First American Financial Corp
Form 10-Q
April 25, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

OR

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

For the transition period from ______ to ______

Commission file number 001-34580

FIRST AMERICAN FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	26-1911571
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1 First American Way, Santa Ana, California	92707-5913
(Address of principal executive offices)	(Zip Code)

(714) 250-3000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No 1

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 1

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 1 No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes 1 No 1

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

On April 22, 2019, there were 112,098,764 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

PART I: FINANCIAL INFORMATION

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Items 3 through 5 of Part II have been omitted because they are not applicable with respect to the current reporting period.

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THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE FACT THAT THEY DO NOT RELATE STRICTLY TO HISTORICAL OR CURRENT FACTS AND MAY CONTAIN THE WORDS "BELIEVE," "ANTICIPATE," "EXPECT," "INTEND," "PLAN," "PREDICT," "ESTIMATE," "PROJECT," "WILL BE," "WILL CONTINUE," "WILL LIKELY RESU OTHER SIMILAR WORDS AND PHRASES OR FUTURE OR CONDITIONAL VERBS SUCH AS "WILL," "MAY," "MIGHT," "SHOULD," "WOULD," OR "COULD." THESE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION, STATEMENTS REGARDING FUTURE OPERATIONS, PERFORMANCE, FINANCIAL CONDITION, PROSPECTS, PLANS AND STRATEGIES. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON CURRENT EXPECTATIONS AND ASSUMPTIONS THAT MAY PROVE TO BE INCORRECT.

RISKS AND UNCERTAINTIES EXIST THAT MAY CAUSE RESULTS TO DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE THE ANTICIPATED RESULTS TO DIFFER FROM THOSE DESCRIBED IN THE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION:

- INTEREST RATE FLUCTUATIONS;
- CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;
- VOLATILITY IN THE CAPITAL MARKETS;
- UNFAVORABLE ECONOMIC CONDITIONS;
- FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;
- CHANGES IN APPLICABLE LAWS AND GOVERNMENT REGULATIONS, INCLUDING DATA PRIVACY LAWS;
- HEIGHTENED SCRUTINY BY LEGISLATORS AND REGULATORS OF THE COMPANY'S TITLE INSURANCE AND SERVICES SEGMENT AND CERTAIN OTHER OF THE COMPANY'S BUSINESSES;
- USE OF SOCIAL MEDIA BY THE COMPANY AND OTHER PARTIES;
- REGULATION OF TITLE INSURANCE RATES;
- LIMITATIONS ON ACCESS TO PUBLIC RECORDS AND OTHER DATA;
- CHANGES IN RELATIONSHIPS WITH LARGE MORTGAGE LENDERS AND GOVERNMENT-SPONSORED ENTERPRISES;
- CHANGES IN MEASURES OF THE STRENGTH OF THE COMPANY'S TITLE INSURANCE UNDERWRITERS, INCLUDING RATINGS AND STATUTORY CAPITAL AND SURPLUS;
- LOSSES IN THE COMPANY'S INVESTMENT PORTFOLIO;
- MATERIAL VARIANCE BETWEEN ACTUAL AND EXPECTED CLAIMS EXPERIENCE;
- DEFALCATIONS, INCREASED CLAIMS OR OTHER COSTS AND EXPENSES ATTRIBUTABLE TO THE COMPANY'S USE OF TITLE AGENTS;
- ANY INADEQUACY IN THE COMPANY'S RISK MANAGEMENT FRAMEWORK;
- SYSTEMS DAMAGE, FAILURES, INTERRUPTIONS AND INTRUSIONS, OR UNAUTHORIZED DATA DISCLOSURES;
- INNOVATION EFFORTS OF THE COMPANY AND OTHER INDUSTRY PARTICIPANTS AND ANY RELATED MARKET DISRUPTION;
- ERRORS AND FRAUD INVOLVING THE TRANSFER OF FUNDS;
- THE COMPANY'S USE OF A GLOBAL WORKFORCE;
- INABILITY OF THE COMPANY'S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS; AND
-

OTHER FACTORS DESCRIBED IN THIS QUARTERLY REPORT ON FORM 10-Q, INCLUDING UNDER THE CAPTION “RISK FACTORS” IN ITEM 1A OF PART II.

THE FORWARD-LOOKING STATEMENTS SPEAK ONLY AS OF THE DATE THEY ARE MADE. THE COMPANY DOES NOT UNDERTAKE TO UPDATE FORWARD-LOOKING STATEMENTS TO REFLECT CIRCUMSTANCES OR EVENTS THAT OCCUR AFTER THE DATE THE FORWARD-LOOKING STATEMENTS ARE MADE.

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.
FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

	March 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	$1,337,052	$1,467,129
Accounts and accrued income receivable, net	310,813	325,686
Income taxes receivable	8,952	11,007
Investments:		
Deposits with banks	45,062	36,209
Debt securities, includes pledged securities of $82,698 and $110,975	5,959,345	5,713,811
Equity securities	344,790	353,535
Other investments	195,220	121,965
	6,544,417	6,225,520
Secured financings receivable	127,640	76,311
Property and equipment, net	452,911	457,840
Operating lease assets	309,880	—
Title plants and other indexes	580,073	577,467
Deferred income taxes	16,636	16,636
Goodwill	1,145,285	1,144,166
Other intangible assets, net	102,559	109,372
Other assets	224,050	219,501
	$11,160,268	$10,630,635
Liabilities and Equity		
Deposits	$3,921,903	$3,786,183
Accounts payable and accrued liabilities	631,536	778,688
Deferred revenue	228,547	243,280
Reserve for known and incurred but not reported claims	1,033,634	1,042,679
Income taxes payable	54,451	8,988
Deferred income taxes	217,097	217,097
Secured financings payable	127,647	76,313
Operating lease liabilities	333,964	—
Notes and contracts payable	730,953	732,019
	7,279,732	6,885,247

Commitments and contingencies (Note 14)		
Stockholders’ equity:		
Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—
Common stock, $0.00001 par value; Authorized—300,000 shares; Outstanding—112,072 shares and 111,496 shares	1	1
Additional paid-in capital	2,265,143	2,258,290
Retained earnings	1,707,140	1,644,165
Accumulated other comprehensive loss	(94,257)	(160,575)
Total stockholders’ equity	3,878,027	3,741,881
Noncontrolling interests	2,509	3,507
Total equity	3,880,536	3,745,388
	$11,160,268	$10,630,635

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2019	2018
Revenues		
Direct premiums and escrow fees	$514,202	$543,878
Agent premiums	501,537	527,714
Information and other	172,892	188,658
Net investment income	82,268	42,792
Net realized investment gains (losses)	32,682	(5,654)
	1,303,581	1,297,388
Expenses		
Personnel costs	411,612	413,642
Premiums retained by agents	396,607	416,637
Other operating expenses	196,447	218,480
Provision for policy losses and other claims	97,712	100,580
Depreciation and amortization	32,934	29,747
Premium taxes	14,663	16,014
Interest	11,936	9,223
	1,161,911	1,204,323
Income before income taxes	141,670	93,065
Income taxes	31,866	16,893
Net income	109,804	76,172
Less: Net income (loss) attributable to noncontrolling interests	229	(55)
Net income attributable to the Company	$109,575	$76,227
Net income per share attributable to the Company’s stockholders (Note 9):		
Basic	$0.97	$0.68
Diluted	$0.97	$0.67
Cash dividends declared per share	$0.42	$0.38
Weighted-average common shares outstanding (Note 9):		
Basic	112,703	112,232
Diluted	113,224	113,035

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended March 31, 2019	2018
Net income	$109,804	$76,172
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on debt securities	59,505	(46,796)
Foreign currency translation adjustment	6,888	(3,752)
Pension benefit adjustment	(76)	120
Total other comprehensive income (loss), net of tax	66,317	(50,428)
Comprehensive income	176,121	25,744
Less: Comprehensive income (loss) attributable to noncontrolling interests	228	(74)
Comprehensive income attributable to the Company	$175,893	$25,818

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Stockholders' Equity

(in thousands)

(unaudited)

	First American Financial Corporation Stockholders							
	Shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total stockholders' equity	Noncontrolling interests	Total
Balance at December 31, 2018	111,496	$1	$2,258,290	$1,644,165	$(160,575)	$3,741,881	$3,507	$3,745,388
Cumulative-effect adjustment (Note 1)	—	—	—	1,283	—	1,283	—	1,283
Net income for three months ended March 31, 2019	—	—	—	109,575	—	109,575	229	109,804
Dividends on common shares	—	—	—	(47,021)	—	(47,021)	—	(47,021)
Purchase of Company shares	(47)	—	(2,066)	—	—	(2,066)	—	(2,066)
Shares issued in connection with share-based compensation	623	—	(10,618)	(862)	—	(11,480)	—	(11,480)
Share-based compensation	—	—	19,597	—	—	19,597	—	19,597
Net activity related to noncontrolling interests	—	—	(60)	—	—	(60)	(1,226)	(1,286)
Other comprehensive income (loss)	—	—	—	—	66,318	66,318	(1)	66,317
Balance at March 31, 2019	112,072	$1	$2,265,143	$1,707,140	$(94,257)	$3,878,027	$2,509	$3,880,536

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Stockholders' Equity – (Continued)

(in thousands)

(unaudited)

	First American Financial Corporation Stockholders							
	Shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total stockholders' equity	Noncontrolling interests	Total
Balance at December 31, 2017	110,925	$1	$2,236,351	$1,311,112	$(67,509)	$3,479,955	$3,070	$3,483,025
Cumulative-effect adjustment	—	—	—	40,550	(40,550)	—	—	—
Net income (loss) for three months ended March 31, 2018	—	—	—	76,227	—	76,227	(55)	76,172
Dividends on common shares	—	—	—	(42,330)	—	(42,330)	—	(42,330)
Shares issued in connection with share-based compensation	620	—	(11,759)	(847)	—	(12,606)	—	(12,606)
Share-based compensation	—	—	19,509	—	—	19,509	—	19,509
Net activity related to noncontrolling interests	—	—	189	—	—	189	(1,090)	(901)
Other comprehensive loss	—	—	—	—	(50,409)	(50,409)	(19)	(50,428)
Balance at March 31, 2018	111,545	$1	$2,244,290	$1,384,712	$(158,468)	$3,470,535	$1,906	$3,472,441

See notes to condensed consolidated financial statements.

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FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended March 31, 2019	2018
Cash flows from operating activities:		
Net income	$109,804	$76,172
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	97,712	100,580
Depreciation and amortization	32,934	29,747
Amortization of premiums and accretion of discounts on debt securities, net	5,464	6,743
Net realized investment (gains) losses	(32,682)	5,654
Share-based compensation	19,597	19,509
Equity in earnings of equity method investments, net	180	296
Dividends from equity method investments	545	805
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(99,992)	(104,614)
Net change in income tax accounts	29,186	12,320
Decrease in accounts and accrued income receivable	2,543	5,493
Decrease in accounts payable and accrued liabilities	(118,318)	(95,978)
Decrease in deferred revenue	(13,447)	(14,378)
Other, net	945	818
Cash provided by operating activities	34,471	43,167
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(225)	(24,484)
Net (increase) decrease in deposits with banks	(8,824)	2,292
Purchases of debt and equity securities	(727,001)	(586,150)
Proceeds from sales of debt and equity securities	461,447	213,432
Proceeds from maturities of debt securities	136,670	126,920
Net (increase) decrease in other investments	(73,964)	640
Advances under secured financing agreements	(985,478)	—
Collections of secured financings receivable	934,149	—
Capital expenditures	(27,386)	(22,344)
Proceeds from sales of property and equipment	12	1,015
Cash used for investing activities	(290,600)	(288,679)
Cash flows from financing activities:		
Net change in deposits	135,720	91,140
Borrowings under secured financing agreements	985,878	—

Repayments of secured financings payable	(934,544)	—
Repayments of notes and contracts payable	(1,411)	(1,422)
Net activity related to noncontrolling interests	(1,065)	(895)
Net payments in connection with share-based compensation	(11,480)	(12,606)
Purchase of Company shares	(2,066)	—
Payments of cash dividends	(47,021)	(42,330)
Cash provided by financing activities	124,011	33,887
Effect of exchange rate changes on cash	2,041	1,017
Net decrease in cash and cash equivalents	(130,077)	(210,608)
Cash and cash equivalents—Beginning of period	1,467,129	1,387,226
Cash and cash equivalents—End of period	$1,337,052	$1,176,618
Supplemental information:		
Cash paid during the period for:		
Interest	$10,353	$8,318
Premium taxes	$24,353	$28,877
Income taxes, less refunds of $548 and $18	$2,559	$4,187

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 – Basis of Condensed Consolidated Financial Statements

Basis of Presentation

The condensed consolidated financial information included in this report has been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X. The principles for condensed interim financial information do not require the inclusion of all the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2018. The condensed consolidated financial statements included herein are unaudited; however, in the opinion of management, they contain all normal recurring adjustments necessary for a fair statement of the consolidated results for the interim periods. All material intercompany transactions and balances have been eliminated upon consolidation.

Recently Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued updated guidance that requires the rights and obligations associated with leasing arrangements be reflected on the balance sheet in order to increase transparency and comparability among organizations. Under the updated guidance, lessees will be required to recognize a right-of-use asset and a liability to make lease payments and disclose key information about leasing arrangements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2018. The updated guidance may either be adopted using a modified retrospective transition approach or may be initially applied on the adoption date with the recognition of a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company adopted and initially applied the updated guidance on January 1, 2019. Upon adoption, the Company recognized deferred gains of $1.3 million on previous sale and operating leaseback transactions as a cumulative-effect adjustment to retained earnings. The Company elected to adopt the package of practical expedients allowed under the guidance, which was applied to all leases as of the adoption date. The package of practical expedients includes (1) entities can choose not to reassess whether any expired or existing contracts are or contain leases, (2) entities can choose not to reassess the lease classification for any expired or existing leases, and (3) entities can choose not to reassess initial direct costs for any existing leases. See Note 4 Leases for further information on the Company's leasing arrangements.

Pending Accounting Pronouncements

In August 2018, the FASB issued updated guidance that is intended to reduce potential diversity in practice in accounting for the costs of implementing cloud computing arrangements (i.e., hosting arrangements) that are service contracts. The updated guidance aligns the requirements for capitalizing implementation costs for these arrangements with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its condensed consolidated financial statements.

In August 2018, the FASB issued updated guidance as part of its disclosure framework project intended to improve the effectiveness of disclosures in the notes to the financial statements. The updated guidance eliminates, adds and modifies certain disclosure requirements related to fair value measurements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In January 2017, the FASB issued updated guidance intended to simplify how an entity tests goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Under the updated guidance, an entity will perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and will recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, with the loss recognized limited to the total amount of goodwill allocated to that reporting unit. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
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Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In June 2016, the FASB issued updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its condensed consolidated financial statements.

Note 2 – Escrow Deposits, Like-kind Exchange Deposits and Trust Assets

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $7.7 billion and $7.6 billion at March 31, 2019 and December 31, 2018, respectively, of which $3.8 billion and $3.6 billion, respectively, were held at First American Trust, FSB. The escrow deposits held at First American Trust, FSB are temporarily invested in cash and cash equivalents and debt securities, with offsetting liabilities included in deposits in the accompanying condensed consolidated balance sheets. The remaining escrow deposits were held at third-party financial institutions.

Trust assets held or managed by First American Trust, FSB totaled $4.0 billion and $3.6 billion at March 31, 2019 and December 31, 2018, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. However, the Company could be held contingently liable for the disposition of these assets.

In conducting its operations, the Company often holds customers' assets in escrow, pending completion of real estate transactions and, as a result, the Company has ongoing programs for realizing economic benefits with various financial institutions. The results from these programs are included as income or a reduction in expense in the condensed consolidated statements of income, as appropriate, based on the nature of the arrangement and benefit received.

The Company facilitates tax-deferred property exchanges for customers pursuant to Section 1031 of the Internal Revenue Code and tax-deferred reverse exchanges pursuant to Revenue Procedure 2000-37. As a facilitator and intermediary, the Company holds the proceeds from sales transactions and takes temporary title to property identified by the customer to be acquired with such proceeds. Upon the completion of each such exchange, the identified property is transferred to the customer or, if the exchange does not take place, an amount equal to the sales proceeds or, in the case of a reverse exchange, title to the property held by the Company is transferred to the customer. Like-kind exchange funds held by the Company totaled $2.2 billion and $2.7 billion at March 31, 2019 and December 31, 2018, respectively. The like-kind exchange deposits are held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. All such amounts are placed in deposit accounts insured, up to applicable limits, by the Federal Deposit Insurance

Corporation. The Company could be held contingently liable to the customer for the transfers of property, disbursements of proceeds and the returns on such proceeds.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Note 3 – Debt and Equity Securities

Investments in debt securities, classified as available-for-sale, are as follows:

(in thousands)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
March 31, 2019				
U.S. Treasury bonds	$148,860	$1,278	$(324)	$149,814
Municipal bonds	1,058,106	22,510	(2,197)	1,078,419
Foreign government bonds	152,539	1,285	(472)	153,352
Governmental agency bonds	352,350	2,577	(2,372)	352,555
Governmental agency mortgage-backed securities	3,331,671	24,421	(20,810)	3,335,282
U.S. corporate debt securities	596,614	7,677	(4,456)	599,835
Foreign corporate debt securities	288,738	2,987	(1,637)	290,088
	$5,928,878	$62,735	$(32,268)	$5,959,345
December 31, 2018				
U.S. Treasury bonds	$162,904	$741	$(1,139)	$162,506
Municipal bonds	1,050,134	7,210	(12,309)	1,045,035
Foreign government bonds	158,885	571	(2,159)	157,297
Governmental agency bonds	319,115	1,145	(4,093)	316,167
Governmental agency mortgage-backed securities	3,219,585	12,030	(29,016)	3,202,599
U.S. corporate debt securities	575,646	1,113	(15,499)	561,260
Foreign corporate debt securities	274,881	551	(6,485)	268,947
	$5,761,150	$23,361	$(70,700)	$5,713,811

Sales of debt securities resulted in realized gains of $3.1 million and $0.7 million, realized losses of $3.0 million and $1.2 million, and proceeds of $391.4 million and $155.7 million for the three months ended March 31, 2019 and 2018, respectively.

FIRST AMERICAN FINANCIAL CORPORATION
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Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Gross unrealized losses on investments in debt securities are as follows:

	Less than 12 months		12 months or longer		Total	
(in thousands)	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
March 31, 2019						
U.S. Treasury bonds	$2,243	$(5)	$39,855	$(319)	$42,098	$(324)
Municipal bonds	8,130	(10)	258,588	(2,187)	266,718	(2,197)
Foreign government bonds	18,842	(85)	30,536	(387)	49,378	(472)
Governmental agency bonds	37,180	(188)	107,168	(2,184)	144,348	(2,372)
Governmental agency mortgage-backed securities	789,483	(4,251)	1,115,558	(16,559)	1,905,041	(20,810)
U.S. corporate debt securities	147,143	(2,324)	149,021	(2,132)	296,164	(4,456)
Foreign corporate debt securities	52,285	(469)	79,731	(1,168)	132,016	(1,637)
	$1,055,306	$(7,332)	$1,780,457	$(24,936)	$2,835,763	$(32,268)
December 31, 2018						
U.S. Treasury bonds	$19,749	$(85)	$55,615	$(1,054)	$75,364	$(1,139)
Municipal bonds	172,387	(1,772)	369,139	(10,537)	541,526	(12,309)
Foreign government bonds	23,654	(1,037)	42,119	(1,122)	65,773	(2,159)
Governmental agency bonds	56,270	(748)	90,631	(3,345)	146,901	(4,093)
Governmental agency mortgage-backed securities	850,459	(6,955)	982,610	(22,061)	1,833,069	(29,016)
U.S. corporate debt securities	374,473	(10,537)	109,844	(4,962)	484,317	(15,499)
Foreign corporate debt securities	175,762	(4,575)	50,802	(1,910)	226,564	(6,485)
	$1,672,754	$(25,709)	$1,700,760	$(44,991)	$3,373,514	$(70,700)

Based on the Company's review of its debt securities in an unrealized loss position at March 31, 2019, it determined that the losses were primarily the result of changes in interest rates, which were considered to be temporary, rather than a deterioration in credit quality. The Company does not intend to sell and it is not more likely than not that the Company will be required to sell these securities prior to recovering their amortized cost. As such, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2019.

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Investments in debt securities at March 31, 2019, by contractual maturities, are as follows:

(in thousands)	Due in one year or less	Due after one through five years	Due after five through ten years	Due after ten years	Total
U.S. Treasury bonds					
Amortized cost	$ 77,616	$59,440	$109	$11,695	$148,860
Estimated fair value	$ 77,629	$59,405	$135	$12,645	$149,814
Municipal bonds					
Amortized cost	$ 70,623	$172,540	$250,240	$564,703	$1,058,106
Estimated fair value	$ 70,741	$173,669	$255,697	$578,312	$1,078,419
Foreign government bonds					
Amortized cost	$ 12,427	$110,708	$21,071	$8,333	$152,539
Estimated fair value	$ 12,419	$111,507	$21,321	$8,105	$153,352
Governmental agency bonds					
Amortized cost	$ 24,404	$123,819	$151,773	$52,354	$352,350
Estimated fair value	$ 24,297	$123,194	$153,607	$51,457	$352,555
U.S. corporate debt securities					
Amortized cost	$ 40,749	$284,110	$246,706	$25,049	$596,614
Estimated fair value	$ 40,671	$285,483	$247,694	$25,987	$599,835
Foreign corporate debt securities					
Amortized cost	$ 26,900	$170,011	$80,814	$11,013	$288,738
Estimated fair value	$ 26,880	$170,424	$81,624	$11,160	$290,088
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 252,719	$920,628	$750,713	$673,147	$2,597,207
Estimated fair value	$ 252,637	$923,682	$760,078	$687,666	$2,624,063
Total mortgage-backed securities					
Amortized cost					$3,331,671
Estimated fair value					$3,335,282
Total debt securities					
Amortized cost					$5,928,878
Estimated fair value					$5,959,345

Mortgage-backed securities, which include contractual terms to maturity, are not categorized by contractual maturity as borrowers may have the right to call or prepay obligations with, or without, call or prepayment penalties.

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Investments in equity securities are as follows:

(in thousands)	Cost	Estimated fair value
March 31, 2019		
Preferred stocks	$17,082	$13,888
Common stocks	305,857	330,902
	$322,939	$344,790
December 31, 2018		
Preferred stocks	$16,892	$14,162
Common stocks	341,460	339,373
	$358,352	$353,535

Net gains (realized and unrealized) of $32.5 million and net losses (realized and unrealized) of $5.9 million were recognized for the three months ended March 31, 2019 and 2018, respectively, as a result of changes in the fair values of equity securities. Included in net gains during the three months ended March 31, 2019 were net unrealized gains of $29.0 million related to equity securities still held at March 31, 2019, and included in net losses during the three months ended March 31, 2018 were net unrealized losses of $6.5 million related to equity securities still held at March 31, 2018.

The composition of the investment portfolio at March 31, 2019, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
(in thousands, except percentages)	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage
Debt securities:								
U.S. Treasury bonds	$149,814	100.0	$—	—	$—	—	$149,814	100.0
Municipal bonds	1,028,992	95.4	43,349	4.0	6,078	0.6	1,078,419	100.0
Foreign government bonds	132,570	86.5	17,369	11.3	3,413	2.2	153,352	100.0
Governmental agency bonds	352,555	100.0	—	—	—	—	352,555	100.0
			—	—	—	—	3,335,282	100.0

Governmental agency mortgage-backed securities	3,335,282	100.0						
U.S. corporate debt securities	249,623	41.6	196,564	32.8	153,648	25.6	599,835	100.0
Foreign corporate debt securities	121,150	41.7	140,931	48.6	28,007	9.7	290,088	100.0
Total debt securities	5,369,986	90.1	398,213	6.7	191,146	3.2	5,959,345	100.0
Preferred stocks	49	0.4	12,629	90.9	1,210	8.7	13,888	100.0
Total	$5,370,035	89.9	$410,842	6.9	$192,356	3.2	$5,973,233	100.0

Included in debt securities at March 31, 2019, were bank loans totaling $148.9 million, of which $136.4 million were non-investment grade; high yield corporate debt securities totaling $38.7 million, all of which were non-investment grade; and emerging market debt securities totaling $69.8 million, of which $10.0 million were non-investment grade.

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The composition of the debt securities portfolio in an unrealized loss position at March 31, 2019, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
(in thousands, except percentages)	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage
U.S. Treasury bonds	$42,098	100.0	$—	—	$—	—	$42,098	100.0
Municipal bonds	261,506	98.1	2,970	1.1	2,242	0.8	266,718	100.0
Foreign government bonds	33,358	67.5	14,643	29.7	1,377	2.8	49,378	100.0
Governmental agency bonds	144,348	100.0	—	—	—	—	144,348	100.0
Governmental agency mortgage-backed securities	1,905,041	100.0	—	—	—	—	1,905,041	100.0
U.S. corporate debt securities	104,171	35.1	72,752	24.6	119,241	40.3	296,164	100.0
Foreign corporate debt securities	47,648	36.1	64,909	49.2	19,459	14.7	132,016	100.0
Total	$2,538,170	89.5	$155,274	5.5	$142,319	5.0	$2,835,763	100.0

Debt securities in an unrealized loss position at March 31, 2019, included bank loans totaling $134.9 million, of which $124.8 million were non-investment grade; high yield corporate debt securities totaling $11.2 million, all of which were non-investment grade; and emerging market debt securities totaling $29.5 million, of which $4.1 million were non-investment grade.

The credit ratings in the above tables reflect published ratings obtained from globally recognized securities rating agencies. If a security was rated differently among the rating agencies, the lowest rating was selected. Governmental agency mortgage-backed securities are not rated by any of the ratings agencies; however, these securities have been included in the above table in the “A- or higher” rating category because the payments of principal and interest are guaranteed by the governmental agency that issued the security.

Note 4 – Leases

On January 1, 2019, the Company adopted updated accounting guidance which requires lessees in leasing arrangements to recognize a right-of-use asset and a liability to make lease payments on the balance sheet.

The Company leases commercial real estate, including office buildings and office space, and also leases certain equipment. The Company has elected the practical expedient for its leases of commercial real estate whereby it does not separately account for nonlease components (e.g., common-area maintenance costs) from the associated lease components (e.g., fixed payments including rent, real estate taxes and insurance costs) and instead accounts for both components as a single lease component. Variable lease costs, which include any variable lease and nonlease components and rents that vary based on changes to an index or rate, are expensed as incurred.

Most of the Company's leases of commercial real estate include one or more options to renew, with renewal terms that can extend the lease term from one to five years, and some leases include options to terminate the lease within the first year.

The Company has elected the practical expedient which allows for leases with an initial term of 12 months or less to be excluded from recognition on the balance sheet and for which lease expense is recognized on a straight-line basis over the lease term.

As most of the Company's leases do not provide an implicit discount rate, the Company applies its incremental borrowing rate, which is based on the information available as of the commencement date, in determining the present value of lease payments.

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Lease assets and liabilities are summarized as follows:

(in thousands)	Classification	March 31, 2019
Assets		
Operating lease assets	Operating lease assets	$309,880
Finance lease assets	Other assets	4,838
Total lease assets		$314,718
Liabilities		
Operating lease liabilities	Operating lease liabilities	$333,964
Finance lease liabilities	Notes and contracts payable	5,078
Total lease liabilities		$339,042

The components of lease expense are as follows:

(in thousands)	Classification	Three Months Ended March 31, 2019
Operating lease cost	Other operating expenses	$22,093
Finance lease cost:		
Amortization of lease assets	Depreciation and amortization	573
Interest of lease liabilities	Interest	56
Variable lease cost	Other operating expenses	6,989
Short-term lease cost	Other operating expenses	461
Sublease income	Information and other	(477)
Net lease cost		$29,695

Future minimum lease payments under operating and finance leases with noncancelable lease terms, as of March 31, 2019, are as follows:

(in thousands)	Operating Leases	Finance Leases	Total
Remainder of 2019	$65,448	$1,415	$66,863
2020	78,098	1,432	79,530
2021	63,304	1,130	64,434
2022	51,791	1,036	52,827
2023	37,740	434	38,174
2024	26,021	—	26,021
Thereafter	57,068	—	57,068
Total lease payments	379,470	5,447	384,917
Interest	(45,506)	(369)	(45,875)
Present value of lease liabilities	$333,964	$5,078	$339,042

Information related to lease terms and discount rates is as follows:

	March 31, 2019
Weighted-average remaining lease terms (years):	
Operating leases	5.7
Finance leases	3.6
Weighted-average discount rates:	
Operating leases	4.32 %
Finance leases	4.25 %

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Cash flow information related to lease liabilities is as follows:

(in thousands)	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$21,879
Operating cash flows from finance leases	$56
Financing cash flows from finance leases	$474
Operating lease assets obtained in exchange for new operating lease liabilities	$10,376

Future minimum lease payments under operating leases with noncancelable lease terms, as of December 31, 2018, are as follows:

Year	in thousands
2019	$ 76,375
2020	68,026
2021	54,853
2022	41,859
2023	28,948
Thereafter	64,732
Total lease payments	$ 334,793

Total rental expense for all operating leases was $22.2 million for the three months ended March 31, 2018.

Note 5 – Goodwill

A summary of the changes in the carrying amount of goodwill, by reportable segment, for the three months ended March 31, 2019, is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance at December 31, 2018	$1,097,401	$46,765	$1,144,166
Foreign currency translation	1,119	—	1,119
Balance at March 31, 2019			