CAROLINA FINANCIAL CORPORATION

2010 ANNUAL REPORT

March 11, 2011

Dear Shareholder,

Carolina Financial Corporation had a net loss for the year ended December 31, 2010 of $12.6 million or $(6.58) per share diluted for fiscal 2010, as compared to net income of $7.2 million for fiscal 2009, or $3.72 per share diluted.

Net interest income for the year ended December 31, 2010 decreased $1.9 million, or 6.2%, to $29.8 million from $31.7 million during the year ended December 31, 2009. The net decrease was primarily due to the Company shrinking the balance sheet to preserve capital and an increase in non-performing assets (NPAs). The provision for loan losses for the year ended December 31, 2010 totaled $30.8 million compared to $10.5 million in the prior year. The increase in the provision is primarily attributable to the deterioration of construction, land development, and other loans secured by real estate, resulting in an increase in NPAs and severity of losses.

Non-interest income for the year ended December 31, 2010 decreased $6.3 million to $21.6 million from $27.9 million for the prior year. The net decrease is primarily due to a change from a gain on sale of securities to a loss on sale of securities of $2.9 million, an increase in the loss on extinguishment of debt of $1.8 million and other-than-temporary impairment of securities of $2.5 million. Also during the year, the Company sold mortgage servicing rights and realized a gain of $526,000.

Non-interest expense for the year ended December 31, 2010 increased $1.4 million or 3.7%, to $39.1 million from $37.7 million for the prior year. The increase was primarily attributable to an increase in other expenses related to legal and other loan collection activities.

Total assets at December 31, 2010 were $930.7 million compared to $1.1 billion at December 31, 2009. Loans receivable, net decreased 15.4% to $584.0 million at December 31, 2010 from $690.2 million at December 31, 2009. Total deposits decreased 9.4% to $689.8 million at December 31, 2010 from $761.1 million at December 31, 2009. Stockholders' equity decreased $9.6 million, primarily due to a net loss of $12.6 million, offset by an increase on accumulated other comprehensive income of $2.6 million.

Non-performing assets increased to the highest levels in our history due to distressed coastal real estate markets and declining real estate values. Non-performing assets were $68.2 million at December 31, 2010 compared to $35.7 million at December 31, 2009. These NPA levels have affected financial performance in many areas of our balance sheet and earnings statement. Non-accrual loans caused a reduction in net interest income. Provision for loan losses and corresponding reserves are at their highest levels. Additionally, expenses for attorneys to assist with troubled debt workouts and foreclosures as well as expenses to maintain foreclosed properties have increased.

However, we continue to enjoy good performance in our wholesale mortgage business. This was a substantial year in the mortgage industry and we participated in significant levels of mortgage loan production and sales. Performance in 2010 was comparable to 2009 which had been one of our best years in this business.

While these have been very trying times, your company and subsidiary banks remain well-capitalized. Though credit issues remain, we have seen indications that NPAs appear to have bottomed and that the economy, and troubled credits, will start to show improvement. We continue to work towards a capital raise and hope to be able to discuss investment opportunities with you early in the year.

Thank you for your continued support!

Sincerely,

John D. Russ
President and Chief Executive Officer

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CAROLINA FINANCIAL CORPORATION
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CAROLINA FINANCIAL CORPORATION
SUMMARY OF SELECTED FINANCIAL DATA

Set forth below is selected consolidated financial and other data of the Company at and for the periods indicated. The information below is only a summary and should be read together with the accompanying Financial Discussion, which follows this data, and the consolidated financial statements presented herein.

	For The Years Ended December 31,				
	2010	2009	2008	2007	2006
Operating Data:			(In thousands)		
Interest income	$ **46,842**	56,736	63,049	65,572	56,073
Interest expense	**17,077**	25,019	33,227	37,285	29,711
Net interest income	**29,765**	31,717	29,822	28,287	26,362
Provision for loan losses	**30,755**	10,460	6,361	1,775	2,755
Net interest income (loss) after provision for loan losses	**(990)**	21,257	23,461	26,512	23,607
Noninterest income	**21,600**	27,938	9,227	8,869	9,063
Noninterest expense	**39,070**	37,673	23,882	22,301	20,317
Income (loss) before income taxes	**(18,460)**	11,522	8,806	13,080	12,353
Income tax expense (benefit)	**(5,872)**	4,353	3,256	4,806	4,543
Net income (loss)	$ **(12,588)**	7,169	5,550	8,274	7,810

	At December 31,				
	2010	2009	2008	2007	2006
Balance Sheet Data:			(In thousands)		
Total assets	$ **930,749**	1,078,757	1,138,994	977,139	804,435
Interest-bearing cash	**21,415**	17,759	16,285	4,241	8,311
Securities available for sale	**151,574**	104,401	120,988	157,456	58,091
Securities held to maturity	**9,848**	125,633	113,689	-	-
Federal Home Loan Bank stock	**11,129**	12,456	11,874	10,147	5,689
Loans held for sale	**82,615**	71,233	28,283	25,030	30,449
Loans receivable, net	**583,995**	690,163	776,621	738,705	661,465
Allowance for loan losses	**14,263**	13,032	11,300	10,083	8,406
Deposits	**689,814**	761,108	717,389	692,100	622,456
Short-term borrowed funds	**57,759**	43,787	148,090	85,603	15,117
Long-term debt	**123,339**	203,638	218,465	137,965	110,465
Stockholders' equity	**46,494**	56,138	46,591	49,535	40,659

CAROLINA FINANCIAL CORPORATION
SUMMARY OF SELECTED FINANCIAL DATA

	For The Years Ended December 31,				
	2010	2009	2008	2007	2006
	(Dollars in thousands)				
Selected Average Balances:					
Total assets	**$ 1,018,130**	1,114,132	1,090,787	864,497	762,158
Loans receivable, net	**640,646**	737,448	774,183	708,629	608,868
Deposits	**742,409**	767,814	750,110	665,252	580,472
Stockholders' equity	**50,065**	51,949	47,552	44,823	35,615
Performance Ratios:					
Return on average equity	**(25.14)%**	13.80%	11.67%	18.46%	21.93%
Return on average assets	**(1.24)%**	0.64%	0.51%	0.96%	1.02%
Average earning assets to average total assets	**94.24%**	94.59%	95.66%	95.22%	94.83%
Average loans receivable, net to average deposits	**86.29%**	96.05%	103.21%	106.52%	104.89%
Average equity to average assets	**4.92%**	4.66%	4.36%	5.18%	4.67%
Net interest margin	**3.10%**	3.01%	2.86%	3.44%	3.65%
Net charge-offs to average loans receivable, net	**4.61%**	1.18%	0.66%	0.01%	0.01%
Non-performing assets to period end loans receivable, net	**11.69%**	5.17%	2.71%	2.18%	0.19%
Non-performing assets to total assets	**7.33%**	3.31%	1.85%	1.40%	0.13%
Non-performing loans to total loans	**9.60%**	3.96%	1.77%	2.09%	0.09%
Allowance for loan losses as a percentage of loans receivable (end of period)	**2.38%**	1.85%	1.43%	1.35%	1.25%
Allowance for loan losses as a percentage of nonperforming loans	**24.84%**	46.83%	81.08%	64.35%	1353.62%

	At or For The Years Ended December 31,				
	2010	2009	2008	2007	2006
Per Share Data:					
Book value (end of period)	**$ 24.23**	29.35	24.36	27.55	22.70
Basic earnings (loss)	**(6.58)**	3.75	2.95	4.61	4.51
Diluted earnings (loss)	**(6.58)**	3.72	2.83	4.23	4.10
Average common shares - basic	**1,913,240**	1,912,449	1,883,101	1,794,659	1,729,964
Average common shares - diluted	**1,913,240**	1,924,720	1,960,362	1,954,392	1,902,818

Financial Discussion

Carolina Financial Corporation is not a publicly traded company subject to reporting and disclosure requirements of the Securities and Exchange Commission ("SEC") as enumerated in Article 9 of Regulation S-X, Guide 3 or any other requirements for SEC registrants. The Company also does not have an actively traded market for its stock. The accompanying Financial Discussion is provided to assist the reader of these consolidated financial statements and is not intended to comply with disclosure requirements of the SEC as enumerated above.

Discussion of Forward-Looking Statements

The accompanying Financial Discussion contains certain "forward-looking statements" concerning risks and uncertainties about the financial condition and future operations of Carolina Financial Corporation (the "Company") and its wholly-owned subsidiary banks, Community FirstBank of Charleston ("Community FirstBank") and Crescent Bank, (together, the "Banks"), and its wholly-owned subsidiary service corporation, Carolina Services Corporation of Charleston ("Carolina Services"). Effective July 27, 2009, Carolina Financial Corporation contributed 100% of its wholly-owned mortgage subsidiary Crescent Mortgage Company ("Crescent Mortgage") to Community FirstBank. Crescent Mortgage continues to operate as a wholly-owned subsidiary of Community FirstBank.

These forward-looking statements, as defined by federal securities laws, relate to, among others, expectations of the business environment in which the Company operates, projections of future performance, including operating efficiencies, perceived opportunities in the market, potential future credit experience, and statements regarding the Company's mission and vision. These forward-looking statements are based upon Management's current expectations, and may therefore involve risks and uncertainties. Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. The Company's actual results, performance or achievements may differ materially from those suggested, expressed or implied by forward-looking statements due to a wide range of factors, including, but not limited to, the general business environment, general economic conditions nationally and within the State of South Carolina, interest rates, the South Carolina and national real estate markets, the demand for mortgage loans, the credit risk of lending activities, including changes in the levels of and trends of loan delinquencies and charge-offs, results of examinations by our banking regulators, competitive conditions between banks and non-bank financial service providers, regulatory changes, changes in federal and state tax matters and other risks. No assurance can be given that the results of any forward-looking statements will be achieved and actual results could be affected by one or more factors, which could cause them to differ materially. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act or other applicable legal provisions.

Risk Factors

The Company operates in a business environment that has inherent risks. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or items we currently deem to be immaterial may become material and adversely affect our business, financial condition and results of operations.

Our Business Has Been Adversely Affected By Downturns In The Local Economies Of Our Market Areas And Further Downturns Could Significantly Adversely Impact Our Business.

Our business is directly affected by market conditions, industry and finance trends, legislative and regulatory changes, and changes in governmental monetary and fiscal policies and inflation, all of which are beyond our control. Currently our markets are experiencing a prolonged economic downturn and continue to reflect weakness in business and economic conditions that may result in (i) a decrease in the demand for loans and other products and services offered by the Company, (ii) a further decrease in the value of loan collateral, or (iii) a further increase in the number of customers and counterparties who become delinquent, file for bankruptcy protection under bankruptcy laws or default on their loans or other obligations. A further increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs, and provision for loan losses that could adversely impact our results of operations and financial condition.

Further Downturns In The Real Estate Markets In Our Primary Market Area Could Significantly Adversely Impact Our Business.

Our business activities and credit exposure are primarily concentrated in Charleston, Dorchester, and Horry counties in South Carolina. The real estate markets have experienced a significant decline in these markets and these real estate markets may experience further declines. As of December 31, 2010, substantially all of the Company's loan portfolio is secured by real estate located in South Carolina. If real estate values continue to decline, the collateral for these loans will provide less security. As a result, the borrower's ability to pay, or the Company's ability to recover on defaulted loans by selling the underlying collateral, would be diminished.

Our Non-Performing Assets Have Increased Recently Which May Negatively Impact Our Earnings.

Our non-performing assets, which consist of nonaccrual loans, accruing loans 90 days or more past due, and real estate acquired through foreclosure, have increased recently as a result of the recent economic recession and the downturn in the real estate market in our primary market areas. At December 31, 2010, we had total non-performing assets of $68.2 million or 7.33% of total assets, compared to $35.7 million or 3.31% of total assets at December 31, 2009. Our non-performing assets may continue to increase in future periods. Our non-performing assets adversely affect our net income in various ways. We do not record interest income on non-accrual loans or investments or on real estate owned. We must establish an allowance for loan losses that reserves for losses inherent in the loan portfolio that are both probable and reasonably estimable through current period provisions for loan losses, which are recorded as a charge to income. From time to time, we also write down the other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to the other real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from our overall supervision of operations and other income-producing activities.

We Have Experienced Net Losses For Fiscal 2010 And We May Not Return To Profitability In The Near Future.

We have experienced net losses of $12.6 million for fiscal 2010. The losses have been primarily caused by a significant increase in non-performing assets, which necessitated a provision for loan losses of $30.8 million for fiscal 2010, compared to a provision of $10.5 million for fiscal 2009. We charged off $30.8 million of loans during 2010 as compared to $10.5 million of charge offs during 2009. Non-accrual loans (generally loans 90 days or more past due in principal or interest payments) totaled $57.4 million, or 9.82% of total loans, net at December 31, 2010, compared to $27.1 million, or 3.92% of total loans, net at December 31, 2009. We also recognized other-than-temporary impairment losses related to our investment portfolio of $2.5 million in the consolidated statement of operations for fiscal 2010. There were no other-than-temporary impairment losses in our investment portfolio in fiscal 2009. As a result of these factors and other conditions such as weakness in our local economy, we may not be able to generate sustainable net income or achieve profitability in the near future.

Commercial Real Estate Loans, Commercial Business Loans And Construction And Development Loans Increase Our Exposure To Credit Risks.

At December 31, 2010, our commercial real estate loans totaled $271.7 million, or 46.52% of total loans receivable, net, our commercial business loans totaled $46.0 million, or 7.87% of total loans receivable, net, and our construction and development loans totaled $99.5 million, or 17.03% of total loans. Commercial real estate loans and commercial business loans generally expose us to a greater risk of nonpayment and loss than one-to-four family residential real estate loans because repayment of such loans often depends on the successful business operations and income stream of the borrowers. Similarly, construction and development loans expose us to a greater risk of nonpayment and loss because repayment is dependent upon the successful completion of the project and the ability of the contractor or builder to repay the loan from the sale of the property or obtaining permanent financing. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Many of our borrowers have more than one commercial loan or construction and development loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship may expose us to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four family residential real estate loan. Finally, if we foreclose on a commercial real estate, commercial business or construction and development loan, our holding period for the collateral, if any, typically is longer than for one-to-four family residential mortgage loans because there are fewer potential purchasers of the collateral. The risks of commercial and construction and development loans have been exacerbated by the extended recession in

commercial real estate and commercial land values, and the downturn in residential construction, particularly in our market areas. During fiscal 2010, we charged off $3.6 million, $1.1 million and $15.3 million of commercial real estate loans, commercial business loans and construction and development loans, respectively.

Increases To The Allowance For Loan Losses Would Cause Our Earnings To Decrease.

Our customers may not repay their loans according to the original terms, and the collateral securing the payment of these loans may be insufficient to repay the remaining principal balance of the loan. Hence, we may experience significant loan losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the amount of the allowance for loan losses, we rely on loan quality reviews, past loss experience, and an evaluation of economic conditions, among other factors. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, which would require us to make additions to the allowance. Material additions to the allowance would materially decrease our net income.

Bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities would have an adverse effect on our results of operations and/or financial condition.

We Could Record Future Losses On Our Holdings Of Investment Securities. In Addition, We May Not Receive Full Future Interest Payments On These Securities.

We review our held-to-maturity investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of our held-to-maturity investment securities has declined below its carrying value, we are required to assess whether the decline is other than temporary. If we conclude that the decline is other-than-temporary, we are required to write down the value of that security through a charge to earnings.

We own trust preferred securities with an amortized cost basis of $9.8 million and a fair value of $3.2 million at December 31, 2010. We recognized total pre-tax other-than-temporary impairment of $4.2 million and $-0- for fiscal 2010 and 2009, respectively, of which $2.5 million and $-0- was credit-related losses recorded through our consolidated statement of operations as a reduction of non-interest income, and $1.7 million and $-0- was recorded as a decrease to other comprehensive income, net of tax.

We also own private label mortgage-backed securities in our held-to-maturity portfolio with an amortized cost basis of $131.8 million and a fair value of $129.0 million at December 31, 2010. We have evaluated these securities and do not consider them to be other than temporarily impaired at December 31, 2010.

A number of factors or combinations of factors could require us to conclude in one or more future reporting periods that an unrealized loss that exists with respect to our securities portfolio constitutes additional impairment that is other than temporary, which could result in material losses to us. These factors include, but are not limited to, a continued failure by an issuer to make scheduled interest payments, an increase in the severity of the unrealized loss on a particular security, an increase in the continuous duration of the unrealized loss without an improvement in value or changes in market conditions and/or industry or issuer specific factors that would render us unable to forecast a full recovery in value. In addition, the fair values of securities could decline if the overall economy and the financial condition of some of the issuers continue to deteriorate and there remains limited liquidity for these securities.

Future Changes In Interest Rates Could Impact Our Financial Condition And Results Of Operations.

Net income is the amount by which net interest income and non-interest income exceeds non-interest expense and the provision for loan losses. Net interest income makes up a majority of our income and is based on the difference between:

- interest income earned on interest-earning assets, such as loans and securities; and
- interest expense paid on interest-bearing liabilities, such as deposits and borrowings.

A substantial percentage of our interest-earning assets, such as residential and commercial mortgage loans, have longer maturities than our interest-bearing liabilities, which consist primarily of savings and demand accounts, certificates of deposit and borrowings. As a result, our net interest income is adversely affected if the average cost of our interest-bearing liabilities increases more rapidly than the average yield on our interest-earning assets.

The Federal Reserve Board maintained the federal funds rate at the historically low rate of 0.25% during fiscal 2010 and 2009. The federal funds rate has a direct correlation to general rates of interest, including our interest-bearing deposits. Our mix of asset and liabilities are considered to be sensitive to interest rate changes. In a low rate environment, we may be susceptible to the payoff or refinance of high rate mortgage loans that could reduce net interest income. On the other hand, if interest rates rise, net interest income could be reduced because interest paid on interest-bearing liabilities, including deposits and borrowings, increases more quickly than interest received on interest-earning assets, including loans and mortgage-backed and related securities. In addition, rising interest rates may negatively affect income because higher rates may reduce the demand for loans and the value of mortgage-related and investment securities.

We May Not Be Able To Continue To Support The Realization Of Our Deferred Tax Asset.

We calculate income taxes in accordance with ASC 740 Income Taxes (formerly Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes"), which requires the use of the asset and liability method. In accordance with ASC 740, we regularly assess available positive and negative evidence to determine whether it is more likely than not that our deferred tax asset balances will be recovered from reversals of deferred tax liabilities, potential utilization of net operating loss carrybacks, tax planning strategies and future taxable income. At December 31, 2010, our net deferred tax asset was $10.3 million, for which we have not established a valuation allowance. We recognized the deferred tax asset because management believes, based on detailed financial projections, that it is more likely than not, we will have sufficient future earnings to utilize this asset to offset future income tax liabilities. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires the future occurrence of circumstances that cannot be predicted with certainty. We cannot assure you that we will achieve sufficient future taxable income as the basis for the ultimate realization of our deferred tax asset and therefore we may have to establish a full or partial valuation allowance at some point in the future. If we determine that a valuation allowance is necessary, this would require us to incur a charge to operations that would adversely affect our capital position. At December 31, 2010, we had $10.3 million of allowable net deferred tax assets for regulatory capital purposes, which is the amount that is expected to be recovered based on a two-year net operating loss carryback and the next four quarters calculation. There is no assurance that we will be able to continue to recognize any, or all, of the deferred tax asset for regulatory capital purposes.

Our Ability To Service The Company's Debt And Pay Other Obligations Of The Company As They Come Due Is Substantially Dependent On Capital Distributions From The Banks. These Distributions Are Subject To Regulatory Limits And Other Restrictions, Including Directives From The FDIC Which Prohibit Distributions By The Banks Without Prior Regulatory Approval.

Carolina Financial is a bank holding company and relies upon dividends from the Banks to fund a significant portion of its operations. We use dividends from the Banks to service the Company's debt obligations (including our outstanding line of credit and our trust preferred securities), and to otherwise fund the Company's operations and to meet its obligations. The ability of the Banks to pay dividends or make other capital distributions to the Company is subject to the regulatory authority of the FDIC and the South Carolina Board. Because of restrictions set forth in the memorandums of understanding that the FDIC has imposed on the Banks, the Banks cannot pay dividends to the Company without prior regulatory approval. If the Banks are unable to pay dividends to the Company, the Company may not be able to service its debts as they come due and, in such event, our creditors may seek remedies against us that would adversely affect our business and the value of your shares of Common Stock.

Beginning with the scheduled payment date of December 31, 2010, the Company has deferred the payment of interest on its outstanding subordinated debentures for an indefinite period (which can be no longer than 20 consecutive quarterly periods). This and any future deferred distributions will continue to accrue interest. Distributions on the trust preferred securities are cumulative. Therefore, in accordance with generally accepted accounting principles, the Company will continue to accrue the monthly cost of the trust preferred securities as it has since issuance. The balance of deferred payments at December 31, 2010 is approximately $47,000. Subsequent to December 31, 2010, the Company deferred an additional $85,000 on its outstanding subordinated debentures.

The Dodd-Frank Wall Street Reform And Consumer Protection Act Could Increase Our Regulatory Compliance Burden And Associated Costs, Place Restrictions On Certain Products And Services, And Limit Our Future Capital Raising Strategies.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act will implement significant changes in the financial regulatory landscape and will impact all financial institutions, including the Company and the Banks. The Dodd-Frank Act will likely increase our regulatory compliance burden and may have a material adverse effect on us, including by increasing the costs associated with our regulatory examinations and compliance measures. However, it is too early for us to fully assess the impact of the Dodd-Frank Act and subsequent regulatory rulemaking processes on our business, financial condition or results of operations.

Among the Dodd-Frank Act's significant regulatory changes, the act will create a new financial consumer protection agency that could impose new regulations on us and include its examiners in our routine regulatory examinations conducted by the Federal Reserve Board of the FDIC, which could increase our regulatory compliance burden and costs and restrict the financial products and services we offer to our customers. The Dodd-Frank Act will increase regulatory supervision and examination of bank holding companies and their banking and non-banking subsidiaries, which could increase our regulatory compliance burden and costs and restrict our ability to generate revenues from non-banking operations. The Dodd-Frank Act will impose more stringent capital requirements on bank holding companies, which could limit our future capital strategies and could require us to engage in recapitalization transactions, the cost of which cannot be determined at this time. The Dodd-Frank Act will also increase regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate hedging transactions.

We May Be Required To Pay Significantly Higher FDIC Premiums Or Special Assessments That Could Adversely Affect Our Earnings.

Market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. As a result, we may be required to pay significantly higher premiums or additional special assessments that could adversely affect our earnings. In the second quarter of 2009, the FDIC implemented a special assessment that resulted in approximately $514,000 of additional expense during the quarter. It is possible that the FDIC may impose additional special assessments in the future as part of its restoration plan. In addition, on November 12, 2009, the FDIC adopted a rule requiring banks to prepay, on December 30, 2009, three years' worth of premiums to replenish the depleted insurance fund. As a result, the amount of our prepaid assessment was approximately $5.7 million. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there is additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases or required prepayments in FDIC insurance premiums may materially adversely affect our results of operations.

The Fiscal And Monetary Policy Of The Federal Government And Its Agencies Could Have A Material Adverse Effect On Our Earnings.

The Federal Reserve Board regulates the supply of money and credit in the United States. Its policies determine in large part the cost of funds for lending and investing and the return earned on those loans and investments, both of which affect the net interest margin. Its policies also can materially decrease the value of financial instruments that we hold, such as debt securities and mortgage servicing rights. Its policies also can adversely affect borrowers, potentially increasing the risk that they may fail to repay their loans. Further, our mortgage subsidiary's loan production volumes are significantly affected by changes in long-term interest rates. Changes in Federal Reserve Board policies are beyond our control and difficult to predict; consequently, the impact of these changes on our activities and results of operations is difficult to predict.

Our Funding Sources May Prove Insufficient To Replace Deposits And Support Future Growth.

We rely on customer deposits, including brokered deposits, advances from the Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB"), and other borrowings to fund operations. Although the Company has historically been able to replace maturing deposits and advances, if desired, no assurance can be given that we would be able to replace such funds in the future if the financial condition of the FHLB or programs sponsored by the FRB, regulatory restrictions on brokered deposits or regulatory restrictions on the pricing of local deposits or other market conditions were to change. In addition, certain borrowing sources are on a secured basis. Over the last two years, the FHLB has become more restrictive on the types of collateral it will accept and the amount of borrowings allowed on acceptable collateral. Due to changes applied by

rating agencies on bonds, changes in collateral requirements or deteriorating loan quality, outstanding borrowings could be required to be repaid, incurring prepayment penalties. Our financial flexibility will be severely constrained if we are unable to maintain access to funding at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future operations, our revenues may not increase proportionally to cover these costs. Since December 31, 2008, we have decreased our reliance on wholesale funding sources such as brokered deposits and FHLB advances, and placed greater focus on increasing our core transaction accounts.

In addition, the Company's mortgage company funds mortgage loans held for sale through warehouse lines of credit and purchase and sale agreements. Due to recent economic conditions, sources of warehouse lending have decreased and could affect Crescent Mortgage's ability to fund loans held for sale.

The Company Is Subject To Liquidity Risk.

The inability of the Company to raise funds through deposits, including brokered deposits, borrowings, sale of securities or other sources could have a substantial negative impact on the Company's liquidity. Factors that could detrimentally impact the Company's access to liquidity include a decrease in the level of the Company's business activity or adverse regulatory action against the Company. The Company's ability to borrow could be impaired by such factors as a disruption in the financial markets or negative views and expectations of the prospects for the financial services industry. Although the Company's current sources of funds are considered adequate for its current liquidity needs, there can be no assurance in this regard for the future. If additional debt is needed in the future, there can be no assurance that such debt would be available or, if available, would be on favorable terms. The ability of the Company to raise capital or borrow in the debt markets has been negatively affected by recent economic conditions. If additional financing sources are unavailable or not available on reasonable terms, the Company's financial condition, results of operations and future prospects could be adversely affected.

We May Elect Or Be Compelled To Seek Additional Capital In The Future, But That Capital May Not Be Available When It Is Needed.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. Should we elect or be required by regulatory authorities to raise additional capital, we may seek to do so through the issuance of, among other things, our common or preferred stock. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside of our control, and our financial performance. Accordingly, there is no assurance that we will have the ability to raise additional capital if needed or on terms acceptable to us. Failure to be able to raise additional capital could result in the Company not meeting our regulatory capital standards.

If Our Investment In The Federal Home Loan Bank Of Atlanta Were Impaired In The Future, Our Earnings And Stockholders' Equity Would Decrease.

We own common stock of the Federal Home Loan Bank of Atlanta. We hold this stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank's advance program. There is no market for our Federal Home Loan Bank of Atlanta common stock. Recent published reports indicate that certain member banks of the Federal Home Loan Bank System may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the Federal Home Loan Bank of Atlanta, could be substantially diminished. Consequently, there is a risk that our investment in Federal Home Loan Bank of Atlanta common stock could be impaired at some time in the future. If this occurs, it would cause our earnings and stockholders' equity to decrease.

The Company Is Subject To Extensive Governmental Regulation, Which Could Have An Adverse Impact On Our Operations.

The banking and mortgage banking industry is extensively regulated and supervised under both federal and state law. The Company is subject to the regulation and supervision of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Company, and the South Carolina Board of Financial Institutions as well as a number of states where our mortgage subsidiary originates or purchases loans. These regulations are intended primarily to protect depositors, the public and the FDIC insurance fund, and not our shareholders. These regulations govern matters ranging from the maintenance of

adequate capital to the general business operations and financial condition of the Company. Any changes in any federal and state law, as well as regulations and governmental policies, income tax laws and accounting principles, could affect the Company in substantial and unpredictable ways, including ways that could adversely affect its business, financial condition or results of operations.

Our Operating Results In Fiscal 2010 and 2009 Have Been Highly Dependent Upon The Results Of Our Mortgage Subsidiary.

There are a number of items that could adversely affect the volumes and margin of the Company's mortgage banking operations. These include, but are not limited to, the Federal Reserve's monetary policy including its quantitative easing program, aggressively low rates, reduction in prices paid by the mortgage banking aggregators, aggressive competition, the housing market recovery, the status and financial condition of Fannie Mae and Freddie Mac, potential changes in Fannie Mae and Freddie Mac lending guidelines and programs, proposed changes in the FHA lending requirements, extensive regulatory changes and liquidity. Should these factors significantly impact production of mortgages, it is likely that the Company's earnings would be adversely affected.

Our Mortgage Subsidiary's Operations Are Subject To Significant Repurchase Risk.

Our mortgage subsidiary is exposed to significant repurchase risk on mortgage loan production related to potential reimbursements for loans sold to third parties for borrower fraud, underwriting and documentation issues, early defaults and prepayments of sold loans. If the Company experiences significant losses related to repurchase risk, it is possible that the reserve established for such exposure is not adequate. The Company continues to receive repurchase requests. The Company evaluates each request and provides estimated reserves as necessary. We believe that the reserve related to repurchase risk is adequate to absorb probable losses; however, we cannot predict these losses or whether our reserve will be adequate. Any of these occurrences could materially and adversely affect our business, financial condition and profitability.

The Value Of Our Loan Servicing Portfolio May Become Impaired In The Future.

As of December 31, 2010, our mortgage subsidiary serviced approximately $877.1 million of loans. At that date, our mortgage loan servicing rights were recorded as an asset with a carrying value of approximately $5.2 million. We expect that our loan servicing portfolio will increase in the future. If interest rates decline and the actual and expected mortgage loan prepayment rates increase, the Company could incur an impairment of its mortgage loan servicing asset.

Hurricanes And Other Natural Disasters May Adversely Affect Loan Portfolios And Operations And Increase The Cost Of Doing Business.

The Company operates in markets that are susceptible to natural disasters. Large-scale natural disasters may significantly affect loan portfolios by damaging properties pledged as collateral, affecting the economies our borrowers live in, and by impairing the ability of the borrower to repay their loans.

Overview

Carolina Financial Corporation, a bank holding company, is a Delaware corporation that was incorporated in 1996 and began operations in 1997. We operate principally through Community FirstBank of Charleston and Crescent Bank, both South Carolina state-chartered banks. Our assets are approximately $930.7 million at December 31, 2010 and $1.1 billion at December 31, 2009.

Our subsidiaries provide a full range of financial services designed to meet the financial needs of our customers, including:

- Commercial and retail banking
- Mortgage banking
- Cash management, and
- Retail investment services and asset management.

Carolina Financial, through Community FirstBank and Crescent Bank, currently conducts business through 10 bank branches located in the following counties: Charleston (4), Dorchester (2), and Horry (4) in South Carolina. Effective July 27, 2009, Carolina Financial Corporation contributed 100% of its wholly-owned mortgage subsidiary Crescent Mortgage Company ("Crescent Mortgage") to Community FirstBank. Crescent Mortgage is located in Dekalb County, Georgia, and is qualified to originate loans in 43 states.

Comparison of Operating Results for the Years Ended December 31, 2010 and 2009

Net Income (Loss). Net income decreased $19.8 million, or 275.6%, to a net loss of $12.6 million, or $(6.58) diluted earnings per share, during the year ended December 31, 2010 compared to net income of $7.2 million, or $3.72 diluted earnings per share, during the year ended December 31, 2009. The decrease in net income to a net loss primarily resulted from a decrease in net interest income of $1.9 million and an increase in provision for loan losses of $20.3 million to $30.8 million during the year ended December 31, 2010 compared to $10.5 million during the year ended December 31, 2009. In addition, noninterest income decreased by $6.3 million to $21.6 million during the year ended December 31, 2010 compared to $27.9 million during the year ended December 31, 2009. Noninterest expense increased by $1.4 million to $39.1 million during the year ended December 31, 2010 compared to $37.7 million during the year ended December 31, 2009. Income taxes reflected a benefit of $5.9 million during fiscal 2010 related to a pre-tax loss of $18.5 million compared to income tax expense of $4.4 million on pre-tax income of $11.5 million during fiscal 2009.

Net Interest Income. Net interest income decreased $1.9 million, or 6.2%, to $29.8 million during the year ended December 31, 2010 from $31.7 million during the year ended December 31, 2009.

Average interest-earning assets decreased $94.4 million to $959.5 million during the year ended December 31, 2010 as compared to $1.0 billion during the year ended December 31, 2009 with a corresponding decrease in average yield of 50 basis points during that same period. The reduction is primarily the result of nonperforming assets and a decision by management to shrink the balance sheet to preserve capital. During that same period, interest-bearing liabilities also decreased $100.3 million to $909.6 million with a corresponding decrease in the average interest rate paid of 60 basis points. The reduction in average interest-bearing liabilities was primarily the result of the Company shrinking its balance sheet to preserve capital. The reduction in the average interest rate paid was due primarily to the re-pricing of liabilities in a falling rate environment during the period. The overall change in interest-earning assets and interest-bearing liabilities with their corresponding changes in interest yields earned and interest rates paid resulted in an increase in the net interest margin during the period of 9 basis points. During the year ended December 31, 2010, the Company also focused on increasing checking and money market deposits and reducing brokered deposits and higher-rate certificates of deposits.

Total interest income decreased $9.9 million, or 17.4%, to $46.8 million during the year ended December 31, 2010 from $56.7 million during the year ended December 31, 2009. Average loans receivable, net decreased $96.8 million, or 13.1%, to $640.6 million during the year ended December 31, 2010 from $737.4 million during the comparable period in 2009. The average yield earned on loans receivable, net decreased to 5.42% from 5.60% during the years ended December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, approximately 60% and 65%, respectively, of the loan portfolio consisted of adjustable rate loans and 40% and 35%, respectively, are fixed rate loans. Additionally, the Company's net interest income was adversely affected by the increase in the average balance of nonaccrual loans that increased to $35.3 million during the year ended December 31, 2010 from $22.4 million during the year ended December 31, 2009. Lost interest, interest not recorded in the accompanying consolidated statements of operations related to loans on nonaccrual, loans charged off during the period, and loans transferred to real estate acquired through foreclosure, totaled approximately $3.2 million and $1.6 million for the year ended December 31, 2010 and 2009, respectively. The average balance of securities available for sale increased $1.3 million, or 1.3%, to $106.6 million during 2010 from $105.3 million during 2009. The yield earned on securities available for sale decreased to 3.76% from 5.16% during the year ended December 31, 2010 and 2009, respectively. During the year ended December 31, 2009, the Company transferred approximately $30.6 million of securities available-for-sale to securities held-to-maturity. No securities were transferred from available-for-sale to held-to-maturity during the year ended December 31, 2010. During 2010, the Company transferred 30 mortgage-backed securities held-to-maturity totaling $91.5 million to securities available-for-sale and subsequently sold 16 of these securities totaling $63.9 million. The Company received $59.4 million of gross proceeds related to the sale of these securities and recognized gross gains of $157,000 and gross losses of $4.6 million. The Company's original intent was to hold these securities to maturity. However, these securities experienced significant deterioration in the issuer's creditworthiness. In addition, due to credit rating agency downgrades in these securities, the risk weights used for regulatory risk-based capital purposes increased. Accordingly, the Company changed its intent to hold these securities to maturity. Management believes that these held-to-

maturity securities were sold under exceptions "a." and "d." of ASC 320-10-25-6. As a result, the sale of these securities is not considered inconsistent with the original intent and classification and, therefore, does not taint the remaining securities held-to-maturity portfolio. The average balance of securities held-to-maturity decreased $26.1 million, or 19.8%, to $105.7 million during the year ended December 31, 2010 from $131.8 million during the comparable period in 2009. The average yield earned on securities held-to-maturity decreased to 5.05% from 5.57% during the years ended December 31, 2010 and 2009, respectively.

Total interest expense decreased $7.9 million, or 31.7%, to $17.1 million during the year ended December 31, 2010 from $25.0 million during the year ended December 31, 2009. Average interest-bearing liabilities decreased $100.3 million, or 9.9%, to $909.6 million during the year ended December 31, 2010 from $1.0 billion during the comparable period in 2009. Average money market balances increased $55.4 million, or 45.9%, to $176.0 million during the year ended December 31, 2010 from $120.6 million during the comparable period in 2009. In addition, the average interest rate paid on money markets during the year ended December 31, 2010 decreased to 1.30% compared to 1.55% during the comparable period in 2009. Average certificates of deposit balances decreased $92.2 million, or 16.0%, to $485.1 million during the year ended December 31, 2010 from $577.4 million during the comparable period in 2009. In addition, the average interest rate paid on certificates of deposit during the year ended December 31, 2010 decreased to 1.94% compared to 2.73% during the comparable period in 2009. Average short-term borrowing balances decreased $44.8 million, or 66.4%, to $22.7 million during the year ended December 31, 2010 from $67.5 million during the comparable period in 2009. The average rate paid during the year ended December 31, 2010 on these borrowings was 3.12% compared to 2.02% during the comparable period in 2009. Average long-term borrowing balances decreased $27.1 million, or 12.6%, to $188.5 million during the year ended December 31, 2010 from $215.6 million during the comparable period in 2009. The average rate paid during the year ended December 31, 2010 on these borrowings was 2.40% compared to 2.73% during the comparable period in 2009.

Provision for Loan Losses. The provision for loan losses increased $20.3 million to $30.8 million during the year ended December 31, 2010 compared to $10.5 million during the year ended December 31, 2009. The Company had net charge-offs of $29.5 million or 4.61% of average loans receivable, net during the year ended December 31, 2010 compared to net charge-offs of $8.7 million or 1.18% of average loans receivable, net during the comparable period in 2009. The allowance for loan losses was 2.38% of net loans receivable, or $14.3 million at December 31, 2010, an increase of $1.3 million from the allowance for loan losses of $13.0 million or 1.85% of the loans receivable, at December 31, 2009. The 53 basis point increase in the allowance for loan losses as a percentage of loans receivable, net is primarily due to the increase in non-performing loans to gross loans receivable to 9.60% at December 31, 2010 from 3.96% at December 31, 2009. An additional cause of the increase is continued review of the risk factors related to the underlying loan portfolio, including increased delinquencies of construction mortgages, internal loan level risk rating changes, and slowing external economic conditions in the residential real estate market.

Noninterest Income. Total noninterest income decreased $6.3 million, or 22.7%, to $21.6 million during the year ended December 31, 2010 from $27.9 million during the comparable period in 2009. This decrease is primarily attributable to other-than-temporary impairment of $2.5 million, an increase in the loss on sale of securities of $2.9 million, and an increase in the loss on extinguishment of debt of $1.8 million.

During the year ended December 31, 2010, the Company had held-to-maturity bonds that experienced other-than-temporary impairment. Other-than-temporary impairment expense reflected in the accompanying income statement totaled $2.5 million. There was no other-than-temporary impairment during the year ended December 31, 2009.

Net loss on sale of securities during the year ended December 31, 2010 totaled $2.0 million compared to a net gain on sale of securities of $963,000 during the comparable period in 2009. The increase in the loss on sale of securities during the year ended December 31, 2010 was due to management's decision to reduce criticized assets, while taking advantage of improved market prices on certain securities.

In connection with the Company's balance sheet management to preserve capital, certain borrowings were prepaid to manage the related interest rate sensitivity, resulting in a net loss on the extinguishment of debt of $2.5 million and $711,000 during 2010 and 2009, respectively

Noninterest Expense. Total noninterest expense increased $1.4 million, or 3.7%, to $39.1 million during the year ended December 31, 2010 from $37.7 million during the comparable period in 2009. This increase is primarily attributable to an increase in other expenses related to legal and other loan collection activities.

Income Tax Expense. Income tax expense decreased $10.2 million to a tax benefit of $5.9 million during the year ended December 31, 2010 from income tax expense of $4.4 million during the comparable period in 2009. The Company's effective tax (benefit) rate was (31.8)% and 37.8% during the years ended December 31, 2010 and 2009, respectively.

Comparison of Operating Results for the Years Ended December 31, 2009 and 2008

Net Income. Net income increased $1.6 million, or 29.2%, to $7.2 million, or $3.72 diluted earnings per share, during 2009 compared to $5.6 million, or $2.83 diluted earnings per share, during 2008. The net increase in net income primarily resulted from increases in net interest income of $1.9 million to $31.7 million during 2009 compared to $29.8 million during 2008 offset by an increase in provision for loan losses of $4.1 million to $10.5 million during 2009 compared to $6.4 million during 2008. Noninterest income increased by $18.7 million to $27.9 million during 2009 compared to $9.2 million during 2008. There was also an increase in noninterest expense of $13.8 million to $37.7 million during 2009 compared to $23.9 million during 2008. Income tax expense increased $1.1 million in 2009 over 2008.

Net Interest Income. Net interest income increased $1.9 million, or 6.3%, to $31.7 million during 2009 from $29.8 million during 2008. This increase is primarily the result of an increase in the Company's net interest margin to 3.05% in 2009 from 2.86% in 2008, an improvement of 19 basis points.

The improvement in net interest margin during fiscal 2009 over fiscal 2008 is primarily the result of the mix of interest-bearing liabilities to lower-rate liabilities and the re-pricing of higher-rate liabilities, net of the reduction in yield earned on interest-earning assets. The rate paid on interest-bearing liabilities in 2009 was 2.51% as compared to 3.36% in 2008, a reduction of 85 basis points. During fiscal 2009, the Company focused on increasing checking and money market deposits and reducing brokered deposits and higher-rate certificates of deposits. The yield earned on interest-earning assets in 2009 was 5.46% as compared to 6.04% in 2008, a reduction of 58 basis points. Fiscal 2008 experienced a falling rate environment as evidenced by the reduction in the prime rate. During fiscal 2008 the prime rate dropped from 7.25% at the beginning of the year to 3.25% by December 31, 2008. During fiscal 2009, the prime rate remained at 3.25% all year. Accordingly, yields earned on interest-bearing assets and rates paid on interest-bearing liabilities that are tied to the prime rate or other variable index, reflected a reduction in the interest rates.
Total interest income decreased $6.3 million, or 10.0%, to $56.7 million during 2009 from $63.0 million during 2008. Average loans receivable, net decreased $36.7 million, or 4.7 %, to $737.4 million during 2009 from $774.2 million during 2008. The yield earned on loans receivable, net decreased to 5.60% from 6.21% during 2009 and 2008, respectively. At December 31, 2009 and 2008, approximately 65% and 70%, respectively, of the loan portfolio consisted of adjustable rate loans and 35% and 30%, respectively, are fixed rate loans. Additionally, the Company's net interest income was adversely affected by the Company's nonaccrual loans that increased to $27.1 million at the end of 2009 from $13.9 million at the end of 2008. Lost interest, interest not recorded in the accompanying consolidated statements of operations related to loans on nonaccrual, loans charged off during the period, and loans transferred to real estate acquired through foreclosure, totaled approximately $1.6 million and $1.2 for fiscal 2009 and 2008, respectively. The average balance of securities available for sale decreased $88.4 million, or 45.6%, to $105.3 million during 2009 from $193.6 million during 2008. The yield earned on securities available for sale decreased to 5.16% from 5.76% during 2009 and 2008, respectively. During 2009 and 2008, the Company transferred approximately $30.6 million and $112.3 million, respectively, of securities available for sale to securities held to maturity. The average balance of securities held to maturity increased $107.8 million, or 449.2%, to $131.8 million during 2009 from $24.0 million during 2008. The yield earned on securities held to maturity decreased to 5.57% from 6.31% during 2009 and 2008, respectively.

Total interest expense decreased $8.2 million, or 24.7%, to $25.0 million during 2009 from $33.2 million during 2008. Average interest-bearing liabilities increased $8.6 million, or 0.9%, to $996.6 million during 2009 from $988.1 million during 2008. Average money market balances increased $22.1 million, or 22.5%, to $120.6 million during 2009 from $98.4 million during 2008. In addition, the effective rate paid on money markets during 2009 was 1.55% compared to 1.90% during 2008. Average short-term borrowings decreased $22.2 million, or 29.1%, to $54.2 million during 2009 from $76.4 million during 2008. The effective rate paid during 2009 on these borrowings was 2.51% compared to 2.61% during 2008. Average long-term borrowings increased $9.5 million, or 4.6%, to $215.6 million during 2009 from $206.2 million during 2008. The effective rate paid during 2009 on these borrowings was 2.73% compared to 3.49% during 2008.

Provision for Loan Losses. The provision for loan losses increased $4.1 million to $10.5 million during 2009 compared to $6.4 million during 2008. The Company had net charge-offs of $8.7 million or 1.28% of average loans receivable, net during 2009 compared to net charge-offs of $5.1 million or 0.66% of average loans receivable, net during 2008. The allowance for

loan losses was 1.85% of net loans receivable, or $13.0 million at December 31, 2009, an increase of $1.7 million from the allowance for loan losses of $11.3 million or 1.44% of the loans receivable, at December 31, 2008. The 41 basis point increase in the allowance for loan losses as a percentage of loans receivable, net is primarily due to the increase in non-performing assets to loans receivable, net to 5.17% at December 31, 2009 from 2.71% at December 31, 2008. An additional cause of the increase is continued review of the risk factors related to the underlying loan portfolio, including increased delinquencies of construction mortgages, internal loan level risk rating changes, and slowing external economic conditions in the residential real estate market.

Noninterest Income. Total noninterest income increased $18.7 million, or 202.8%, to $27.9 million during 2009 from $9.2 million during 2008. This increase is primarily attributable to an increase in net gain on sale of loans of $19.4 million, net of a reduction in the gain on derivatives of $728,000 and an increase in the loss on extinguishment of debt of $659,000.

Net gain on sale of loans held for sale increased $19.4 million, or 423.7%, to $24.0 million during 2009 compared to $4.6 million during 2008. The increase in net gain on sale of loans held for sale is due to increased volume and margin. Loans held for sale originations increased to $1.7 billion during 2009 compared to $712.8 million during 2008. Margin on loan sales, which includes the gain on sale of loans, net fee income and the change in market value of the pipeline, was 129.6 basis points during 2009 compared to 64.1 basis points during 2008.

Net gain on derivatives in 2009 totaled $411,000 compared to $1.1 million during 2008. The decrease in the derivative fair values during the year ended December 31, 2009 was due to unfavorable movement in mortgage interest rates at year-end resulting in a decrease in the derivative values.

The Company incurred losses on extinguishment of debt totaling $711,000 and $52,000 in 2009 and 2008, respectively on the prepayment of certain debt advances with interest rates higher than market at the time of the prepayment.

Noninterest Expense. Total noninterest expense increased $13.8 million, or 57.7%, to $37.7 million during 2009 from $23.9 million during 2008. This increase is primarily attributable to increases in salaries and employee benefits expense, other real estate expense, mortgage loan repurchase losses, FDIC insurance and other expenses.
Salaries and employee benefits expense increased a net $5.7 million, or 39.2%, to $20.2 million during 2009 from $14.5 million during 2008. The increase in compensation and benefits in 2009 of $4.8 million over 2008 primarily relates to an increase in the number of employees at the mortgage company and the related incentives earned during 2009.

Other real estate expense increased $1.8 million during 2009 related to write-downs of other real estate and the additional expenses of managing other real estate.

Mortgage loan repurchase losses increased $3.1 million during 2009 as the Company provided for exposure on mortgage loan production related to potential reimbursements for loans sold to third parties for borrower fraud, underwriting and documentation issues, early defaults and prepayments of sold loans.

FDIC insurance expense increased $1.6 million, or 256.7%, to $2.2 million during 2009 from $617,000 during 2008 primarily due to higher insurance rates and the FDIC special assessment of $514,000 in the second quarter of 2009.

Other expense increased $1.2 million, or 27.0%, to $5.8 million during 2009 from $4.5 million during 2008 primarily related to the increased loan volumes at the mortgage company. There were no other individually significant changes.

Income Tax Expense. Income tax expense increased $1.1 million to $4.4 million during 2009 from $3.3 million during 2008. The increase was due to an increase in income before income taxes in 2009. The Company's effective tax rate was 37.8% and 37.0% during 2009 and 2008, respectively.

Yields on Average Interest-Earning Assets and Rates on Average Interest-Bearing Liabilities

The following table summarizes the Company's yields on average interest-earning assets and rates on average interest-bearing liabilities during the periods indicated:

	For The Years Ended December 31,								
	2010			2009			2008		
	Average Balance	**Interest Paid/ Earned**	**Average Yield/ Rate**	Average Balance	Interest Paid/ Earned	Average Yield/ Rate	Average Balance	Interest Paid/ Earned	Average Yield/ Rate
	(Dollars in thousands)								
Interest-earning assets:									
Loans held for sale	**$ 56,855**	**2,647**	**4.66%**	49,294	2,567	5.21%	22,973	1,401	6.10%
Loans receivable, net (1)	**640,646**	**34,720**	**5.42%**	737,448	41,325	5.60%	774,183	48,115	6.21%
Interest-bearing cash	**37,212**	**70**	**0.19%**	17,522	19	0.11%	16,412	407	2.48%
Securities available for sale	**106,598**	**4,013**	**3.76%**	105,265	5,427	5.16%	193,616	11,146	5.76%
Securities held to maturity	**105,658**	**5,334**	**5.05%**	131,760	7,341	5.57%	23,991	1,514	6.31%
Federal Home Loan Bank stock	**12,029**	**42**	**0.35%**	12,153	39	0.32%	11,474	403	3.51%
Other investments	**465**	**16**	**3.44%**	465	18	3.87%	802	63	7.86%
Total interest-earning assets	**959,463**	**46,842**	**4.88%**	1,053,907	56,736	5.38%	1,043,451	63,049	6.04%
Non-earning assets	**58,667**			60,225			47,336		
Total assets	**$ 1,018,130**			1,114,132			1,090,787		
Interest-bearing liabilities:									
Demand accounts	**34,160**	**138**	**0.40%**	26,231	123	0.47%	24,726	166	0.67%
Money market accounts	**175,966**	**2,285**	**1.30%**	120,573	1,864	1.55%	98,448	1,873	1.90%
Savings accounts	**3,130**	**19**	**0.61%**	2,643	16	0.61%	2,029	14	0.69%
Certificates of deposit	**485,126**	**9,408**	**1.94%**	577,364	15,778	2.73%	580,264	21,983	3.79%
Short-term borrowed funds	**22,720**	**708**	**3.12%**	67,532	1,361	2.02%	76,455	1,998	2.61%
Long-term debt	**188,541**	**4,519**	**2.40%**	215,626	5,877	2.73%	206,170	7,193	3.49%
Total interest-bearing liabilities	**909,643**	**17,077**	**1.88%**	1,009,969	25,019	2.48%	988,092	33,227	3.36%
Noninterest-bearing deposits	**44,027**			41,003			44,643		
Other liabilities	**14,395**			11,211			10,500		
Stockholders' equity	**50,065**			51,949			47,552		
Total liabilities and Stockholders' equity	**$ 1,018,130**			1,114,132			1,090,787		
Net interest spread			**3.00%**			2.90%			2.68%
Net interest margin	**3.10%**			3.01%			2.86%		
Net interest income		**29,765**			31,717			29,822	

(1) Average balances of loans include non-accrual loans.

Analysis of Changes in Net Interest Income

The following table shows changes in interest income and interest expense based upon changes in volume and changes in interest rates during the periods indicated:

	For The Years Ended December 31,							
	2010 vs. 2009				2009 vs. 2008			
	Increase (decrease) due to		**Rate/**	**Net Dollar**	Increase (decrease) due to		Rate/	Net Dollar
	Volume	**Rate**	**Volume**	**Change**	Volume	Rate	Volume	Change
	(In thousands)							
Loans held for sale	**$ 393**	**(271)**	**(42)**	**80**	1,604	(204)	(234)	1,166
Loans receivable, net	**(5,452)**	**(1,327)**	**174**	**(6,605)**	(2,283)	(4,732)	225	(6,790)
Interest-bearing cash	**21**	**14**	**16**	**51**	28	(390)	(26)	(388)
Securities available for sale	**69**	**(1,464)**	**(19)**	**(1,414)**	(5,086)	(1,164)	531	(5,719)
Securities held to maturity	**(1,458)**	**(685)**	**136**	**(2,007)**	6,801	(177)	(797)	5,827
FHLB stock	**-**	**3**	**-**	**3**	24	(366)	(22)	(364)
Other investments	**-**	**(2)**	**-**	**(2)**	(26)	(32)	13	(45)
Interest income	**(6,427)**	**(3,732)**	**265**	**(9,894)**	1,062	(7,065)	(310)	(6,313)
Demand accounts	**39**	**(18)**	**(6)**	**15**	10	(50)	(3)	(43)
Money market accounts	**860**	**(301)**	**(138)**	**421**	421	(351)	(79)	(9)
Savings accounts	**3**	**-**	**-**	**3**	4	(2)	-	2
Certificates of deposit	**(2,518)**	**(4,581)**	**729**	**(6,370)**	(110)	(6,126)	31	(6,205)
Short-term borrowed funds	**(903)**	**743**	**(493)**	**(653)**	(233)	(457)	53	(637)
Long-term debt	**(735)**	**(712)**	**89**	**(1,358)**	330	(1,574)	(72)	(1,316)
Interest expense	**(3,254)**	**(4,869)**	**181**	**(7,942)**	422	(8,560)	(70)	(8,208)
Net interest income	**$ (3,173)**	**1,137**	**84**	**(1,952)**	640	1,495	(240)	1,895

Loans by Type

The following table summarizes loans by type and percent of total at the end of the periods indicated:

	At December 31,			
	2010		2009	
	Amount	**% of Total Loans**	Amount	% of Total Loans
	(Dollars in thousands)			
Real estate loans:				
One-to-four family	**$ 138,482**	**22.39%**	165,054	22.71%
Home equity	**38,798**	**6.28%**	50,891	7.00%
Commercial real estate	**276,199**	**44.67%**	296,330	40.77%
Construction and development	**102,195**	**16.53%**	146,736	20.19%
Consumer loans	**6,225**	**1.01%**	8,455	1.16%
Commercial business loans	**56,362**	**9.12%**	59,417	8.17%
Total gross loans receivable	**618,261**	**100.00%**	726,883	100.00%
Less:				
Undisbursed loans in process	**19,708**		23,230	
Allowance for loan losses	**14,263**		13,032	
Deferred fees, net	**295**		458	
Total loans receivable, net	**$ 583,995**		690,163	

Non-Performing and Problem Assets

The following table summarizes non-performing and problem assets at the end of the periods indicated.

	At December 31,	
	2010	2009
	(In thousands)	
Non-Performing Assets:		
Nonaccrual loans-renegotiated loans	$ **34,829**	3,505
Nonaccrual loans-other	**22,552**	23,554
Accruing loans 90 days or more delinquent	**48**	771
Real estate acquired through foreclosure, net	**10,816**	7,853
Total Non-Performing Assets	$ **68,245**	35,683
Problem Assets not included in Non-Performing Assets-		
Accruing renegotiated loans outstanding less than one year	$ **16,344**	5,269

Substantially all of the nonaccrual loans, accruing loans 90 days or more delinquent and accruing renegotiated loans for fiscal 2010 and 2009 are collateralized by real estate. Management believes based on information known and available currently, the probable losses related to problem assets are adequately reserved in the allowance for loan losses.

Market Risk Management and Interest Rate Risk

The effective management of market risk is essential to achieving the Company's objectives. As a financial institution, the Company's most significant market risk exposure is interest rate risk. The primary objective of managing interest rate risk is to minimize the effect that changes in interest rates have on net income. This is accomplished through active asset and liability management, which requires the strategic pricing of asset and liability accounts and management of appropriate maturity mixes of assets and liabilities. The expected result of these strategies is the development of appropriate maturity and re-pricing opportunities in those accounts to produce consistent net income during periods of changing interest rates. The Banks' Asset/Liability Management Committees ("ALCO") monitor loan, investment and liability portfolios to ensure comprehensive management of interest rate risk. These portfolios are analyzed for proper fixed-rate and variable-rate mixes under various interest rate scenarios. The asset/liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities or re-pricing opportunities of interest-earning assets, deposits and borrowed funds. It is the responsibility of the ALCO to determine and achieve the most appropriate volume and mix of interest-earning assets and interest-bearing liabilities, as well as ensure an adequate level of liquidity and capital, within the context of corporate performance goals. The ALCO also set policy guidelines and establishes long-term strategies with respect to interest rate risk exposure and liquidity. The ALCO meet regularly to review the Company's interest rate risk and liquidity positions in relation to present and prospective market and business conditions, and adopt funding and balance sheet management strategies that are intended to ensure that the potential impact on earnings and liquidity as a result of fluctuations in interest rates is within acceptable standards.

The Company uses interest rate sensitivity analysis to measure the sensitivity of projected net interest income to changes in interest rates. Management monitors the Company's interest sensitivity by means of a computer model that incorporates current volumes, average rates earned and paid, and scheduled maturities, payments of asset and liability portfolios, together with multiple scenarios of prepayments, repricing opportunities and anticipated volume growth. Interest rate sensitivity analysis shows the effect that the indicated changes in interest rates would have on net interest income as projected for the next twelve months under the current interest rate environment. The resulting change in net interest income reflects the level of sensitivity that net interest income has in relation to changing interest rates.

The following table summarizes the Company's interest rate sensitivity position at the Banks as of December 31, 2010:

Interest Rate Scenario		Annualized Hypothetical Percentage Change in
Change	Prime Rate	Net Interest Income
0.00%	3.25%	0.00%
1.00%	4.25%	0.20%
2.00%	5.25%	0.90%
3.00%	6.25%	6.25%

The Company also uses derivatives intended to reduce interest rate risk incurred as a result of market movements. These derivatives primarily consist of mortgage loan interest rate lock commitments, mortgage loan forward sales commitments and options to deliver mortgage-backed securities. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. The Company uses derivatives primarily to minimize interest rate risk related to its pipeline of loan interest rate lock commitments issued on residential mortgage loans in the process of origination for sale or loans held for sale. Mortgage loan forward sales commitments and options to deliver mortgage-backed securities that generally correspond with the composition of the locked pipeline are used to economically hedge a percentage of the Company's locked pipeline. The Mortgage Company's Asset/Liability Committee has developed a comprehensive hedging policy to monitor the use of derivatives to reduce interest rate risk. The Company's derivative positions are classified as trading assets and liabilities, and as such, the changes in the fair market value of the derivative positions are recognized in the consolidated statement of operations.

The derivative positions of the Company at December 31, 2010 and 2009 are as follows:

	At December 31,			
	2010		2009	
	Fair Value	**Notional Value**	Fair Value	Notional Value
	(In thousands)			
Derivative assets:				
Mortgage loan interest rate lock commitments	**$ 449**	**197,075**	-	-
Mortgage loan forward sales commitments	**-**	**-**	428	46,588
Mortgage-backed securities forward sales commitments	**1,776**	**175,000**	1,914	130,000
	$ 2,225	**372,075**	2,342	176,588
Derivative liabilities:				
Mortgage loan interest rate lock commitments	**-**	**-**	891	177,282
Mortgage loan forward sales commitments	**173**	**22,842**	-	-
	$ 173	**22,842**	891	177,282

Liquidity and Financial Condition

The Company's assets and liabilities are monitored on a daily basis to ensure funds are available to meet liquidity requirements. The Company also utilizes borrowing facilities in order to maintain adequate liquidity including: the Federal Home Loan Bank of Atlanta ("FHLB") advance window, the Federal Reserve Bank ("FRB"), federal funds purchased, and warehouse lines of credit. Periodically, the Company will use wholesale deposit products, including brokered deposits as well as national certificate of deposit services. Additionally, the Company has certain investment securities classified as available for sale that are carried at market value with changes in market value, net of tax, recorded through stockholders' equity.

Lines of credit with the Federal Home Loan Bank of Atlanta are based upon FHLB-approved percentages of Bank assets, but must be supported by appropriate collateral to be available. At December 31, 2010 and December 31, 2009, the Banks have pledged first lien residential mortgage, second lien residential mortgage, residential home equity line of credit, commercial mortgage and multifamily mortgage portfolios under blanket lien agreements resulting in approximately $160.0 million and

$177.8 million, respectively, of collateral for these advances. In addition, at December 31, 2010 and December 31, 2009, the Company has pledged $58.6 million and $59.8 million, respectively, of securities for these advances. At December 31, 2010 and December 31, 2009, the Banks had maximum FHLB lines of $290.6 million and $339.1 million, respectively, based on FHLB limits. At December 31, 2010 and December 31, 2009, collateral totaling $218.6 million and $237.6 million, respectively, was pledged to support FHLB advances. At December 31, 2010 and December 31, 2009 the Banks had FHLB advances of $125.5 million and $176.5 million, respectively, outstanding with excess collateral pledged to the FHLB during those periods that would support additional borrowings of approximately $93.1 million and $61.1 million, respectively.

Lines of credit with the FRB are based on collateral pledged. The Banks have pledged certain non-mortgage commercial and consumer, acquisition and development, and lot loan portfolios under blanket lien agreements as collateral to the FRB for these advances. At December 31, 2010 and December 31, 2009 the Banks had lines available with the FRB for $34.0 million and $71.6 million, respectively. At December 31, 2010 and December 31, 2009 the Banks had no FRB advances outstanding.

At December 31, 2010 and December 31, 2009, Crescent Mortgage had a mortgage loan warehouse line of credit from a correspondent with a $35.0 million credit limit, of which $31.0 million and $15.9 million, respectively, is still available. The facility is secured by Crescent Mortgage's residential mortgage loans held for sale and other assets.

Effective October 1, 2009, the Company modified a $5.0 million unsecured line of credit with a correspondent bank, of which $3.0 million was outstanding at December 31, 2010 and December 31, 2009. The unsecured line of credit bears interest at prime plus 1.50% and the term expires October 1, 2011. In connection with this modification, the Company obtained a $3.0 million subordinated debenture that requires the Company to keep at least a $500,000 principal balance outstanding on the line of credit until the subordinated debenture is paid in full. If the Company does not maintain the $500,000 balance, there is a $150,000 prepayment penalty. During the year ended December 31, 2010 and 2009, the Company maintained at least a $500,000 principal balance outstanding on the line of credit. Also as a result of the modification, no additional advances can be made on this unsecured line of credit. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios, nonperforming asset ratios and return on asset ratios. As of December 31, 2010 and 2009, the Company is not in compliance with all of the covenants. While the lender has not called the line of credit, it has the right to do so. Accordingly, the Company has developed alternatives to replace the line of credit, if necessary, by restructuring the existing loan, obtaining financing from other sources or raising capital. As a result, management does not believe that default of this covenant will have a material adverse effect on the Company's financial condition or the results of its operations.

Capital Resources

The Company and the Banks are subject to numerous regulatory capital requirements administered by federal banking agencies. If these capital requirements are not met, regulators can initiate certain mandatory – and possibly additional discretionary – actions that, if undertaken, could affect operations. Under capital adequacy guidelines and the regulatory framework for corrective action, the Company and the Banks must meet certain capital guidelines, which involve quantitative measures of the Company's and the Banks' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Banks' capital amounts and classification are subject to qualitative judgments by the regulators about components, risk weightings and certain other factors.

Quantitative measures set up by regulation to guarantee capital adequacy require the Company and the Banks to sustain minimum amounts and ratios of Tier 1 capital and total risk based capital to risk-weighted assets and Tier 1 capital to total average assets. The Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets, and Tier 1 capital to total average assets of 4%, 8%, and 3%, respectively. To be considered "Well Capitalized", the Company and the Banks must maintain at least Tier 1 capital and total risk based capital to risk weighted assets, and Tier 1 capital to total average assets of 6%, 10%, and 5%, respectively. As of December 31, 2010, the Company and the Banks are considered "Well Capitalized" under regulatory capital adequacy guidelines.

The following schedule shows the Company's and the Banks' actual capital amounts and ratios at December 31, 2010 and 2009, respectively:

	At December 31,			
	2010		2009	
	Amount	**Ratio**	Amount	Ratio
	(Dollars in thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	**66,576**	**9.3%**	78,773	9.2%
Total risk based capital (to risk weighted assets)	**87,479**	**12.2%**	101,696	11.9%
Tier 1 capital (to total average assets)	**66,576**	**6.9%**	78,773	7.3%
Community FirstBank				
Tier 1 capital (to risk weighted assets)	**44,373**	**10.6%**	45,166	10.4%
Total risk based capital (to risk weighted assets)	**54,660**	**13.0%**	55,633	12.8%
Tier 1 capital (to total average assets)	**44,373**	**7.6%**	45,166	7.7%
Crescent Bank				
Tier 1 capital (to risk weighted assets)	**24,383**	**8.2%**	35,404	8.4%
Total risk based capital (to risk weighted assets)	**34,989**	**11.8%**	47,849	11.4%
Tier 1 capital (to total average assets)	**24,383**	**6.4%**	35,404	7.2%

Recently Adopted Accounting Standards

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and disclosure of financial information by the Company.

In January 2010, guidance was issued to alleviate diversity in the accounting for distributions to shareholders that allowed the shareholder to elect to receive their entire distribution in cash or shares but with a limit on the aggregate amount of cash to be paid. The amendment states that the stock portion of the distribution to shareholders that allows them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance. The amendment is effective for interim and annual periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

In January 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or a nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a non-controlling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in-substance real estate or conveyance of oil or gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

In January 2010, fair value guidance was amended to require disclosures for significant amounts transferred in and out of Levels 1 and 2 and the reasons for such transfers and to require that gross amounts of purchases, sales, issuances and settlements be provided in the Level 3 reconciliation. The new disclosures are effective for the Company and have been reflected in the Fair Value note to the financial statements.

In March 2010, guidance related to derivatives and hedging was amended to exempt embedded credit derivative features related to the transfer of credit risk from potential bifurcation and separate accounting. Embedded features related to other types of risk and other embedded credit derivative features are not exempt from potential bifurcation and separate accounting. The amendments were effective for the Company on July 1, 2010. These amendments had no impact on the financial statements.

Stock compensation guidance was updated in April 2010 to address the classification of employee share-based payment awards with exercise prices dominated in the currency of a market in which a substantial portion of the entity's equity securities trade. The guidance states that these awards should not be considered to contain a condition that is not a market, performance, or service condition. Share based payments that contain conditions related to market performance and service must be recorded as liabilities. These awards should not be classified as liabilities if they otherwise qualify to be classified as equity. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The Company does not expect the update to have an impact on the financial statements.

In July 2010, the Receivables topic of the ASC was amended to require expanded disclosures related to a company's allowance for credit losses and the credit quality of its financing receivables. The amendments will require the allowance disclosures to be provided on a disaggregated basis. The Company is required to begin to comply with the disclosures in its financial statements for the year ended December 31, 2011.

In December 2010, the Intangibles topic of the ASC was amended to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. Any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings upon adoption. Impairments occurring subsequent to adoption should be included in earnings. For nonpublic entities, the amendment is effective for fiscal years, and interim periods within those years, beginning January 1, 2012; however, nonpublic entities may early adopt the amendments using the effective date for public entities.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Effect of Inflation and Changing Prices

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require the measurement of financial position and results of operations in terms of historical dollars without consideration of changes in the relative purchasing power over time due to inflation.

Unlike many other industries, nearly all assets and liabilities of a financial institution are monetary in nature. Therefore, interest rates usually have a more significant impact on a financial institution's performance than does the effect of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services since such prices are affected by inflation. We are committed to continuing to actively manage the gap between our interest-sensitive assets and interest-sensitive liabilities.

New Federal Legislation

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes several provisions that will affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage, and impose new capital requirements on bank and thrift holding companies. The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting originator compensation, minimum repayment standards, and pre-payments. Management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on our business, financial condition, and results of operations.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Carolina Financial Corporation
Charleston, South Carolina

We have audited the accompanying consolidated statements of financial condition of Carolina Financial Corporation and Subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carolina Financial Corporation and Subsidiaries, as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

Elliott Davis LLC

Elliott Davis, LLC
Charleston, South Carolina
March 11, 2011

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2010 AND 2009

	December 31, 2010	December 31, 2009
	(In thousands)	
ASSETS		
Cash and due from banks	$ **3,322**	2,901
Interest-bearing cash	**21,415**	17,759
Cash and cash equivalents	**24,737**	20,660
Securities available for sale (cost of $153,820 at December 31, 2010 and $102,119 at December 31, 2009)	**151,574**	104,401
Securities held to maturity (fair value of $3,167 at December 31, 2010 and $105,450 at December 31, 2009)	**9,848**	125,633
Federal Home Loan Bank stock, at cost	**11,129**	12,456
Other investments	**465**	465
Derivative assets	**2,225**	2,342
Loans held for sale	**82,615**	71,233
Loans receivable, net of allowance for loan losses of $14,263 at December 31, 2010 and $13,032 at December 31, 2009	**583,995**	690,163
Premises and equipment, net	**16,808**	17,443
Accrued interest receivable	**3,483**	4,550
Real estate acquired through foreclosure, net	**10,816**	7,853
Deferred tax assets, net	**10,340**	10,349
Income taxes receivable	**5,420**	-
Prepaid FDIC insurance	**4,161**	5,677
Mortgage servicing rights	**5,249**	1,797
Other assets	**7,884**	3,735
Total assets	$ **930,749**	1,078,757
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Noninterest-bearing deposits	$ **51,509**	37,543
Interest-bearing deposits	**638,305**	723,565
Total deposits	**689,814**	761,108
Short-term borrowed funds	**57,759**	43,787
Long-term debt	**123,339**	203,638
Derivative liabilities	**173**	891
Drafts outstanding	**3,145**	3,117
Advances from borrowers for insurance and taxes	**396**	198
Accrued interest payable	**939**	1,484
Income taxes payable	**-**	996
Accrued expenses and other liabilities	**8,690**	7,400
Total liabilities	**884,255**	1,022,619
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value $.01; 200,000 shares authorized; no shares issued or outstanding	**-**	-
Common stock, par value $.01; 6,800,000 shares authorized; 1,918,992 issued and outstanding at December 31, 2010 and 1,912,492 at December 31, 2009	**19**	19
Additional paid-in capital	**21,711**	21,320
Retained earnings, restricted	**29,845**	42,433
Accumulated other comprehensive income (loss), net of tax	**(5,081)**	(7,634)
Total stockholders' equity	**46,494**	56,138
Total liabilities and stockholders' equity	$ **930,749**	1,078,757

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	For the Years Ended December 31,		
	2010	2009	2008
	(In thousands, except share data)		
Interest income			
Loans	$ **37,367**	43,892	49,516
Debt securities	**9,364**	12,786	12,660
Dividends	**42**	39	466
Interest-bearing cash	**69**	19	407
Total interest income	**46,842**	56,736	63,049
Interest expense			
Deposits	**11,850**	17,781	24,036
Short-term borrowed funds	**708**	1,361	1,998
Long-term debt	**4,519**	5,877	7,193
Total interest expense	**17,077**	25,019	33,227
Net interest income	**29,765**	31,717	29,822
Provision for loan losses	**30,755**	10,460	6,361
Net interest income (loss) after provision for loan losses	**(990)**	21,257	23,461
Noninterest income			
Net gain on sale of loans held for sale	**23,481**	23,982	4,579
Deposit service charges	**1,765**	1,584	1,449
Income from ATM and debit card transactions	**377**	320	308
Income from sales of non-depository products	**884**	788	867
Net loss on extinguishment of debt	**(2,536)**	(711)	(52)
Net (loss) gain on sale of securities	**(1,955)**	963	952
Net loss on other investments	**-**	-	(337)
Other-than-temporary impairment of securities	**(2,480)**	-	-
Net loss on sale of real estate acquired through foreclosure	**(108)**	(26)	(55)
Net gain on derivatives	**601**	411	1,139
Net gain on sale of servicing assets	**526**	-	-
Other	**1,045**	627	377
Total noninterest income	**21,600**	27,938	9,227
Noninterest expense			
Salaries and employee benefits	**20,594**	20,182	14,497
Occupancy and equipment	**3,439**	3,413	3,011
Marketing and public relations	**630**	630	655
FDIC insurance	**1,798**	2,201	617
Expense from ATM and debit card transactions	**360**	281	276
Other real estate expense	**1,725**	1,843	5
Mortgage loan repurchase losses	**2,627**	3,362	285
Legal expense	**1,322**	509	179
Other	**6,575**	5,252	4,357
Total noninterest expense	**39,070**	37,673	23,882
Income (loss) before income taxes	**(18,460)**	11,522	8,806
Income tax expense (benefit)	**(5,872)**	4,353	3,256
Net income (loss)	$ **(12,588)**	7,169	5,550
Earnings (loss) per common share:			
Basic	$ **(6.58)**	3.75	2.95
Diluted	$ **(6.58)**	3.72	2.83
Average common shares outstanding:			
Basic	**1,913,240**	1,912,449	1,883,101
Diluted	**1,913,240**	1,924,720	1,960,362

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Earnings	Income (Loss)	Total
	(In thousands, except share data)					
Balance, December 31, 2007	1,798,262	$ 18	19,717	29,714	86	49,535
Exercise of stock options	103,950	1	843	-	-	844
Restricted stock awards	10,000	-	-	-	-	-
Stock-based compensation expense, net	-	-	365	-	-	365
Net income	-	-	-	5,550	-	5,550
Other comprehensive income (loss):						
Unrealized loss on securities, net of tax of $5,234	-	-	-	-	(9,094)	
Reclassification adjustment for gains included in net income, net of tax of $343	-	-	-	-	(609)	
Other comprehensive loss					(9,703)	(9,703)
Comprehensive loss						(4,153)
Balance, December 31, 2008	1,912,212	19	20,925	35,264	(9,617)	46,591
Exercise of stock options	280	-	5	-	-	5
Stock-based compensation expense, net	-	-	390	-	-	390
Net income	-	-	-	7,169	-	7,169
Other comprehensive income (loss):						
Unrealized gain on securities, net of tax of $1,583	-	-	-	-	2,580	
Reclassification adjustment for gains included in net income, net of tax of $366	-	-	-	-	(597)	
Other comprehensive income					1,983	1,983
Comprehensive income						9,152
Balance, December 31, 2009	**1,912,492**	**19**	**21,320**	**42,433**	**(7,634)**	**56,138**
Restricted stock awards	**6,500**	**-**	**-**	**-**	**-**	**-**
Stock-based compensation expense, net	**-**	**-**	**391**	**-**	**-**	**391**
Net loss	**-**	**-**	**-**	**(12,588)**	**-**	**(12,588)**
Other comprehensive income (loss):						
Unrealized gain on securities, net of tax of $766	**-**	**-**	**-**	**-**	**1,311**	
Reclassification adjustment for losses included in net loss, net of tax benefit of $713	**-**	**-**	**-**	**-**	**1,242**	
Other comprehensive income					**2,553**	**2,553**
Comprehensive loss						**(10,035)**
Balance, December 31, 2010	**1,918,992**	**$ 19**	**21,711**	**29,845**	**(5,081)**	**46,494**

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	For the Years Ended December 31,		
	2010	2009	2008
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	**$ (12,588)**	7,169	5,550
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:			
Provision for loan losses	**30,755**	10,460	6,361
Deferred tax benefit	**(1,470)**	(2,019)	(633)
Amortization of unearned discount/premiums on investments, net	**1,348**	(128)	(212)
Amortization of deferred loan fees	**(3,904)**	(604)	(831)
Amortization of mortgage servicing rights	**651**	275	103
(Recovery of) provision for mortgage servicing rights impairment	**-**	(105)	75
Loss (gain) on sale of available for sale securities, net	**1,955**	(963)	(952)
Loss on write off of other investments	**-**	-	337
Gain on sale of loans held for sale, net	**(23,481)**	(23,982)	(4,579)
Originations of loans held for sale	**(1,652,257)**	(1,700,377)	(712,784)
Proceeds from sale of loans held for sale	**1,667,033**	1,681,410	714,110
Loss on extinquishment of debt	**2,536**	711	52
Gain on derivatives, net	**(601)**	(411)	(1,139)
Stock-based compensation	**391**	390	365
Depreciation	**1,290**	1,254	1,265
Loss on disposals of premises and equipment	**3**	59	20
Loss on sale of real estate acquired through foreclosure	**108**	26	55
Write-down of real estate acquired through foreclosure	**2,063**	1,495	-
Gain on sale of servicing assets	**(526)**	-	-
Proceeds from the sale of servicing assets	**1,810**	-	-
Originations of mortgage servicing assets	**(5,387)**	(1,717)	(118)
Decrease (increase) in:			
Accrued interest receivable	**1,067**	(39)	936
Income taxes receivable	**(6,416)**	-	(222)
Prepaid FDIC insurance	**1,516**	(5,677)	-
Other assets	**(4,149)**	362	581
Increase (decrease) in:			
Accrued interest payable	**(545)**	(1,279)	(420)
Income taxes payable	**-**	2,601	-
Accrued expenses and other liabilities	**1,290**	3,532	(465)
	2,492	(27,557)	7,455

Continued

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	For the Years Ended December 31,		
	2010	2009	2008
		(In thousands)	
Cash flows from investing activities:			
Activity in available-for-sale securities:			
Purchases	**$ (83,078)**	(64,365)	(175,843)
Maturities, payments and calls	**41,887**	23,759	20,229
Proceeds from sales	**88,898**	29,054	64,996
Activity in held-to-maturity securities:			
Purchases	**-**	(4,052)	(3,585)
Maturities, payments and calls	**21,633**	24,632	2,829
(Increase) decrease in Federal Home Loan Bank stock	**1,327**	(583)	(1,727)
Decrease (increase) in loans receivable, net	**65,695**	68,092	(50,969)
Purchase of premises and equipment	**(736)**	(807)	(1,104)
Proceeds from disposals of premises and equipment	**78**	32	68
Proceeds from sale of real estate acquired through foreclosure	**5,813**	6,238	636
	141,517	82,000	(144,470)
Cash flows from financing activities:			
Net increase (decrease) in deposit accounts	**(71,294)**	43,719	25,289
Net (decrease) increase in Federal Home Loan Bank advances	**(53,536)**	(47,211)	29,199
Net (decrease) increase in Federal Reserve Bank advances	**-**	(91,000)	91,000
Net increase (decrease) in other short-term borrowed funds	**(15,103)**	(2,029)	19,737
Procceds from issuance of TLGP debt	**-**	20,400	-
Proceeds from issuance of subordinated debt	**-**	-	3,000
Principal repayment of subordinated debt	**(225)**	-	-
Net increase (decrease) in drafts outstanding	**28**	802	(3,390)
Net increase in advances from borrowers for insurance and taxes	**198**	40	11
Proceeds from exercise of stock options	**-**	5	844
	(139,932)	(75,274)	165,690
	4,077	(20,831)	28,675
Cash and cash equivalents, beginning of year	**20,660**	41,491	12,816
Cash and cash equivalents, end of year	**$ 24,737**	20,660	41,491
Supplemental disclosure			
Cash paid for:			
Interest on deposits and borrowed funds	**$ 17,622**	26,298	33,647
Income taxes paid, net of refunds	**2,014**	3,666	4,050
Non-cash investing and financing activities:			
Other-than-temporary impairment reflected through accumulated other comprehensive income	**1,685**	-	-
Other-than-temporary impairment reflected through the statement of operations	**(2,480)**	-	-
Transfer of loans receivable to real estate acquired through foreclosure	**10,947**	8,507	7,524
Transfer of available for sale securities to held to maturity securities	**-**	30,597	112,343
Transfer of held to maturity securities to available for sale securities	**91,512**	-	-
Unrealized gain (loss) in securities available for sale, net	**1,311**	2,580	(9,094)

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Carolina Financial Corporation ("Carolina Financial" or the "Company"), incorporated under the laws of the State of Delaware, is a multi-bank holding company with two wholly-owned subsidiary banks, Community FirstBank of Charleston ("Community FirstBank") and Crescent Bank (together, the "Banks"), and one wholly-owned service corporation, Carolina Services Corporation of Charleston ("Carolina Services"). Effective July 27, 2009, Carolina Financial contributed 100% of its wholly-owned mortgage subsidiary Crescent Mortgage Company ("Crescent Mortgage") to Community FirstBank. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Community FirstBank, Crescent Bank and Carolina Services. In consolidation, all material intercompany accounts and transactions have been eliminated. The results of operations of the businesses acquired in transactions accounted for as purchases are included only from the dates of acquisition. All majority-owned subsidiaries are consolidated unless control is temporary or does not rest with the Company.

At December 31, 2010, 2009 and 2008, statutory business trusts ("Trusts") created by the Company had outstanding trust preferred securities with an aggregate par value of $15,000,000. The principal assets of the Trusts are $15,465,000 of the Company's subordinated debentures with identical rates of interest and maturities as the trust preferred securities. The Trusts have issued $465,000 of common securities to the Company and are included in other investments in the accompanying consolidated balance sheets. The Trusts are not consolidated subsidiaries of the Company.

Management's Estimates

The financial statements are prepared in accordance with generally accepted accounting principles in the United States of America which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, including valuation for impaired loans, the valuation of real estate acquired in connection with foreclosure or in satisfaction of loans, the valuation of securities, the valuation of derivative instruments, the valuation of mortgage servicing rights, the determination of the reserve for mortgage loan repurchase losses, and deferred tax assets or liabilities. In connection with the determination of the allowance for loan losses and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

Management uses available information to recognize losses on loans and foreclosed real estate. However, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Banks' allowances for loan losses and foreclosed real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for loan losses and foreclosed real estate may change materially in the near term.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the statement of financial condition but arose after that date. Management has reviewed events occurring through March 11, 2011, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash and due from banks and interest-bearing cash with banks. Substantially all of the interest-bearing cash at December 31, 2010 and 2009 is Federal Reserve Bank and Federal Home Loan Bank overnight deposits. Cash and cash equivalents have maturities of three months or less. Accordingly, the carrying amount of such instruments is considered a reasonable estimate of fair value. The Banks are required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2010 and 2009, these reserve balances amounted to $1.7 million and $1.3

million, respectively. In addition, the mortgage company is required to keep $1.0 million in cash related to its warehouse line of credit.

Securities

Investment securities are classified into three categories: (a) Held to Maturity – debt securities that the Company has positive intent and ability to hold to maturity, which are reported at amortized cost; (b) Trading – debt and equity securities that are bought and held principally for the purpose of selling them in the near term, which are reported at fair value, with unrealized gains and losses included in earnings; and (c) Available for Sale – debt and equity securities that may be sold under certain conditions, which are reported at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated other comprehensive income as a separate component of stockholders' equity, net of income taxes.

The Company determines investment and mortgage-backed securities classification at the time of purchase. If a security is transferred from available for sale to held to maturity, the fair value at the time of transfer becomes the held to maturity security's new cost basis. Premiums and discounts on securities are accreted and amortized as an adjustment to interest yield over the estimated life of the security using a method which approximates a level yield. Dividends and interest income are recognized when earned. Unrealized losses on securities, reflecting a decline in value judged by the Company to be other-than-temporary, are charged to income in the consolidated statements of operations.

The cost basis of securities sold is determined by specific identification. Purchases and sales of securities are recorded on a trade date basis.

Loans Held for Sale

The Company's residential mortgage lending activities for sale in the secondary market are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgage loans and selling mortgage loans to investors under pre-existing commitments. Funded residential mortgages held for sale to investors are reported at the lower of aggregate cost or estimated fair value. Net unrealized losses, if any, are recognized in a valuation allowance by charges to operations. Gains or losses realized on the sales of loans are recognized at the time of sale and are determined by the difference between the net sales proceeds and the carrying value of the loans sold, adjusted for any servicing asset or liability retained. Gains and losses on sales of loans are included in noninterest income.

The Company issues rate lock commitments to borrowers on prices quoted by secondary market investors. Derivatives related to these commitments are recorded as either assets or liabilities in the balance sheet and are measured at fair value. Changes in the fair value of the derivatives are reported in current earnings or other comprehensive income depending on the purpose for which the derivative is held and whether the derivative qualifies for hedge accounting. The Company does not currently engage in any activities that qualify for hedge accounting. Accordingly, changes in fair values of these derivative instruments are included in noninterest income in the consolidated statements of operations.

Loans Receivable, Net

Loans that management has the intent and ability to hold for the foreseeable future are reported at their outstanding principal balances net of any unearned income, charge-offs, deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. The net amount of nonrefundable loan origination fees, commitment fees and certain direct costs associated with the lending process are deferred and amortized to interest income over the contractual lives of the loans using methods that approximate a level yield, or noninterest income when the loan is sold. Discounts and premiums on purchased loans are amortized to interest income over the estimated life of the loans using methods that approximate a level yield, or noninterest income when the loan is sold. Commercial loans and substantially all installment loans accrue interest on the unpaid balance of the loans.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral-dependent. When the fair value of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a specific reserve allocation that is a component of the allowance for loan losses. A loan is charged-off against the allowance for loan losses when all meaningful collection efforts have been exhausted and the loan is viewed as uncollectible in the immediate or foreseeable future.

Mortgage Servicing Rights, Fees and Costs

The Company initially measures servicing assets and liabilities retained related to the sale of residential loans held for sale ("mortgage servicing rights") at fair value, if practicable. For subsequent measurement purposes, the Company measures servicing assets and liabilities based on the lower of cost or market.

Mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing income. The amortization of the mortgage servicing rights is analyzed periodically and is adjusted to reflect changes in prepayment rates and other estimates.

The Company evaluates potential impairment of mortgage servicing rights based on the difference between the carrying amount and current estimated fair value of the servicing rights. In determining impairment, the Company aggregates all servicing rights and stratifies them into tranches based on predominant risk characteristics of interest rate, loan type and investor type. If impairment exists, a valuation allowance is established for any excess of amortized cost over the current estimated fair value by a charge to income. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Service fee income is recorded for fees earned for servicing mortgage loans under servicing agreements with the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC"), Government National Mortgage Association ("GNMA") and certain private investors. The fees are based on a contractual percentage of the outstanding principal balance of the loans serviced and are recorded as income when received. The amortization of mortgage servicing rights is netted against loan servicing fee income. Mortgage servicing costs are charged to expense when incurred. Service fee income, net of amortization and servicing costs, is recorded in other income.

Nonperforming Assets

Nonperforming assets include loans on which interest is not being accrued, accruing loans that are 90 days or more delinquent and foreclosed property. Foreclosed property consists of real estate and other assets acquired as a result of a borrower's loan default. Loans are generally placed on nonaccrual status when concern exists that principal or interest is not fully collectible, or when any portion of principal or interest becomes 90 days past due, whichever occurs first. Loans past due 90 days or more may remain on accrual status if management determines that concern over the collectability of principal and interest is not significant. When loans are placed on nonaccrual status, interest receivable is reversed against interest income in the current period. Interest payments received thereafter are applied as a reduction to the remaining principal balance as long as concern exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when concern no longer exists as to the collectability of principal or interest.

Assets acquired as a result of foreclosure are carried at the lower of cost or fair value less estimated selling costs. If cost exceeds fair value less estimated selling costs at the time of foreclosure, the asset is written down to fair value less estimated selling costs with the difference being charged against the allowance for loan losses. Generally, such properties are appraised annually, and the carrying value, if greater than the fair value less estimated selling costs, is adjusted with a charge to noninterest expense. Routine maintenance costs and declines in market value are included in noninterest expense. Net gains or losses on sale are included in noninterest income.

Allowance for Loan Losses

The allowance for loan losses is Management's estimate of probable credit losses inherent in the loan portfolio at the balance sheet date. Management determines the allowance based on an ongoing evaluation. This evaluation is inherently subjective because it requires material estimates and is based on evaluations of the collectability of loans. Impaired loans, including nonaccrual loans, loans past due 90 or more days and still accruing, troubled-debt restructured loans, and loans in excess of a defined threshold that are not paying in accordance with contractual terms, are evaluated for specific impairment. The specific reserves are determined on a loan-by-loan basis based on Management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the value of any underlying collateral. Management's estimate of losses in the remainder of the portfolio is based on certain observable data that Management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; portfolio aging; loan volumes; geographic, borrower and industry concentrations; seasoning of the loan portfolio; the findings of internal credit quality assessments and results from external bank regulatory examinations.

While Management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or, if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Guarantees

Standby letters of credit obligate the Company to meet certain financial obligations of its customers, under the contractual terms of the agreement, if the customers are unable to do so. Payment is only guaranteed under these letters of credit upon the borrower's failure to perform its obligations to the beneficiary. The Company can seek recovery of the amounts paid from the borrower; however, these standby letters of credit are generally not collateralized. Commitments under standby letters of credit are usually one year or less. At December 31, 2010 the Company had recorded no liability for the current carrying amount of the obligation to perform as a guarantor; as such amounts are not considered material. The maximum potential amount of undiscounted future payments related to standby letters of credit at December 31, 2010 was $558,000.

Premises and Equipment, Net

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the asset's estimated useful life. Estimated lives range up to forty years for buildings and improvements and up to ten years for furniture, fixtures and equipment. Maintenance and repairs are charged to expense as incurred. Improvements that extend the lives of the respective assets are capitalized. When property or equipment is sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the respective accounts and the resulting gain or loss is reflected in income.

Advertising

The Company expenses advertising costs as incurred. These expenses are reflected as marketing and public relations in the accompanying consolidated statements of operations.

Income Taxes

The provision for income taxes is based upon income or loss before taxes for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes. Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with the cumulative effects included in the current year's income tax provision.

Positions taken by the Company's tax returns may be subject to challenge by the taxing authorities upon examination. The benefits of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain tax positions have been recorded.

Interest and penalties on income tax uncertainties are classified within income tax expense in the statement of operations. The Company had no interest or penalties during fiscal 2010, 2009, and 2008.

Drafts Outstanding

The Company invests excess funds on deposit at other banks (including amounts on deposit for payment of outstanding disbursement checks) on a daily basis in an overnight interest-bearing account. Accordingly, outstanding checks are reported as a liability.

Reserve for Mortgage Loan Repurchase Losses

The Company sells mortgage loans to various third parties, including government-sponsored entities, under contractual provisions that include various representations and warranties that typically cover ownership of the loan, compliance with loan criteria set forth in the applicable agreement, validity of the lien securing the loan, absence of delinquent taxes or liens against the property securing the loan, and similar matters. The Company may be required to repurchase the mortgage loans with identified defects, indemnify the investor or insurer, or reimburse the investor for credit loss incurred on the loan (collectively "repurchase") in the event of a material breach of such contractual representations or warranties. Risk associated with potential repurchases or other forms of settlement is managed through underwriting and quality assurance practices and by servicing mortgage loans to meet investor and secondary market standards.

The Company establishes mortgage repurchase reserves related to various representations and warranties that reflect management's estimate of losses based on a combination of factors. Such factors incorporate estimated levels of defects on internal quality assurance, default expectations, historical investor repurchase demand and appeals success rates, reimbursement by correspondent and other third party originators, and projected loss severity. The Company establishes a reserve at the time loans are sold and continually updates the reserve estimate during the estimated loan life. The reserve for repurchases, included in accrued expenses and other liabilities in the accompanying consolidated statements of financial condition, was $5.3 million and $3.0 million at December 31, 2010 and 2009, respectively. To the extent that economic conditions and the housing market do not recover or future investor repurchase demand and appeals success rates differ from past experience, the Company could continue to have increased demands and increased loss severities on repurchases, causing future additions to the repurchase reserve.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income or loss and net unrealized gains (losses) on securities and is presented in the consolidated statements of changes in stockholders' equity and comprehensive income (loss). The Company's other comprehensive income (loss) for the years ended December 31, 2010, 2009 and 2008 and accumulated other comprehensive income (loss) as of December 31, 2010 and 2009 are comprised solely of unrealized gains (losses) on certain investment securities.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Company entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commitments under revolving credit agreements, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded.

Stock-Based Compensation

At December 31, 2010 and 2009, the Company had three stock-based payment plans for directors, officers and other key employees, which are described below.

When share options are issued, the fair value at the date of grant of the stock option is estimated using the Black-Scholes option-pricing model based on certain assumptions. The dividend yield is based on estimated future dividend yields. The risk-free rate for periods within the contractual term of the share option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatilities are generally based on historical volatilities. The expected term of share options granted is generally derived from historical experience. Compensation expense is recognized on a straight-line basis over the stock option vesting period. There were no options issued during fiscal 2010 and 2009.

The Company adopted the 2006 Recognition and Retention Plan under which an aggregate of 60,000 shares have been reserved for issuance by the Company upon the grant of non-vested common stock. The plan provides for the grant of stock to key employees and Directors of the Company and its subsidiaries. The non-vested common stock vests ratably over a five-year period. During 2010 and 2008, 6,500 and 10,000 shares, respectively, of non-vested restricted common stock of the

Company were granted to non-employees and a key employee of the Company, respectively, at $8.11 per share and $37.57 per share, respectively. As of December 31, 2010, 56,500 shares have been awarded under the plan, of which 36,000 shares have vested and 20,500 shares are unvested.

Additionally, the Company has adopted the 1998 Stock Option Plan and the 2002 Stock Option Plan under which an aggregate of 7,590 shares and 138,750 shares, respectively, have been reserved for issuance by the Company upon the grant of stock options or limited rights. The plans provide for the grant of options to key employees and Directors as determined by a Stock Option Committee. The options vest ratably over a five-year period and have a ten-year term, both of which begin at the date of grant. The aggregate options available and the option exercise prices have been adjusted to reflect the issuance of a 15% stock dividend during 1998 and the issuance of a 10% stock dividend during 2000.

The expense recognition of employee stock option and restricted stock awards resulted in net expense of approximately $391,000, $390,000 and $365,000 during the twelve months ended December 31, 2010, 2009 and 2008, respectively.

A summary of the status of the Company's stock option plans at December 31, 2010, 2009 and 2008 and changes during the years then ended is presented below:

	At and For the Year Ended December 31,					
	2010		2009		2008	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	**144,980**	**$ 15.83**	145,760	$ 15.86	249,990	$ 12.67
Granted	-	-	-	-	-	-
Exercised	-	-	(280)	17.57	(103,950)	8.12
Forfeited or expired	-	-	(500)	24.00	(280)	38.50
Outstanding at end of year	**144,980**	**$ 15.83**	144,980	$ 15.83	145,760	$ 15.86
Options exercisable at end of year	**144,570**	**$ 15.77**	142,920	$ 15.63	141,050	$ 15.49

The following table summarizes information about the options outstanding at December 31, 2010:

	At December 31, 2010				
	Options Outstanding			**Options Exercisable**	
Range of Exercise Prices	**Number Outstanding**	**Weighted Avg. Remaining Years Contractual Life**	**Weighted Average Exercise Price**	**Number Outstanding**	**Weighted Average Exercise Price**
$ 15.00 to $20.00	137,090	1.4	$ 15.15	137,090	$ 15.15
$ 20.01 to $25.00	5,840	4.5	24.00	5,840	24.00
$ 35.00 to $40.00	2,050	5.8	38.50	1,640	38.50
	144,980	1.6	$ 15.83	144,570	$ 15.77

There were no options granted during the years ended December 31, 2010, 2009 and 2008. No stock options were exercised during the year ended December 31, 2010. The total intrinsic value of options exercised was $0, $2,000, and $246,000 during the twelve months ended December 31, 2010, 2009 and 2008, respectively. Fair values have been retroactively restated for all stock dividends since the date the option was granted. As of December 31, 2010, there was approximately $412,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements. Unrecognized cost is projected to be recognized over a weighted average period of approximately two years. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

Reclassification
Certain reclassifications of accounts reported for previous periods have been made in these consolidated financial statements. Such reclassifications had no effect on stockholders' equity or the net income as previously reported.

Recently Issued Accounting Pronouncements
The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and disclosure of financial information by the Company.

In January 2010, guidance was issued to alleviate diversity in the accounting for distributions to shareholders that allowed the shareholder to elect to receive their entire distribution in cash or shares but with a limit on the aggregate amount of cash to be paid. The amendment states that the stock portion of the distribution to shareholders that allows them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance. The amendment is effective for interim and annual periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

Also in January 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or a nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a non-controlling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in-substance real estate or conveyance of oil or gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

In January 2010, fair values guidance was amended to require disclosures for significant amounts transferred in and out of Levels 1 and 2 and the reasons for such transfers and to require that gross amounts of purchases, sales, issuances and settlements be provided in the Level 3 reconciliation. Disaggregation of classes of assets and liabilities is also required. The new disclosures are effective for the Company for the current year and have been reflected in Note 13 – Estimated Fair Value of Financial Instruments.

In March 2010, guidance related to derivatives and hedging was amended to exempt embedded credit derivative features related to the transfer of credit risk from potential bifurcation and separate accounting. Embedded features related to other types of risk and other embedded credit derivative features are not exempt from potential bifurcation and separate accounting. The amendments were effective for the Company on July 1, 2010. These amendments had no impact on the financial statements.

Stock compensation guidance was updated in April 2010 to address the classification of employee share-based payment awards with exercise prices dominated in the currency of a market in which a substantial portion of the entity's equity securities trade. The guidance states that these awards should not be considered to contain a condition that is not a market, performance, or service condition. Share based payments that contain conditions related to market, performance and service must be recorded as liabilities. These awards should not be classified as liabilities if they otherwise qualify to be classified as equity. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011. The Company does not expect the update to have an impact on the financial statements.

In July 2010, the Receivables topic of the ASC was amended to require expanded disclosures related to a company's allowance for credit losses and the credit quality of its financing receivables. The amendments will require the allowance disclosures to be provided on a disaggregated basis. The Company is required to begin to comply with the disclosures in its financial statements for the year ended December 31, 2011.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes several provisions that will affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage, and impose new capital requirements on bank and thrift holding companies. The Dodd-Frank Act also establishes the Bureau

of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting originator compensation, minimum repayment standards, and pre-payments. Management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on our business, financial condition, and results of operations.

In December 2010, the Intangibles topic of the ASC was amended to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. Any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings upon adoption. Impairments occurring subsequent to adoption should be included in earnings. For nonpublic entities, the amendment is effective for fiscal years, and interim periods within those years, beginning January 1, 2012; however, nonpublic entities may early adopt the amendments using the effective date for public entities.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Risks and Uncertainties

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk, and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or re-price at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default on the loan portfolio or certain securities that results from borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. Periodic examinations by the regulatory agencies may subject the Company to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

NOTE 2 - SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and fair value of investments securities available for sale and held to maturity at December 31, 2010 and 2009 follows:

	At December 31,							
	2010				2009			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				(In thousands)				
GNMA	**$ 21,989**	**555**	**(5)**	**22,539**	4,088	29	-	4,117
Mortgage-backed securities	**131,831**	**3,146**	**(5,942)**	**129,035**	98,031	2,661	(408)	100,284
Total securities available for sale	**$ 153,820**	**3,701**	**(5,947)**	**151,574**	102,119	2,690	(408)	104,401
Securities held-to-maturity:								
Mortgage-backed securities	**$ -**	**-**	**-**	**-**	111,660	1,144	(13,552)	99,252
Asset-backed securities	**9,848**	**-**	**(6,681)**	**3,167**	13,973	-	(7,775)	6,198
Total securities held to maturity	**$ 9,848**	**-**	**(6,681)**	**3,167**	125,633	1,144	(21,327)	105,450

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2010 follows:

	Amortized Cost	Fair Value
	(In thousands)	
Securities available-for-sale:		
Six to ten years	$ 1,527	1,744
After ten years	152,293	149,830
Total	$ 153,820	151,574
Securities held-to-maturity:		
Six to ten years	$ 1,158	856
After ten years	8,690	2,311
Total	$ 9,848	3,167

The contractual maturity dates of the securities were used for mortgage-backed securities and asset-backed securities. No estimates were made to anticipate principal repayments.

During 2010, the Company sold 20 securities available-for-sale totaling $26.9 million. The Company received $29.4 million of gross proceeds related to the sale of these securities and recognized gross gains of $2.5 million.

Also during 2010, the Company transferred 30 mortgage-backed securities held-to-maturity totaling $91.5 million to securities available-for-sale and subsequently sold 16 of these securities totaling $63.9 million. The Company received $59.4 million of gross proceeds related to the sale of these securities and recognized gross gains of $157,000 and gross losses of $4.6 million. The Company's original intent was to hold these securities to maturity. However, these securities experienced significant deterioration in the issuer's creditworthiness. In addition, due to credit rating agency downgrades in these securities, the risk weights used for regulatory risk-based capital purposes increased. Accordingly, the Company changed its intent to hold these securities to maturity. Management believes that these held-to-maturity securities were sold under exceptions "a." and "d." of ASC 320-10-25-6. As a result, the sale of these securities is not considered inconsistent with the original intent and classification and, therefore, does not taint the remaining securities held-to-maturity portfolio.

At December 31, 2010, the Company has pledged $58.6 million of securities for these advances. See Note 9 – Short-Term Borrowed Funds for further discussion.

The gross unrealized losses and fair value of the Company's investments available for sale with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2010 are as follows:

	At December 31, 2010								
	Less than 12 Months			12 Months or Greater			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
	(In thousands)								
Securities available-for-sale:									
GNMA	**$ 1,503**	**1,498**	**(5)**	**-**	**-**	**-**	**1,503**	**1,498**	**(5)**
Mortgage-backed securities	**23,448**	**23,023**	**(425)**	**30,975**	**25,458**	**(5,517)**	**54,423**	**48,481**	**(5,942)**
Total	**$ 24,951**	**24,521**	**(430)**	**30,975**	**25,458**	**(5,517)**	**55,926**	**49,979**	**(5,947)**
Securities held-to-maturity:									
Asset-backed securities	**$ -**	**-**	**-**	**9,848**	**3,167**	**(6,681)**	**9,848**	**3,167**	**(6,681)**

The gross unrealized losses and fair value of the Company's investments available for sale with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2009 are as follows:

	At December 31, 2009								
	Less than 12 Months			12 Months or Greater			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
	(In thousands)								
Securities available-for-sale:									
Mortgage-backed securities	$ 19,847	19,451	(396)	2,531	2,519	(12)	22,378	21,970	(408)
Securities held-to-maturity:									
Mortgage-backed securities	$ 23,228	18,146	(5,082)	70,489	62,019	(8,470)	93,717	80,165	(13,552)
Asset-backed securities	-	-	-	13,973	6,198	(7,775)	13,973	6,198	(7,775)
Total	$ 23,228	18,146	(5,082)	84,462	68,217	(16,245)	107,690	86,363	(21,327)

At December 31, 2010 and 2009, the Company had 25 and 14, respectively, individual investments available-for-sale that were in an unrealized loss position. The unrealized losses on the Company's investments in mortgage-backed securities and asset-backed securities summarized above were attributable primarily to credit quality, credit rating changes and liquidity. Management has performed various analyses, including cash flows, and has recorded other-than-temporary impairment expense of $2.5 million related to 5 held-to-maturity bonds in the accompanying statement of operations for the year ended December 31, 2010. Other than these 5 held-to-maturity bonds, management believes that there are no other securities other-than-temporarily impaired at December 31, 2010. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost.

The Banks, as members of the Federal Home Loan Bank ("FHLB") of Atlanta, are required to own capital stock in the FHLB of Atlanta based generally upon a membership-based requirement and an activity based requirement. FHLB capital stock is pledged to secure FHLB advances. No secondary market exists for this stock, and it has no quoted market price. However, redemption through the FHLB of this stock has historically been at par value. The Company's investment in FHLB capital stock was $11.1 million and $12.5 million at December 31, 2010 and 2009, respectively.

Other investments at December 31, 2010 and 2009 consisted of $465,000 invested in capital stock of statutory business trusts (See Note 10 – Long-term debt).

NOTE 3 – DERIVATIVES

The derivative positions of the Company at December 31, 2010 and 2009 are as follows:

	At December 31,			
	2010		2009	
	Fair Value	**Notional Value**	Fair Value	Notional Value
	(In thousands)			
Derivative assets:				
Mortgage loan interest rate lock commitments	**$ 449**	**197,075**	-	-
Mortgage loan forward sales commitments	**-**	**-**	428	46,588
Mortgage-backed securities forward sales commitments	**1,776**	**175,000**	1,914	130,000
	$ 2,225	**372,075**	2,342	176,588
Derivative liabilities:				
Mortgage loan interest rate lock commitments	**-**	**-**	891	177,282
Mortgage loan forward sales commitments	**173**	**22,842**	-	-
	$ 173	**22,842**	891	177,282

The Company also uses derivatives intended to reduce interest rate risk incurred as a result of market movements. These derivatives primarily consist of mortgage loan interest rate lock commitments, mortgage loan forward sales commitments and options to deliver mortgage-backed securities. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. The Company uses derivatives primarily to minimize interest rate risk related to its pipeline of loan interest rate lock commitments issued on residential mortgage loans in the process of origination for sale or loans held for sale. Mortgage loan forward sales commitments and options to deliver mortgage-backed securities that generally correspond with the composition of the locked pipeline are used to economically hedge a percentage of the Company's locked pipeline. The Company's Secondary Market Committee has developed a comprehensive hedging policy to monitor the use of derivatives to reduce interest rate risk. The Company's derivative positions are classified as trading assets and liabilities, and as such, the changes in the fair market value of the derivative positions are recognized in the consolidated statement of operations.

NOTE 4 - LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2010 and 2009 are summarized by category as follows:

	At December 31,			
	2010		2009	
	Amount	**% of Total Loans**	Amount	% of Total Loans
	(Dollars in thousands)			
Real estate loans:				
One-to-four family	**$ 138,482**	**22.39%**	165,054	22.71%
Home equity	**38,798**	**6.28%**	50,891	7.00%
Commercial real estate	**276,199**	**44.67%**	296,330	40.77%
Construction and development	**102,195**	**16.53%**	146,736	20.19%
Consumer loans	**6,225**	**1.01%**	8,455	1.16%
Commercial business loans	**56,362**	**9.12%**	59,417	8.17%
Total gross loans receivable	**618,261**	**100.00%**	726,883	100.00%
Less:				
Undisbursed loans in process	**19,708**		23,230	
Allowance for loan losses	**14,263**		13,032	
Deferred fees, net	**295**		458	
Total loans receivable, net	**$ 583,995**		690,163	

The composition of gross loans outstanding, net of undisbursed amounts, by rate type is as follows:

	At December 31,			
	2010		2009	
	(Dollars in thousands)			
Variable rate loans	**$ 358,549**	**59.90%**	456,128	64.82%
Fixed rate loans	**240,004**	**40.10%**	247,525	35.18%
Total gross loans	**$ 598,553**	**100.00%**	703,653	100.00%

Activity in the allowance for loan losses for the years ended December 31, 2010, 2009 and 2008 are as follows:

	At December 31,		
	2010	2009	2008
	(In thousands)		
Balance at beginning of year	**$ 13,032**	11,300	10,083
Provision for loan losses	**30,755**	10,460	6,361
Charge-offs	**(29,786)**	(9,442)	(5,190)
Recoveries	**262**	714	46
Balance at end of year	**$ 14,263**	13,032	11,300

The following is a summary of information pertaining to impaired and nonaccrual loans at December 31:

	At December 31,	
	2010	2009
	(In thousands)	
Impaired loans without a valuation allowance	**$ 55,817**	45,735
Impaired loans with a valuation allowance	**18,478**	23,244
Total impaired loans	**$ 74,295**	68,979
Valuation allowance related to impaired loans	**$ 4,271**	3,827
Nonaccrual loans-renegotiated loans	**$ 34,829**	3,505
Nonaccrual loans-other	**22,552**	23,554
Total nonaccrual loans	**$ 57,381**	27,059
Total loans past due 90 days and still accruing interest	**$ 48**	771
Accruing renegotiated loans	**$ 16,344**	5,269

	At December 31,		
	2010	2009	2008
	(In thousands)		
Average of impaired loans during the year	**$ 76,732**	44,393	17,046
Average of non-accrual loans during the year	**35,324**	22,355	16,490

Total impaired loans at December 31, 2010 and 2009 of $74.3 million and $69.0 million, respectively, reflect partial charge-offs of $14.5 million and $4.9 million, respectively.

Substantially all of the non-accrual loans, accruing loans 90 days or more delinquent and accruing renegotiated loans for the years ended December 31, 2010 and 2009 are collateralized by real estate. Management believes based on information

known and available currently, the probable losses related to problem assets are adequately reserved in the allowance for loan losses. A summary of the composition of loans on non-accrual follows:

	At December 31,	
	2010	2009
	(In thousands)	
Real estate loans:		
One-to-four family	$ **17,552**	11,921
Home equity	**350**	231
Commercial real estate	**21,298**	2,578
Construction and development	**16,543**	11,740
Consumer loans	**85**	21
Commercial business loans	**1,553**	568
	$ **57,381**	27,059

The company recognized interest income of $7,500, $4,000 and $0 on loans that are past due 90 days and still accruing during the years ended December 31, 2010, 2009 and 2008, respectively. The Company had $51.2 million and $8.8 million of restructured loans as of December 31, 2010 and 2009, respectively.

The Company's net interest income was adversely affected by the increase in the average balance of nonaccrual loans that increased to $35.3 million during the year ended December 31, 2010, compared to $22.4 million and $17.0 million during the years ended December 31, 2009 and 2008, respectively. Lost interest, interest not recorded in the accompanying consolidated statements of operations related to loans on nonaccrual, loans charged off during the period, and loans transferred to real estate acquired through foreclosure, totaled approximately $3.2 million, $1.6 million and $1.2 million for the years ended December 31, 2010, 2009 and 2008, respectively

Loans serviced for the benefit of others under loan participation arrangements amounted to approximately $33.5 million and $32.4 million at December 31, 2010 and 2009, respectively.

Activity in loans to officers, directors and other related parties for the years ended December 31, 2010 and 2009 is summarized as follows:

	At December 31,	
	2010	2009
	(In thousands)	
Balance at beginning of year	$ **21,357**	20,584
New loans	**12,122**	9,044
Repayments	**(10,558)**	(8,271)
Balance at end of year	$ **22,921**	21,357

In management's opinion, related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with an unrelated person and generally do not involve more than the normal risk of collectability.

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

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments as for on-balance sheet instruments. At December 31, 2010 and 2009, the Banks had commitments to extend credit in the amount of $36.3 million and $50.1 million, respectively. At December 31, 2010 and 2009, the Banks had standby letters of credit in the amount of $558,000 and $910,000, respectively.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require a payment of a fee. Since commitments may expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include inventory, property and equipment, residential real estate and income producing commercial properties.

NOTE 5 - PREMISES AND EQUIPMENT, NET

Premises and equipment, net at December 31, 2010 and 2009 consists of the following:

	At December 31,	
	2010	2009
	(In thousands)	
Land	$ **5,029**	5,040
Buildings	**11,277**	11,277
Furniture, fixtures and equipment	**7,698**	7,123
Construction in process	**25**	25
Total premises and equipment	**24,029**	23,465
Less: accumulated depreciation	**(7,221)**	(6,022)
Premises and equipment, net	$ **16,808**	17,443

Depreciation expense included in operating expenses for the years ended December 31, 2010, 2009 and 2008 amounted to $1.3 million, $1.2 million, and $1.3 million, respectively. There was no interest capitalized during fiscal 2010 and 2009.

NOTE 6 – REAL ESTATE ACQUIRED THROUGH FORECLOSURE

Transactions in other real estate owned for the years ended December 31, 2010 and 2009 are summarized below:

	At December 31,	
	2010	2009
	(In thousands)	
Balance at beginning of year	$ **7,853**	7,105
Additions	**10,947**	8,507
Sales	**(5,921)**	(6,264)
Write downs	**(2,063)**	(1,495)
Balance at end of year	$ **10,816**	7,853

A summary of the composition of real estate acquired through foreclosure follows:

	At December 31,	
	2010	2009
	(In thousands)	
Real estate loans:		
One-to-four family	$ **1,887**	766
Commercial real estate	**299**	284
Construction and development	**8,630**	6,803
	$ **10,816**	7,853

NOTE 7 – MORTGAGE SERVICING RIGHTS

Mortgage loans serviced for others are not included in the accompanying statement of financial condition. The value of mortgage servicing rights is included in other assets on the Company's statement of financial condition. The unpaid principal balances of loans serviced for others were $877.1 million and $282.5 million, respectively, at December 31, 2010 and 2009.

The economic estimated fair values of mortgage servicing rights were $9.8 million and $3.1 million, respectively, at December 31, 2010 and 2009. The estimated fair value of servicing rights at December 31, 2010 were determined using discount rates ranging from 9.50% to 18.46%, prepayment speed assumptions ("PSA") ranging from 118.0 to 576.2, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of 0.90% as determined by a third party. The estimated fair value of servicing rights at December 31, 2009 were determined using discount rates ranging from 9.50% to 17.29%, prepayment speed assumptions ("PSA") ranging from 135.5 to 423.6, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of 3.89% as determined by a third party.

During 2010, servicing rights related to approximately $191.8 million of unpaid loan principal serviced for others were sold. The Company received $1.8 million in proceeds and recognized a gain in the accompanying consolidated statement of operations of $526,000.

The following summarizes the activity in mortgage servicing rights, along with the aggregate activity in the related valuation allowances, for the years ended December 31, 2010 and 2009:

	At December 31,	
	2010	2009
	(In thousands)	
MSR beginning balance	$ **1,797**	250
Amount capitalized	**5,387**	1,717
Amount sold	**(1,284)**	-
Amount amortized	**(651)**	(275)
Recovery for loss in fair value	-	105
MSR ending balance	$ **5,249**	1,797

Activity in the allowance for loss in fair value in mortgage servicing rights for the years ended December 31, 2010 and 2009 are as follows:

	At December 31,	
	2010	2009
	(In thousands)	
Balance at beginning of year	$ -	105
Provision for loss in fair value	-	-
Impairment recoveries	-	(105)
Balance at end of year	$ -	-

The estimated amortization expense for mortgage servicing rights for the years ended December 31, 2011, 2012, 2013, 2014, 2015 and thereafter is $714,000, $640,000, $564,000, $493,000, $428,000 and $2.41 million, respectively. The estimated amortization expense is based on current information regarding loan payments and prepayments. Amortization expense could change in future periods based on changes in the volume of prepayments and economic factors.

At December 31, 2010 and 2009, servicing related trust funds of approximately $5.1 million, and $401,000, respectively, representing both principal and interest due investors and escrows received from borrowers, are on deposit in affiliated trust bank custodial accounts and are included in noninterest-bearing deposits in the accompanying financial statements.

At December 31, 2010 and 2009, the Company had blanket bond coverage of $5.0 million and errors and omissions coverage of $5.0 million.

NOTE 8 - DEPOSITS

Deposits outstanding by type of account at December 31, 2010 and 2009 are summarized as follows:

	At December 31,	
	2010	2009
	(In thousands)	
Noninterest-bearing demand accounts	**$ 51,509**	37,543
Interest-bearing demand accounts	**34,555**	31,710
Savings accounts	**3,722**	2,824
Money market accounts	**192,243**	155,019
Certificates of deposit		
1.00% to 2.99%	**402,630**	465,140
3.00% to 4.99%	**4,424**	67,389
5.00% to 7.99%	**731**	1,483
Total certificates of deposit	**407,785**	534,012
Total deposits	**$ 689,814**	761,108

The aggregate amount of certificates of deposit, excluding brokered deposits, with a minimum denomination of $100,000 was $35.7 million and $118.9 million at December 31, 2010 and 2009, respectively. The aggregate amount of brokered certificates of deposit was $45.2 million and $115.7 million at December 31, 2010 and 2009, respectively. The aggregate amount of institutional certificates of deposit was $50.6 million and $32.2 million at December 31, 2010 and 2009, respectively.

The amounts and scheduled maturities of certificates of deposit at December 31, 2010 and 2009 are as follows:

	At December 31,	
	2010	2009
	(In thousands)	
Maturing within one year	**$ 322,049**	425,397
Maturing one through three years	**80,575**	105,422
Maturing after three years	**5,161**	3,193
	$ 407,785	534,012

The Company has pledged $1.5 million of U.S. government agencies and corporations' securities available for sale as of December 31, 2010, respectively, to secure public agency funds.

NOTE 9 – SHORT-TERM BORROWED FUNDS

Short-term borrowed funds at December 31, 2010 and 2009 are summarized as follows:

	At December 31,			
	2010		2009	
	Balance	**Interest Rate**	Balance	Interest Rate
	(Dollars in thousands)			
Unsecured line of credit	**$ 3,000**	**4.75%**	3,000	4.75%
Short-term FHLB advances	**50,500**	**0.19%-3.70%**	21,500	0.36%-2.72%
Mortgage loan warehouse line of credit	**3,959**	**3.5%-5.50%**	19,062	5.25%-8.50%
Subordinated debenture, due 2020	**300**	**2.74%**	225	2.75%
Total short-term borrowed funds	**$ 57,759**		43,787	

Lines of credit with the Federal Home Loan Bank of Atlanta are based upon FHLB-approved percentages of Bank assets, but must be supported by appropriate collateral to be available. The Banks have pledged first lien residential mortgage, second lien residential mortgage, residential home equity line of credit, commercial mortgage and multifamily mortgage portfolios under blanket lien agreements resulting in approximately $160.0 million of collateral for these advances. In addition, at December 31, 2010, the Company has pledged $58.6 million of securities for these advances. At December 31, 2010, the Banks had maximum FHLB lines of $290.6 million based on FHLB limits. At December 31, 2010, collateral totaling $218.6 million was pledged to support FHLB advances. At December 31, 2010 the Banks had FHLB advances of $125.5 million outstanding with excess collateral pledged to the FHLB during those periods that would support additional borrowings of approximately $93.1 million.

Lines of credit with the FRB are based on collateral pledged. The Banks have pledged certain non-mortgage commercial, acquisition and development, and lot loan portfolios under blanket lien agreements resulting in approximately $34.0 million of collateral to the FRB for these advances. At December 31, 2010 the Banks had lines available with the FRB for $34.0 million. At December 31, 2010 the Banks had no FRB advances outstanding.

At December 31, 2010, Crescent Mortgage had a mortgage loan warehouse line of credit from a correspondent with a $35.0 million credit limit, of which $31.0 million is still available. The facility is secured by Crescent Mortgage's residential mortgage loans held for sale and other assets.

Effective October 1, 2009, the Company modified a $5.0 million unsecured line of credit with a correspondent bank, of which $3.0 million was outstanding at December 31, 2010 and December 31, 2009. The unsecured line of credit bears interest at prime plus 1.50% and the term expires October 1, 2011. In connection with this modification, the Company obtained a $3.0 million subordinated debenture that requires the Company to keep at least a $500,000 principal balance outstanding on the line of credit until the subordinated debenture is paid in full. If the Company does not maintain the $500,000 balance, there is a $150,000 prepayment penalty. During the year ended December 31, 2010 and 2009, the Company maintained at least a $500,000 principal balance outstanding on the line of credit. Also as a result of the modification, no additional advances can be made on this unsecured line of credit. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios, nonperforming asset ratios and return on asset ratios. As of December 31, 2010 and 2009, the Company is not in compliance with all of the covenants. While the lender has not called the line of credit, it has the right to do so. Accordingly, the Company has developed alternatives to replace the line of credit, if necessary, by restructuring the existing loan, obtaining financing from other sources or raising capital. As a result, management does not believe that default of this covenant will have a material adverse effect on the Company's financial condition or the results of its operations.

The Company has a subordinated debenture totaling $3.0 million that has principal repayments that began in 2010. See Note 10 – Long-Term Debt for additional disclosure.

In addition, at December 31, 2010, the Banks had $7.2 million available under federal funds purchase line agreements with correspondent banks.

In connection with the Company's balance sheet management to preserve capital, certain borrowings were prepaid to manage the related interest rate sensitivity, resulting in a net loss on the extinguishment of debt of $2.5 million, $711,000 and $52,000 during 2010, 2009 and 2008, respectively

NOTE 10 – LONG-TERM DEBT

Long-term debt at December 31, 2010 and 2009 are summarized as follows:

	December 31, 2010	
	Balance	**Interest Rate**
	(Dollars in thousands)	
Long-term FHLB advances, due 2011 through 2021	**$ 75,000**	**0.00% - 4.23%**
TLGP, due 2012	**20,399**	**2.74%**
Subordinated debentures, due 2016 through 2020	**12,475**	**1.79% - 2.74%**
Subordinated debentures issued to Carolina Financial Capital Trust I, due 2032	**5,155**	**3.75%**
Subordinated debentures issued to Carolina Financial Capital Trust II, due 2034	**10,310**	**3.34%**
Total long-term debt	**$ 123,339**	

	December 31, 2009	
	Balance	Interest Rate
	(Dollars in thousands)	
Long-term FHLB advances, due 2011 through 2021	$ 155,000	0.00% - 4.23%
TLGP, due 2012	20,398	2.74%
Subordinated debentures, due 2016 through 2020	12,775	1.78% - 2.75%
Subordinated debentures issued to Carolina Financial Capital Trust I, due 2032	5,155	3.75%
Subordinated debentures issued to Carolina Financial Capital Trust II, due 2034	10,310	3.33%
Total long-term debt	$ 203,638	

As of December 31, 2010, the principal amounts due on long-term debt in 2011, 2012, 2013, 2014, 2015 and thereafter were $57.8 million, $30.7 million, $15.3 million, $5.3 million, $5.3 million and $66.7 million, respectively. As of December 31, 2010, the principal amounts callable by the FHLB on advances in 2011, 2012, 2013, 2014 and 2015 were $35.0 million, $5.0 million, $5.0 million, and $0 million, respectively.

Long-term FHLB borrowings include two advances totaling $35.0 million that currently have a rate of zero percent. These two advances have a one-time call feature at the FHLB's option during the first quarter of 2011. If the advances are not called, both advances then convert to ten year fixed rate advances at 4.00%.

During 2009 the Company issued $20.4 million of indebtedness under the Federal Deposit Insurance Corporation's ("FDIC") Temporary Liquidity Guarantee Program ("TLGP"). The FDIC guarantees the debt until its maturity in 2012.

At December 31, 2010 and 2009, statutory business trusts ("Trusts") created by the Company had outstanding trust preferred securities with an aggregate par value of $15.0 million. The trust preferred securities have floating interest rates ranging from 3.34% to 3.75% at December 31, 2010 and maturities ranging from December 31, 2032 to January 7, 2034. The principal assets of the Trusts are $15.5 million of the Company's subordinated debentures with identical rates of interest and maturities as the trust preferred securities. The Trusts have issued $465,000 of common securities to the Company.

The trust preferred securities, the assets of the Trusts and the common securities issued by the Trusts are redeemable in whole or in part beginning on or after December 31, 2008, or at any time in whole but not in part from the date of issuance on the occurrence of certain events. The obligations of the Company with respect to the issuance of the trust preferred securities constitutes a full and unconditional guarantee by the Company of the Trusts' obligations with respect to the trust preferred securities. Subject to certain exceptions and limitations, the Company may elect from time to time to defer subordinated debenture interest payments, which would result in a deferral of distribution payments on the related trust preferred securities.

Beginning with the scheduled payment date of December 31, 2010, the Company has deferred the payment of interest on its outstanding subordinated debentures for an indefinite period (which can be no longer than 20 consecutive quarterly periods).

This and any future deferred distributions will continue to accrue interest. Distributions on the trust preferred securities are cumulative. Therefore, in accordance with generally accepted accounting principles, the Company will continue to accrue the monthly cost of the trust preferred securities as it has since issuance. The balance of deferred payments at December 31, 2010 is approximately $47,000. Subsequent to December 31, 2010, the Company deferred an additional $85,000 on its outstanding subordinated debentures.

As currently defined by the Federal Reserve Board, the Company had $15.0 million of long-term debt that qualified as Tier 1 capital at December 31, 2010 and 2009, respectively. The Company had $11.9 million and $12.2 million of long-term debt that qualified as Tier 2 capital at December 31, 2010 and 2009, respectively.

The Company has $3.0 million outstanding on an unsecured line of credit with a correspondent bank. See Note 9 – Short-Term Borrowed Funds for additional disclosure.

NOTE 11 - INCOME TAXES

Deferred tax assets are recognized for future deductible amounts resulting from differences in the financial statement and tax bases of assets and liabilities and operating loss carryforwards. A valuation allowance is then established to reduce that deferred tax asset to the level that it is "more likely than not" that the tax benefit will be realized. The realization of a deferred tax benefit by the Company depends upon having sufficient taxable income of an appropriate character in the future periods.
Income tax expense for the years ended December 31, 2010, 2009 and 2008 consists of the following:

	For the Year Ended December 31,		
	2010	2009	2008
		(In thousands)	
Current income tax expense (benefit)			
Federal	**$ (4,837)**	5,776	3,565
State	**435**	596	324
	(4,402)	6,372	3,889
Deferred income tax expense (benefit)			
Federal	**(1,433)**	(2,248)	(551)
State	**(37)**	229	(82)
	(1,470)	(2,019)	(633)
Total income tax expense (benefit)	**$ (5,872)**	4,353	3,256

A reconciliation from expected Federal tax expense to actual income tax expense for the years ended December 31, 2010, 2009 and 2008, using the base federal tax rates of 34%, 35% and 34%, respectively, follows:

	For the Year Ended December 31,		
	2010	2009	2008
		(In thousands)	
Computed federal income taxes (benefit)	**$ (6,276)**	4,033	2,994
State income tax, net of federal benefit	**263**	311	300
Change in valuation allowance	**(16)**	(38)	43
Other, net	**157**	47	(81)
Total income tax expense (benefit)	**$ (5,872)**	4,353	3,256

The following is a summary of the tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2010 and 2009:

	At December 31,	
	2010	2009
Deferred tax assets:	(In thousands)	
Loan loss reserve	**$ 4,104**	4,431
Loan fees	**101**	157
Unrealized loss on securities available for sale	**2,938**	4,417
Tax vs. book gain on loans held for sale	**28**	26
Debt issuance costs	**97**	101
Net operating loss carryforwards	**206**	106
Reserve for mortgage loan buy-back	**1,928**	1,031
OREO write-downs	**993**	353
Securities yield adjustments	**222**	230
Other	**271**	218
	10,888	11,070
Valuation allowance	**(148)**	(106)
Total gross deferred tax assets	**10,740**	10,964
Deferred tax liabilities:		
Depreciation	**(283)**	(360)
Stock-based compensation	**(44)**	(123)
Short-term disability accrual	**(73)**	(132)
Total gross deferred tax liabilities	**(400)**	(615)
Deferred tax assets, net	**$ 10,340**	10,349

A portion of the annual change in the net deferred income tax asset relates to unrealized gains and losses on debt and equity securities. The deferred income tax (benefit) related to the unrealized gains and losses on debt and equity securities of $53,000 and $2.1 million, respectively, for the years ended December 31, 2010 and 2009, respectively, was recorded directly to stockholders' equity as a component of accumulated other comprehensive income. The balance of the change in the net deferred tax asset of $1.5 million and $2.0 million, respectively, for the years ended December 31, 2010 and 2009, respectively, is reflected as a deferred income tax benefit in the consolidated statement of operations.

The valuation allowances relate to state net operating loss carry-forwards. It is management's belief that the realization of the remaining net deferred tax assets is more likely than not.

At December 31, 2010, income tax returns from 2009, 2008 and 2007 remain subject to review by tax authorities.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The Company has entered into agreements to lease its office facilities under non-cancellable operating lease agreements expiring on various dates through June 2020. The Company's rental expense for its office facilities for the years ended December 31, 2010, 2009 and 2008 totaled $719,000, $807,000 and $524,000, respectively.

Minimum rental commitments (in thousands) under the leases are as follows:

Year 1	$ 564
Year 2	581
Year 3	598
Year 4	434
Year 5	120
After Year 5	183
Total	$ 2,480

The Company is not a defendant in any lawsuits. One of its banking subsidiary's is a plaintiff in one lawsuit and a defendant in two lawsuits arising out of the normal course of business. The lawsuits are in their discovery phases and management does not have sufficient information with which to estimate potential ranges of loss, if any. Accordingly, no accrual related to these lawsuits has been recorded in accompanying statement of financial condition at December 31, 2010.

NOTE 13 – ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

Current accounting literature requires disclosures about the fair value of all financial instruments whether or not recognized in the balance sheet, for which it is practicable to estimate the value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized through immediate settlement of the instrument. Certain items are specifically excluded from disclosure requirements, including the Company's stock, premises and equipment, accrued interest receivable and payable and other assets and liabilities.

The fair value of a financial instrument is an amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced sale. Fair values are estimated at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

The Company has used Management's best estimate of fair value based on the above assumptions. Thus the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses that would be incurred in an actual sale or settlement are not taken into consideration in the fair values presented.

Cash and due from banks - The carrying amounts of these financial instruments approximate fair value. All mature within 90 days and present no anticipated credit concerns.

Interest-bearing cash - The carrying amount of these financial instruments approximate fair value.

Securities available for sale and securities held to maturity – Fair values for investment securities available for sale and securities held to maturity are based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Federal Home Loan Bank stock and other non-marketable equity securities - The carrying amount of these financial instruments approximate fair value.

Derivative assets – Fair values are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Loans held for sale and loans receivable, net - For variable-rate loans that re-price frequently and have no significant change in credit risk, estimated fair values are based on carrying values. Estimated fair values for certain mortgage loans, credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Estimated fair values for commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Estimated fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued interest receivable - The fair value approximates the carrying value.

Deposits - The estimated fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities.

Short-term borrowed funds - The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Estimated fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Long-term debt - The estimated fair values of the Company's long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Derivative liabilities - Fair values are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Commitments to extend credit – The carrying amounts of these commitments are considered to be a reasonable estimate of fair value because the commitments underlying interest rates are based upon current market rates.

Accrued interest payable - The fair value approximates the carrying value.

The carrying amount and estimated fair value of the Company's financial instruments at December 31, 2010 and 2009 are as follows:

	At December 31,			
	2010		2009	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets:	(In thousands)			
Cash and due from banks	**$ 3,322**	**3,322**	2,901	2,901
Interest-bearing cash	**21,415**	**21,415**	17,759	17,759
Securities available for sale	**151,574**	**151,574**	104,401	104,401
Securities held to maturity	**9,848**	**3,167**	125,633	105,450
Federal Home Loan Bank stock	**11,129**	**11,129**	12,456	12,456
Other investments	**465**	**465**	465	465
Derivative assets	**2,225**	**2,225**	2,342	2,342
Loans held for sale	**82,615**	**82,999**	71,233	71,682
Loans receivable, net	**583,995**	**588,935**	690,163	699,069
Accrued interest receivable	**3,483**	**3,483**	4,550	4,550
Financial liabilities:				
Deposits	**689,814**	**691,166**	761,108	731,567
Short-term borrowed funds	**57,759**	**57,917**	43,787	45,599
Long-term debt	**123,339**	**128,168**	203,638	209,359
Derivative liabilities	**173**	**173**	891	891
Accrued interest payable	**939**	**939**	1,484	1,484

	Notional Amount	**Estimated Fair Value**	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:	(In thousands)			
Commitments to extend credit	**$ 36,296**	**-**	50,100	-
Standby letters of credit	**558**	**-**	910	-
Derivative assets:				
Mortgage loan interest rate lock commitments	**197,075**	**449**	-	-
Mortgage loan forward sales commitments	**-**	**-**	46,588	428
Mortgage-backed securities forward sales commitments	**175,000**	**1,776**	130,000	1,914
Derivative liabilities:				
Mortgage loan interest rate lock commitments	**-**	**-**	177,282	891
Mortgage loan forward sales commitments	**22,842**	**173**	-	-

In determining appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to fair value disclosures. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

Assets and liabilities that are carried at fair value are classified in one of the following three categories based on a hierarchy for ranking the quality and reliability of the information used to determine fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.
Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.
Level 3 Unobservable inputs that are not corroborated by market data.

Assets and liabilities measured at fair value on a recurring basis are as follows as of December 31, 2010 and 2009:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
		(In thousands)	
December 31, 2010:			
Available-for-sale investment securities:			
GNMA	**$ -**	**22,539**	**-**
Mortgage-backed securities	**-**	**129,035**	**-**
Derivative assets:			
Mortgage loan interest rate lock commitments	**-**	**449**	**-**
Mortgage-backed securities forward sales commitments		**1,776**	
Derivative liabilities-			
Mortgage loan forward sales commitments	**-**	**173**	**-**
Total	**$ -**	**153,972**	**-**
December 31, 2009:			
Available-for-sale investment securities:			
GNMA	$ -	4,117	-
Mortgage-backed securities	-	100,284	-
Derivative assets:			
Mortgage loan forward sales commitments	-	428	-
Mortgage-backed securities forward sales commitments	-	1,914	-
Derivative liabilities-			
Mortgage loan interest rate lock commitments	-	891	-
Total	$ -	107,634	-

Assets measured at fair value on a nonrecurring basis are as follows as of December 31, 2010 and 2009:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
		(In thousands)	
December 31, 2010:			
Impaired loans	**$ -**	**70,024**	**-**
Real estated owned	**-**	**10,816**	**-**
Total	**$ -**	**80,840**	**-**
December 31, 2009:			
Impaired loans	$ -	65,152	-
Real estated owned	-	7,853	-
Total	$ -	73,005	-

The Company predominantly lends with real estate serving as collateral on a substantial majority of loans. Loans that are deemed to be impaired are primarily valued at fair values of the underlying real estate collateral.

NOTE 14 - OFF-BALANCE SHEET FINANCIAL INSTRUMENTS AND CONCENTRATIONS OF CREDIT RISK

The Company is 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 commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments as for on-balance sheet instruments. At December 31, 2010 and 2009, the Banks had commitments to extend credit in the amount of $36.3 million and $50.1 million, respectively. At December 31, 2010 and 2009, the Banks had standby letters of credit in the amount of $558,000 and $910,000, respectively.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require a payment of a fee. Since commitments may expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include inventory, property and equipment, residential real estate and income producing commercial properties.

Standby letters of credit obligate the Company to meet certain financial obligations of its customers, if, under the contractual terms of the agreement, the customers are unable to do so. Payment is only guaranteed under these letters of credit upon the borrower's failure to perform its obligations to the beneficiary. The Company can seek recovery of the amounts paid from the borrower and the letters of credit are generally not collateralized. Commitments under standby letters of credit are usually one year or less. At December 31, 2010, the Company has recorded no liability for the current carrying amount of the obligation to perform as a guarantor; as such amounts are not considered material. The maximum potential of undiscounted future payments related to standby letters of credit at December 31, 2010 was approximately $558,000.

The Company uses derivatives primarily to neutralize interest rate risk related to its pipeline of interest rate lock commitments issued on residential mortgage loans in the process of origination for sale. At December 31, 2010 and 2009, the Company's outstanding mortgage interest rate lock commitments totaled $197.1 million and $177.3 million, respectively. The Company uses forward mortgage loan sales commitments and mortgage-backed securities forward sales commitments that generally correspond with the composition of the locked pipeline to hedge a percentage of the Company's pipeline of mortgage loan interest rate lock commitments and loans held for sale. At December 31, 2010 and 2009, the Company's outstanding forward mortgage loan sales commitments totaled $22.8 million and $46.6 million, respectively. At December 31, 2010 and 2009, the Company's outstanding mortgage-backed forward sales commitments totaled $175.0 million and $130.0 million, respectively. The Company's derivative positions are marked to market as shown in Note 3 - Derivatives.

Management closely monitors its credit concentrations and attempts to diversify the portfolio within its market area. The Company's markets are concentrated along coastal South Carolina. A summary of commercial real estate credit concentrations follows:

	At December 31,	
	2010	2009
	(In thousands)	
Commercial real estate loans, excluding owner occupied and unfunded commitments	**$ 236,408**	288,640
Loans secured by owner occupied commercial real estate	**130,879**	135,546
Unfunded commitments of commercial real estate	**7,222**	7,187
Total	**$ 374,509**	431,373

NOTE 15 - EMPLOYEE BENEFIT PLANS

The Company maintains a 401(k) plan that covers substantially all employees of Community FirstBank, Crescent Bank, and Carolina Services ("CFC participants"). During 2004, the Company added Crescent Mortgage ("CMC Participants") as a separate group that participated in the plan. Participants may contribute up to the maximum allowed by the regulation. During fiscal 2010 and 2009, the Company matched 75% of an employee's contribution up to 6.00% of the participant's

compensation of the CFC Participants and the CMC Participants. For the years ended December 31, 2010, 2009 and 2008, the Company made matching contributions of $448,000, $370,000 and $289,000, respectively.

The Company has an arrangement with four executives whereby the Company paid a lump sum payment to an insurance company on behalf of the executives. The advance is treated as a loan to the executives and the cash surrender value of the payment to the insurance company is included in other assets in the accompanying consolidated statements of financial condition. The cash surrender value of the advance at December 31, 2010 and 2009 is $1.4 million and $1.6 million, respectively. The executives are entitled to the increase in cash value above the Company's original cash value insurance contributions. The executives pay the Company imputed interest on the loan balance and the increase in the cash value is recorded as compensation to the executives. The insurance policy premiums are paid in full by the executives. Generally, each executive is entitled to receive a $1.0 million death benefit and the Company will receive a $1.8 million death benefit. Since the executives pay the insurance premiums, the insurance proceeds would be taxable to the Company.

NOTE 16 - EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share are calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding plus the weighted average number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Diluted earnings (loss) per share include the effects of outstanding stock options issued by the Company if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period.

The following is a summary of the reconciliation of average shares outstanding for the years ended December 31, 2010, 2009 and 2008:

	December 31,					
	2010		2009		2008	
	Basic	**Diluted**	Basic	Diluted	Basic	Diluted
Weighted average shares outstanding	**1,913,240**	**1,913,240**	1,912,449	1,912,449	1,883,101	1,883,101
Effect of dilutive securities - stock options	**-**	**-**	-	12,271	-	77,261
Average shares outstanding	**1,913,240**	**1,913,240**	1,912,449	1,924,720	1,883,101	1,960,362

The average market price used in calculating the dilutive securities under the treasury stock method for the years ended December 31, 2010, 2009 and 2008 was $14.90, $17.53 and $44.92, respectively. For the year ended December 31, 2010, 144,980 option shares were excluded from the calculation of diluted earnings per share during the period because the exercise prices were greater than the average market price of the common shares, and therefore would have been anti-dilutive. For fiscal years 2009 and 2008, there were no options excluded from the calculation of diluted earnings per share. The Company does not have an actively traded market for its shares and, accordingly, the average market price used in calculating dilutive securities is based either on a very limited number of transactions or on an internal valuation model.

NOTE 17 - CAPITAL REQUIREMENTS AND OTHER RESTRICTIONS

The Company and the Banks are subject to various federal and state regulatory requirements, including regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions that if undertaken could have a direct material effect on the Company's and the Banks' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Banks must meet specific capital guidelines that involve quantitative measures of the Company's and the Banks' assets, liabilities, and certain off-balance sheet items as calculated under regulatory methods. The Company's and the Banks' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weighting and other factors. As of December 31, 2010, the most recent notification from federal banking agencies categorized the Company and the Banks as "well capitalized" under the regulatory framework. In order to be considered "adequately capitalized", the Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets and Tier 1 capital to total average assets of 4%, 8%, and 3%, respectively. In order to be considered "well capitalized", the

Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets and Tier 1 capital to total average assets of 6%, 10%, and 5%, respectively. Since December 31, 2010, there have been no events or conditions that management believes have changed the Company's or the Banks' regulatory capital categories.

The actual capital amounts and ratios for the Company and the Banks at December 31, 2010 and 2009 are as follows:

	At December 31,			
	2010		2009	
	Amount	**Ratio**	Amount	Ratio
	(Dollars in thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	**66,576**	**9.3%**	78,773	9.2%
Total risk based capital (to risk weighted assets)	**87,479**	**12.2%**	101,696	11.9%
Tier 1 capital (to total average assets)	**66,576**	**6.9%**	78,773	7.3%
Community FirstBank				
Tier 1 capital (to risk weighted assets)	**44,373**	**10.6%**	45,166	10.4%
Total risk based capital (to risk weighted assets)	**54,660**	**13.0%**	55,633	12.8%
Tier 1 capital (to total average assets)	**44,373**	**7.6%**	45,166	7.7%
Crescent Bank				
Tier 1 capital (to risk weighted assets)	**24,383**	**8.2%**	35,404	8.4%
Total risk based capital (to risk weighted assets)	**34,989**	**11.8%**	47,849	11.4%
Tier 1 capital (to total average assets)	**24,383**	**6.4%**	35,404	7.2%

Any future dividend payments by the Company will be made primarily from dividends received from the Banks. Under applicable federal law, the Banks are restricted to total dividend payments in any calendar year to net profits of that year combined with retained net profits for the two preceding years. At December 31, 2010, the Banks had no retained net profits available for dividends.

NOTE 18 – SUPPLEMENTAL SEGMENT INFORMATION

The Company has three reportable segments: community banking, mortgage banking and other. The community banking segment provides traditional banking services offered through Community FirstBank and Crescent Bank. The mortgage banking segment provides mortgage loan origination and servicing offered through Crescent Mortgage. The other segment provides managerial and operational support to the other business segments through Carolina Services and Carolina Financial.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on net income.

The Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were to third parties, that is, at current market prices.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment has different types and levels of credit and interest rate risk.

The following tables present selected financial information for the Company's reportable business segments for the years ended December 31, 2010, 2009 and 2008:

For the Year Ended December 31, 2010	**Community Banking**	**Mortgage Banking**	**Other**	**Eliminations**	**Total**
			(In thousands)		
Interest income	**$ 45,955**	**891**	**18**	**(22)**	**46,842**
Interest expense	**15,914**	**467**	**718**	**(22)**	**17,077**
Net interest income (expense)	**30,041**	**424**	**(700)**	**-**	**29,765**
Provision for loan losses	**30,755**	**-**	**-**	**-**	**30,755**
Noninterest income (expense) from external customers	**(4,073)**	**24,631**	**1,042**	**-**	**21,600**
Intersegment noninterest income	**-**	**-**	**5,812**	**(5,812)**	**-**
Noninterest expense	**18,694**	**14,600**	**5,776**	**-**	**39,070**
Intersegment noninterest expense	**4,852**	**960**	**-**	**(5,812)**	**-**
Income (loss) before income taxes	**(28,333)**	**9,495**	**378**	**-**	**(18,460)**
Income tax expense (benefit)	**(9,632)**	**3,608**	**152**	**-**	**(5,872)**
Net income (loss)	**$ (18,701)**	**5,887**	**226**	**-**	**(12,588)**
Assets	**$ 917,791**	**29,669**	**71,063**	**(87,774)**	**930,749**
Loans receivable, net	**583,666**	**529**	**-**	**(200)**	**583,995**
Loans held for sale	**67,732**	**14,883**	**-**	**-**	**82,615**
Deposits	**690,969**	**-**	**-**	**(1,155)**	**689,814**
Borrowed funds	**158,675**	**3,959**	**18,665**	**(201)**	**181,098**

For the Year Ended December 31, 2009	Community Banking	Mortgage Banking	Other	Eliminations	Total
			(In thousands)		
Interest income	$ 55,296	1,431	23	(14)	56,736
Interest expense	23,283	1,037	713	(14)	25,019
Net interest income (expense)	32,013	394	(690)	-	31,717
Provision for loan losses	10,460	-	-	-	10,460
Noninterest income from external customers	4,014	23,924	-	-	27,938
Intersegment noninterest income	-	-	4,422	(4,422)	-
Noninterest expense	18,038	14,211	5,424	-	37,673
Intersegment noninterest expense	3,840	582	-	(4,422)	-
Income (loss) before income taxes	3,689	9,525	(1,692)	-	11,522
Income tax expense (benefit)	1,348	3,594	(589)	-	4,353
Net income (loss)	$ 2,341	5,931	(1,103)	-	7,169
Assets	$ 1,051,233	35,607	83,753	(91,836)	1,078,757
Loans receivable, net	690,563	-	-	(400)	690,163
Loans held for sale	43,412	27,821	-	-	71,233
Deposits	763,538	-	-	(2,430)	761,108
Borrowed funds	209,899	19,062	18,865	(401)	247,425

For the Year Ended December 31, 2008	Community Banking	Mortgage Banking	Other	Eliminations	Total
			(In thousands)		
Interest income	$ 62,064	960	72	(47)	63,049
Interest expense	31,488	539	1,247	(47)	33,227
Net interest income (expense)	30,576	421	(1,175)	-	29,822
Provision for loan losses	6,361	-	-	-	6,361
Noninterest income (expense) from external customers	4,304	5,260	(337)	-	9,227
Intersegment noninterest income	-	-	4,536	(4,536)	-
Noninterest expense	14,186	4,939	4,757	-	23,882
Intersegment noninterest expense	3,780	756	-	(4,536)	-
Income (loss) before income taxes	10,553	(14)	(1,733)	-	8,806
Income tax expense (benefit)	3,853	(5)	(592)	-	3,256
Net income (loss)	$ 6,700	(9)	(1,141)	-	5,550
Assets	$ 1,111,268	26,827	76,520	(75,621)	1,138,994
Loans receivable, net	776,802	156	-	(337)	776,621
Loans held for sale	6,684	21,599	-	-	28,283
Deposits	719,655	-	-	(2,266)	717,389
Borrowed funds	327,001	21,090	18,802	(338)	366,555

NOTE 19 - PARENT COMPANY FINANCIAL INFORMATION

The condensed financial statements for the parent company are presented below:

Carolina Financial Corporation
Condensed Statements of Financial Condition

	At December 31, 2010	At December 31, 2009
	(In thousands)	
Assets:		
Cash and cash equivalents	**$ 311**	895
Investment in bank subsidiaries	**63,675**	72,627
Investment in non-bank subsidiaries	**490**	372
Investment in unconsolidated statutory business trusts	**465**	465
Securities available for sale	**9**	502
Other assets	**143**	127
Total assets	**$ 65,093**	74,988
Liabilities and stockholders' equity:		
Accrued expenses and other liabilities	**134**	385
Short-term debt	**3,000**	3,000
Long-term debt	**15,465**	15,465
Stockholders' equity	**46,494**	56,138
Total liabilities and stockholders' equity	**$ 65,093**	74,988

Carolina Financial Corporation
Condensed Statements of Operations

	For the Year Ended December 31,		
	2010	2009	2008
		(In thousands)	
Dividend income from bank subsidiaries	**$ -**	900	-
Dividend income from non-bank subsidiaries	**300**	1,000	-
Interest income	**18**	23	40
Gain on sale of securities available for sale	**1,042**	-	-
Other income	**-**	126	300
Total income	**1,360**	2,049	340
Interest expense	**697**	704	1,210
General and administrative expenses	**653**	805	755
Total expenses	**1,350**	1,509	1,965
Income (loss) before income taxes and equity in undistributed earnings (losses) of subsidiaries	**10**	540	(1,625)
Income tax benefit	**(99)**	(464)	(552)
Income (loss) before equity in undistributed earnings of subsidiaries	**109**	1,004	(1,073)
Equity in undistributed earnings (losses) of Community FirstBank	**(793)**	1,894	3,108
Equity in undistributed earnings (losses) of Crescent Bank	**(12,021)**	1,598	3,592
Equity in undistributed earnings (losses) of Crescent Mortgage	**-**	2,881	(9)
Equity in undistributed earnings (losses) of Carolina Services	**117**	(208)	(68)
Total equity in undistributed earnings (losses) of subsidiaries	**(12,697)**	6,165	6,623
Net income (loss)	**$ (12,588)**	7,169	5,550

Carolina Financial Corporation
Condensed Statements of Cash Flows

	For the Year Ended December 31,		
	2010	2009	2008
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	**$ (12,588)**	7,169	5,550
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Equity in undistributed earnings (losses) in subsidiaries	**12,697**	(6,165)	(6,623)
Gain on sale of securities available for sale	**(1,042)**	-	-
Stock-based compensation	**391**	390	365
(Increase) decrease in other assets	**144**	(8)	39
Increase (decrease) in other liabilities	**(251)**	(508)	(111)
Net cash provided by (used in) operating activities	**(649)**	878	(780)
Cash flows from investing activities:			
Purchase of securities available for sale	**-**	(35)	-
Proceeds from the sale of securities available for sale	**1,065**	-	-
Equity investment in bank subsidiaries	**(1,000)**	(700)	-
Net cash provided by (used in) financing activities	**65**	(735)	-
Cash flows from financing activities -			
Proceeds from exercise of stock options	**-**	5	844
Net cash provided by financing activities	**-**	5	844
Net increase (decrease) in cash and cash equivalents	**(584)**	148	64
Cash and cash equivalents, beginning of year	**895**	747	683
Cash and cash equivalents, end of year	**$ 311**	895	747

NOTE 20 – QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below represent the quarterly results of operations for the years ending December 31, 2010, 2009 and 2008 respectively:

	For the Year Ended December 31, 2010			
	First	**Second**	**Third**	**Fourth**
	(In thousands, except per share data)			
Total interest income	**$ 12,563**	**12,242**	**11,657**	**10,380**
Total interest expense	**4,708**	**4,580**	**4,158**	**3,631**
Net interest income	**7,855**	**7,662**	**7,499**	**6,749**
Provision for loan losses	**4,940**	**9,630**	**8,030**	**8,155**
Net interest income (loss) after provision for loan losses	**2,915**	**(1,968)**	**(531)**	**(1,406)**
Noninterest income	**5,184**	**5,432**	**7,658**	**3,326**
Noninterest expense	**8,442**	**9,102**	**10,563**	**10,963**
Loss before taxes	**(343)**	**(5,638)**	**(3,436)**	**(9,043)**
Income tax benefit	**(88)**	**(2,037)**	**(885)**	**(2,862)**
Net loss	**$ (255)**	**(3,601)**	**(2,551)**	**(6,181)**
Basic earnings (losses) per share	**$ (0.14)**	**(1.88)**	**(1.33)**	**(3.23)**
Diluted earnings (losses) per share	**$ (0.14)**	**(1.88)**	**(1.33)**	**(3.23)**

	For the Year Ended December 31, 2009			
	First	Second	Third	Fourth
	(In thousands, except per share data)			
Total interest income	$ 14,587	14,458	14,039	13,652
Total interest expense	6,992	6,626	5,950	5,451
Net interest income	7,595	7,832	8,089	8,201
Provision for loan losses	1,661	2,206	2,516	4,077
Net interest income after provision for loan losses	5,934	5,626	5,573	4,124
Noninterest income	5,354	8,469	5,624	8,491
Noninterest expense	7,901	10,097	9,049	10,626
Income before taxes	3,387	3,998	2,148	1,989
Income tax expense	1,249	1,525	813	766
Net income	$ 2,138	2,473	1,335	1,223
Basic earnings per share	$ 1.12	1.29	0.70	0.64
Diluted earnings per share	$ 1.12	1.29	0.70	0.61

	For the Year Ended December 31, 2008			
	First	Second	Third	Fourth
	(In thousands, except per share data)			
Total interest income	$ 16,694	15,612	15,401	15,342
Total interest expense	9,476	8,311	7,725	7,715
Net interest income	7,218	7,301	7,676	7,627
Provision for loan losses	1,280	607	1,524	2,950
Net interest income after provision for loan losses	5,938	6,694	6,152	4,677
Noninterest income	3,192	2,473	1,713	1,849
Noninterest expense	6,227	6,488	5,152	6,015
Income before taxes	2,903	2,679	2,713	511
Income tax expense	1,068	979	1,012	197
Net income	$ 1,835	1,700	1,701	314
Basic earnings per share	$ 1.01	0.89	0.89	0.16
Diluted earnings per share	$ 0.94	0.87	0.86	0.16

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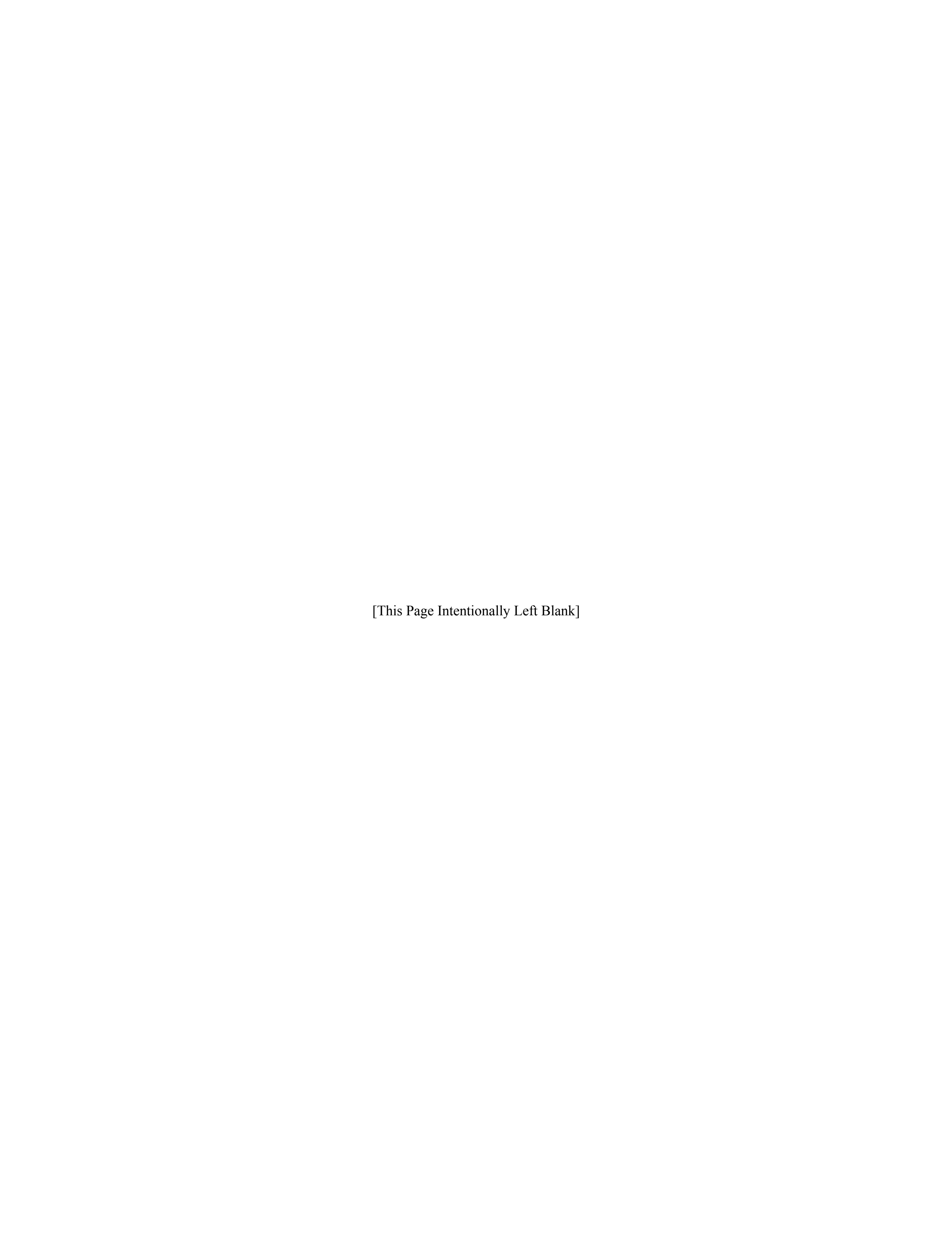
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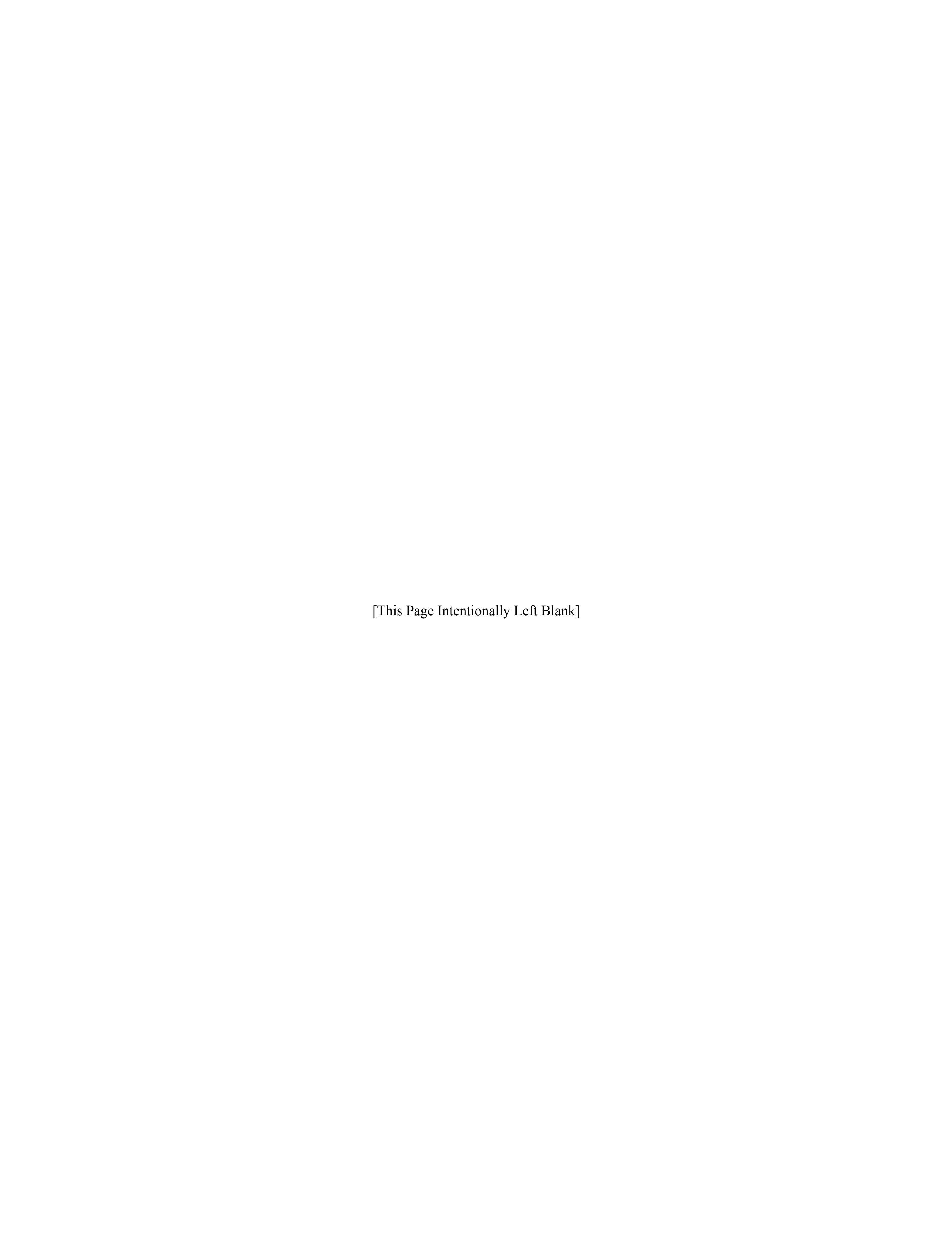

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