, 2018			
(In thousands)	Recorded Investment	Prior Charge-Offs	Specific Valuation Allowance	Carrying Balance
Impaired loans recorded at fair value	\$6,377	\$ 3,708	\$ 130	\$6,247
Remaining impaired loans	40,383	7,361	1,716	38,667
Total impaired loans	\$46,760	\$ 11,069	\$ 1,846	\$44,914
	December 31, 2017			
(In thousands)	Recorded Investment	Prior Charge-Offs	Specific Valuation Allowance	Carrying Balance
Impaired loans recorded at fair value	\$3,577	\$ 2,780	\$ 3	\$3,574
Remaining impaired loans	52,987	7,260	681	52,306
Total impaired loans	\$56,564	\$ 10,040	\$ 684	\$55,880

The expense from credit adjustments related to impaired loans carried at fair value during the three months ended September 30, 2018 and 2017 was \$0.1 million and \$0.7 million, respectively. The expense from credit adjustments related to impaired loans carried at fair value during the nine months ended September 30, 2018 and 2017 was \$0.3 million and \$1.2 million, respectively.

MSRs totaled \$10.1 million at September 30, 2018. Of this \$10.1 million MSR carrying balance, \$1.5 million was recorded at fair value and included a valuation allowance of \$0.3 million. The remaining \$8.6 million was recorded at cost, as the fair value of the MSRs exceeded cost at September 30, 2018. At December 31, 2017, MSRs totaled \$9.7 million. Of this \$9.7 million MSR carrying balance, \$7.3 million was recorded at fair value and included a valuation allowance of \$0.6 million. The remaining \$2.4 million was recorded at cost, as the fair value exceeded cost at December 31, 2017. The expense related to MSRs carried at fair value during the three months ended September 30, 2018 and 2017 was \$26,000 and \$108,000, respectively. The income (expense) related to MSRs carried at fair value during the nine months ended September 30, 2018 and 2017 was \$356,000 and \$(8,000), respectively.

Total OREO held by Park at September 30, 2018 and December 31, 2017 was \$5.3 million and \$14.2 million, respectively. Approximately 73% and 46% of OREO held by Park at September 30, 2018 and December 31, 2017, respectively, was carried at fair value due to fair value adjustments made subsequent to the initial OREO measurement. At September 30, 2018 and December 31, 2017, OREO held at fair value, less estimated selling costs, amounted to \$3.9 million and \$6.5 million, respectively. The net expense related to OREO fair value adjustments was \$77,000 and \$22,000 for the three-month periods ended September 30, 2018 and 2017, respectively. The net expense related to OREO fair value adjustments was \$398,000 and \$367,000 for the nine-month periods ended September 30, 2018 and 2017, respectively.

Other repossessed assets totaled \$7.2 million at September 30, 2018, all of which was recorded at fair value. There were no other repossessed assets as of December 31, 2017. The net expense related to other repossessed asset fair value adjustments was \$269,000 for each of the three-month and nine-month periods ended September 30, 2018. There was no expense related to fair value adjustments on other repossessed assets for either the three-month or nine-month periods ended September 30, 2017.

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The following tables present qualitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at September 30, 2018 and December 31, 2017:

September 30, 2018

(In thousands)	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
Commercial real estate	\$4,020	Sales comparison approach	Adj to comparables	0.0% - 55.0% (25.4%)
		Income approach	Capitalization rate	10.6% - 11.8% (11.5%)
		Cost approach	Accumulated depreciation	3.7% - 90.1% (12.9%)
Construction real estate	\$1,635	Sales comparison approach	Adj to comparables	5.0% - 90.0% (26.1%)
Residential real estate	\$592	Sales comparison approach	Adj to comparables	1.0% - 40.0% (18.5%)
		Income approach	Capitalization rate	10.5% (10.5%)
Other real estate owned:				
Commercial real estate	\$2,295	Sales comparison approach	Adj to comparables	0.9% - 68.4% (34.7%)
		Income approach	Capitalization rate	13.0% (13.0%)
Construction real estate	\$889	Sales comparison approach	Adj to comparables	0.0% - 45.0% (21.9%)
Residential real estate	\$679	Sales comparison approach	Adj to comparables	0.9% - 54.6% (40.7%)

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Balance at December 31, 2017

(In thousands)	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
Commercial real estate	\$2,735	Sales comparison approach	Adj to comparables	0.0% - 90.0% (22.7%)
		Income approach	Capitalization rate	9.0% - 11.0% (9.9%)
		Cost approach	Accumulated depreciation	90.1% (90.1%)
Construction real estate	\$127	Sales comparison approach	Adj to comparables	0.0% - 4.8% (2.4%)
Residential real estate	\$712	Sales comparison approach	Adj to comparables	0.3% - 33.0% (12.5%)
		Income approach	Capitalization rate	10.5% (10.5%)
Other real estate owned:				
Commercial real estate	\$2,295	Sales comparison approach	Adj to comparables	0.9% - 68.4% (34.7%)
		Income approach	Capitalization rate	13.0% (13.0%)
Construction real estate	\$3,204	Sales comparison approach	Adj to comparables	0.0% - 90.0% (24.5%)
		Bulk sale approach	Discount rate	15.0% (15.0%)
Residential real estate	\$1,021	Sales comparison approach	Adj to comparables	1.2% - 79.7% (31.8%)

## Assets Measured at Net Asset Value:

The adoption of ASU 2016-01 on January 1, 2018 required Park to evaluate the accounting for equity investments, including those previously held at cost. Under the new guidance, Park determined that its portfolio of equity investments in limited partnerships which provide mezzanine funding ("Partnership Investments") should be valued using the net asset value ("NAV") practical expedient in accordance with ASC 820. The adoption of this guidance on January 1, 2018, resulted in a \$1.2 million increase to Partnership Investments, which are included within other assets on the consolidated condensed balance sheet, and a \$922,000 increase to beginning retained earnings.

As of September 30, 2018 and December 31, 2017, Park had Partnerships Investments with a NAV of \$10.7 million and \$8.8 million, respectively. As of September 30, 2018 and December 31, 2017, Park had \$6.1 million and \$7.2 million in unfunded commitments related to these Partnership Investments. For the nine months ended September 30, 2018, Park had recognized \$1.2 million in income related to these Partnership Investments.

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The fair value of certain financial instruments at September 30, 2018 and December 31, 2017, was as follows:

(In thousands)	September 30, 2018				Total fair value
	Carrying value	Fair Value Measurements			
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and money market instruments	\$ 144,604	\$ 144,604	\$—	\$—	\$ 144,604
Investment securities <sup>(1)</sup>	1,382,907	—	1,376,606	—	1,376,606
Other investment securities <sup>(2)</sup>	1,902	1,478	—	424	1,902
<b>Loans held for sale</b>					
Mortgage IRLCs	6,441	—	6,441	—	6,441
Impaired loans carried at fair value	128	—	128	—	128
Other loans, net <sup>(3)</sup>	6,247	—	—	6,247	6,247
Loans receivable, net	5,562,261	—	—	5,493,865	5,493,865
	\$ 5,575,077	\$—	\$ 6,569	\$ 5,500,112	\$ 5,506,681
<b>Financial liabilities:</b>					
Time deposits	1,090,117	—	1,089,966	—	1,089,966
Other	5,186	5,186	—	—	5,186
Deposits (excluding demand deposits)	\$ 1,095,303	\$ 5,186	\$ 1,089,966	\$—	\$ 1,095,152
<b>Short-term borrowings</b>					
Long-term debt	\$ 179,818	\$—	\$ 179,818	\$—	\$ 179,818
Subordinated notes	400,000	—	397,640	—	397,640
	15,000	—	12,987	—	12,987
<b>Derivative financial instruments:</b>					
Fair value swap	\$ 226	\$—	\$—	\$ 226	\$ 226

(1) Includes debt securities AFS and debt securities HTM.

(2) Excludes FHLB stock and FRB stock which are carried at their respective redemption values. Additionally, excludes investment securities accounted for at modified cost, as these investments do not have a readily determinable fair value.

(3) Fair value calculated using an exit price notion consistent with Topic 820, Fair Value Measurement.



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(In thousands)	December 31, 2017				Total fair value
	Carrying value	Fair Value Measurements			
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and money market instruments	\$ 169,112	\$ 169,112	\$—	\$—	\$ 169,112
Investment securities <sup>(1)</sup>	1,449,078	—	1,455,660	—	1,455,660
Other investment securities <sup>(2)</sup>	1,935	1,518	—	417	1,935
Loans held for sale	4,148	—	4,148	—	4,148
Mortgage IRLCs	94	—	94	—	94
Impaired loans carried at fair value	3,574	—	—	3,574	3,574
Other loans, net	5,314,679	—	—	5,247,021	5,247,021
Loans receivable, net	\$5,322,495	\$—	\$4,242	\$5,250,595	\$5,254,837
<b>Financial liabilities:</b>					
Time deposits	1,033,476	—	1,035,093	—	1,035,093
Other	1,269	1,269	—	—	1,269
Total deposits	\$ 1,034,745	\$ 1,269	\$ 1,035,093	\$—	\$ 1,036,362
Short-term borrowings	\$ 391,289	\$—	\$ 391,289	\$—	\$ 391,289
Long-term debt	500,000	—	504,503	—	504,503
Subordinated notes	15,000	—	13,370	—	13,370
<b>Derivative financial instruments:</b>					
Fair value swap	\$ 226	\$—	\$—	\$ 226	\$ 226

(1) Includes debt securities AFS and debt securities HTM.

(2) Excludes FHLB stock and FRB stock which are carried at their respective redemption values. Additionally, excludes investment securities carried at their cost basis as these investments do not have a readily determinable fair value.

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## Note 17 – Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) components, net of income tax, are shown in the following table for the three-month and nine-month periods ended September 30, 2018 and 2017:

(in thousands)	Changes in pension plan assets and benefit obligations	Change in unrealized losses on debt securities	Total
Beginning balance at July 1, 2018	\$ (26,701 )	\$ (28,308 )	\$ (55,009 )
Other comprehensive loss before reclassifications	—	(5,141 )	(5,141 )
Amounts reclassified from accumulated other comprehensive loss	—	—	—
Net current period other comprehensive loss	—	(5,141 )	(5,141 )
Ending balance at September 30, 2018	\$ (26,701 )	\$ (33,449 )	\$ (60,150 )
Beginning balance at July 1, 2017	\$ (14,740 )	\$ 1,028	\$ (13,712 )
Other comprehensive income before reclassifications	—	707	707
Amounts reclassified from accumulated other comprehensive loss	—	—	—
Net current period other comprehensive income	—	707	707
Ending balance at September 30, 2017	\$ (14,740 )	\$ 1,735	\$ (13,005 )

  

(in thousands)	Changes in pension plan assets and benefit obligations	Change in unrealized losses on debt securities	Total
Beginning balance at January 1, 2018	\$ (23,526 )	\$ (2,928 )	\$ (26,454 )
Other comprehensive loss before reclassifications	—	(30,919 )	(30,919 )
Reclassification of disproportionate income tax effects	(3,175 )	(631 )	(3,806 )
Cumulative effect of change in accounting principle for marketable equity securities, net of tax	—	(995 )	(995 )
Amounts reclassified from accumulated other comprehensive loss	—	2,024	2,024
Activity for the period	(3,175 )	(30,521 )	(33,696 )
Ending balance at September 30, 2018	\$ (26,701 )	\$ (33,449 )	\$ (60,150 )
Beginning balance at January 1, 2017	\$ (14,740 )	\$ (3,005 )	\$ (17,745 )
Other comprehensive income before reclassifications	—	4,740	4,740
Amounts reclassified from accumulated other comprehensive loss	—	—	—
Net current period other comprehensive income	—	4,740	4,740
Ending balance at September 30, 2017	\$ (14,740 )	\$ 1,735	\$ (13,005 )

During the nine-month period ended September 30, 2018, there was \$2.6 million (\$2.0 million net of tax) reclassified out of accumulated other comprehensive loss due to losses on the sale of AFS debt securities. These losses were recorded within net loss on sale of investment securities on the consolidated condensed statements of income. During the three-month periods ended September 30, 2018 and September 30, 2017 and the nine-month period ended September 30, 2017, there were no reclassifications out of accumulated other comprehensive loss.

## Note 18 – Investment in Qualified Affordable Housing

Park makes certain equity investments in various limited partnerships that sponsor affordable housing projects. The purposes of these investments are to achieve a satisfactory return on capital, help create affordable housing opportunities, and assist the Company to achieve its goals associated with the Community Reinvestment Act.

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The table below details the balances of Park's affordable housing tax credit investments and related unfunded commitments as of September 30, 2018 and December 31, 2017.

(in thousands)	SeptemberDecember	
	30, 2018	31, 2017
Affordable housing tax credit investments	\$ 52,116	\$ 49,669
Unfunded commitments	22,282	14,282

Commitments are funded when capital calls are made by the general partner. Park expects that the current commitments will be funded between 2018 and 2029.

During each of the three months ended September 30, 2018 and 2017, Park recognized amortization expense of \$1.9 million and during each of the nine months ended September 30, 2018 and 2017, Park recognized amortization expense of \$5.6 million, which was included within the provision for income taxes. Additionally, during the three months ended September 30, 2018 and 2017, Park recognized tax credits and other benefits from its affordable housing tax credit investments of \$2.0 million and \$2.3 million, respectively, and during each of the nine months ended September 30, 2018 and 2017, Park recognized tax credits and other benefits from its affordable housing tax credit investments of \$6.9 million which was included within the provision for income taxes.

#### Note 19 – Repurchase Agreement Borrowings

Securities sold under agreements to repurchase ("repurchase agreements") with customers represent funds deposited by customers, generally on an overnight basis, that are collateralized by investment securities owned by Park. Repurchase agreements with customers are included in short-term borrowings on the consolidated condensed balance sheets.

All repurchase agreements are subject to terms and conditions of repurchase/security agreements between Park and the client and are accounted for as secured borrowings. Park's repurchase agreements consisted of customer accounts and securities which are pledged on an individual security basis.

At September 30, 2018 and December 31, 2017, Park's repurchase agreement borrowings totaled \$154 million and \$183 million, respectively. These borrowings were collateralized with U.S. government and agency securities with a carrying value of \$208 million and \$213 million at September 30, 2018 and December 31, 2017, respectively. Declines in the value of the collateral would require Park to pledge additional securities. As of September 30, 2018 and December 31, 2017, Park had \$926 million and \$975 million, respectively, of available unpledged securities.

The table below shows the remaining contractual maturity of repurchase agreements by collateral pledged at September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018				Total
	Remaining Contractual Maturity of the Agreements				
	Overnight	Up to 30 days	30 - 90 days	Greater than 90 days	
U.S. government and agency securities	\$ 153,818	\$ —	\$ —	\$ —	\$ 153,818

(in thousands)	December 31, 2017				Total
	Remaining Contractual Maturity of the Agreements				
	Overnight	Up to 30 days	30 - 90 days	Greater than 90 days	

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	Continuous	days	days	days
U.S. government and agency securities	\$ 182,185	\$ —	—\$ 1,104	\$ 183,289

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## Note 20 - Revenue from Contracts with Customers

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning on and after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

All of Park's revenue from contracts with customers within the scope of ASC 606 is recognized within "Other income" in the Consolidated Condensed Statements of Income. The following table presents the Corporation's sources of other income by revenue stream and operating segment for the three-month and nine-month periods ended September 30, 2018 and September 30, 2017.

Revenue by Operating Segment (in thousands)	Three Months Ended September 30, 2018				Total
	PNB	GFSC	SEPH	All Other	
Income from fiduciary activities					
Personal trust and agency accounts	\$ 1,994	\$ —	\$ —	\$ —	\$ 1,994
Employee benefit and retirement-related accounts	1,703	—	—	—	1,703
Investment management and investment advisory agency accounts	2,353	—	—	—	2,353
Other	368	—	—	—	368
Service charges on deposit accounts					
Non-sufficient funds (NSF) fees	1,926	—	—	—	1,926
Demand deposit account (DDA) charges	764	—	—	—	764
Other	171	—	—	—	171
Other service income <sup>(1)</sup>					
Credit card	592	6	—	—	598
HELOC	128	—	—	—	128
Installment	60	—	6	—	66
Real estate	2,145	—	—	—	2,145
Commercial	291	—	18	—	309
Checkcard fee income	4,352	—	—	—	4,352
Bank owned life insurance income <sup>(2)</sup>	960	—	—	1,625	2,585
ATM fees	500	—	—	—	500
OREO valuation adjustments <sup>(2)</sup>	(78	) —	1	—	(77 )
Gain (loss) on sale of OREO, net	36	—	(117	) —	(81 )
Net loss on sale of investment securities <sup>(2)</sup>	—	—	—	—	—
(Loss) gain on equity securities, net <sup>(2)</sup>	(44	) —	—	(282	) (326 )
Other components of net periodic pension benefit income <sup>(2)</sup>	1,653	18	34	—	1,705
Miscellaneous <sup>(3)</sup>	2,685	39	(41	) 198	2,881
Total other income	\$22,559	\$ 63	\$ (99)	\$ 1,541	\$ 24,064

<sup>(1)</sup> Of the \$3.2 million of revenue included within "Other service income", approximately \$1.2 million is within the scope of ASC 606, with the remaining \$2 million consisting primarily of residential real estate loan fees which are out of scope.

<sup>(2)</sup> Not within the scope of ASC 606.

<sup>(3)</sup> "Miscellaneous" income includes brokerage income, safe deposit box rentals, and miscellaneous bank fees totaling \$2.9 million, all of which are within the scope of ASC 606.



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Revenue by Operating Segment (in thousands)	Three Months Ended September 30, 2017				
	PNB	GFSC	SEPH	All Other	Total
Income from fiduciary activities					
Personal trust and agency accounts	\$ 1,995	\$ —	\$ —	\$ —	\$ 1,995
Employee benefit and retirement-related accounts	1,532	—	—	—	1,532
Investment management and investment advisory agency accounts	2,077	—	—	—	2,077
Other	328	—	—	—	328
Service charges on deposit accounts					
Non-sufficient funds (NSF) fees	2,100	—	—	—	2,100
Demand deposit account (DDA) charges	941	—	—	—	941
Other	175	—	—	—	175
Other service income <sup>(1)</sup>					
Credit card	537	—	—	—	537
HELOC	123	—	—	—	123
Installment	53	1	—	—	54
Real estate	2,144	—	31	—	2,175
Commercial	297	—	171	—	468
Checkcard fee income	3,974	—	—	—	3,974
Bank owned life insurance income <sup>(2)</sup>	1,478	—	—	95	1,573
ATM fees	605	—	—	—	605
OREO valuation adjustments <sup>(2)</sup>	(22	)	—	—	(22
Gain on sale of OREO, net	44	—	7	—	51
Other components of net periodic pension benefit income <sup>(2)</sup>	1,403	16	29	—	1,448
Miscellaneous <sup>(3)</sup>	1,986	17	202	1,198	3,403
Total other income	\$ 21,770	\$ 34	\$ 440	\$ 1,293	\$ 23,537

<sup>(1)</sup> Of the \$3.4 million of revenue included within "Other service income", approximately \$1.1 million is within the scope of ASC 606, with the remaining \$2.3 million consisting primarily of residential real estate loan fees which are out of scope.

<sup>(2)</sup> Not within the scope of ASC 606.

<sup>(3)</sup> "Miscellaneous" income includes brokerage income, safe deposit box rentals, and miscellaneous bank fees totaling \$3.4 million, all of which are within the scope of ASC 606.

<sup>(4)</sup> The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to current year presentation.



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Revenue by Operating Segment (in thousands)	Nine Months Ended September 30, 2018				Total
	PNB	GFSC	SEPH	All Other	
Income from fiduciary activities					
Personal trust and agency accounts	\$6,383	\$—	\$—	\$—	\$6,383
Employee benefit and retirement-related accounts	5,003	—	—	—	5,003
Investment management and investment advisory agency accounts	6,936	—	—	—	6,936
Other	1,157	—	—	—	1,157
Service charges on deposit accounts					
Non-sufficient funds (NSF) fees	5,608	—	—	—	5,608
Demand deposit account (DDA) charges	2,503	—	—	—	2,503
Other	498	—	—	—	498
Other service income <sup>(1)</sup>					
Credit card	1,652	20	—	—	1,672
HELOC	345	—	—	—	345
Installment	197	—	6	—	203
Real estate	6,748	—	—	—	6,748
Commercial	847	—	1,075	—	1,922
Checkcard fee income	12,736	—	—	—	12,736
Bank owned life insurance income <sup>(2)</sup>	2,822	—	—	1,803	4,625
ATM fees	1,534	—	—	—	1,534
OREO valuation adjustments <sup>(2)</sup>	(179 )	—	(219 )	—	(398 )
Gain on sale of OREO, net	1,442	—	2,651	—	4,093
Net loss on sale of investment securities <sup>(2)</sup>	(2,271 )	—	—	—	(2,271 )
(Loss) gain on equity securities, net <sup>(2)</sup>	(11 )	—	—	3,478	3,467
Other components of net periodic pension benefit income <sup>(2)</sup>	4,957	56	102	—	5,115
Miscellaneous <sup>(3)</sup>	5,637	59	(56 )	690	6,330
Total other income	\$64,544	\$ 135	\$3,559	\$5,971	\$74,209

<sup>(1)</sup> Of the \$10.9 million of revenue included within "Other service income", approximately \$4.4 million is within the scope of ASC 606, with the remaining \$6.5 million consisting primarily of residential real estate loan fees which are out of scope.

<sup>(2)</sup> Not within the scope of ASC 606.

<sup>(3)</sup> "Miscellaneous" income includes brokerage income, safe deposit box rentals, and miscellaneous bank fees totaling \$6.3 million, all of which are within the scope of ASC 606.

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Revenue by Operating Segment (in thousands)	Nine Months Ended September 30, 2017 <sup>(4)</sup>				Total
	PNB	GFSC	SEPH	All Other	
Income from fiduciary activities					
Personal trust and agency accounts	\$5,793	\$ —	\$ —	\$ —	\$5,793
Employee benefit and retirement-related accounts	4,499	—	—	—	4,499
Investment management and investment advisory agency accounts	6,188	—	—	—	6,188
Other	991	—	—	—	991
Service charges on deposit accounts					
Non-sufficient funds (NSF) fees	6,100	—	—	—	6,100
Demand deposit account (DDA) charges	2,900	—	—	—	2,900
Other	511	—	—	—	511
Other service income <sup>(1)</sup>					
Credit card	1,454	(9 )	—	—	1,445
HELOC	345	—	3	—	348
Installment	330	1	—	—	331
Real estate	6,368	—	31	—	6,399
Commercial	891	—	194	—	1,085
Checkcard fee income	11,775	—	—	—	11,775
Bank owned life insurance income <sup>(2)</sup>	3,499	—	—	291	3,790
ATM fees	1,708	—	—	—	1,708
OREO valuation adjustments <sup>(2)</sup>	(367 )	—	—	—	(367 )
Gain on sale of OREO, net	192	—	12	—	204
Other components of net periodic pension benefit income <sup>(2)</sup>	4,209	48	87	—	4,344
Miscellaneous <sup>(3)</sup>	4,080	18	150	899	5,147
Total other income	\$61,466	\$ 58	\$ 477	\$1,190	\$63,191

<sup>(1)</sup> Of the \$9.6 million of revenue included within "Other service income", approximately \$3.4 million is within the scope of ASC 606, with the remaining \$6.2 million consisting primarily of residential real estate loan fees which are out of scope.

<sup>(2)</sup> Not within the scope of ASC 606.

<sup>(3)</sup> "Miscellaneous" income includes brokerage income, safe deposit box rentals, and miscellaneous bank fees totaling \$5.1 million, all of which are within the scope of ASC 606.

<sup>(4)</sup> The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to current year presentation.

A description of Park's revenue streams accounted for under ASC 606 follows:

**Income from fiduciary activities (Gross):** Park earns fiduciary fee income and investment brokerage fees from its contracts with trust customers for various fiduciary and investment-related services. These fees are earned over time as the Company provides the contracted monthly and quarterly services and are generally assessed based on the market value of the trust assets.

**Service charges on deposit accounts and ATM fees:** The Corporation earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are generally recognized at the end of the month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in

time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Other service income: Other service income includes income from 1) the sale and servicing of loans sold to the secondary market, 2) incentive income from third-party credit card issuers, and 3) loan customers for various loan-related activities and services. These fees are generally recognized at a point in time following the completion of a loan sale or related service activity.

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Checkcard fee income: Park earns interchange fees from debit cardholder transactions conducted primarily through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, net of card network fees, concurrently with the transaction processing services provided to the cardholder.

Gain on sale of OREO, net: The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of delivery of an executed deed. When Park finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform the buyer's obligation under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

Note 21 - Subsequent Events

On September 12, 2018, Park and CAB Financial Corporation, a South Carolina corporation (“CABF”), entered into an Agreement and Plan of Merger and Reorganization (the “CABF Merger Agreement”), pursuant to which CABF will merge with and into Park (the “CABF Merger”). Following the CABF Merger, CABF’s wholly-owned bank subsidiary, Carolina Alliance Bank, will merge with and into Park's wholly-owned bank subsidiary, PNB, with PNB as the surviving bank. Subject to the terms and conditions of the CABF Merger Agreement, at the effective time of the CABF Merger (the “Effective Time”), CABF shareholders will receive, for each share of CABF’s common stock, \$1.00 par value per share, (i) \$3.80 in cash and (ii) 0.1378 of Park's common shares (the “Merger Consideration”).

At the Effective Time, CABF stock options with an exercise price of less than \$19.00 will be cancelled and converted into the right to receive the Merger Consideration. CABF stock options with an exercise price of \$19.00 or more will be assumed and converted into an option to purchase Park common shares, on the same terms and conditions as were applicable under such CABF stock option. At the Effective Time, CABF restricted stock awards will fully vest (with any performance-based vesting condition deemed satisfied) and will be cancelled and converted automatically into the right to receive Merger Consideration.

The CABF Merger Agreement contains customary representations, warranties, and covenants of each party. Subject to certain terms and conditions, the CABF Merger Agreement provides that the board of directors of CABF will recommend the approval and adoption of the CABF Merger Agreement by the shareholders of CABF. CABF has also agreed not to solicit acquisition proposals relating to alternative business combination transactions. In addition, CABF has agreed not to participate in discussions or negotiations or provide information in connection with any acquisition proposals for alternative business combination transactions unless certain conditions are satisfied.

Closing of the CABF Merger is subject to customary conditions, including, among others, approval of the CABF Merger Agreement by CABF’s shareholders, receipt of required regulatory approvals, effectiveness of the registration statement to be filed by Park, and approval for listing on NYSE AMERICAN with respect to the Park common shares to be issued in the CABF Merger.

The CABF Merger Agreement provides certain termination rights for each party and further provides that, in the event the CABF Merger Agreement is terminated under certain circumstances in connection with a competing acquisition transaction, CABF will be required to pay Park a termination fee equal to \$5,317,500.

In connection with the CABF Merger Agreement, Park entered into voting and support agreements with the directors and executive officers of CABF, in their capacities as shareholders. Pursuant to the terms of the voting and support agreements, each director and executive officer of CABF has agreed to vote the shares of CABF common stock they own in favor of the CABF Merger Agreement, subject to the exceptions set forth in the voting agreements.

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis ("MD&A") contains forward-looking statements that are provided to assist in the understanding of anticipated future financial performance. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance. The forward-looking statements are based on management's expectations and are subject to a number of risks and uncertainties. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements. Risks and uncertainties that could cause actual results to differ materially include,

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without limitation: Park's ability to execute our business plan successfully and within the expected timeframe; general economic and financial market conditions, specifically in the real estate markets and the credit markets, either nationally or in the states in which Park and our subsidiaries do business, may experience a slowing or reversal of the recent economic expansion in addition to continuing residual effects of recessionary conditions and an uneven spread of positive impacts of recovery on the economy and our counterparties, resulting in adverse impacts on the demand for loan, deposit and other financial services, delinquencies, defaults and counterparties' ability to meet credit and other obligations and the possible impairment of collectability of loans; changes in interest rates and prices may adversely impact prepayment penalty income, mortgage banking income, the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our consolidated balance sheet as well as reduce interest margins and impact loan demand; changes in consumer spending, borrowing and saving habits, whether due to the tax reform legislation, changing business and economic conditions, legislative and regulatory initiatives, or other factors; changes in unemployment; changes in customers', suppliers', and other counterparties' performance and creditworthiness; the adequacy of our risk management program in the event of changes in the market, economic, operational, asset/liability repricing, liquidity, credit and interest rate risks associated with Park's business; disruption in the liquidity and other functioning of U.S. financial markets; our liquidity requirements could be adversely affected by changes to regulations governing bank and bank holding company capital and liquidity standards as well as by changes in our assets and liabilities; competitive factors among financial services organizations could increase significantly, including product and pricing pressures, changes to third-party relationships and our ability to attract, develop and retain qualified banking professionals; customers could pursue alternatives to bank deposits, causing us to lose a relatively inexpensive source of funding; uncertainty regarding the nature, timing, cost and effect of changes in banking regulations or other regulatory or legislative requirements affecting the respective businesses of Park and our subsidiaries, including major reform of the regulatory oversight structure of the financial services industry and changes in laws and regulations concerning taxes, pensions, bankruptcy, consumer protection, rent regulation and housing, financial accounting and reporting, environmental protection, insurance, bank products and services, bank capital and liquidity standards, fiduciary standards, securities and other aspects of the financial services industry, specifically the reforms provided for in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") and the Basel III regulatory capital reforms, as well as regulations already adopted and which may be adopted in the future by the relevant regulatory agencies, including the Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board, to implement the Dodd-Frank Act's provisions, and the Basel III regulatory capital reforms; the effects of easing restrictions on participants in the financial services industry; the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the SEC, the Public Company Accounting Oversight Board and other regulatory agencies, and the accuracy of our assumptions and estimates used to prepare our financial statements; changes in law and policy accompanying the current presidential administration, including the Tax Cuts and Jobs Act, and uncertainty or speculation pending the enactment of such changes; uncertainties in Park's preliminary review of, and additional analysis of, the impact of the Tax Cuts and Jobs Act; significant changes in the tax laws, which may adversely affect the fair values of net deferred tax assets and obligations of state and political subdivisions held in Park's investment securities portfolio; the impact of our ability to anticipate and respond to technological changes on our ability to respond to customer needs and meet competitive demands; operational issues stemming from and/or capital spending necessitated by the potential need to adapt to industry changes in information technology systems on which Park and our subsidiaries are highly dependent; the ability to secure confidential information and deliver products and services through the use of computer systems and telecommunications networks; a failure in or breach of our operational or security systems or infrastructure, or those of our third-party vendors and other service providers, resulting in failures or disruptions in customer account management, general ledger, deposit, loan, or other systems, including as a result of cyber attacks; the existence or exacerbation of general geopolitical instability and uncertainty; the effect of trade policies (including the impact of tariffs, a U.S. withdrawal from or significant renegotiation of trade agreements, trade wars and other changes in trade regulations), monetary and other fiscal policies (including the impact of money supply and interest rate policies of the Federal Reserve Board) and other governmental policies of the U.S. federal government; the impact on financial markets and the economy of any

changes in the credit ratings of the U.S. Treasury obligations and other U.S. government - backed debt, as well as issues surrounding the levels of U.S., European and Asian government debt and concerns regarding the creditworthiness of certain sovereign governments, supranationals and financial institutions in Europe and Asia; the uncertainty surrounding the actions to be taken to implement the referendum by United Kingdom voters to exit the European Union; our litigation and regulatory compliance exposure, including the costs and effects of any adverse developments in legal proceedings or other claims and the costs and effects of unfavorable resolution of regulatory and other governmental examinations or other inquiries; continued availability of earnings and excess capital sufficient for the lawful and prudent declaration of dividends; fraud, scams and schemes of third parties; the impact of widespread natural and other disasters, pandemics, dislocations, civil unrest, terrorist activities or international hostilities on the economy and financial markets generally and on us or our counterparties specifically; the effect of healthcare laws in the U.S. and potential changes for such laws which may increase our healthcare and other costs and negatively impact our operations and financial results; Park's ability to integrate recent acquisitions (including NewDominion Bank) as well as any future acquisitions, which may be unsuccessful, or may be more difficult, time-consuming or costly than expected; the ability to obtain required governmental and shareholder approvals with respect to, and

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the ability to complete the proposed merger of Park and CAB Financial Corporation ("CAB") on the proposed terms and within the expected time frame; the risk that the businesses of Park and CAB will not be integrated successfully or such integration may be more difficult, time-consuming or costly than expected; expected revenue synergies and cost savings from the proposed merger of Park and CAB may not be fully realized or realized within the expected time frame; revenues following the proposed merger of Park and CAB may be lower than expected; customer and employee relationships and business operations may be disrupted by the proposed merger of Park and CAB; Park issued equity securities in the acquisition of NewDominion Bank and may issue equity securities in connection with future acquisitions, including the proposed merger of Park and CAB, which could cause ownership and economic dilution to Park's current shareholders; and other risk factors relating to the banking industry as detailed from time to time in Park's reports filed with the SEC including those described in "Item 1A. Risk Factors" of Part I of Park's Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Park does not undertake, and specifically disclaims any obligation, to publicly release the results of any revisions that may be made to update any forward-looking statement to reflect the events or circumstances after the date on which the forward-looking statement was made, or reflect the occurrence of unanticipated events, except to the extent required by law.

## Critical Accounting Policies

Note 1 of the Notes to Consolidated Financial Statements included in Park's 2017 Annual Report lists significant accounting policies used in the development and presentation of Park's consolidated financial statements. The accounting and reporting policies of Park conform with U.S. GAAP and general practices within the financial services industry. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

Park believes the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb probable incurred credit losses in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses is based on periodic evaluations of the loan portfolio and of current economic conditions. However, this evaluation has subjective components requiring material estimates, including expected default probabilities, the expected loss given default, the amounts and timing of expected future cash flows on impaired loans, and estimated losses on consumer loans and residential mortgage loans based on historical loss experience and current economic conditions. All of these factors may be susceptible to significant change. To the extent that actual results differ from management estimates, additional loan loss provisions may be required that would adversely impact earnings in future periods. Refer to the "Credit Metrics and Provision for (Recovery of) Loan Losses" section within this MD&A for additional discussion.

Other real estate owned ("OREO"), property acquired through foreclosure, is recorded at estimated fair value less anticipated selling costs (net realizable value). If the net realizable value is below the carrying value of the loan on the date of transfer, the difference is charged to the allowance for loan losses. Subsequent declines in value, OREO devaluations, are reported as adjustments to the carrying amount of OREO and are expensed within other income. Gains or losses not previously recognized, resulting from the sale of OREO, are recognized within other income on the date of sale.

U.S. GAAP requires management to establish a fair value hierarchy, which has the objective of maximizing the use of observable market inputs. U.S. GAAP also requires enhanced disclosures regarding the inputs used to calculate fair value. These are classified as Level 1, Level 2, and Level 3. Level 3 inputs are those with significant unobservable inputs that reflect a company's own assumptions about the market for a particular instrument. Some of these inputs could be based on internal models and cash flow analyses. The large majority of Park's assets whose fair value is



determined using Level 2 inputs consists of AFS securities. The fair value of these AFS securities is obtained largely through the use of matrix pricing, which is a mathematical technique widely used in the financial services industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities. Please see Note 16 - Fair Value of the Notes to Unaudited Consolidated Condensed Financial Statements in this Quarterly Report on Form 10-Q for additional information on fair value.

Management believes that the accounting for goodwill and other intangibles also involves a higher degree of judgment than most other significant accounting policies. U.S. GAAP establishes standards for the impairment assessment of goodwill. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. Park's goodwill, as of September 30, 2018, relates to the value inherent in the banking industry and that value is dependent upon the ability of Park's national bank subsidiary, The Park National Bank ("PNB") to provide quality, cost-effective banking services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base, the inability to deliver

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cost-effective services over sustained periods or significant credit problems can lead to impairment of goodwill that could adversely impact earnings in future periods. U.S. GAAP requires an annual evaluation of goodwill for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Park's most recent evaluation was completed during the second quarter of 2018 and resulted in no impairment of goodwill. Further, there have been no events subsequent to that analysis that provide any evidence that goodwill is impaired. The fair value of the goodwill, which resides on the books of PNB, is estimated by reviewing the past and projected operating results for PNB, deposit and loan totals for PNB and banking industry comparable information.

The determination of pension plan obligations and related expenses requires the use of assumptions to estimate the amount of benefits that employees will earn while working, as well as the present value of those benefits. Annual pension expense is principally based on four components: (1) the value of benefits earned by employees for working during the year (service cost), (2) the increase in the liability due to the passage of time (interest cost), and (3) other gains and losses, reduced by (4) the expected return on plan assets for our pension plan.

Significant assumptions used to measure our annual pension expense include:

- the interest rate used to determine the present value of liabilities (discount rate);
- certain employee-related factors, such as turnover, retirement age and mortality;
- the expected return on assets in our funded pension plan; and
- the rate of salary increases where benefits are based on earnings.

Our assumptions reflect our historical experience and management's best judgment regarding future expectations. Due to the significant management judgment involved, our assumptions could have a material impact on the measurement of our pension plan expense and obligation.

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Comparison of Results of Operations

For the Three and Nine Months Ended September 30, 2018 and 2017

Summary Discussion of Results

Net income for the three months ended September 30, 2018 was \$24.8 million, compared to \$22.1 million for the third quarter of 2017. Diluted earnings per common share were \$1.56 for the third quarter of 2018, compared to \$1.44 for the third quarter of 2017. Weighted average diluted common shares outstanding were 15,832,734 for the third quarter of 2018, compared to 15,351,590 weighted average diluted common shares outstanding for the third quarter of 2017.

Net income for the nine months ended September 30, 2018 was \$84.1 million, compared to \$61.4 million for the nine months ended September 30, 2017. Diluted earnings per common share were \$5.41 for the first nine months of 2018, compared to \$3.99 for the first nine months of 2017. Weighted average diluted common shares outstanding were 15,560,666 for the first nine months of 2018, compared to 15,394,199 weighted average diluted common shares outstanding for the first nine months of 2017.

During the first quarter of 2018, Park adopted ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost. This ASU is required to be applied retrospectively to all periods presented. As a result of the adoption of this ASU, all prior periods have been recast to separately record the service cost component and other components of net benefit cost. For all periods presented for Park, this resulted in an increase in other income and an offsetting increase in other expense with no change to net income.

During the first quarter of 2018, Park adopted ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Changes reflected in the current U.S. GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. As a result of the adoption of this ASU, Park recorded an increase of \$1.9 million to beginning retained earnings and a \$995,000 increase to beginning accumulated other comprehensive loss. Additional income of \$3.2 million, \$1.3 million and \$89,000 was recorded in other income in the first, second and third quarters of 2018, respectively, as the result of changes to the accounting for equity investments.

On July 1, 2018, NewDominion Bank, a North Carolina state-chartered bank (“NewDominion”), merged with and into PNB, with PNB continuing as the surviving entity pursuant to the Agreement and Plan of Merger and Reorganization, dated as of January 22, 2018, by and among Park, PNB, and NewDominion. On the acquisition date, NewDominion had \$328 million in total assets, \$278 million in total loans, and \$284 million in total deposits. The acquisition was valued at \$79.2 million and resulted in Park issuing 435,457 Park common shares and paying \$30.7 million in cash as merger consideration in exchange for 91.45% of NewDominion's outstanding common shares. The remaining 8.55% of NewDominion's outstanding common shares were previously held by Park. For the nine months ended September 30, 2018, Park recorded merger-related expenses of \$3.6 million associated with the NewDominion acquisition.

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## Financial Results by Segment

The table below reflects the net income (loss) by segment for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016. Park's segments include PNB, Guardian Financial Services Company ("GFSC"), SE Property Holdings, LLC ("SEPH") and all other which primarily consists of Park as the "Parent Company."

Net income (loss) by segment

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
PNB	\$27,856	\$28,797	\$26,745	\$83,398	\$62,946	\$87,315	\$84,451
GFSC	254	295	57	606	468	260	(307 )
Parent Company	(3,059 )	(973 )	1,465	(2,567 )	(2,040 )	(2,457 )	(4,557 )
Ongoing operations	\$25,051	\$28,119	\$28,267	\$81,437	\$61,374	\$85,118	\$79,587
SEPH	(289 )	122	2,856	2,689	37	(876 )	6,548
Total Park	\$24,762	\$28,241	\$31,123	\$84,126	\$61,411	\$84,242	\$86,135

The category "Parent Company" above excludes the results for SEPH, an entity which is winding down commensurate with the disposition of SEPH's nonperforming assets. Management considers the "Ongoing operations" results, which exclude the results of SEPH, to reflect the business of Park and Park's subsidiaries going forward. The discussion below provides additional information regarding the segments that make up the "Ongoing operations", followed by additional information regarding SEPH.

## The Park National Bank (PNB)

The table below reflects PNB's net income for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016.

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
Net interest income	\$66,195	\$62,683	\$61,441	\$190,319	\$174,717	\$235,243	\$227,576
Provision for (recovery of) loan losses	2,935	1,623	(67 )	4,491	9,114	9,898	2,611
Other income	22,559	22,070	19,915	64,544	61,466	82,742	79,959
Other expense	51,982	48,169	49,001	149,152	137,876	185,891	182,718
Income before income taxes	\$33,837	\$34,961	\$32,422	\$101,220	\$89,193	\$122,196	\$122,206
Income tax expense	5,981	6,164	5,677	17,822	26,247	34,881	37,755
Net income	\$27,856	\$28,797	\$26,745	\$83,398	\$62,946	\$87,315	\$84,451

Net interest income of \$190.3 million for the nine months ended September 30, 2018 represented a \$15.6 million, or 8.9%, increase compared to \$174.7 million for the nine months ended September 30, 2017. The increase was the result of a \$15.1 million increase in interest income and a \$472,000 decrease in interest expense.

The \$15.1 million increase in interest income was due to a \$13.4 million increase in interest income on loans, along with a \$1.7 million increase in interest income on investments. The increase in interest income on loans was partially the result of a \$102.8 million increase in average loans from \$5.28 billion for the nine months ended September 30, 2017, to \$5.38 billion for the nine months ended September 30, 2018. Additionally, the yield on loans increased by 24 basis points to 4.79% for the nine months ended September 30, 2018, compared to 4.55% for the nine months ended September 30, 2017. Included in interest income for the nine months ended September 30, 2018 and 2017 was

\$817,000 and \$149,000, respectively, in interest income, related to PNB participations in legacy Vision Bank ("Vision") assets.

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The \$472,000 decrease in interest expense was due to a \$8.7 million increase in interest expense on deposits being more than offset by a \$9.1 million decrease in interest expense on borrowings. The increase in interest expense on deposits was partially the result of a \$104.6 million, or 2.4%, increase in average interest-bearing deposits from \$4.36 billion for the nine months ended September 30, 2017, to \$4.46 billion for the nine months ended September 30, 2018. Additionally, the cost of deposits increased by 24 basis points from 0.43% for the nine months ended September 30, 2017 to 0.67% for the nine months ended September 30, 2018. The decrease in interest expense on borrowings was the result of a decrease in long-term debt. During the fourth quarter of 2017, Park utilized excess cash to repay \$350 million of long-term debt which matured during November 2017. The effective interest rate on the repaid long-term debt had been 3.22%.

The provision for loan losses of \$4.5 million for the nine months ended September 30, 2018 represented a decrease of \$4.6 million, compared to \$9.1 million for the nine months ended September 30, 2017. Refer to the “Credit Metrics and Provision for (Recovery of) Loan Losses” section for additional details regarding the level of the provision for (recovery of) loan losses recognized in each period presented above.

Other income of \$64.5 million for the nine months ended September 30, 2018 represented an increase of \$3.1 million, or 5.0%, compared to \$61.5 million for the nine months ended September 30, 2017. The \$3.1 million increase was primarily related to a \$2.0 million increase in income from fiduciary activities, a \$1.3 million increase in gain on sale of OREO, net, a \$961,000 increase in checkcard fee income, a \$747,000 increase in other components of net periodic pension benefit income, a \$526,000 increase in equity investment income which is included in miscellaneous income, a \$515,000 increase in gains on sale of assets, net, and a \$400,000 increase in other service income, offset by a \$2.3 million net loss on sales of investment securities during the nine months ended September 30, 2018, a \$901,000 decrease in service charges on deposit accounts and a \$677,000 decrease in bank owned life insurance income, primarily from the change in death benefits paid on policies during 2018 and 2017.

Other expense of \$149.2 million for the nine months ended September 30, 2018 represented an increase of \$11.3 million, or 8.2%, compared to \$137.9 million for the nine months ended September 30, 2017. The \$11.3 million increase was primarily related to a \$4.2 million increase in salaries expense, a \$3.6 million increase in employee benefits expense, a \$829,000 increase in professional fees and services expense, a \$828,000 increase in furniture and equipment expense, a \$722,000 increase in occupancy expense, a \$565,000 increase in state tax expense, a \$556,000 increase in data processing expense, a \$477,000 increase in marketing expense, a \$323,000 increase in non-loan related losses which are included in miscellaneous expense, and a \$289,000 increase in core deposit intangible expense which are included in amortization of intangibles, offset by a \$1.5 million decrease in contribution expense which is included in miscellaneous expense and a \$562,000 decrease in insurance expense.

Income tax expense of \$17.8 million for the nine months ended September 30, 2018 represented a decrease of \$8.4 million compared to \$26.2 million for the nine months ended September 30, 2017. The decrease in income tax expense was largely due to a decrease in the corporate federal income tax rate from 35% to 21%, effective January 1, 2018.

PNB's results for the first nine months of 2018 and 2017, and for the fiscal year ended December 31, 2017, included income and expense related to participations in legacy Vision assets. The impact of these participations on particular items within PNB's income and expense for these periods is detailed in the table below:

(In thousands)	Nine Months YTD 2018			Nine Months YTD 2017			2017		
	PNB as reported	Adjustments	PNB as adjusted <sup>(1)</sup>	PNB as reported <sup>(1)</sup>	Adjustments	PNB as adjusted	PNB as reported <sup>(1)</sup>	Adjustments	PNB as adjusted
Net interest income	\$ 190,319	\$ 817	\$ 189,502	\$ 174,717	\$ 149	\$ 174,568	\$ 235,243	\$ 233	\$ 235,010
Provision for (recovery of) loan losses	4,491	(6)	4,497	9,114	(5)	9,119	9,898	(5)	9,903
Other income	64,544	1,458	63,086	61,466	216	61,250	82,742	244	82,498
Other expense	149,152	147	149,005	137,876	398	137,478	185,891	492	185,399
	\$ 101,220	\$ 2,134	\$ 99,086	\$ 89,193	\$ (28)	\$ 89,221	\$ 122,196	\$ (10)	\$ 122,206

Income (loss) before  
income taxes

Federal income tax expense (benefit)	17,822	376	17,446	26,247	(8	)	26,255	34,881	(3	)	34,884
Net income (loss)	\$83,398	\$ 1,758	\$81,640	\$62,946	\$ (20	)	\$62,966	\$87,315	\$ (7	)	\$87,322

(1) Adjustments consist of the impact on the particular items reported in PNB's income statement of PNB participations in legacy Vision assets.

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The table below provides certain balance sheet information and financial ratios for PNB as of or for the nine months ended September 30, 2018 and 2017, as of or for the six months ended June 30, 2018 and as of or for the fiscal year ended December 31, 2017.

(In thousands)	September 30, 2018	June 30, 2018	December 31, 2017	September 30, 2017	% change from 6/30/18	% change from 12/31/17	% change from 09/30/17
Loans	\$5,605,925	\$5,305,560	\$5,339,255	\$5,332,308	5.66	% 4.99	% 5.13
Allowance for loan losses	47,981	47,110	47,607	52,888	1.85	% 0.79	% (9.28)
Net loans	5,557,944	5,258,450	5,291,648	5,279,420	5.70	% 5.03	% 5.28
Investment securities	1,435,046	1,501,991	1,507,926	1,564,051	(4.46)	% (4.83)	% (8.25)
Total assets	7,707,474	7,404,498	7,467,851	7,788,248	4.09	% 3.21	% (1.04)
Total deposits	6,353,965	6,126,119	5,896,676	6,051,268	3.72	% 7.76	% 5.00
Average assets <sup>(1)</sup>	7,523,967	7,396,316	7,664,725	7,665,957	1.73	% (1.84)	% (1.85)
Efficiency ratio <sup>(3)</sup>	58.04	% 58.01	% 57.56	% 57.51	% 0.05	% 0.83	% 0.92
Return on average assets <sup>(2)</sup>	1.48	% 1.51	% 1.14	% 1.10	% (1.99)	% 29.82	% 34.55

(1) Average assets for the nine months ended September 30, 2018 and 2017, for the six months ended June 30, 2018 and for the fiscal year ended December 31, 2017.

(2) Annualized for the nine months ended September 30, 2018 and 2017 and for the six months ended June 30, 2018.

(3) Calculated utilizing fully taxable equivalent net interest income which includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustments were \$2.1 million and \$3.5 million for the nine months ended September 30, 2018 and 2017, respectively, \$1.4 million for the six months ended June 30, 2018 and \$5.0 million for the fiscal year ended December 31, 2017.

Loans outstanding at September 30, 2018 were \$5.61 billion, compared to \$5.31 billion at June 30, 2018, an increase of \$300.4 million, or 5.7%. The increase in loan balances from June 30, 2018 to September 30, 2018 resulted from increases in commercial loan balances of \$198.3 million (7.4%), residential loan balances of \$58.9 million (5.1%), home equity line of credit balances of \$33.0 million (17.5%) and consumer loan balances of \$9.5 million (0.7%).

Excluding loans outstanding at NewDominion, loans outstanding at September 30, 2018 were \$5.33 billion, compared to \$5.31 billion at June 30, 2018, an increase of \$26.6 million, or 0.5%. The increase in loan balances from June 30, 2018 to September 30, 2018, excluding loans at NewDominion, resulted from increases in commercial loan balances of \$16.0 million (0.6%), consumer loan balances of \$9.3 million (0.7%) and residential loan balances of \$4.4 million (0.4%), offset by a decline in home equity line of credit balances of \$3.3 million (1.8%).

Loans outstanding at September 30, 2018 were \$5.61 billion, compared to \$5.34 billion at December 31, 2017, an increase of \$266.7 million, or 5.0%. The increase in loan balances in the first nine months of 2018 resulted from increases in commercial loan balances of \$167.4 million (6.2%), residential loan balances of \$44.0 million (3.7%), home equity line of credit balances of \$18.9 million (9.3%) and consumer loan balances of \$36.4 million (2.9%).

Excluding loans outstanding at NewDominion, loans outstanding at September 30, 2018 were \$5.33 billion, compared to \$5.34 billion at December 31, 2017, a decrease of \$7.1 million, or 0.1%. The loan decline in the first nine months of 2018, excluding NewDominion, resulted from declines in commercial loan balances of \$14.9 million (0.5%), residential loan balances of \$10.9 million (0.9%) and home equity line of credit balances of \$17.4 million (8.6%), offset by consumer loan growth of \$36.2 million (2.9%).



PNB's allowance for loan losses increased by \$374,000, or 0.8%, to \$48.0 million at September 30, 2018, compared to \$47.6 million at December 31, 2017. Net charge-offs were \$4.1 million, or 0.10% of total average loans, for the nine months ended September 30, 2018 and were \$5.0 million, or 0.13% of total average loans, for the nine months ended September 30, 2017. Refer to the "Credit Metrics and Provision for (Recovery of) Loan Losses" section for additional information regarding PNB's loan portfolio and the level of provision for (recovery of) loan losses recognized in each period presented.

Total deposits at September 30, 2018 were \$6.35 billion, compared to \$5.90 billion at December 31, 2017, an increase of \$457.3 million, or 7.8%. The deposit growth for the nine months ended September 30, 2018 consisted of savings deposit growth of \$137.4 million (7.3%), transaction account growth of \$171.1 million (13.6%), non-interest bearing deposits growth of \$88.2 million (5.1%) and time deposits growth of \$56.6 million (5.5%).

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Excluding deposits at NewDominion, total deposits at September 30, 2018 were \$6.09 billion, compared to \$5.90 billion at December 31, 2017, an increase of \$188.7 million, or 3.2%. The deposit growth for the nine months ended September 30, 2018, excluding NewDominion, consisted of savings deposit growth of \$135.3 million (7.2%) and transaction account growth of \$66.8 million (5.3%), offset by a reduction in non-interest bearing deposits of \$3.3 million (0.2%) and a reduction in time deposits of \$14.1 million (1.4%).

## Guardian Financial Services Company (GFSC)

The table below reflects GFSC's net income (loss) for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016.

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
Net interest income	\$1,252	\$1,261	\$1,305	\$3,818	\$4,424	\$5,839	\$5,874
Provision for loan losses	183	87	503	773	1,419	1,917	1,887
Other income	63	42	30	135	58	103	57
Other expense	810	842	760	2,412	2,343	3,099	4,515
Income (loss) before income taxes	\$322	\$374	\$72	\$768	\$720	\$926	\$(471)
Income tax expense (benefit)	68	79	15	162	252	666	(164)
Net income (loss)	\$254	\$295	\$57	\$606	\$468	\$260	\$(307)

The table below provides certain balance sheet information and financial ratios for GFSC as of or for the nine months ended September 30, 2018 and 2017 and as of or for the fiscal year ended December 31, 2017.

(In thousands)	September 30, 2018	December 31, 2017	September 30, 2017	% change from 12/31/17	% change from 9/30/17
Loans	\$29,849	\$33,385	\$33,686	(10.59)%	(11.39)%
Allowance for loan losses	2,265	2,382	2,344	(4.91)%	(3.37)%
Net loans	27,584	31,003	31,342	(11.03)%	(11.99)%
Total assets	28,551	32,077	33,260	(10.99)%	(14.16)%
Average assets <sup>(1)</sup>	30,126	33,509	33,537	(10.10)%	(10.17)%
Return on average assets <sup>(2)</sup>	2.69	%0.78	%1.86	%244.87	%44.62

(1) Average assets for the nine months ended September 30, 2018 and 2017 and for the fiscal year ended December 31, 2017.

(2) Annualized for the nine months ended September 30, 2018 and 2017.



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## Park Parent Company

The table below reflects the Park Parent Company net (loss) income for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016.

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
Net interest income (expense)	\$110	\$182	\$227	\$519	\$256	\$588	\$(138 )
Provision for loan losses	—	—	—	—	—	—	—
Other income	1,541	1,059	3,371	5,971	1,190	3,065	955
Other expense	5,961	2,666	2,522	11,149	6,407	8,805	9,731
Net (loss) income before income tax benefit	\$(4,310)	\$(1,425)	\$1,076	\$(4,659)	\$(4,961)	\$(5,152)	\$(8,914)
Income tax benefit	(1,251 )	(452 )	(389 )	(2,092 )	(2,921 )	(2,695 )	(4,357 )
Net (loss) income	\$(3,059)	\$(973 )	\$1,465	\$(2,567)	\$(2,040)	\$(2,457)	\$(4,557)

The net interest income (expense) for Park's parent company included, for all periods presented, interest income on subordinated debt investments in PNB, which were eliminated in the consolidated Park National Corporation totals. For the fiscal year ended December 31, 2016, the net interest expense included interest income on loans to SEPH (paid off on December 14, 2016). Additionally, net interest income (expense) for the first nine months of 2017 and for the fiscal years ended December 31, 2017 and 2016, included interest expense related to the \$30.00 million of 7% Subordinated Notes due April 20, 2022 issued by Park to accredited investors on April 20, 2012, which Park prepaid in full (principal plus accrued interest) on April 24, 2017.

Other income of \$6.0 million for the nine months ended September 30, 2018 represented an increase of \$4.8 million compared to \$1.2 million for the nine months ended September 30, 2017. The \$4.8 million increase was largely due to a \$3.2 million increase in income related to certain equity securities and a \$1.5 million increase in bank owned life insurance income, primarily from death benefits paid on policies during 2018.

Other expense of \$11.1 million for the nine months ended September 30, 2018 represented an increase of \$4.7 million, or 74.0%, compared to \$6.4 million for the nine months ended September 30, 2017. The \$4.7 million increase was primarily related to an increase of \$3.3 million in salaries expense, which included \$1.6 million of merger-related expenses related to the acquisition of NewDominion, and an increase of \$2.4 million in professional fees and services, which included \$2.0 million of merger-related expenses related to the acquisition of NewDominion, offset by a \$475,000 decrease in state tax expense.

## SEPH

The table below reflects SEPH's net (loss) income for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016. SEPH holds the remaining assets and liabilities retained by Vision subsequent to the sale of the Vision business on February 16, 2012. Prior to holding the remaining Vision assets, SEPH held OREO assets that were transferred from Vision to SEPH. This segment represents a run-off portfolio of the legacy Vision assets.

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
Net interest income	\$119	\$616	\$1,877	\$2,612	\$ 884	\$2,089	\$4,774

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Recovery of loan losses	(178 )	(324 )	(176 )	(678 )	(1,793 )	(3,258 )	(9,599 )
Other income	(99 )	71	3,587	3,559	477	519	3,068
Other expense	563	857	2,025	3,445	3,097	5,367	7,367
(Loss) income before income taxes	\$(365)	\$154	\$3,615	\$3,404	\$ 57	\$499	\$10,074
Income tax (benefit) expense	(76 )	32	759	715	20	1,375	3,526
Net (loss) income	\$(289)	\$122	\$2,856	\$2,689	\$ 37	\$(876 )	\$6,548

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Net interest income increased to \$2.6 million for the nine months ended September 30, 2018 from \$884,000 for the nine months ended September 30, 2017. The increase was the result of an increase in interest payments received from SEPH impaired loan relationships.

For the nine months ended September 30, 2018, SEPH had net recoveries of loan losses of \$678,000, compared to net recoveries of loan losses of \$1.8 million for the nine months ended September 30, 2017.

The \$3.1 million increase in other income for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, was primarily the result of a \$2.6 million increase in gains on sale of OREO and a \$853,000 increase in loan fee income as a result of payments received from SEPH impaired loan relationships.

The \$348,000 increase in other expense for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, was the result of a \$1.0 million increase in management and consulting fees associated with the collection of payments on certain SEPH impaired loan relationships during 2018, offset by a \$742,000 decrease in legal fees.

Legacy Vision assets at SEPH totaled \$4.0 million as of September 30, 2018, compared to \$18.8 million at December 31, 2017 and \$18.7 million at September 30, 2017. In addition to these SEPH assets, PNB participations in legacy Vision assets totaled \$2.5 million at September 30, 2018, compared to \$9.0 million at both December 31, 2017 and September 30, 2017.

## Park National Corporation

The table below reflects Park's consolidated net income for the first, second and third quarters of 2018, for the first nine months of 2018 and 2017, and for the fiscal years ended December 31, 2017 and 2016.

(In thousands)	Q3 2018	Q2 2018	Q1 2018	Nine months YTD 2018	Nine months YTD 2017	2017	2016
Net interest income	\$67,676	\$64,742	\$64,850	\$197,268	\$180,281	\$243,759	\$238,086
Provision for (recovery of) loan losses	2,940	1,386	260	4,586	8,740	8,557	(5,101)
Other income	24,064	23,242	26,903	74,209	63,191	86,429	84,039
Other expense	59,316	52,534	54,308	166,158	149,723	203,162	204,331
Income before income taxes	\$29,484	\$34,064	\$37,185	\$100,733	\$85,009	\$118,469	\$122,895
Income taxes	4,722	5,823	6,062	16,607	23,598	34,227	36,760
Net income	\$24,762	\$28,241	\$31,123	\$84,126	\$61,411	\$84,242	\$86,135

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## Net Interest Income

Park's principal source of earnings is net interest income, the difference between total interest income and total interest expense. Net interest income results from average balances outstanding for interest earning assets and interest bearing liabilities in conjunction with the average rates earned and paid on them.

## Comparison for the Third Quarters of 2018 and 2017

Net interest income increased by \$6.1 million, or 10.0%, to \$67.7 million for the third quarter of 2018, compared to \$61.6 million for the third quarter of 2017. See the discussion under the table below.

(Dollars in thousands)	Three months ended September 30, 2018				Three months ended September 30, 2017			
	Average balance	Interest	Tax equivalent yield/cost		Average balance	Interest	Tax equivalent yield/cost	
Loans <sup>(1)</sup>	\$5,609,813	\$70,034	4.95	%	\$5,337,206	\$63,338	4.71	%
Taxable investments	1,205,206	7,691	2.53	%	1,293,571	6,757	2.07	%
Tax-exempt investments <sup>(2)</sup>	303,949	2,792	3.64	%	271,305	3,037	4.44	%
Money market instruments	87,143	428	1.95	%	427,157	1,383	1.28	%
Interest earning assets	\$7,206,111	\$80,945	4.46	%	\$7,329,239	\$74,515	4.03	%
Interest bearing deposits	\$4,642,530	\$9,740	0.83	%	\$4,505,040	\$5,403	0.48	%
Short-term borrowings	179,109	288	0.64	%	187,319	197	0.42	%
Long-term debt	415,000	2,525	2.42	%	863,205	6,073	2.79	%
Interest bearing liabilities	\$5,236,639	\$12,553	0.95	%	\$5,555,564	\$11,673	0.83	%
Excess interest earning assets	\$1,969,472				\$1,773,675			
Tax equivalent net interest income		\$68,392				\$62,842		
Net interest spread			3.51	%			3.20	%
Net interest margin			3.77	%			3.40	%

(1) Loan interest income includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$129,000 for the three months ended September 30, 2018 and \$228,000 for the same period of 2017.

(2) Interest income on tax-exempt investment securities includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$587,000 for the three months ended September 30, 2018 and \$1.1 million for the same period of 2017.

Average interest earning assets for the third quarter of 2018 decreased by \$123 million, or 1.7%, to \$7,206 million, compared to \$7,329 million for the third quarter of 2017. The average yield on interest earning assets increased by 43 basis points to 4.46% for the third quarter of 2018, compared to 4.03% for the third quarter of 2017.

Interest income for the three months ended September 30, 2018 included \$120,000 related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB, as well as \$439,000 related to the accretion of purchase accounting adjustments related to the acquisition of NewDominion. Interest income for the three months ended September 30, 2017 included \$552,000 related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB. Excluding these additional sources of income, the yield on loans was 4.91% and 4.68% for the three months ended September 30, 2018 and 2017, respectively, and the yield on earning assets was 4.42% and 4.01% for the three months ended September 30, 2018 and 2017, respectively.

Average interest bearing liabilities for the third quarter of 2018 decreased by \$319 million, or 5.7%, to \$5,237 million, compared to \$5,556 million for the third quarter of 2017. The average cost of interest bearing liabilities increased by 12 basis points to 0.95% for the third quarter of 2018, compared to 0.83% for the third quarter of 2017. Approximately \$608,000 of the cost of funds increase, or 5 basis points, during the three months ended September 30, 2018, resulted from an accrual for an interest rate adjustment on an interest bearing deposit product. Without this adjustment the cost of funds for total interest bearing deposits was 0.78% and the cost of funds for interest bearing liabilities was 0.90%.



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Removing the impacts of interest income related to payments on certain SEPH loan relationships, the accretion related to purchase accounting adjustments and the accrual for an interest rate adjustment on an interest bearing deposit product, the net interest margin was 3.77% and 3.38% for the three months ended September 30, 2018 and 2017, respectively.

Yield on Loans: Average loan balances increased by \$273 million, or 5.1%, to \$5,610 million for the third quarter of 2018, compared to \$5,337 million for the third quarter of 2017. The average yield on the loan portfolio increased by 24 basis points to 4.95% for the third quarter of 2018, compared to 4.71% for the third quarter of 2017.

The table below shows the average balance and tax equivalent yield by type of loan for the three months ended September 30, 2018 and 2017.

(Dollars in thousands)	Three months ended September 30, 2018			Three months ended September 30, 2017		
	Average balance	Tax equivalent yield		Average balance	Tax equivalent yield	
Home equity	\$ 223,460	5.28	%	\$ 208,741	4.56	%
Installment loans	1,306,405	5.07	%	1,261,542	4.96	%
Real estate loans	1,205,812	4.21	%	1,188,550	3.87	%
Commercial loans <sup>(1)</sup>	2,869,221	5.17	%	2,673,207	4.96	%
Other	4,915	12.41	%	5,166	11.97	%
Total loans and leases before allowance	\$ 5,609,813	4.95	%	\$ 5,337,206	4.71	%

(1) Commercial loan interest income includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$129,000 for the three months ended September 30, 2018 and \$228,000 for the same period of 2017.

Loan interest income for the three months ended September 30, 2018 included income related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB, as well as the accretion of purchase accounting adjustments related to the acquisition of NewDominion. Excluding these sources of income, the yield on home equity loans was 5.12%, the yield on real estate loans was 4.10%, the yield on commercial loans was 5.15% and the yield on total loans was 4.91%.

Loan interest income for the three months ended September 30, 2017 includes income related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB. Excluding this income, the yield on commercial loans was 4.91% and the yield on total loans was 4.68%.

Cost of Deposits: Average interest bearing deposit balances increased by \$137 million, or 3.1%, to \$4,643 million for the third quarter of 2018, compared to \$4,505 million for the third quarter of 2017. The average cost of funds on deposit balances increased by 35 basis points to 0.83% for the third quarter of 2018, compared to 0.48% for the third quarter of 2017.

The table below shows for the three months ended September 30, 2018 and 2017, the average balance and cost of funds by type of deposit.

(Dollars in thousands)	Three months ended September 30, 2018		Three months ended September 30, 2017	
	Average balance	Cost of funds	Average balance	Cost of funds
Transaction accounts	\$ 1,483,691	0.81 %	\$ 1,395,919	0.30 %

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Savings deposits and clubs	2,063,376	0.65 %	2,011,251	0.36 %
Time deposits	1,095,463	1.21 %	1,097,870	0.91 %
Total interest bearing deposits	\$ 4,642,530	0.83 %	\$ 4,505,040	0.48 %

Interest expense for the three months ended September 30, 2018, included a \$608,000 accrual for an interest rate adjustment on an interest bearing deposit product. Without this adjustment, the cost of funds for transaction accounts was 0.65% and the cost of funds for total interest bearing deposits was 0.78%

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## Comparison for the First Nine Months of 2018 and 2017

Net interest income increased by \$17.0 million, or 9.4%, to \$197.3 million for the first nine months of 2018, compared to \$180.3 million for the first nine months of 2017. See the discussion under the table below.

(Dollars in thousands)	Nine months ended September 30, 2018				Nine months ended September 30, 2017			
	Average balance	Interest	Tax equivalent yield/cost		Average balance	Interest	Tax equivalent yield/cost	
Loans <sup>(1)</sup>	\$5,401,631	\$199,181	4.93 %		\$5,314,501	\$185,034	4.66 %	
Taxable investments	1,205,747	22,204	2.46 %		1,329,589	20,787	2.09 %	
Tax-exempt investments <sup>(2)</sup>	301,501	8,301	3.68 %		232,751	7,844	4.51 %	
Money market instruments	79,256	1,070	1.80 %		271,778	2,330	1.15 %	
Interest earning assets	\$6,988,135	\$230,756	4.41 %		\$7,148,619	\$215,995	4.04 %	
Interest bearing deposits	\$4,467,206	22,574	0.68 %		\$4,363,065	13,926	0.43 %	
Short-term borrowings	225,310	1,283	0.76 %		223,043	616	0.37 %	
Long-term debt	424,615	7,509	2.36 %		806,584	17,632	2.92 %	
Interest bearing liabilities	\$5,117,131	\$31,366	0.82 %		\$5,392,692	\$32,174	0.80 %	
Excess interest earning assets	\$1,871,004				\$1,755,927			
Tax equivalent net interest income		\$199,390				\$183,821		
Net interest spread			3.59 %				3.24 %	
Net interest margin			3.81 %				3.44 %	

(1) Loan interest income includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$378,000 for the nine months ended September 30, 2018 and \$794,000 for the same period of 2017.

(2) Interest income on tax-exempt investment securities includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$1.7 million for the nine months ended September 30, 2018 and \$2.7 million for the same period of 2017.

Average interest earning assets for the first nine months of 2018 decreased by \$160 million, or 2.2%, to \$6,988 million, compared to \$7,149 million for the first nine months of 2017. The average yield on interest earning assets increased by 37 basis points to 4.41% for the first nine months of 2018, compared to 4.04% for the first nine months of 2017.

Interest income for the nine months ended September 30, 2018 included \$3.4 million related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB, as well as \$439,000 related to the accretion of purchase accounting adjustments related to the acquisition of NewDominion. Interest income for the nine months ended September 30, 2017 included \$1.0 million related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB. Excluding these sources of income, the yield on loans was 4.84% and 4.64% for the nine months ended September 30, 2018 and 2017, respectively, the yield on earning assets was 4.34% and 4.03% for the nine months ended September 30, 2018 and 2017, respectively, and the net interest margin was 3.74% and 3.43% for the nine months ended September 30, 2018 and 2017, respectively.

Average interest bearing liabilities for the first nine months of 2018 decreased by \$276 million, or 5.1%, to \$5,117 million, compared to \$5,393 million for the first nine months of 2017. The average cost of interest bearing liabilities

increased by 2 basis points to 0.82% for the first nine months of 2018, compared to 0.80% for the first nine months of 2017.

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Yield on Loans: Average loan balances increased by \$87 million, or 1.6%, to \$5,402 million for the first nine months of 2018, compared to \$5,315 million for the first nine months of 2017. The average yield on the loan portfolio increased by 27 basis points to 4.93% for the first nine months of 2018, compared to 4.66% for the first nine months of 2017.

The table below shows for the nine months ended September 30, 2018 and 2017, the average balance and tax equivalent yield by type of loan:

(Dollars in thousands)	Nine months ended September 30, 2018			Nine months ended September 30, 2017		
	Average balance	Tax equivalent yield		Average balance	Tax equivalent yield	
Home equity	\$204,550	5.06	%	\$210,648	4.38	%
Installment loans	1,289,192	5.01	%	1,226,508	4.97	%
Real estate loans	1,170,162	4.08	%	1,199,414	3.84	%
Commercial loans <sup>(1)</sup>	2,733,077	5.23	%	2,672,555	4.89	%
Other	4,650	12.85	%	5,376	11.55	%
Total loans and leases before allowance	\$5,401,631	4.93	%	\$5,314,501	4.66	%

(1) Commercial loan interest income includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate in 2018 and a 35% federal corporate income tax rate in 2017. The taxable equivalent adjustment was \$378,000 for the nine months ended September 30, 2018 and \$794,000 for the same period of 2017.

Loan interest income for the nine months ended September 30, 2018 included income related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB, as well as the accretion of purchase accounting adjustments related to the acquisition of NewDominion. Excluding these sources of income, the yield on home equity loans was 4.99%, the yield on real estate loans was 4.04%, the yield on commercial loans was 5.07% and the yield on total loans was 4.84%.

Loan interest income for the nine months ended September 30, 2017 included income related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB. Excluding this income, the yield on commercial loans was 4.86% and the yield on total loans was 4.64%.

Yield on Average Interest Earning Assets: The following table shows the tax equivalent yield on average interest earning assets for the nine months ended September 30, 2018 and for the fiscal years ended December 31, 2017, 2016 and 2015.

	Loans (1) (3)	Investments (2)		Money Market Instruments		Total(3)
2015 - year	4.66%	2.46	%	0.26	%	3.95 %
2016 - year	4.74%	2.30	%	0.51	%	4.08 %
2017 - year	4.69%	2.47	%	1.18	%	4.08 %
2018 - first nine months	4.93%	2.71	%	2.03	%	4.42 %

(1) Loan interest income includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate for 2018 and a 35% federal corporate income tax rate for 2017, 2016 and 2015. The taxable equivalent adjustment was \$378,000 for the nine months ended September 30, 2018, and \$1.1 million, \$1.0 million and \$767,000 for the fiscal years ended December 31, 2017, 2016 and 2015, respectively.

(2) Interest income on tax-exempt investment securities includes the effects of taxable equivalent adjustments using a 21% federal corporate income tax rate for 2018 and a 35% federal corporate income tax rate for 2017, 2016 and 2015. The taxable equivalent adjustment was \$1.7 million for the nine months ended September 30, 2018, and \$3.9 million, \$1.4 million and \$98,000 for the fiscal years ended December 31, 2017, 2016, and 2015, respectively.

(3) Interest income for the nine months ended September 30, 2018, and the fiscal years ended December 31, 2017, 2016, and 2015 includes \$3.9 million, \$2.3 million, \$6.2 million, and \$1.1 million, respectively, related to payments received on certain SEPH impaired loan relationships, some of which are participated with PNB, as well as the accretion of purchase accounting adjustments related to the acquisition of NewDominion for the nine months ended September 30, 2018. Excluding these sources of income, the yield on loans was 4.84%, 4.66%, 4.64% and 4.66%, for the nine months ended September 30, 2018, and the fiscal years ended December 31, 2017, 2016, and 2015, respectively and the yield on earning assets was 4.34%, 4.05%, 4.00%, and 3.95%, for the nine months ended September 30, 2018 and for the fiscal years ended December 31, 2017, 2016, and 2015, respectively.

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Cost of Deposits: Average interest bearing deposit balances increased by \$104 million, or 2.4%, to \$4,467 million for the first nine months of 2018, compared to \$4,363 million for the first nine months of 2017. The average cost of funds on deposit balances increased by 25 basis points to 0.68% for the first nine months of 2018, compared to 0.43% for the first nine months of 2017.

The table below shows the average balance and cost of funds by type of deposit for the nine months ended September 30, 2018 and 2017.

(Dollars in thousands)	Nine months ended September 30, 2018		Nine months ended September 30, 2017	
	Average balance	Cost of funds	Average balance	Cost of funds
Transaction accounts	\$ 1,388,097	0.55 %	\$ 1,319,492	0.24 %
Savings deposits and clubs	2,027,438	0.54 %	1,935,887	0.30 %
Time deposits	1,051,671	1.11 %	1,107,686	0.86 %
Total interest bearing deposits	\$ 4,467,206	0.68 %	\$ 4,363,065	0.43 %

Cost of Average Interest Bearing Liabilities: The following table shows the cost of funds on average interest bearing liabilities for the nine months ended September 30, 2018 and for the fiscal years ended December 31, 2017, 2016 and 2015.

	Interest bearing deposits	Short-term borrowings	Long-term debt	Total
2015 - year	0.30 %	0.18 %	3.10 %	0.72 %
2016 - year	0.32 %	0.19 %	3.13 %	0.74 %
2017 - year	0.44 %	0.43 %	2.86 %	0.80 %
2018 - first nine months	0.68 %	0.76 %	2.36 %	0.82 %

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## Credit Metrics and Provision for (Recovery of) Loan Losses

The provision for (recovery of) loan losses is the amount added to the allowance for loan and lease losses ("ALLL") to ensure the allowance is sufficient to absorb probable, incurred credit losses. The amount of the provision for (recovery of) loan losses is determined by management after reviewing the risk characteristics of the loan portfolio, historic and current loan loss experience and current economic conditions.

Park's ongoing operation subsidiaries, PNB and GFSC, are the only subsidiaries that carry an ALLL balance. The table below provides additional information on the provision for (recovery of) loan losses and the ALLL for Park, Park's ongoing operations, and SEPH for the three-month and nine-month periods ended September 30, 2018 and 2017.

(Dollars in thousands)	Three Months Ended		Nine Months Ended		
	September 30, 2018	2017	September 30, 2018	2017	
ALLL, beginning balance	\$49,452	\$53,822	\$49,988	\$50,624	
Net charge-offs (recoveries) :					
Park's ongoing operations	2,324	3,019	5,006	5,925	
SEPH	(178 )	(1,146 )	(678 )	(1,793 )	
Park	2,146	1,873	4,328	4,132	
Provision for (recovery of) loan losses:					
Park's ongoing operations	3,118	4,429	5,264	10,533	
SEPH	(178 )	(1,146 )	(678 )	(1,793 )	
Park	2,940	3,283	4,586	8,740	
ALLL, ending balance	\$50,246	\$55,232	\$50,246	\$55,232	
Annualized ratio of net charge-offs (recoveries) to average loans:					
Park's ongoing operations	0.16	% 0.22	% 0.12	% 0.15	%
SEPH	(38.97 )	)(41.46 )	)(31.53 )	)(20.54 )	)(
Park	0.15	% 0.14	% 0.11	% 0.10	%

Loans acquired as part of the acquisition of NewDominion were recorded at fair value on the date of acquisition. An allowance is only established on these loans as a result of credit deterioration post acquisition. As of September 30, 2018, there was no allowance related to acquired loans.

SEPH, as a non-bank subsidiary of Park, does not carry an ALLL balance, but recognizes a provision for loan losses when a charge-off is taken and recognizes a recovery of loan losses when a recovery is received.



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The following table provides additional information related to the allowance for loan losses for Park's ongoing operations, including information related to specific reserves and general reserves, at September 30, 2018, December 31, 2017 and September 30, 2017.

## Park ongoing operations - Allowance for Loan Losses

(In thousands)	September 30, 2018	December 31, 2017	September 30, 2017		
Total allowance for loan losses	\$50,246	\$49,988	\$55,232		
Specific reserves	1,846	684	5,102		
General reserves	\$48,400	\$49,304	\$50,130		
Total loans	\$5,623,522	\$5,361,593	\$5,355,142		
Impaired commercial loans	45,062	46,242	63,407		
Total loans less impaired commercial loans	\$5,578,460	\$5,315,351	\$5,291,735		
Total allowance for loan losses to total loans ratio	0.89	% 0.93	% 1.03	%	
General reserves as a % of total loans less impaired commercial loans	0.87	% 0.93	% 0.95	%	

The allowance for loan losses of \$50.2 million at September 30, 2018 represented a \$258,000, or 0.5%, increase compared to \$50.0 million at December 31, 2017. This increase was the result of a \$904,000 decrease in general reserves, offset by a \$1.2 million increase in specific reserves. As of September 30, 2018, no allowance had been established for acquired loans. Excluding acquired loans, the general reserve as a percentage of total loans less impaired commercial loans was 0.91%.

Generally, management obtains updated valuations for all nonperforming loans, including those held at SEPH, at least annually. As new valuation information is received, management performs an evaluation and applies a discount for anticipated disposition costs to determine the net realizable value of the collateral, which is compared against the outstanding principal balance to determine if additional write-downs are necessary.

Nonperforming Assets: Nonperforming assets include: 1) loans whose interest is accounted for on a nonaccrual basis; 2) TDRs on accrual status; 3) loans which are contractually past due 90 days or more as to principal or interest payments but whose interest continues to accrue; (4) OREO which results from taking possession of property that served as collateral for a defaulted loan; and (5) other nonperforming assets which consist of other foreclosed or repossessed assets.

The following table compares Park's nonperforming assets at September 30, 2018, December 31, 2017 and September 30, 2017.

## Park National Corporation - Nonperforming Assets

(In thousands)	September 30, 2018	December 31, 2017	September 30, 2017
Nonaccrual loans	\$66,654	\$72,056	\$90,568
Accruing TDRs	14,602	20,111	19,401
Loans past due 90 days or more	2,025	1,792	1,980
Total nonperforming loans	\$83,281	\$93,959	\$111,949
OREO – PNB	3,061	6,524	6,701
OREO – SEPH	2,215	7,666	7,665
Other nonperforming assets - PNB	7,170	4,849	—
Total nonperforming assets	\$95,727	\$112,998	\$126,315

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Percentage of nonaccrual loans to total loans	1.18	%	1.34	%	1.69	%
Percentage of nonperforming loans to total loans	1.48	%	1.75	%	2.09	%
Percentage of nonperforming assets to total loans	1.70	%	2.10	%	2.35	%
Percentage of nonperforming assets to total assets	1.23	%	1.50	%	1.61	%

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Nonperforming assets for Park's ongoing operations and for SEPH as of September 30, 2018, December 31, 2017 and September 30, 2017 were as reported in the following two tables:

## Park's ongoing operations - Nonperforming Assets

(In thousands)	September 30, 2018	December 31, 2017	September 30, 2017		
Nonaccrual loans	\$65,019	\$61,753	\$80,424		
Accruing TDRs	14,602	20,111	19,401		
Loans past due 90 days or more	2,025	1,792	1,980		
Total nonperforming loans	\$81,646	\$83,656	\$101,805		
OREO – PNB	3,061	6,524	6,701		
Other nonperforming assets - PNB	7,170	4,849	—		
Total nonperforming assets	\$91,877	\$95,029	\$108,506		
Percentage of nonaccrual loans to total loans	1.16	% 1.15	% 1.50	%	
Percentage of nonperforming loans to total loans	1.45	% 1.56	% 1.90	%	
Percentage of nonperforming assets to total loans	1.63	% 1.77	% 2.03	%	
Percentage of nonperforming assets to total assets	1.19	% 1.27	% 1.39	%	

## SEPH - Nonperforming Assets

(In thousands)	September 30, 2018	December 31, 2017	September 30, 2017
Nonaccrual loans	\$ 1,635	\$ 10,303	\$ 10,144
Accruing TDRs	—	—	—
Loans past due 90 days or more	—	—	—
Total nonperforming loans	\$ 1,635	\$ 10,303	\$ 10,144
OREO – SEPH	2,215	7,666	7,665
Total nonperforming assets	\$ 3,850	\$ 17,969	\$ 17,809

Impaired Loans: Park's allowance for loan losses includes an allocation for loans specifically identified as impaired under GAAP. At September 30, 2018, loans considered to be impaired consisted substantially of commercial loans graded as "substandard" or "doubtful" and placed on non-accrual status. Specific reserves on impaired commercial loans are typically based on management's best estimate of the fair value of collateral securing these loans. The amount ultimately charged off for these loans may be different from the specific reserve as the ultimate liquidation of the collateral may be for an amount different from management's estimate.

When determining the quarterly loan loss provision, Park reviews the grades of commercial loans. These loans are graded from 1 to 8. A grade of 1 indicates little or no credit risk and a grade of 8 is considered a loss. Commercial loans that are pass-rated (graded an 1 through a 4) are considered to be of acceptable credit risk. Commercial loans graded a 5 (special mention) are considered to be watch list credits and a higher loan loss reserve percentage is allocated to these loans. Commercial loans graded a 6 (substandard), also considered to be watch list credits, represent higher credit risk than those rated special mention and, as a result, a higher loan loss reserve percentage is allocated to these loans. Commercial loans that are graded a 7 (doubtful) are shown as nonperforming and Park charges these loans down to their fair value by taking a partial charge-off or recording a specific reserve. Certain 6-rated loans and all 7-rated loans are included within the impaired category. A loan is deemed impaired when management determines that the borrower's ability to perform in accordance with the contractual loan agreement is in doubt. Any commercial

loan graded an 8 (loss) is completely charged-off.

As of September 30, 2018, Park had taken partial charge-offs of \$11.1 million related to the \$46.7 million of commercial loans considered to be impaired, compared to partial charge-offs of \$10.0 million related to the \$56.5 million of impaired commercial loans at December 31, 2017.

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Purchase credit impaired ("PCI") loans: In conjunction with the NewDominion acquisition, Park acquired loans with a book value of \$277.9 million as of July 1, 2018. These loans were recorded at the preliminary fair value of \$272.8 million. Loans acquired with deteriorated credit quality with a book value of \$5.1 million were recorded at the preliminary fair value of \$4.9 million. The carrying amount of loans acquired with deteriorated credit quality at September 30, 2018 was \$4.5 million, while the outstanding customer balance was \$4.7 million.

Allowance for loan losses: Loss factors are reviewed quarterly and updated at least annually to reflect recent loan loss history and incorporate current risks and trends which may not be recognized in historical data. The historical loss factors were last updated in the fourth quarter of 2017 to incorporate losses through December 31, 2017.

Excluding acquired loans, the allowance for loan losses related to performing commercial loans was \$31.5 million, or 1.18% of the outstanding principal balance of performing commercial loans at September 30, 2018. Excluding acquired loans, at September 30, 2018, the coverage level within the commercial loan portfolio was approximately 3.19 years compared to 3.24 years at December 31, 2017. Historical loss experience, defined as charge-offs plus changes in specific reserves, over the 96-month period ended December 31, 2017, for the commercial loan portfolio was 0.37%. This 96-month loss experience includes only the performance of the PNB loan portfolio and excludes the impact of PNB participations in Vision loans.

Excluding acquired loans, the overall reserve of 1.18% for other accruing commercial loans breaks down as follows: pass-rated commercial loans are reserved at 1.17%; special mention commercial loans are reserved at 2.94%; and substandard commercial loans are reserved at 10.37%. The reserve levels for pass-rated, special mention and substandard commercial loans in excess of the 96-month loss experience of 0.37% are due to the following factors which management reviews on a quarterly or annual basis:

**Historical Loss Factor:** Management updated the historical loss calculation during the fourth quarter of 2017, incorporating net charge-offs plus changes in specific reserves through December 31, 2017. With the addition of 2017 historical losses, management extended the historical loss period to 96 months from 84 months. The 96-month historical loss period captures all annual periods subsequent to June 2009, the end of the most recent recession, thus encompassing the full economic cycle to date.

**Loss Emergence Period Factor:** At least annually, management calculates the loss emergence period for each commercial loan segment. The loss emergence period is calculated based upon the average period of time it takes from the probable occurrence of a loss event to the credit being moved to nonaccrual. If the loss emergence period for any commercial loan segment is greater than one year, management applies additional general reserves to all performing loans within that segment of the commercial loan portfolio. The loss emergence period was last updated in the fourth quarter of 2017.

**Loss Migration Factor:** Park's commercial loans are individually risk graded. If loan downgrades occur, the probability of default increases, and accordingly, management allocates a higher percentage reserve to those accruing commercial loans graded special mention and substandard. Annually, management calculates a loss migration factor for each commercial loan segment for special mention and substandard credits based on a review of losses over the period of time a loan takes to migrate from pass-rated to impaired. The loss migration factor was last updated in the fourth quarter of 2017.

**Environmental Loss Factor:** Management has identified certain macroeconomic factors that trend in accordance with losses in Park's commercial loan portfolio. These macroeconomic factors are reviewed quarterly and the adjustments made to the environmental loss factor impacting each segment in the performing commercial loan portfolio correlate to changes in the macroeconomic environment. There was no change to the environmental loss factor during the third quarter of 2018.

Generally, consumer loans are not individually graded. Consumer loans include: (1) mortgage and installment loans included in the construction real estate segment of the loan portfolio; (2) mortgage, home equity lines of credit

("HELOC"), and installment loans included in the residential real estate segment of the loan portfolio; and (3) all loans included in the consumer segment of the loan portfolio. The amount of loan loss reserve assigned to these loans is based on historical loss experience over the past 96 months, through December 31, 2017. Management generally considers a one-year coverage period (the "Historical Loss Factor") appropriate because the probable loss on any given loan in the consumer loan pool should ordinarily become apparent in that time frame. However, management may incorporate adjustments to the Historical Loss Factor as circumstances warrant additional reserves (e.g., increased loan delinquencies, improving or deteriorating economic conditions, changes in lending management and changes in underwriting standards). Excluding acquired loans, at September 30, 2018, the coverage level

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within the consumer loan portfolio was approximately 1.88 years compared to 1.92 years at December 31, 2017. Historical loss experience, over the 96-month period ended December 31, 2017, for the consumer loan portfolio was 0.34%.

Loans acquired as part of the acquisition of NewDominion were recorded at fair value on the date of acquisition. An allowance is only established on these NewDominion loans as a result of credit deterioration post acquisition. As of September 30, 2018, there was no allowance related to acquired NewDominion loans.

The judgmental increases discussed above incorporate management's evaluation of the impact of environmental qualitative factors which pose additional risks and assignment of a component of the allowance for loan losses in consideration of these factors. Such environmental qualitative factors include: global, national and local economic trends and conditions; experience, ability and depth of lending management and staff; effects of any changes in lending policies and procedures; and levels of, and trends in, consumer bankruptcies, delinquencies, impaired loans and charge-offs and recoveries. The determination of this component of the allowance for loan losses requires considerable management judgment. Actual loss experience may be more or less than the amount allocated.

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## Other Income

Other income increased by \$527,000 to \$24.1 million for the quarter ended September 30, 2018, compared to \$23.5 million for the third quarter of 2017, and increased by \$11.0 million to \$74.2 million for the nine months ended September 30, 2018, compared to \$63.2 million for the nine months ended September 30, 2017.

The following table is a summary of the changes in the components of other income:

(In thousands)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Change	2018	2017	Change
Income from fiduciary activities	\$6,418	\$5,932	\$ 486	\$19,479	\$17,471	\$2,008
Service charges on deposit accounts	2,861	3,216	(355 )	8,609	9,511	(902 )
Other service income	3,246	3,357	(111 )	10,890	9,608	1,282
Checkcard fee income	4,352	3,974	378	12,736	11,775	961
Bank owned life insurance income	2,585	1,573	1,012	4,625	3,790	835
ATM fees	500	605	(105 )	1,534	1,708	(174 )
OREO valuation adjustments	(77 )	(22 )	(55 )	(398 )	(367 )	(31 )
(Loss) gain on sale of OREO, net	(81 )	51	(132 )	4,093	204	3,889
Net loss on sale of investment securities	—	—	—	(2,271 )	—	(2,271 )
(Loss) gain on equity securities, net	(326 )	—	(326 )	3,467	—	3,467
Other components of net periodic pension benefit income	1,705	1,448	257	5,115	4,344	771
Miscellaneous	2,881	3,403	(522 )	6,330	5,147	1,183
Total other income	\$24,064	\$23,537	\$ 527	\$74,209	\$63,191	\$11,018

The following table breaks out the change in total other income for the three and nine months ended September 30, 2018 compared to the same periods ended September 30, 2017 between Park's ongoing operations and SEPH.

(In thousands)	Change from 2017 to 2018 for the three months ended September 30			Change from 2017 to 2018 for the nine months ended September 30		
	Park less SEPH	SEPH	Total	Park less SEPH	SEPH	Total
Income from fiduciary activities	\$486	\$—	\$486	\$2,008	\$—	\$2,008
Service charges on deposit accounts	(355 )	—	(355 )	(902 )	—	(902 )
Other service income	67	(178 )	(111 )	429	853	1,282
Checkcard fee income	378	—	378	961	—	961
Bank owned life insurance income	1,012	—	1,012	835	—	835
ATM fees	(105 )	—	(105 )	(174 )	—	(174 )
OREO valuation adjustments	(55 )	—	(55 )	188	(219 )	(31 )
(Loss) gain on sale of OREO, net	(6 )	(126 )	(132 )	1,250	2,639	3,889
Net loss on sale of investment securities	—	—	—	(2,271 )	—	(2,271 )
(Loss) gain on equity securities, net	(326 )	—	(326 )	3,467	—	3,467
Other components of net periodic pension benefit income	252	5	257	756	15	771
Miscellaneous	(282 )	(240 )	(522 )	1,389	(206 )	1,183
Total other income	\$1,066	\$(539)	\$527	\$7,936	\$3,082	\$11,018





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Income from fiduciary activities, which represents revenue earned from Park's trust activities, increased by \$486,000, or 8.2%, to \$6.4 million for the three months ended September 30, 2018, compared to \$5.9 million for the same period in 2017 and increased \$2.0 million, or 11.5%, to \$19.5 million for the nine months ended September 30, 2018, compared to \$17.5 million for the same period in 2017. Fiduciary fees charged are generally based on the market value of customer accounts. The average market value for assets under management for the nine months ended September 30, 2018 was \$5,496 million compared to \$4,976 million for the nine months ended September 30, 2017.

Service charges on deposit accounts decreased by \$355,000, or 11.0%, to \$2.9 million for the three months ended September 30, 2018, compared to \$3.2 million for the same period in 2017 and decreased \$902,000, or 9.5%, to \$8.6 million for the nine months ended September 30, 2018, compared to \$9.5 million for the same period in 2017, largely as a result of a decline in non-sufficient funds (NSF) fee income and service charges on demand deposit accounts.

Other service income increased by \$1.3 million, or 13.3%, to \$10.9 million for the nine months ended September 30, 2018, compared to \$9.6 million for the same period of 2017. The primary reason for the increase was the recovery of fees from certain SEPH impaired relationships.

Checkcard fee income increased by \$378,000, or 9.5%, to \$4.4 million for the three months ended September 30, 2018, compared to \$4.0 million for the same period of 2017 and increased \$961,000, or 8.2%, to \$12.7 million for the nine months ended September 30, 2018, compared to \$11.8 million for the same period of 2017. The increases in 2018 were attributable to continued increases in the volume of debit card transactions. The number of transactions for the nine months ended September 30, 2018 increased 7.2% from the same period in 2017.

Bank owned life insurance income increased by \$1.0 million, or 64.3%, to \$2.6 million for the three months ended September 30, 2018, compared to \$1.6 million for the same period of 2017 and increased \$835,000, or 22.0%, to \$4.6 million for the nine months ended September 30, 2018, compared to \$3.8 million for the same period of 2017. The increases were primarily related to fluctuations in income from death benefits paid on policies. Park recorded \$1.5 million of income from death benefits paid on policies for the three months ended September 30, 2018, compared to \$478,000 for the same period of 2017 and recorded \$1.5 million in income from death benefits paid on policies for the nine months ended September 30, 2018, compared to \$478,000 for the same period of 2017.

Gain on sale of OREO, net increased by \$3.9 million, to \$4.1 million for the nine months ended September 30, 2018, compared to \$204,000 for the same period in 2017. The increase was primarily due to a \$4.1 million gain on the sale of one OREO property during the first three months of 2018, which was partially participated to PNB from SEPH.

During the nine months ended September 30, 2018, investment securities with a book value of \$254.3 million were sold at a net loss of \$2.3 million. There were no securities sold during the same period of 2017.

During the nine months ended September 30, 2018, \$33,000 of unrealized losses were recorded within "(Loss) gain on equity securities, net". An additional \$3.5 million gain recorded within "(Loss) gain on equity securities, net" for the nine months ended September 30, 2018 relates to an investment security which was no longer held at September 30, 2018. Prior to January 1, 2018, gains on equity securities were recognized in other comprehensive income. With the adoption of ASU 2016-01 on January 1, 2018, Park recorded an increase of \$1.9 million to beginning retained earnings with all future changes in unrealized gains/loss on equity securities being recorded on the consolidated condensed statement of income.

Other components of net periodic pension benefit income increased by \$257,000, or 17.7%, to \$1.7 million for the three months ended September 30, 2018, compared to \$1.4 million for the same period in 2017 and increased \$771,000, or 17.7%, to \$5.1 million for the nine months ended September 30, 2018, compared to \$4.3 million for the same period in 2017. The increase was largely due to an increase in the expected return on plan assets.

Miscellaneous income decreased by \$522,000 to \$2.9 million for the three months ended September 30, 2018, compared to \$3.4 million for the three months ended September 30, 2017 and increased \$1.2 million to \$6.3 million for the nine months ended September 30, 2018, compared to \$5.1 million for the nine months ended September 30, 2017. The increase for the year-to-date period was primarily related to a \$601,000 increase in rental income from repossessed assets and a \$515,000 increase in net gain on sale of assets for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017.

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## Other Expense

Other expense increased by \$8.1 million to \$59.3 million for the quarter ended September 30, 2018, compared to \$51.3 million for the third quarter of 2017, and increased by \$16.4 million to \$166.2 million for the nine months ended September 30, 2018, compared to \$149.7 million for the nine months ended September 30, 2017.

The following table is a summary of the changes in the components of other expense:

(In thousands)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Change	2018	2017	Change
Salaries	\$27,229	\$23,302	\$3,927	\$76,652	\$69,020	\$7,632
Employee benefits	7,653	5,943	1,710	22,312	18,617	3,695
Occupancy expense	2,976	2,559	417	8,482	7,759	723
Furniture and equipment expense	3,807	3,868	(61 )	11,969	11,126	843
Data processing fees	2,580	1,919	661	6,255	5,560	695
Professional fees and services	8,065	6,100	1,965	20,378	16,947	3,431
Marketing	1,364	1,122	242	3,767	3,262	505
Insurance	1,388	1,499	(111 )	4,012	4,586	(574 )
Communication	1,207	1,110	97	3,646	3,598	48
State tax expense	1,000	912	88	3,063	2,918	145
Amortization of intangibles	289	—	289	289	—	289
Miscellaneous	1,758	2,925	(1,167 )	5,333	6,330	(997 )
Total other expense	\$59,316	\$51,259	\$8,057	\$166,158	\$149,723	\$16,435

The following table breaks out the change in total other expense for the three and nine months ended September 30, 2018, compared to the same period ended September 30, 2017 between Park's ongoing operations and SEPH.

(In thousands)	Change from 2017 to 2018 for the three months ended September 30			Change from 2017 to 2018 for the nine months ended September 30		
	Park less SEPH	SEPH	Total	Park less SEPH	SEPH	Total
Salaries	\$3,922	\$5	\$3,927	\$7,645	\$(13 )	\$7,632
Employee benefits	1,837	(127 )	1,710	3,862	(167 )	3,695
Occupancy expense	417	—	417	723	—	723
Furniture and equipment expense	(61 )	—	(61 )	843	—	843
Data processing fees	661	—	661	695	—	695
Professional fees and services	2,432	(467 )	1,965	3,112	319	3,431
Marketing	242	—	242	505	—	505
Insurance	(111 )	—	(111 )	(574 )	—	(574 )
Communication	97	—	97	48	—	48
State tax expense	52	36	88	99	46	145
Amortization of intangibles	289	—	289	289	—	289
Miscellaneous	(1,257 )	90	(1,167 )	(1,160 )	163	(997 )
Total other expense	\$8,520	\$(463)	\$8,057	\$16,087	\$348	\$16,435



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Salaries increased by \$3.9 million, or 16.9%, to \$27.2 million for the three months ended September 30, 2018, compared to \$23.3 million for the same period in 2017 and increased by \$7.6 million, or 11.1%, to \$76.7 million for the nine months ended September 30, 2018, compared to \$69.0 million for the same period in 2017. The increase for the three months ended September 30, 2018 was due to a \$1.6 million increase in salary expense related to the acquisition of NewDominion, a \$1.1 million increase in salary expense, a \$556,000 increase in incentive compensation expense, and a \$320,000 increase in share-based compensation expense related to PBR SU awards granted under the 2013 Incentive Plan (prior to 2017) and the 2017 Employee LTIP. The increase for the nine months ended September 30, 2018 was due to a \$1.1 million one-time incentive paid out in March 2018, along with a \$2.3 million increase in salary expense, a \$1.6 million increase in salary expense related to the acquisition of NewDominion, a \$949,000 increase in share-based compensation expense related to PBR SU awards granted under the 2013 Incentive Plan (prior to 2017) and the 2017 Employee LTIP, and a \$1.1 million increase in incentive compensation expense.

Employee benefits increased by \$1.7 million, or 28.8%, to \$7.7 million for the three months ended September 30, 2018, compared to \$5.9 million for the same period in 2017 and increased by \$3.7 million, or 19.8%, to \$22.3 million for the nine months ended September 30, 2018, compared to \$18.6 million for the same period in 2017. The increase for the three months ended September 30, 2018 was primarily due to a \$776,000 increase in group insurance costs, a \$452,000 increase in expense related to Park's voluntary salary deferral plan and a \$277,000 increase in pension service cost expense. The increase for the nine months ended September 30, 2018 was primarily due to a \$1.2 million increase in expense related to Park's voluntary salary deferral plan, a \$1.4 million increase in group insurance costs and a \$832,000 increase in pension service cost expense. The Company matching contribution under the voluntary salary deferral plan was increased from 25% to 50% in March of 2018.

Occupancy expense increased by \$417,000, or 16.3%, to \$3.0 million for the three months ended September 30, 2018, compared to \$2.6 million for the same period in 2017 and increased by \$723,000, or 9.3%, to \$8.5 million for the nine months ended September 30, 2018, compared to \$7.8 million for the same period in 2017. The increases were primarily related to the acquisition of NewDominion and an increase in maintenance and repairs on building and grounds.

Furniture and equipment expense decreased by \$61,000, or 1.6%, to \$3.8 million for the three months ended September 30, 2018, compared to \$3.9 million for the same period in 2017 and increased by \$843,000, or 7.6%, to \$12.0 million for the nine months ended September 30, 2018, compared to \$11.1 million for the same period in 2017. The increases for the nine months ended September 30, 2018 was primarily due to maintenance and repairs on equipment.

Data processing fees increased by \$661,000, or 34.4%, to \$2.6 million for the three months ended September 30, 2018, compared to \$1.9 million for the same period of 2017 and increased by \$695,000, or 12.5%, to \$6.3 million for the nine months ended September 30, 2018, compared to \$5.6 million for the same period 2017. The increases were primarily related to a re-classification of expenses from Professional fees and services as well as an increase in data processing fees related to the acquisition of NewDominion.

Professional fees and services increased by \$2.0 million, or 32.2%, to \$8.1 million for the three months ended September 30, 2018, compared to \$6.1 million for the same period in 2017 and increased \$3.5 million, or 20.2%, to \$20.4 million for the nine months ended September 30, 2018, compared to \$16.9 million for the same period in 2017. The \$467,000 decrease at SEPH for the three months ended September 30, 2018 was the result of a \$307,000 decrease in legal fees and a \$154,000 decrease in management and consulting expense. The \$2.4 million increase at the Park less SEPH operations for the three months ended September 30, 2018 was largely the result of a \$1.5 million increase in management and consulting expense and a \$399,000 increase in other fees at the Parent Company, both primarily related to the acquisition of NewDominion. PNB had a \$668,000 increase in other fees for the three months ended

September 30, 2018, primarily related to activities associated with repossessed assets.

The \$319,000 increase at SEPH for professional fees and services for the nine months ended September 30, 2018 was primarily the result of a \$1.0 million increase in management and consulting fees associated with the collection of payments on certain SEPH impaired loan relationships during the first nine months of 2018, offset by a \$742,000 decrease in legal expense. The \$3.1 million increase at Park less SEPH operations for the nine months ended September 30, 2018 was largely the result of a \$1.5 million increase in management and consulting expense and a \$411,000 increase in legal expense at the Parent Company, both primarily related to the acquisition of NewDominion. PNB had an increase of \$430,000 in management and consulting expense and an increase of \$484,000 in other fees expense, primarily related to activities associated with repossessed assets.

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Miscellaneous expense decreased \$1.1 million, or 39.9%, to \$1.8 million for the three months ended September 30, 2018, compared to \$2.9 million for the same period in 2017 and decreased \$1.0 million, or 15.8%, to \$5.3 million for the nine months ended September 30, 2018, compared to \$6.3 million for the same period in 2017. The decrease for the three months ended September 30, 2018 was primarily the result of a \$1.5 million decrease in contribution expense, and the decrease for the nine months ended September 30, 2018 was primarily the result of a \$1.5 million decrease in contribution expense, partially offset by a \$322,000 increase in fraud losses and a \$183,000 increase in supplies expense.

Income Tax

Federal income tax expense was \$4.7 million for the third quarter of 2018, compared to \$8.4 million for the third quarter of 2017, and was \$16.6 million for the nine months ended September 30, 2018, compared to \$23.6 million for the nine months ended September 30, 2017. Effective January 1, 2018, the federal corporate income tax rate was lowered to 21% from 35%. The effective federal income tax rate for the third quarter of 2018 was 16.0%, compared to 27.6% for the same period in 2017 and the effective federal income tax rate for the nine months ended September 30, 2018 was 16.5%, compared to 27.8% for the nine months ended September 30, 2017. The difference between the statutory federal income tax rate and Park's effective federal income tax rate is due to permanent tax differences, primarily consisting of tax-exempt interest income from investments and loans, the tax benefit of investments in qualified affordable housing projects, bank owned life insurance income, and dividends paid on the common shares held within Park's salary deferral plan. Park expects permanent tax differences for the 2018 year will be approximately \$5.7 million.

Park and its Ohio-based affiliates do not pay state income taxes to the state of Ohio, but Park pays a franchise tax based on Park's year-end equity. The franchise tax expense is included in "state taxes" as part of other expense on Park's Consolidated Condensed Statements of Income.



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Comparison of Financial Condition

At September 30, 2018 and December 31, 2017

Changes in Financial Condition

Total assets increased by \$218.9 million, or 2.9%, during the first nine months of 2018 to \$7,756 million at September 30, 2018, compared to \$7,538 million at December 31, 2017. This increase was primarily due to the following:

Loans increased by \$252.8 million, or 4.7%, of which \$273.8 million was due to the acquisition of NewDominion, to \$5,625 million at September 30, 2018, compared to \$5,372 million at December 31, 2017.

Goodwill and other intangibles increased by \$47.7 million, or 65.9%, to \$120.0 million at September 30, 2018, compared to \$72.3 million at December 31, 2017. The increase was due to the acquisition of NewDominion.

Investment securities decreased \$73.8 million, or 4.9%, to \$1,439 million at September 30, 2018, compared to \$1,513 million at December 31, 2017.

Cash and cash equivalents decreased by \$24.5 million to \$144.6 million at September 30, 2018, compared to \$169.1 million at December 31, 2017. Money market instruments were \$38.0 million at September 30, 2018, compared to \$37.2 million at December 31, 2017 and Cash and due from banks were \$106.6 million at September 30, 2018, compared to \$131.9 million at December 31, 2017.

Total liabilities increased by \$165.9 million, or 2.4%, during the first nine months of 2018 to \$6,947 million at September 30, 2018, from \$6,782 million at December 31, 2017. This increase was primarily due to the following:

Total deposits increased by \$462.0 million, or 7.9%, of which \$268.6 million was due to the acquisition of NewDominion, to \$6,279 million at September 30, 2018, compared to \$5,817 million at December 31, 2017.

Short-term borrowings decreased by \$211.5 million, or 54.0%, to \$179.8 million at September 30, 2018, compared to \$391.3 million at December 31, 2017.

Long-term borrowings decreased by \$100.0 million, or 20.0%, to \$400.0 million at September 30, 2018, compared to \$500.0 million at December 31, 2017.

Total shareholders' equity increased by \$53.0 million, or 7.0%, to \$809.1 million at September 30, 2018, from \$756.1 million at December 31, 2017.

Retained earnings increased by \$41.2 million during the period as a result of net income of \$84.1 million and cumulative effects of changes in accounting principles of \$5.7 million, offset by common share dividends of \$48.3 million.

Treasury shares increased by \$4.5 million during the period as a result of the repurchase of treasury shares, offset by the issuance of treasury shares.

Common shares increased by \$50.0 million during the period as a result of the issuance of common shares related to the acquisition of NewDominion.

Accumulated other comprehensive loss, net of taxes increased by \$33.7 million during the period as a result of unrealized net holding losses on securities available for sale, net of taxes, of \$30.9 million, and the cumulative effects of changes in accounting principles of \$4.8 million, offset by a net realized loss on the sale of securities of \$2.0 million reclassified from accumulated other comprehensive loss.

Increases or decreases in the investment securities portfolio, short-term borrowings and long-term debt are greatly dependent upon the growth in loans and deposits. The primary objective of management is to grow loan and deposit totals. To the extent that management is unable to grow loan totals at a desired growth rate, additional investment securities may be acquired. Likewise, both short-term borrowings and long-term debt are utilized to fund the growth in earning assets if the growth in deposits and cash flow from operations are not sufficient to do so.

Liquidity

Cash provided by operating activities was \$98.1 million and \$66.7 million for the nine months ended September 30, 2018 and 2017, respectively. Net income was the primary source of cash from operating activities for each of the nine months ended September 30, 2018 and 2017.

Cash provided by investing activities was \$65.6 million for the nine months ended September 30, 2018 and cash used in investing activities was \$82.4 million for the nine months ended September 30, 2017. Proceeds from the sale, repayment, or maturity of investment securities provide cash and purchases of investment securities use cash. Net investment securities

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transactions provided cash of \$32.4 million for the nine months ended September 30, 2018 and provided cash of \$15.0 million for the nine months ended September 30, 2017. Another major use or source of cash in investing activities is the net increase or decrease in the loan portfolio. Cash provided by the net decrease in the loan portfolio was \$12.0 million and cash used by the net increase in the loan portfolio was \$95.8 million for the nine months ended September 30, 2018 and 2017, respectively.

Cash used in financing activities was \$188.2 million for the nine months ended September 30, 2018 and cash provided by financing activities was \$319.6 million for the nine months ended September 30, 2017. A major source of cash for financing activities is the net change in deposits. Deposits increased and provided \$177.6 million and \$452.4 million of cash for the nine months ended September 30, 2018 and 2017, respectively. Another major source/use of cash from financing activities is borrowings in the form of short-term borrowings and long-term debt. For the nine months ended September 30, 2018, net short-term borrowings decreased and used \$211.5 million in cash, and net long-term borrowings decreased and used \$100.0 million in cash. For the nine months ended September 30, 2017, net short-term borrowings decreased and used \$201.9 million in cash, while net long-term borrowings increased and provided \$120.0 million in cash. Finally, cash declined by \$47.9 million for the nine months ended September 30, 2018 and \$43.1 million for the nine months ended September 30, 2017, from the payment of dividends.

Effective liquidity management ensures that the cash flow requirements of depositors and borrowers, as well as the operating cash needs of the Corporation, are met. Funds are available from a number of sources, including the securities portfolio, the core deposit base, FHLB borrowings, the capability to securitize or package loans for sale, and a \$50.0 million revolving line of credit with another financial institution, which had no outstanding balance as of September 30, 2018. The Corporation's loan to asset ratio was 72.52% at September 30, 2018, compared to 71.28% at December 31, 2017 and 68.24% at September 30, 2017. Cash and cash equivalents were \$144.6 million at September 30, 2018, compared to \$169.1 million at December 31, 2017 and \$450.4 million at September 30, 2017. Management believes that the present funding sources provide more than adequate liquidity for the Corporation to meet its cash flow needs.

### Capital Resources

Shareholders' equity at September 30, 2018 was \$809.1 million, or 10.4% of total assets, compared to \$756.1 million, or 10.0% of total assets, at December 31, 2017 and \$759.4 million, or 9.7% of total assets, at September 30, 2017.

Financial institution regulators have established guidelines for minimum capital ratios for banks, thrifts and bank holding companies. Park has elected not to include the net unrealized gain or loss on AFS debt securities in computing regulatory capital. During the first quarter of 2015, Park adopted the Basel III regulatory capital framework as approved by the federal banking agencies. The adoption of this framework modified the calculation of the various capital ratios, added a new ratio, common equity tier 1, and revised the adequately and well capitalized thresholds under the prompt corrective action regulations applicable to PNB. Additionally, under this framework, in order to avoid limitations on capital distributions, including dividend payments, and repurchases of common shares, Park must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2018 is 1.875%. The amounts shown below as the adequately capitalized ratio plus capital conservation buffer includes the fully phased-in 2.50% buffer. The Federal Reserve Board has also adopted requirements Park must satisfy to be deemed "well capitalized" and to remain a financial holding company.

Park and PNB met each of the well capitalized ratio guidelines applicable to them at September 30, 2018. The following table indicates the capital ratios for PNB and Park at September 30, 2018 and December 31, 2017.

As of September 30, 2018		
Leverage	Tier 1	Common Total
Risk-Based	Equity	Risk-Based

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				Tier 1			
The Park National Bank	8.16%	11.00	%	11.00	%	12.28	%
Park National Corporation	9.79%	13.19	%	12.93	%	14.06	%
Adequately capitalized ratio	4.00%	6.00	%	4.50	%	8.00	%
Adequately capitalized ratio plus capital conservation buffer	4.00%	8.50	%	7.00	%	10.50	%
Well capitalized ratio (PNB)	5.00%	8.00	%	6.50	%	10.00	%
Well capitalized ratio (Park)	N/A	6.00	%	N/A		10.00	%

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	As of December 31, 2017						
	Leverage	Tier 1 Risk-Based	%	Common Equity Tier 1	%	Total Risk-Based	%
The Park National Bank	7.36%	10.35	%	10.35	%	11.60	%
Park National Corporation	9.44%	13.22	%	12.94	%	14.14	%
Adequately capitalized ratio	4.00%	6.00	%	4.50	%	8.00	%
Adequately capitalized ratio plus capital conservation buffer	4.00%	8.50	%	7.00	%	10.50	%
Well capitalized ratio (PNB)	5.00%	8.00	%	6.50	%	10.00	%
Well capitalized ratio (Park)	N/A	6.00	%	N/A		10.00	%

## Contractual Obligations and Commitments

In the ordinary course of operations, Park enters into certain contractual obligations. Such obligations include the funding of operations through debt issuances as well as leases for premises. See page 43 of Park's 2017 Annual Report (Table 38) for disclosure concerning contractual obligations and commitments at December 31, 2017. There were no significant changes in contractual obligations and commitments during the first nine months of 2018.

## Financial Instruments with Off-Balance Sheet Risk

PNB is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include loan commitments and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements.

The exposure to credit loss (for PNB) in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. PNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Since many of the loan commitments may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

The total amounts of off-balance sheet financial instruments with credit risk were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Loan commitments	\$1,052,880	\$893,205
Standby letters of credit	\$14,320	\$13,421

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ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management reviews interest rate sensitivity on a monthly basis by modeling the consolidated financial statements under various interest rate scenarios. The primary reason for these efforts is to guard Park from adverse impacts of unforeseen changes in interest rates. Management continues to believe that further changes in interest rates will have a small impact on net income, consistent with the disclosure on page 43 of Park’s 2017 Annual Report.

On page 43 (Table 37) of Park’s 2017 Annual Report, management reported that Park’s twelve-month cumulative rate sensitivity gap was a positive (assets exceeding liabilities) \$407 million or 5.88% of total interest earning assets at December 31, 2017. At September 30, 2018, Park’s twelve-month cumulative rate sensitivity gap was a positive (assets exceeding liabilities) \$302 million or 4.24% of total interest earning assets.

Management supplements the interest rate sensitivity gap analysis with periodic simulations of balance sheet sensitivity under various interest rate and what-if scenarios to better forecast and manage the net interest margin. Management uses a 50 basis point change in market interest rates per quarter for a total of 200 basis points per year in evaluating the impact of changing interest rates on net interest income and net income over a twelve-month horizon.

On page 43 of Park’s 2017 Annual Report, management reported that at December 31, 2017, the earnings simulation model projected that net income would decrease by 1.8% using a rising interest rate scenario and decrease by 5.2% using a declining interest rate scenario over the next year. At September 30, 2018, the earnings simulation model projected that net income would decrease by 2.4% using a rising interest rate scenario and would decrease by 1.8% in a declining interest rate scenario. At September 30, 2018, management continues to believe that gradual changes in interest rates (50 basis points per quarter for a total of 200 basis points per year) will have a small impact on net income.

ITEM 4 – CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

With the participation of the Chief Executive Officer and President (the principal executive officer) and the Chief Financial Officer, Secretary and Treasurer (the principal financial officer) of Park, Park’s management has evaluated the effectiveness of Park’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, Park’s Chief Executive Officer and President and Park’s Chief Financial Officer, Secretary and Treasurer have concluded that:

information required to be disclosed by Park in this Quarterly Report on Form 10-Q and other reports that Park files or submits under the Exchange Act would be accumulated and communicated to Park’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure;

information required to be disclosed by Park in this Quarterly Report on Form 10-Q and the other reports that Park files or submits under the Exchange Act would be recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms; and

Park’s disclosure controls and procedures were effective as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q.

Changes in Internal Control Over Financial Reporting

There were no changes in Park's internal control over financial reporting (as defined in Rule 13a-5(f) under the Exchange Act) that occurred during Park's fiscal quarter ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, Park's internal control over financial reporting.

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## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings

There are no pending legal proceedings to which Park or any of its subsidiaries is a party or to which any of their property is subject, except for routine legal proceedings which Park's subsidiaries are parties to incidental to their respective businesses. Park considers none of those proceedings to be material.

## Item 1A. Risk Factors

There are certain risks and uncertainties in our business that could cause our actual results to differ materially from those anticipated. In “ITEM 1A. RISK FACTORS” of Part I of Park’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “2017 Form 10-K”), we included a detailed discussion of our risk factors. All of these risk factors should be read carefully in connection with evaluating our business and in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q. Any of the risks described in the 2017 Form 10-K could materially adversely affect our business, financial condition or future results and the actual outcome of matters as to which forward-looking statements are made. These are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

(a) Not applicable

(b) Not applicable

(c) The following table provides information concerning purchases of Park’s common shares made by or on behalf of Park or any “affiliated purchaser” as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended, during the three months ended September 30, 2018, as well as the maximum number of common shares that may be purchased under Park’s previously announced stock repurchase authorizations to fund the 2017 Long-Term Incentive Plan for Employees (the “2017 Employees LTIP”) and the 2017 Long-Term Incentive Plan for Non-Employee Directors (the “2017 Non-Employee Directors LTIP”) and Park's previously announced 2017 stock repurchase authorization:

Period	Total number of common shares purchased	Average price paid per common share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of common shares that may yet be purchased under the plans or programs (1)
July 1 through July 31, 2018	—	\$ —	—	1,330,000
August 1 through August 31, 2018	—	—	—	1,330,000
September 1 through September 30, 2018	—	—	—	1,330,000
Total	—	\$ —	—	1,330,000

(1) The number shown represents, as of the end of each period, the maximum number of common shares that may yet be purchased as part of Park’s publicly announced stock repurchase authorizations to fund the 2017 Employees LTIP which became effective on April 24, 2017, and to fund the 2017 Non-Employee Directors LTIP, both of



which became effective on April 24, 2017; and Park's publicly announced 2017 stock repurchase authorization which became effective on January 23, 2017.

At the 2017 Annual Meeting of Shareholders held on April 24, 2017, Park's shareholders approved the 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP. The common shares to be issued and delivered under the 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP may consist of either common shares currently held or common shares subsequently acquired by Park as treasury shares. No newly-issued common shares will be delivered under the 2017 Employees LTIP or the 2017 Non-Employee Directors LTIP. On April 24, 2017, Park's Board of Directors authorized the

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purchase, from time to time, of up to 750,000 common shares and 150,000 common shares, respectively, to be held as treasury shares for subsequent issuance and delivery under the 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP.

On January 23, 2017, the Park Board of Directors authorized Park to purchase, from time to time, up to an aggregate of 500,000 Common Shares. Purchases may be made through NYSE American, in the over-the-counter market or in privately negotiated transactions, in each case in compliance with applicable laws and regulations and the rules applicable to issuers having securities listed on NYSE American. Purchases will be made upon such terms and conditions and at such times and in such amounts as any one or more of the authorized officers of Park deem to be appropriate, subject to market conditions, regulatory requirements and other factors, and in the best interest of Park and Park's shareholders. The January 23, 2017 stock repurchase authorization is distinct from the stock repurchase authorizations to fund the 2017 Employees LTIP and the 2017 Non-Employee Directors LTIP.

Item 3. Defaults Upon Senior Securities

(a), (b) Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

(a), (b) Not applicable.

Item 6. Exhibits

2.1 Agreement and Plan of Merger and Reorganization among Park National Corporation, The Park National Bank and NewDominion Bank, dated as of January 22, 2018, (Incorporated herein by reference to Exhibit 2.1 to Park National Corporation's Current Report on Form 8-K dated and filed on January 26, 2018 (File No. 1-13006))\*

2.2 Agreement and Plan of Merger and Reorganization, dated as of September 12, 2018, by and between Park National Corporation and CAB Financial Corporation (Incorporated herein by reference to Exhibit 2.1 to Park National Corporation's Current Report on Form 8-K dated and filed on September 14, 2018 (File No. 1-13006))\*

3.1(a) Articles of Incorporation of Park National Corporation as filed with the Ohio Secretary of State on March 24, 1992 (Incorporated herein by reference to Exhibit 3(a) to Park National Corporation's Form 8-B, filed on May 20, 1992 (File No. 0-18772) ("Park's Form 8-B"))

3.1(b) Certificate of Amendment to the Articles of Incorporation of Park National Corporation as filed with the Ohio Secretary of State on May 6, 1993 (Incorporated herein by reference to Exhibit 3(b) to Park National Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 1993 (File No. 0-18772))

3.1(c) Certificate of Amendment to the Articles of Incorporation of Park National Corporation as filed with the Ohio Secretary of State on April 16, 1996 (Incorporated herein by reference to Exhibit 3(a) to Park National Corporation's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 (File No. 1-13006))

3.1(d) Certificate of Amendment by Shareholders to the Articles of Incorporation of Park National Corporation as filed with the Ohio Secretary of State on April 22, 1997 (Incorporated herein by reference to Exhibit 3(a)(1) to Park National Corporation's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1997 (File No. 1-13006) ("Park's June 30, 1997 Form 10-Q"))

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- 3.1(e) Certificate of Amendment by Shareholders as filed with the Ohio Secretary of State on December 18, 2008 in order to evidence the adoption by the shareholders of Park National Corporation on December 18, 2008 of an amendment to Article FOURTH of Park National Corporation's Articles of Incorporation to authorize Park National Corporation to issue up to 200,000 preferred shares, without par value (Incorporated herein by reference to Exhibit 3.1 to Park National Corporation's Current Report on Form 8-K dated and filed December 19, 2008 (File No. 1-13006))
- 3.1(f) Certificate of Amendment by Directors to Articles as filed with the Ohio Secretary of State on December 19, 2008, evidencing adoption of amendment by Board of Directors of Park National Corporation to Article FOURTH of Articles of Incorporation to establish express terms of Fixed Rate Cumulative Perpetual Preferred Shares, Series A, each without par value, of Park National Corporation (Incorporated herein by reference to Exhibit 3.1 to Park National Corporation's Current Report on Form 8-K dated and filed December 23, 2008 (File No. 1-13006))
- 3.1(g) Certificate of Amendment by Shareholders as filed with the Ohio Secretary of State on April 18, 2011 in order to evidence the adoption by Park National Corporation's shareholders of an amendment to Article SIXTH of Park National Corporation's Articles of Incorporation in order to provide that shareholders do not have preemptive rights (Incorporated herein by reference to Exhibit 3.1 to Park National Corporation's Current Report on Form 8-K dated and filed April 19, 2011 (File No. 1-13006))
- 3.1(h) Articles of Incorporation of Park National Corporation [This document represents the Articles of Incorporation of Park National Corporation in compiled form incorporating all amendments. This compiled document has not been filed with the Ohio Secretary of State.] (Incorporated herein by reference to Exhibit 3.1(h) to Park National Corporation's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2011 (File No. 1-13006))
- 3.2(a) Regulations of Park National Corporation (Incorporated herein by reference to Exhibit 3(b) to Park's Form 8-B)
- 3.2(b) Certified Resolution regarding Adoption of Amendment to Subsection 2.02(A) of the Regulations of Park National Corporation by Shareholders on April 21, 1997 (Incorporated herein by reference to Exhibit 3(b)(1) to Park's June 30, 1997 Form 10-Q)
- 3.2(c) Certificate Regarding Adoption of Amendments to Sections 1.04 and 1.11 of Park National Corporation's Regulations by the Shareholders on April 17, 2006 (Incorporated herein by reference to Exhibit 3.1 to Park National Corporation's Current Report on Form 8-K dated and filed on April 18, 2006 (File No. 1-13006))
- 3.2(d) Certificate Regarding Adoption by the Shareholders of Park National Corporation on April 21, 2008 of Amendment to Regulations to Add New Section 5.10 to Article Five (Incorporated herein by reference to Exhibit 3.2(d) to Park National Corporation's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2008 (File No. 1-13006) ("Park's March 31, 2008 Form 10-Q"))
- 3.2(e) Regulations of Park National Corporation [This document represents the Regulations of Park National Corporation in compiled form incorporating all amendments] (Incorporated herein by reference to Exhibit 3.2(e) to Park's March 31, 2008 Form 10-Q)
- 31.1 Rule 13a – 14(a) / 15d – 14(a) Certifications (Principal Executive Officer) (Filed herewith)
- 31.2 Rule 13a – 14(a) / 15d – 14(a) Certifications (Principal Financial Officer) (Filed herewith)

- 32.1 Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (Principal Executive Officer) (Furnished herewith)
- 32.2 Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (Principal Financial Officer) (Furnished herewith)

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The following information from Park's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018 formatted in XBRL (eXtensible Business Reporting Language) pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Condensed Balance Sheets as of September 30, 2018 and December 31, 2017 (unaudited); (ii) the Consolidated Condensed Statements of Income for the three and nine months ended September 30, 2018 and 2017 (unaudited); (iii) the Consolidated Condensed Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017 (unaudited); (iv) the Consolidated Condensed Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2018 and 2017 (unaudited); (v) the Consolidated Condensed Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 (unaudited); and (vi) the Notes to Unaudited Consolidated Condensed Financial Statements (electronically submitted herewith).

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\*Schedules have been omitted pursuant to Item 601(b)(2) of SEC Regulation S-K. A copy of any omitted schedules will be furnished supplementally to the SEC upon its request.

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SIGNATURES

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

PARK NATIONAL CORPORATION

DATE: November 2, 2018 /s/ David L. Trautman  
David L. Trautman  
Chief Executive Officer and President

DATE: November 2, 2018 /s/ Brady T. Burt  
Brady T. Burt  
Chief Financial Officer, Secretary and Treasurer