CAROLINA FINANCIAL
CORPORATION

2012 ANNUAL REPORT

March 15, 2013

Dear Shareholder,

Carolina Financial Corporation is pleased to report record net income for the year ended December 31, 2012 of $16.9 million, or $8.80 per diluted share, as compared to a net loss of $971,000, or ($0.51) per diluted share during the comparable prior year period. I am pleased to announce that CresCom Bank was reported as having the #1 return on assets and #1 return on equity of all banks in South Carolina for fiscal 2012, as reported by Financial Management Consulting Group.

In addition to Carolina Financial reporting record earnings, fiscal 2012 has been a year of significant accomplishments.

- Significantly Improved in Asset Quality
- Significantly Increased Capital Levels
- Crescent Mortgage Company reported record earnings, production and margin
- Over 15% growth in Core Deposits during fiscal 2012
- Resolved two of the three litigation matters addressed in the prior year's Annual Report
- Growth in total assets to $888.7 million

These items were accomplished despite the announcement of an approximate $4 million kite fraud perpetrated by a business customer against CresCom Bank identified in May 2012. I am pleased to announce that we have completed the restructuring of our operations group under the leadership of Jamin Hujik, CPA. In addition, under Mr. Hujik's leadership the Company has hired an SVP of Deposit Operations with over 30 years of banking experience. We believe the changes we have initiated along with our new Operations Leadership Team will greatly reduce these risks in the future and position our Company for growth.

The Company continues to be very focused on improving its asset quality and reducing non-performing assets (NPAs). NPAs have decreased 46.6% from $40.3 million at December 31, 2011, to $21.5 million at December 31, 2012, or 2.42% of total assets. This represents our lowest level of NPAs at a quarter-end since December 2008. As a result, the Company's provision for loan losses declined significantly from $10.7 in fiscal 2011 to $2.7 million in fiscal 2012.

Throughout 2012, the Company continued to increase its capital levels. At December 31, 2012, CresCom Bank's Tier 1 Capital was 10.0% compared to 8.2% at December 31, 2011. CresCom Bank's Total Risk Based Capital was 16.0% compared to 13.7% in the prior year. The Bank substantially exceeds the Tier 1 Well Capitalized and Risk Based Well Capitalized levels of 10% and 5%, respectively.

During fiscal 2012, Crescent Mortgage Company ("CMC") originated approximately $2.2 billion in loans held for sale compared to $1.3 billion in 2011. Net income from CMC increased to a record high $21.0 million for the year ended December 31, 2012 compared to $4.2 million for the year ended December 31, 2011. The mortgage banking industry is predicting that origination levels will decrease approximately 25% to 30% in 2013. CMC expects to experience a decrease in volume and margin on loans sold during 2013. As anticipated, year-to-date February 2013, we are seeing a slight decrease in originations versus originations a year earlier, with a decline in margins compared to year end 2012.

For fiscal 2012, Carolina Financial Corporation experienced a decline in loans receivables, net of $11.6 million or 2.3%, primarily resulting from the decline in non-performing loans. However, we are pleased to report that loans

receivable, net, increased by $8.4 million, or 1.7% in the fourth quarter 2012. Our fourth quarter marks the first material increase in our loan portfolio since September 2008. The Company is very focused on achieving material loan growth during 2013.

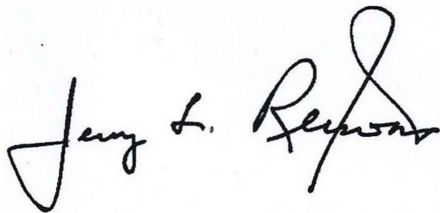
The Company continues to report significant growth in core deposits, defined as checking, money market and statement savings accounts. Core deposits increased $47.3 million, or almost 16%, compared to the prior year. The number of checking accounts also increased by 15% during fiscal 2012 compared to 2011. We remain very pleased with our growth in core deposits and plan significant marketing campaigns in 2013. You may have seen one of our checking ads on television, recently as they are being shown in both the Charleston and Myrtle Beach markets.

Total assets of the Company increased from $826.2 million at December 31, 2011 to $888.7 million at December 31, 2012. During 2013, the Company expects that loans held for sale will decrease but will be more than offset by our planned increase in our loans receivable portfolio. The Company expects to increase lending personnel in 2013 and is actively seeking to increase its commercial and residential lending opportunities.

During 2013 we expect to roll out several technology initiatives that will improve our Customer's banking experience. In the first quarter 2013, we began offering our new state of the art bill pay product. In addition, we expect CMC to enter new markets and are aggressively evaluating new branching opportunities for the Bank.

We remain focused on Bank profitability, growing core deposits, increasing cross sale opportunities, continuing to improve asset quality, and seeing renewed growth in our loans receivable. Management and the Board are confident that with focus, commitment, and action, we will continue sustained profitability and the financial strength to grow and thrive in the current economic environment.

Sincerely,



Jerry L. Rexroad
President and Chief Executive Officer

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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,				
	2012	2011	2010	2009	2008
Operating Data:	(In thousands)				
Interest income	**$ 35,358**	38,441	46,842	56,736	63,049
Interest expense	**7,513**	11,113	17,077	25,019	33,227
Net interest income	**27,845**	27,328	29,765	31,717	29,822
Provision for loan losses	**2,707**	10,735	30,755	10,460	6,361
Net interest income (loss) after provision for loan losses	**25,138**	16,593	(990)	21,257	23,461
Noninterest income	**52,284**	19,721	21,600	27,938	9,227
Noninterest expense	**50,149**	37,413	39,070	37,673	23,882
Income (loss) before income taxes	**27,273**	(1,099)	(18,460)	11,522	8,806
Income tax expense (benefit)	**10,395**	(128)	(5,872)	4,353	3,256
Net income (loss)	**$ 16,878**	(971)	(12,588)	7,169	5,550

	At December 31,				
	2012	2011	2010	2009	2008
Balance Sheet Data:	(In thousands)				
Total assets	**$ 888,724**	826,218	930,749	1,078,757	1,138,994
Interest-bearing cash	**11,340**	16,679	21,415	17,759	16,285
Securities available for sale	**149,670**	136,944	151,574	104,401	120,988
Securities held to maturity	**9,166**	9,401	9,848	125,633	113,689
Federal Home Loan Bank stock	**6,413**	7,185	11,129	12,456	11,874
Loans held for sale	**144,849**	80,007	82,615	71,233	28,283
Loans receivable, net	**501,691**	513,335	583,995	690,163	776,621
Allowance for loan losses	**9,520**	12,039	14,263	13,032	11,300
Deposits	**653,247**	621,803	689,814	761,108	717,389
Short-term borrowed funds	**82,482**	63,484	57,759	43,787	148,090
Long-term debt	**64,840**	80,390	123,339	203,638	218,465
Stockholders' equity	**67,514**	45,655	46,494	56,138	46,591

SUMMARY OF SELECTED FINANCIAL DATA

	For The Years Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Selected Average Balances:					
Total assets	**$ 837,066**	858,432	1,018,130	1,114,132	1,090,787
Loans receivable, net	**495,889**	545,556	640,646	737,448	774,183
Deposits	**641,085**	649,002	742,409	767,814	750,110
Stockholders' equity	**54,002**	47,003	50,065	51,949	47,552
Performance Ratios:					
Return on average equity	**31.25%**	(2.07)%	(25.14)%	13.80%	11.67%
Return on average assets	**2.02%**	(0.11)%	(1.24)%	0.64%	0.51%
Average earning assets to average total assets	**92.29%**	92.24%	94.24%	94.59%	95.66%
Average loans receivable, net to average deposits	**77.35%**	84.06%	86.29%	96.05%	103.21%
Average equity to average assets	**6.45%**	5.48%	4.92%	4.66%	4.36%
Net interest margin	**3.60%**	3.45%	3.10%	3.01%	2.86%
Net charge-offs to average loans receivable, net	**1.05%**	2.38%	4.61%	1.18%	0.66%
Non-performing assets to period end loans receivable, net	**4.29%**	7.84%	11.69%	5.17%	2.71%
Non-performing assets to total assets	**2.42%**	4.87%	7.33%	3.31%	1.85%
Non-performing loans to total loans	**2.98%**	6.50%	9.60%	3.96%	1.77%
Allowance for loan losses as a percentage of loans receivable (end of period)	**1.86%**	2.29%	2.38%	1.85%	1.43%
Allowance for loan losses as a percentage of nonperforming loans	**62.43%**	35.24%	24.84%	46.83%	81.08%

	At or For The Years Ended December 31,				
	2012	2011	2010	2009	2008
Per Share Data:					
Book value (end of period)	**$ 35.18**	23.79	24.23	29.35	24.36
Basic earnings (loss)	**8.80**	(0.51)	(6.58)	3.75	2.95
Diluted earnings (loss)	**8.80**	(0.51)	(6.58)	3.72	2.83
Average common shares - basic	**1,918,992**	1,918,992	1,913,240	1,912,449	1,883,101
Average common shares - diluted	**1,918,992**	1,918,992	1,913,240	1,924,720	1,960,362

Financial Discussion

The accompanying Financial Discussion is provided to assist the reader in understanding the consolidated financial statements of Carolina Financial Corporation (the "Company") and its wholly-owned subsidiary bank, CresCom Bank (the "Bank"). The Company is not a publicly traded company and therefore is not subject to the reporting and disclosure requirements of the Securities and Exchange Commission (the "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 Financial Discussion is not intended to comply with disclosure requirements of the SEC as enumerated above.

Effective July 31, 2011, the Company merged its wholly-owned subsidiary bank, Community FirstBank of Charleston ("Community FirstBank"), with and into its other wholly-owned subsidiary bank, Crescent Bank. In conjunction with this internal reorganization, Crescent Bank's name was changed to CresCom Bank and Crescent Mortgage Company ("Crescent Mortgage"), formerly a wholly-owned subsidiary of Community FirstBank, became a wholly-owned subsidiary of CresCom Bank.

Discussion of Forward-Looking Statements

The accompanying Financial Discussion contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 concerning risks and uncertainties about the financial condition and future operations of the Company, the Bank, and its wholly-owned subsidiary service corporation, Carolina Services Corporation of Charleston ("Carolina Services"). These statements are based on many assumptions and estimates and are not guarantees of future performance. The Company's actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which the Company is unsure, including many factors which are beyond the Company's control. The words "may," "would," "could," "should," "will," "expect," "anticipate," "predict," "project," "potential," "believe," "continue," "assume," "intend," "plan," and "estimate," as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause the Company's actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described below under "Risk Factors" and the following:

- credit losses as a result of declining real estate values, increasing interest rates, increasing unemployment, or changes in payment behavior or other factors;
- credit losses due to loan concentrations;
- changes in the amount of the Company's loan portfolio collateralized by real estate and weaknesses in the South Carolina and national real estate markets;
- restrictions or conditions imposed by the Company's regulators on the Company's operations;
- increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- changes in economic conditions resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in access to funding or increased regulatory requirements with regard to funding;
- increased cybersecurity risk, including potential business disruptions or financial losses;
- changes in deposit flows;
- changes in technology;

- the adequacy of the level of the Company's allowance for loan losses and the amount of loan loss provisions required in future periods;
- examinations by the Company's regulatory authorities, including the possibility that the regulatory authorities may, among other things, require the Company to increase its allowance for loan losses or write-down assets;
- changes in monetary and tax policies;
- changes in accounting policies and practices;
- the rate of delinquencies and amounts of loans charged-off;
- the Company's ability to maintain appropriate levels of capital and to comply with its capital ratio requirements;
- the Company's ability to attract and retain key personnel;
- the Company's ability to retain our existing clients, including our deposit relationships; and
- adverse changes in asset quality and resulting credit risk-related losses and expenses.

If any of these risks or uncertainties materialize, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, the Company's results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" contained herein. The Company urges investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this report. The Company makes these forward-looking statements as of the date of this document and does not intend, and assumes no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements.

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, provision for loan losses, and increased collection expenses 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 Company's primary markets in Charleston and Dorchester counties are heavily influenced by the Port of Charleston, the military, the medical industry and national and international industries. The Company's primary market areas

in Horry County are heavily influenced by tourism, retirement living, and retail. The real estate markets have experienced a significant decline in these markets and, if these economic drivers experience further downturns, real estate in the Company's markets may experience further declines. As of December 31, 2012, the Company's loan portfolio is primarily 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.

An Increase In Our Non-Performing Assets Would Adversely Impact Our Earnings.

At December 31, 2012, we had total non-performing assets of $21.5 million or 2.42% of total assets, compared to $40.3 million or 4.87% of total assets at December 31, 2011. Our non-performing assets may increase in future periods. 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 Earned Net Income In Fiscal 2012, But Experienced Net Losses In Fiscal 2011 And 2010.

We earned net income of $16.9 million in 2012, primarily due to the strong performance of the Company's wholesale mortgage business. However, we experienced a net loss of $1.0 million and $12.6 million for fiscal 2011 and 2010, respectively. In each of these years, the Company experienced significant losses related to historically elevated levels of non-performing assets, which necessitated a provision for loan losses of $2.7 million for fiscal 2012, $10.7 million for fiscal 2011, and $30.8 million for fiscal 2010. We had net charge offs of $5.2 million of loans during 2012, compared to $13.0 million of loans during 2011 and $29.5 million of charge offs during 2010. Non-accrual loans (generally loans 90 days or more past due in principal or interest payments) totaled $15.2 million, or 2.98% of total loans, net at December 31, 2012 compared to $29.9 million, or 5.70% of total loans, net at December 31, 2011. We also recognized other-than-temporary impairment losses related to our investment portfolio of $913,000 in the consolidated statements of operations for fiscal 2012, $1.8 million for fiscal 2011 and $2.5 million for fiscal 2010. Although the credit quality indicators generally showed improvement during fiscal 2012, if we experience further deterioration in our loan portfolio in addition to other factors and conditions out of our control such as weakness in our local economy, we may not be able to maintain profitability in the future.

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

At December 31, 2012, our exposure to commercial real estate loans totaled $240.8 million, or 45.5% of total gross loans receivable, our exposure to commercial business loans totaled $38.7 million, or 7.3% of total gross loans receivable, and our exposure to construction and development loans totaled $68.1 million, or 12.9% of total gross loans receivable. 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 2012, we had net charge offs of $1.2 million, $723,000 and $766,000 of commercial real estate loans, commercial business loans and construction and development loans, respectively.

Our Decisions Regarding Allowance For Loan Losses And Credit Risk May Materially And Adversely Affect Our Business.

Making loans and other extensions of credit is an essential element of our business. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans and other extensions of credit may not be repaid. The risk of nonpayment is affected by a number of factors, including:

- the duration of the credit;
- credit risks of a particular customer;
- changes in economic and industry conditions; and
- in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

We attempt to maintain an appropriate allowance for loan losses to provide for probable losses in our loan portfolio. We periodically determine the amount of the allowance based on consideration of several factors, including:

- an ongoing review of the quality, mix, and size of our overall loan portfolio;
- our historical loan loss experience;
- evaluation of economic conditions;
- regular reviews of loan delinquencies and loan portfolio quality; and
- the amount and quality of collateral, including guarantees, securing the loans.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on our financial condition and results of operations.

We Could Record Other-Than-Temporary Impairment on our Securities Portfolio. In Addition, We May Not Receive Full Future Interest Payments On These Securities.

We review our investment securities portfolio at least quarterly and more frequently when economic conditions warrant, assessing whether there is any indication of other-than-temporary impairment (“OTTI”). Factors considered in the review include estimated future cash flows, length of time and extent to which market value has been less than cost, the financial condition and near term prospect of the issuer, and our intent and ability to retain the security to allow for an anticipated recovery in market value. If the review determines that there is OTTI, then an impairment loss is recognized in earnings equal to the difference between the investment’s cost and its fair value at the balance sheet date of the reporting period for which the assessment is made, or a portion may be recognized in other comprehensive income. The fair value of investments on which OTTI is recognized then becomes the new cost basis of the investment.

At December 31, 2012, the Company had twenty-six individual securities available-for-sale in an unrealized loss position. In addition, the Company had nine individual investments held to maturity that were in unrealized loss in held-to-maturity consisting of pooled trust preferred securities. The Company believes, based on industry analyst reports and third-party OTTI evaluations, that the deterioration in the value of these securities is attributable to a combination of the lack of liquidity in these securities, credit ratings and credit quality concerns.

Management has performed various analyses, including cash flows, and has recorded OTTI expense of $625,000 related to four securities available for sale during fiscal 2012. These four securities available for sale were subsequently sold during fiscal 2012. In addition, OTTI expense totaling $288,000 was recorded related to two held-to-maturity securities during fiscal 2012. There is one additional held-to-maturity security that had OTTI expense recorded in prior years, but did not incur OTTI expense during fiscal 2012. Other than these three held-to-maturity securities, management believes that there are no other

securities other-than-temporarily impaired at December 31, 2012. 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. Management continues to monitor these securities with a high degree of scrutiny. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of the securities may be sold or are other-than-temporarily impaired, which would require a charge to earnings in such periods.

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 significant portion of our income and is based on the difference between:

- interest income earned on interest-earning assets, such as loans held for sale, 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 Board of Governors of the Federal Reserve (the "Federal Reserve Board") maintained the federal funds rate at the historically low rate of 0.25% during fiscal 2012 and 2011. 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, including loan production in the Company's mortgage operations, 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, 2012, our net deferred tax asset was $6.8 million, for which we have not established a valuation allowance. We recognized the deferred tax asset because management believes, based on earnings and detailed financial projections, that it is more likely than not, that 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 be assured 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, 2012, we had $6.8 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 Company's Subsidiaries. These Distributions Are Subject To Regulatory Limits And Other Restrictions, Including Directives From The FDIC Which Prohibit Distributions By The Bank Without Prior Regulatory Approval.

The Company is a bank holding company and relies upon dividends from the Bank and its other subsidiaries to fund a significant portion of its operations. We use these dividends 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 Bank 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 of Financial Institutions (the "South Carolina Board"). In general, a South Carolina state bank may not pay dividends from capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. Unless otherwise instructed by the South Carolina Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Board. However, given the restrictions imposed by the Bank's regulators, at December 31, 2012 the Bank cannot pay dividends without prior approval from the appropriate regulatory agencies. In addition, under the Federal Deposit Insurance Corporation Improvement Act, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. The Federal Reserve Board may also prevent the payment of a dividend by the Bank if it determines that the payment would be an unsafe and unsound banking practice.

If the Bank or Carolina Services 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 trust preferred securities for a period not to exceed 20 consecutive quarterly periods. This and any future deferred distributions will continue to accrue interest. Distributions on these 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, 2012 is approximately $1.2 million.

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.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has and will continue to significantly change bank regulatory structure and affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting and implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

The Dodd-Frank Act also created the Bureau of Consumer Financial Protection and gives it broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair deceptive or abusive" acts and practices.

Proposals for further regulation of the financial services industry are continually being introduced to the Congress of the United States of America. The agencies regulating the financial services industry also periodically adopt changes to their regulations. It is possible that additional legislative proposals may be adopted or regulatory changes may be made that would have any adverse effect on our business. In addition, it is expected that such regulatory changes will increase our operating

and compliance cost. We can provide no assurance regarding the manner in which any new laws and regulations will affect us.

Changes In Economic Conditions, In Particular An Economic Slowdown In South Carolina, Could Materially And Negatively Affect Our Business.

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. Any further deterioration in economic conditions, whether caused by national or local concerns, in particular any further economic slowdown in South Carolina, could result in the following consequences, any of which could hurt our business materially: loan delinquencies may increase; problem assets and foreclosures may increase; demand for our products and services may decrease; low cost or noninterest bearing deposits may decrease; and collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral associated with our existing loans. The State of South Carolina and certain local governments in our market area continue to face fiscal challenges upon which the long-term impact on the State's or the local economy cannot be predicted.

Continuation Of The Economic Downturn Could Reduce Our Customer Base, Our Level Of Deposits, And Demand For Financial Products Such As Loans.

Our success significantly depends upon the growth in population, income levels, deposits, and housing starts in our markets. The current economic downturn has negatively affected the markets in which we operate and, in turn, the quality of our loan portfolio. If the communities in which we operate do not grow or if prevailing economic conditions locally or nationally remain unfavorable, our business may not succeed. A continuation of the economic downturn or prolonged recession would likely result in the continued deterioration of the quality of our loan portfolio and reduce our level of deposits, which in turn would hurt our business. Interest received on loans represented approximately 85% of our interest income for the year ended December 31, 2012. If the economic downturn continues or a prolonged economic recession occurs in the economy as a whole, borrowers will be less likely to repay their loans as scheduled. Moreover, in many cases the value of real estate or other collateral that secures our loans has been adversely affected by the economic conditions and could continue to be negatively affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. A continued economic downturn could, therefore, result in losses that materially and adversely affect our business.

Our Small-To-Medium-Sized Business Target Markets May Have Fewer Financial Resources To Weather A Downturn In The Economy.

We target the banking and financial services needs of small- and medium-sized businesses. These businesses generally have fewer financial resources in terms of capital borrowing capacity than larger entities. If general economic conditions continue to negatively impact these businesses in the markets in which we operate, our business, financial condition, and results of operation may be adversely affected.

Recently Enacted Consumer Protection Regulations Related to Automated Overdraft Payment Programs Could Adversely Affect the Company's Business Operations, Net Income and Profitability.

The Federal Reserve Board and FDIC recently enacted consumer protection regulations related to automated overdraft payment programs offered by financial institutions. The Company has implemented changes to its business practices relating to overdraft payment programs in order to comply with these regulations. For the years ended December 31, 2010 and 2009, the Company's overdraft and insufficient funds fees represented a significant amount of non-interest fees collected by the Bank. Since taking effect on July 1, 2011, the fees received by the Bank for automated overdraft payment services have decreased, thereby adversely impacting the Bank's non-interest income. Complying with these regulations has resulted in increased operational costs. The actual impact of these regulations in future periods could vary due to a variety of factors, including changes in customer behavior, economic conditions and other factors, which could adversely the Company's business operations, net income and profitability.

A Failure In Or Breach Of Our Operational Or Security Systems Or Infrastructure, Or Those Of Our Third Party Vendors And Other Service Providers Or Other Third Parties, Including As A Result Of Cyber Attacks, Could Disrupt Our Businesses, Result In The Disclosure Or Misuse Of Confidential Or Proprietary Information, Damage Our Reputation, Increase Our Costs, And Cause Losses.

We rely heavily on communications and information systems to conduct our business. Information security risks for financial institutions such as ours have generally increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, and terrorists, activists, and other external parties. As client, public, and regulatory expectations regarding operational and information security have increased, our operating systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. Our business, financial, accounting, and data processing systems, or other operating systems and facilities may stop operating properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond our control. For example, there could be electrical or telecommunication outages; natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics; events arising from local or larger scale political or social matters, including terrorist acts; and as described below, cyber attacks.

As noted above, our business relies on our digital technologies, computer and email systems, software and networks to conduct its operations. Although we have information security procedures and controls in place, our technologies, systems, networks, and our clients' devices may become the target of cyber attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of our or our clients' or other third parties' business operations. Third parties with whom we do business or that facilitate our business activities, including financial intermediaries, or vendors that provide service or security solutions for our operations, and other third parties, including the South Carolina Department of Revenue, which had records exposed in a 2012 cyber attack, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints.

While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. Our risk and exposure to these matters remains heightened because of the evolving nature of these threats. As a result, cybersecurity and the continued development and enhancement of our controls, processes, and practices designed to protect our systems, computers, software, data, and networks from attack, damage or unauthorized access remain a focus for us. As threats continue to evolve, we may be required to expend additional resources to continue to modify or enhance our protective measures or to investigate and remediate information security vulnerabilities. Disruptions or failures tin the physical infrastructure or operating systems that support our businesses and clients, or cyber attacks or security breaches of the network, systems or devices that our clients use to access our products and services could result in client attrition, regulatory fines, penalties or intervention, reputation damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could have a material effect on our results of operations or financial condition.

The Company Relies On Other Companies To Provide Key Components Of Its Business Infrastructure.

Third party vendors provide certain key components of the Company's business infrastructure such as internet connections, network access and core transactional and financial systems. While the Company has selected third party vendors carefully, it does not control their operations. Any problems caused by these third parties, including those which result from their failure to provide services for any reason or their poor performance of services, could adversely impact the Company's ability to deliver products and services to its customers and otherwise to conduct its business. Replacing these third parties could also entail significant delay and expense.

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 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. Prepaid FDIC premiums at December 31, 2012 totaled $2.0 million. It is possible that the FDIC may impose additional special assessments in the future as part of its restoration plan. 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. 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. 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.

In addition, Crescent Mortgage funds mortgage loans held for sale through a warehouse line of credit and a purchase and sale agreement. A decline in economic conditions could result in sources of warehouse lending decreasing 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.

The Short-Term And Long-Term Impact Of The Changing Regulatory Capital Requirements And Anticipated New Capital Rules Is Uncertain.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced an agreement to a strengthened set of capital requirements for internationally active banking organizations in the U.S. and around the world, known as Basel III. On June 7, 2012, the Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC issued a joint notice of proposed rulemaking that would implement sections

of the Dodd-Frank Act that encompass certain aspects of Basel III with respect to capital and liquidity. On November 9, 2012, following a public comment period, the U.S. federal banking agencies announced that the originally proposed January 1, 2013 effective date for the proposed rules was being delayed so that the agencies could consider operational and transitional issues identified in the large volume of public comments received. The propose rules, if adopted, would lead to significantly higher capital requirements and more restrictive leverage and liquidity ratios than those currently in place.

Various provisions of the Dodd-Frank Act increase the capital requirements of bank holding companies, such as the Company, and non-bank financial companies that are supervised by the Federal Reserve Board. The leverage and risk-based capital ratios of these entities may not be lower than the leverage and risk-based capital ratios for insured depository institutions. In particular, bank holding companies, many of which have long relied on trust preferred securities as a component of their regulatory capital, will no longer be permitted to issue new trust preferred securities that count toward their Tier 1 capital. While the Basel III changes and other regulatory capital requirements will likely result in generally higher regulatory capital standards, it is difficult at this time to predict how new standards will ultimately be applied to the Company and the Bank.

In addition, in the current economic and regulatory environment, regulators of banks and bank holding companies have become more likely to impose capital requirements on bank holding companies and banks that are more stringent than those required by applicable existing regulations.

The application of more stringent capital requirements for the Company and the Bank could, among other things, result in lower returns on invested capital, require the issuance of additional capital, adversely affect our ability to pay dividends, require us to reduce business levels and result in regulatory actions if we were to be unable to comply with such requirements.

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 FHLB of Atlanta. We hold this stock to qualify for membership in the FHLB System and to be eligible to borrow funds under the FHLB's advance program. There is no market for our FHLB of Atlanta common stock. Recent published reports indicate that certain member banks of the FHLB 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 FHLB, including the FHLB of Atlanta, could be substantially diminished. Consequently, there is a risk that our investment in FHLB 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 Federal Reserve Board, the FDIC, and the South Carolina Board as well as a number of states where Crescent Mortgage 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 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 2012, 2011 and 2010 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 Board'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 Exposed To Significant Repurchase Risk.

Crescent Mortgage 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, 2012, Crescent Mortgage serviced approximately $2.2 billion of loans. At that date, our mortgage loan servicing rights were recorded as an asset with a carrying value of approximately $12.0 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.

Competition With Other Financial Institutions May Have An Adverse Effect On Our Ability To Retain And Grow Our Client Base, Which Could Have A Negative Effect On Our Financial Condition Or Results Of Operations.

The banking and financial services industry is very competitive and includes services offered from other banks, savings and loan associations, credit unions, mortgage companies, other lenders, and institutions offering uninsured investment alternatives. Legal and regulatory developments have made it easier for new and sometimes unregulated competitors to compete with us. The financial services industry has and is experiencing an ongoing trend towards consolidation in which fewer large national and regional banks and other financial institutions are replacing many smaller and more local banks. These larger banks and other financial institutions hold a large accumulation of assets and have significantly greater resources and a wider geographic presence or greater accessibility. In some instances, these larger entities operate without the traditional brick and mortar facilities that restrict geographic presence. Some competitors have more aggressive marketing campaigns and better brand recognition, and are able to offer more services, more favorable pricing or greater customer convenience than our Bank. In addition, competition has increased from new banks and other financial services providers that target our existing or potential customers. As consolidation continues among large banks, we expect other smaller institutions to try to compete in the markets we serve. This competition could reduce our net income by decreasing the number and size of the loans that we originate and the interest rates we charge on these loans. Additionally, these competitors may offer higher interest rates, which could decrease the deposits we attract or require us to increase rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations which could increase our cost of funds.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge as part of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Technological developments have allowed competitors,

including some non-depository institutions, to compete more effectively in local markets and have expanded the range of financial products, services and capital available to our target customers. If we are unable to implement, maintain and use such technologies effectively, we may not be able to offer products or achieve cost-efficiencies necessary to compete in the industry. In addition, some of these competitors have fewer regulatory constraints and lower cost structures.

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.

Negative Public Opinion Surrounding The Company And The Financial Institutions Industry Generally Could Damage Our Reputation And Adversely Impact Our Earnings.

Reputation risk, or the risk to our business, earnings and capital from negative public opinion surrounding our Company and the financial institutions industry generally, is inherent in our business. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees and can expose us to litigation and regulatory action. Although we take steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

The Company And Its Subsidiaries Are Involved In Litigation.

In the course of ordinary business, the Bank is, from time to time, named a party to legal actions and proceedings, primarily related to the collection of loans and foreclosed assets. In accordance with generally accepted accounting principles, the Company establishes reserves for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. When loss contingencies are not both probable and estimable, the Company does not establish reserves.

The Bank also has a claim against it relating to one of its former executive officers. Effective July 31, 2011, the Company combined its wholly-owned subsidiary bank, Community FirstBank, with and into its other wholly-owned subsidiary bank, Crescent Bank, effectuating an internal reorganization. The resultant bank was renamed CresCom Bank. The former executive officer had an employment agreement with Community FirstBank and claims the internal reorganization triggered the severance provisions of the employment agreement. The former executive officer initially claimed he is due an aggregate amount of approximately $1.8 million but has since amended his complaint seeking approximately $10 million in damages. The Company hired special counsel to review the claims made by the former executive officer. Based upon the review by special counsel, the Company strongly disagrees with the former executive officer's assertion that the internal reorganization triggered the severance provisions of the employment agreement and intends to vigorously defend its position, including potentially making certain counterclaims against the former executive officer. Management believes there is not sufficient information available at this time to make an evaluation as to the likelihood of an unfavorable outcome of this claim or to estimate the amount of potential loss, if any. Accordingly, no amounts have been accrued in the accompanying balance sheet as of December 31, 2012.

There Is No Active Public Trading Market For Our Common Stock, And One Is Not Expected To Develop.

Our common stock is not listed for trading on any securities exchange, and we presently do not intend to apply to list our common stock on any national securities exchange at any time in the foreseeable future. Consequently, the liquidity of our common stock, and our investors ability to sell shares of our common stock, will depend upon the interest of the Company, existing shareholders and other potential purchasers. As a result of this limited market, it may be difficult to identify buyers to whom our investors can sell their shares of our common stock, and our investors may be unable to sell their shares at an established market price, at a price that is favorable to the investors, or at all. This limited market will restrict our investors ability to sell shares of our common stock at a desirable or stable price or at all, at any one time. Our investors should be prepared to own our common stock indefinitely.

We May Issue Additional Shares Of Common Or Preferred Stock, Which May Dilute The Interests Of Our Shareholders And May Adversely Impact The Market Price Of Our Common Stock.

We are currently authorized to issue up to 6,800,000 shares of common stock, of which 1,918,992 shares were outstanding as of March 15, 2013, and up to 200,000 shares of preferred stock, of which no shares are outstanding. We may need to incur additional debt or equity financing in the future to strengthen our capital position or to make strategic acquisitions or investments. If we determine, for any reason, that we need to raise capital, our Board of Directors generally has the authority, without action by or vote of the shareholders, to issue all or part of any authorized but unissued shares of stock for any corporate purpose, including issuance of equity-based incentives under or outside of our equity compensation plans. Additionally, we are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. Any issuance of additional shares of common stock or preferred stock will dilute the percentage ownership interest of our shareholders and may dilute the book value per share of our common stock.

Shares Of Our Common Stock Are Not Insured Bank Deposits And Are Subject To Market Risk.

Our shares of common stock are not deposits, savings accounts or other obligations of the Company, our Bank or any other depository institution, are not guaranteed by us or any other entity, and are not insured by the FDIC or any other governmental agency.

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 CresCom Bank, a South Carolina state-chartered bank. Our assets are approximately $888.7 million at December 31, 2012 and approximately $826.2 million at December 31, 2011.

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; and
- Cash management.

Carolina Financial Corporation, through CresCom 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 31, 2011, Carolina Financial Corporation merged its wholly-owned subsidiary bank, Community FirstBank of Charleston (“Community FirstBank”), with and into its other wholly-owned subsidiary bank, Crescent Bank. In conjunction with this internal reorganization, Crescent Bank’s name was changed to CresCom Bank and Crescent Mortgage, formerly a wholly-owned subsidiary of Community FirstBank, became a wholly-owned subsidiary of CresCom Bank. Crescent Mortgage is located in DeKalb County, Georgia, and is qualified to originate loans in 42 states.

The following discussion describes our results of operations for 2012 as compared to 2011 and 2011 as compared to 2010 and also analyzes our financial condition as of December 31, 2012 as compared to December 31, 2011. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, both interest-bearing and noninterest-bearing. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowed funds. In order to maximize our net interest income, we must not only manage the volume of these balance sheet items, but also the yields that we earn on our interest-earning assets and the rates that we pay on interest-bearing liabilities.

Of course, there are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings.

In addition to earning interest on our loans and investments, we derive a substantial portion of our income from Crescent Mortgage through net gain on sale of loans held for sale. We also earn income through fees that we charge to our customers.

Likewise, we incur other operating expenses as well. We describe the various components of this noninterest income, as well as our noninterest expense, in the following discussion.

Comparison of Operating Results for the Years Ended December 31, 2012 and 2011

Net Income (Loss). Net income increased $17.8 million to net income of $16.9 million, or $8.80 diluted earnings per share, during the year ended December 31, 2012 compared to a net loss of $971,000, or $(0.51) diluted loss per share, during the year ended December 31, 2011. The increase in net income primarily resulted from an increase in net interest income of $517,000 and a decrease in provision for loan losses of $8.0 million to $2.7 million during the year ended December 31, 2012 compared to $10.7 million during the year ended December 31, 2011. In addition, noninterest income increased by $32.6 million to $52.3 million during the year ended December 31, 2012 compared to $19.7 million during the year ended December 31, 2011. Noninterest expense increased by $12.7 million to $50.1 million during the year ended December 31, 2012 compared to $37.4 million during the year ended December 31, 2011. Income tax expense totaled $10.4 million during fiscal 2012 related to pre-tax income of $27.3 million compared to income tax benefit of $128,000 on pre-tax loss of $1.1 million during fiscal 2011.

Net Interest Income. Net interest income increased $517,000, or 1.9%, to $27.8 million during the year ended December 31, 2012 from $27.3 million during the year ended December 31, 2011.

Average interest-earning assets decreased $19.2 million to $772.6 million during the year ended December 31, 2012 as compared to $791.8 million during the year ended December 31, 2011 with a corresponding decrease in average yield of 27 basis points during that same period. The reduction in average interest-earning assets is primarily the result of a decrease in nonperforming assets. During that same period, interest-bearing liabilities also decreased $55.8 million to $679.2 million with a corresponding decrease in the average interest rate paid of 40 basis points. The reduction in average interest-bearing liabilities was primarily due to reduced funds needed to support its balance sheet. The reduction in the average interest rate paid was due primarily to the re-pricing of liabilities in a low 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 15 basis points. During the year ended December 31, 2012, the Company also focused on increasing checking and money market deposits.

Total interest income decreased $3.0 million, or 8.0%, to $35.4 million during the year ended December 31, 2012 from $38.4 million during the year ended December 31, 2011. Average loans held for sale increased $56.7 million, or 113.7%, to $106.6 million during the year ended December 31, 2012 from $49.9 million during the comparable period in 2011. The significant increase in the average loans held for sale balances is the result of favorable government programs, a low interest rate environment and management's focus on customer service. The average yield earned on loans held for sale decreased to 3.67% from 4.31% during the years ended December 31, 2012 and 2011, respectively. As a result, interest income increased $1.8 million to $3.9 million during fiscal 2012 from $2.1 million during fiscal 2011. Average loans receivable, net decreased $49.7 million, or 9.1%, to $495.9 million during the year ended December 31, 2012 from $545.6 million during the comparable period in 2011. A significant portion of this reduction was due to management's focus on reducing nonperforming assets. The average yield earned on loans receivable, net decreased to 5.28% from 5.43% during the years ended December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, approximately 52% and 59%, respectively, of the outstanding loans receivable balance consisted of adjustable rate loans and 48% and 41%, respectively, are fixed rate loans. The Company significantly reduced total nonperforming loans during the year to $21.5 million at December 31, 2012 from $40.3 million at December 31, 2011. This reduction reduced the Company's need for interest-bearing liabilities. 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 $3.5 million for the years ended December 31, 2012 and 2011, respectively. The average balance of securities available for sale decreased $9.8 million, or 6.7%, to $138.0 million during 2012 from $147.8 million during 2011. The yield earned on securities available for sale decreased to 3.56% from 4.25% during the year ended December 31, 2012 and 2011, respectively. The average balance of securities held-to-maturity decreased 2.7%, to $9.4 million during the year ended December 31, 2012 from $9.6 million during the comparable period in 2011. The average yield earned on securities held-to-maturity decreased to 2.25% from 2.30% during the years ended December 31, 2012 and 2011, respectively.

Total interest expense decreased $3.6 million, or 32.4%, to $7.5 million during the year ended December 31, 2012 from $11.1 million during the year ended December 31, 2011. Average interest-bearing liabilities decreased $55.8 million, or

7.6%, to $679.2 million during the year ended December 31, 2012 from $735.0 million during the comparable period in 2011. Average money market balances remained constant during the years ended December 31, 2012 and 2011 at approximately $199 million. However, the average interest rate paid on money markets during the year ended December 31, 2012 decreased to 0.62% compared to 0.74% during the comparable period in 2011. Average certificates of deposit balances decreased $39.1 million, or 11.3%, to $306.7 million during the year ended December 31, 2011 from $345.8 million during the comparable period in 2011. In addition, the average interest rate paid on certificates of deposit during the year ended December 31, 2012 decreased significantly to 0.91% compared to 1.44% during the comparable period in 2011. Average short-term borrowing balances decreased $1.5 million, or 3.4%, to $42.4 million during the year ended December 31, 2012 from $43.8 million during the comparable period in 2011. The average rate paid during the year ended December 31, 2012 on these borrowings declined significantly to 1.51% compared to 2.38% during the comparable period in 2011. Average long-term borrowing balances decreased $24.7 million, or 23.5%, to $80.3 million during the year ended December 31, 2012 from $105.0 million during the comparable period in 2011. The average rate paid during the year ended December 31, 2012 on these borrowings was 3.36% compared to 3.32% during the comparable period in 2011.

Provision for Loan Losses. The provision for loan losses decreased $8.0 million to $2.7 million during the year ended December 31, 2012 compared to $10.7 million during the year ended December 31, 2011. The reduction in the provision for loan losses reflects lower net charge-offs and a significant improvement in our credit quality measures over the last year. Specifically, the Company had net charge-offs of $5.2 million or 1.05% of average loans receivable, net during the year ended December 31, 2012 compared to net charge-offs of $13.0 million or 2.38% of average loans receivable, net during the comparable period in 2011. The allowance for loan losses was 1.86% of loans receivable, or $9.5 million at December 31, 2012, a decrease of $2.5 million from the allowance for loan losses of $12.0 million or 2.29% of the loans receivable, at December 31, 2011. The 43 basis point decrease in the allowance for loan losses as a percentage of loans receivable is primarily due to the decrease in non-performing loans to total loans to 2.98% at December 31, 2012 from 6.5% at December 31, 2011.

Noninterest Income. Total noninterest income increased $32.6 million, or 165.1%, to $52.3 million during the year ended December 31, 2012 from $19.7 million during the comparable period in 2011. This increase is primarily attributable to an increase in the gain on sale of loans held for sale of $31.6 million. In addition, noninterest income reflected a net decrease in other-than-temporary impairment of $840,000, a decrease in net gain on sale of securities of $3.3 million, and an increase in the loss on extinguishment of debt of $530,000.

The Company's mortgage company experienced a significant increase in loan production and a corresponding increase in margin due to favorable government programs, a low interest-rate environment and management's focus on customer service resulting in an increase of $31.6 million in gain on sale of loans held for sale.

During the years ended December 31, 2012 and 2011, the Company had investment securities that experienced other-than-temporary impairment. Other-than-temporary impairment expense reflected in the accompanying income statement totaled $913,000 and $1.8 million at December 31, 2012 and 2011, respectively.

Net loss on sale of securities during the year ended December 31, 2012 totaled $3.0 million compared to a net gain on sale of securities of $306,000 during the comparable period in 2011. Included in the $3.0 million net loss during fiscal 2012, the Company specifically sold the four securities that incurred OTTI expense as noted above to improve asset quality. As a result of the sale of those securities, the Company incurred a loss of $3.2 million.

Certain borrowings were prepaid to manage the cost of funds and related interest rate sensitivity, resulting in a net loss on the extinguishment of debt of $1.6 million and $1.1 million during 2012 and 2011, respectively

Noninterest Expense. Total noninterest expense increased $12.7 million, or 34.0%, to $50.1 million during the year ended December 31, 2012 from $37.4 million during the comparable period in 2011. This increase is primarily attributable to an increase in mortgage loan repurchase losses expense of $1.4 million, salaries and employee benefits of $5.7 million, legal expense of $376,000, net of a decrease in FDIC insurance expense of $313,000, other real estate expense of $779,000, and other expenses of $5.4 million.

As a result of the significant increase in the Company's mortgage company subsidiary production, additional expense related to mortgage loan repurchase loss exposure was recorded.

Salaries and benefits expense increased a net $5.7 million, consisting of a net increase at the Company's mortgage company subsidiary related to the increased production totaling $6.5 million and a net reduction in salaries and benefits at the Company's banking subsidiary of $0.7 million.

During fiscal 2012, the Company experienced a $4 million loss related to a kite that is reflected in other expense.

Income Tax Benefit. Net income for 2012 was $16.9 million and the net loss for 2011 was $971,000. Accordingly, the income tax benefit decreased $10.5 million to an expense of $10.4 million during the year ended December 31, 2012 from an income tax benefit of $128,000 during the comparable period in 2011. The Company's effective tax rate was 38% during the year ended December 31, 2012 and the effective benefit rate was 11.6% during the year ended December 31, 2011.

Comparison of Operating Results for the Years Ended December 31, 2011 and 2010

Net Income (Loss). Net loss decreased $11.6 million, or 92.3%, to a net loss of $971,000, or $(0.51) diluted loss per share, during the year ended December 31, 2011 compared to a net loss of $12.6 million, or $(6.58) diluted loss per share, during the year ended December 31, 2010. The reduction in the net loss primarily resulted from a decrease in net interest income of $2.4 million and a decrease in provision for loan losses of $20.0 million to $10.7 million during the year ended December 31, 2011 compared to $30.8 million during the year ended December 31, 2010. In addition, noninterest income decreased by $1.9 million to $19.7 million during the year ended December 31, 2011 compared to $21.6 million during the year ended December 31, 2010. Noninterest expense decreased by $1.7 million to $37.4 million during the year ended December 31, 2011 compared to $39.1 million during the year ended December 31, 2010. Income taxes reflected a benefit of $128,000 during fiscal 2011 related to a pre-tax loss of $1.1 million compared to income tax benefit of $5.9 million on pre-tax loss of $18.5 million during fiscal 2010.

Net Interest Income. Net interest income decreased $2.4 million, or 8.2%, to $27.3 million during the year ended December 31, 2011 from $29.8 million during the year ended December 31, 2010.

Average interest-earning assets decreased $167.7 million to $791.8 million during the year ended December 31, 2011 as compared to $959.5 million during the year ended December 31, 2010 with a corresponding decrease in average yield of 3 basis points during that same period. The reduction in average interest-earning assets is primarily the result of a decrease in nonperforming assets and a decision by management to shrink the balance sheet to preserve capital. During that same period, interest-bearing liabilities also decreased $174.6 million to $735.0 million with a corresponding decrease in the average interest rate paid of 37 basis points. The reduction in average interest-bearing liabilities was primarily due to reduced funds needed resulting from the Company's decision to shrink 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 35 basis points. During the year ended December 31, 2011, 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 $8.4 million, or 17.9%, to $38.4 million during the year ended December 31, 2011 from $46.8 million during the year ended December 31, 2010. Average loans receivable, net decreased $95.1 million, or 14.8%, to $545.6 million during the year ended December 31, 2011 from $640.6 million during the comparable period in 2010. The average yield earned on loans receivable, net increased to 5.43% from 5.42% during the years ended December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, approximately 59% and 60%, respectively, of the loan portfolio consisted of adjustable rate loans and approximately 41% and 40%, respectively, consisted of 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 $36.0 million during the year ended December 31, 2011 from $35.3 million during the year ended December 31, 2010. 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 $3.5 million and $3.2 million for the years ended December 31, 2011 and 2010, respectively. The average balance of securities available for sale increased $41.2 million, or 38.7%, to $147.8 million during 2011 from $106.6 million during 2010. The yield earned on securities available for sale increased to 4.25% from 3.76% during the year ended December 31, 2011 and 2010, respectively. 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. During 2011, the Company did not transfer any securities from held-to-maturity to available-for-sale. The average balance of securities held-to-maturity decreased $96.0 million, or 90.9%, to $9.6 million during the year ended December 31, 2011 from $105.7 million during the comparable period in 2010. The average yield earned on securities held-to-maturity decreased to 2.30% from 5.05% during the years ended December 31, 2011 and 2010, respectively.

Total interest expense decreased $6.0 million, or 34.9%, to $11.1 million during the year ended December 31, 2011 from $17.1 million during the year ended December 31, 2010. Average interest-bearing liabilities decreased $174.6 million, or 19.2%, to $735.0 million during the year ended December 31, 2011 from $909.6 million during the comparable period in 2010. Average money market balances increased $23.6 million, or 13.4%, to $199.5 million during the year ended December 31, 2011 from $176.0 million during the comparable period in 2010. In addition, the average interest rate paid on money markets during the year ended December 31, 2011 decreased to 0.74% compared to 1.30% during the comparable period in 2010. Average certificates of deposit balances decreased $139.3 million, or 28.7%, to $345.8 million during the year ended December 31, 2010 from $485.1 million during the comparable period in 2010. In addition, the average interest rate paid on certificates of deposit during the year ended December 31, 2011 decreased to 1.44% compared to 1.94% during the comparable period in 2010. Average short-term borrowing balances increased $21.1 million, or 93.0%, to $43.8 million during the year ended December 31, 2011 from $22.7 million during the comparable period in 2010. The average rate paid during the year ended December 31, 2011 on these borrowings was 2.38% compared to 3.12% during the comparable period in 2010. Average long-term borrowing balances decreased $83.6 million, or 44.3%, to $105.0 million during the year ended December 31, 2011 from $188.5 million during the comparable period in 2010. The average rate paid during the year ended December 31, 2011 on these borrowings was 3.32% compared to 2.40% during the comparable period in 2010.

Provision for Loan Losses. The provision for loan losses decreased $20.0 million to $10.7 million during the year ended December 31, 2011 compared to $30.8 million during the year ended December 31, 2010. The reduction in the provision for loan losses reflects lower net charge-offs and a significant improvement in our credit quality measures over the prior year. Specifically, the Company had net charge-offs of $13.0 million or 2.38% of average loans receivable, net during the year ended December 31, 2011 compared to net charge-offs of $29.5 million or 4.61% of average loans receivable, net during the comparable period in 2010. The allowance for loan losses was 2.29% of loans receivable, or $12.0 million at December 31, 2011, a decrease of $2.2 million from the allowance for loan losses of $14.3 million or 2.38% of the loans receivable, at December 31, 2010. The 9 basis point decrease in the allowance for loan losses as a percentage of loans receivable is primarily due to the decrease in non-performing loans to gross loans receivable to 6.50% at December 31, 2011 from 9.60% at December 31, 2010.

Noninterest Income. Total noninterest income decreased $1.9 million, or 8.7%, to $19.7 million during the year ended December 31, 2011 from $21.6 million during the comparable period in 2010. This decrease is primarily attributable to a reduction in the gain on sale of loans held for sale of $6.1 million, net of a decrease in other-than-temporary impairment of $727,000, an increase in net gain on sale of securities of $2.3 million, and a decrease in the loss on extinguishment of debt of $1.5 million.

During the years ended December 31, 2011 and 2010, the Company had investment securities that experienced other-than-temporary impairment. Other-than-temporary impairment expense reflected in the accompanying income statement totaled $1.8 million and $2.5 million, respectively.

Net gain on sale of securities during the year ended December 31, 2011 totaled $306,000 compared to a net loss on sale of securities of $2.0 million during the comparable period in 2010.

In connection with the Company's balance sheet management to preserve capital and improve the cost of funds, certain borrowings were prepaid to manage the related interest rate sensitivity, resulting in a net loss on the extinguishment of debt of $1.1 million and $2.5 million during 2011 and 2010, respectively

Noninterest Expense. Total noninterest expense decreased $1.7 million, or 4.2%, to $37.4 million during the year ended December 31, 2011 from $39.1 million during the comparable period in 2010. This decrease is primarily attributable to a decrease in mortgage loan repurchase losses of $1.8 million, salaries and employee benefits of $613,000, and FDIC insurance expense of $409,000, net of an increase in other real estate expense of $700,000, legal expense of $280,000 and other expenses related to wholesale mortgage loan production and other loan collection activities.

Income Tax Benefit. Net loss for 2011 and 2010 was $971,000 and $12.6 million, respectively. Accordingly, the income tax benefit decreased $5.7 million to $128,000 during the year ended December 31, 2011 from income tax benefit of $5.9 million during the comparable period in 2010. The Company's effective benefit rate was 11.6% and 31.8% during the years ended December 31, 2011 and 2010, respectively. The Company files a consolidated federal income tax return that reflects a consolidated net operating loss carryback benefit. Separate state income tax returns are filed for the Crescent Mortgage, the Bank and the Company and its nonbank subsidiary. Since the Crescent Mortgage generated earnings, state income taxes were due. For the South Carolina and North Carolina returns of the bank and the holding company and its nonbank subsidiary, there is no net operating loss carryback provision. Accordingly, the company did not recognize a tax benefit related to these losses.

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,								
	2012			2011			2010		
	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	$106,626	3,914	3.67%	49,895	2,150	4.31%	56,855	2,647	4.66%
Loans receivable, net (1)	495,889	26,160	5.28%	545,556	29,640	5.43%	640,646	34,720	5.42%
Interest-bearing cash	16,765	41	0.24%	29,070	52	0.18%	37,212	69	0.19%
Securities available for sale	137,956	4,908	3.56%	147,808	6,280	4.25%	106,598	4,013	3.76%
Securities held to maturity	9,361	211	2.25%	9,624	221	2.30%	105,658	5,334	5.05%
Federal Home Loan Bank stock	5,508	107	1.94%	9,431	81	0.86%	12,029	42	0.35%
Other investments	465	17	3.66%	465	17	3.66%	465	17	3.66%
Total interest-earning assets	772,570	35,358	4.58%	791,849	38,441	4.85%	959,463	46,842	4.88%
Non-earning assets	64,496			66,583			58,667		
Total assets	$837,066			858,432			1,018,130		
Interest-bearing liabilities:									
Demand accounts	41,361	110	0.27%	34,129	95	0.28%	34,160	138	0.40%
Money market accounts	199,062	1,227	0.62%	199,528	1,470	0.74%	175,966	2,285	1.30%
Savings accounts	9,468	47	0.50%	6,725	36	0.54%	3,130	19	0.61%
Certificates of deposit	306,691	2,794	0.91%	345,823	4,977	1.44%	485,126	9,408	1.94%
Short-term borrowed funds	42,367	640	1.51%	43,845	1,045	2.38%	22,720	708	3.12%
Long-term debt	80,272	2,695	3.36%	104,963	3,490	3.32%	188,541	4,519	2.40%
Total interest-bearing liabilities	679,221	7,513	1.11%	735,013	11,113	1.51%	909,643	17,077	1.88%
Noninterest-bearing deposits	84,503			62,797			44,027		
Other liabilities	19,340			13,619			14,395		
Stockholders' equity	54,002			47,003			50,065		
Total liabilities and Stockholders' equity	$837,066			858,432			1,018,130		
Net interest spread			3.47%			3.34%			3.00%
Net interest margin	3.60%			3.45%			3.10%		
Net interest income		27,845			27,328			29,765	

(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,							
	2012 vs. 2011				2011 vs. 2010			
	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	$ 2,446	(319)	(363)	1,764	(322)	(199)	24	(497)
Loans receivable, net	(2,737)	(818)	75	(3,480)	(5,134)	64	(10)	(5,080)
Interest-bearing cash	(21)	17	(7)	(11)	(14)	(4)	1	(17)
Securities available for sale	(420)	(1,020)	68	(1,372)	1,543	522	202	2,267
Securities held to maturity	(5)	(5)	-	(10)	(4,848)	(2,906)	2,641	(5,113)
FHLB stock	(34)	102	(42)	26	(9)	61	(13)	39
Other investments	-	-	-	-	-	-	-	-
Interest income	(771)	(2,043)	(269)	(3,083)	(8,784)	(2,462)	2,845	(8,401)
Demand accounts	20	(4)	(1)	15	7	(48)	(2)	(43)
Money market accounts	(3)	(241)	1	(243)	306	(989)	(132)	(815)
Savings accounts	15	(3)	(1)	11	22	(2)	(3)	17
Certificates of deposit	(564)	(1,826)	207	(2,183)	(2,702)	(2,426)	697	(4,431)
Short-term borrowed funds	(35)	(383)	13	(405)	659	(166)	(156)	337
Long-term debt	(827)	42	(10)	(795)	(2,006)	1,746	(769)	(1,029)
Interest expense	(1,394)	(2,415)	209	(3,600)	(3,714)	(1,885)	(365)	(5,964)
Net interest income	$ 623	372	(478)	517	(5,070)	(577)	3,210	(2,437)

Loans by Type

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

	At December 31,			
	2012		2011	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars in thousands)			
Loans secured by real estate:				
One-to-four family	$ 146,333	27.66%	124,604	23.10%
Home equity	31,278	5.91%	35,173	6.52%
Commercial real estate	240,764	45.52%	250,560	46.46%
Construction and development	68,113	12.88%	75,985	14.09%
Consumer loans	3,762	0.71%	5,085	0.94%
Commercial business loans	38,714	7.32%	47,933	8.89%
Total gross loans receivable	528,964	100.00%	539,340	100.00%
Less:				
Undisbursed loans in process	17,690		13,898	
Allowance for loan losses	9,520		12,039	
Deferred fees, net	63		68	
Total loans receivable, net	$ 501,691		513,335	

Non-Performing and Problem Assets

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

	At December 31,	
	2012	2011
	(Dollars in thousands)	
Loans secured by real estate:		
Nonaccrual loans-renegotiated loans	**$ 10,733**	18,704
Nonaccrual loans-other	**4,515**	11,227
Accruing loans 90 days or more delinquent	**-**	4,231
Real estate acquired through foreclosure, net	**6,284**	6,097
Total Non-Performing Assets	**$ 21,532**	40,259
Problem Assets not included in Non-Performing Assets-		
Accruing renegotiated loans outstanding	**$ 17,195**	23,421

Substantially all of the nonaccrual loans, accruing loans 90 days or more delinquent and accruing renegotiated loans for fiscal 2012 and 2011 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.

Although non-performing assets remain at an elevated level, credit quality indicators generally showed improvement during 2012 as the Company experienced reduced loan migrations to nonaccrual status, lower loss severity on individual problem assets and a significant reduction in non-performing assets through December 31, 2012. The Company believes this general trend in reduced loans migrating into nonaccrual status is an indication of improving credit quality in the Company's overall loan portfolio and a leading indicator of reduced credit losses going forward. Nevertheless, the Company can make no assurances that non-performing assets will continue to improve in future periods. The Company continues to monitor the loan portfolio and foreclosed assets very carefully and is continually working to reduce its problem assets.

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 Bank's Asset/Liability Management Committee ("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 meets regularly to review the Company's interest rate risk and liquidity positions in relation to present and prospective market and business conditions, and adopts 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 Board of Directors also sets policy guidelines and establishes long-term strategies with respect to interest rate risk exposure and liquidity.

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 Bank as of December 31, 2012:

Interest Rate Scenario		Annualized Hypothetical Percentage Change in
Change	Prime Rate	Net Interest Income
0.00%	3.25%	0.00%
1.00%	4.25%	(2.00%)
2.00%	5.25%	(3.90%)
3.00%	6.25%	(1.90%)

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. Crescent Mortgage'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, 2012 and 2011 are as follows:

	At December 31,			
	2012		2011	
	Fair Value	**Notional Value**	Fair Value	Notional Value
	(In thousands)			
Derivative assets:				
Mortgage loan interest rate lock commitments	**$ 4,783**	**289,584**	2,832	218,465
Mortgage loan forward sales commitments	**1,692**	**59,177**	1,168	47,992
Mortgage-backed securities forward sales commitments	**67**	**308,000**	-	-
	$ 6,542	**656,761**	4,000	266,457
Derivative liabilities:				
Mortgage-backed securities forward sales commitments	**$ -**	**-**	1,234	167,000

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 FHLB of Atlanta advance window, the Federal Reserve Bank ("FRB"), federal funds purchased, and warehouse lines of credit. The Company also uses 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 FHLB of Atlanta are based upon FHLB-approved percentages of Bank assets, but must be supported by appropriate collateral to be available. The Company has 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 $151.8 million of collateral for these advances. In addition, at December 31, 2012, the Company has pledged $6.8 million of securities for these advances. Assuming sufficient collateral was available at

December 31, 2012, the Company had maximum FHLB lines of $266.1 million based on FHLB limits. At December 31, 2012, collateral totaling $158.6 million was pledged to support FHLB advances. At December 31, 2012 the Company had FHLB advances of $115.0 million outstanding with excess collateral pledged to the FHLB during those periods that would support additional borrowings of approximately $43.6 million.

Lines of credit with the FRB are based on collateral pledged. The Company has pledged certain non-mortgage commercial, acquisition and development, and lot loan portfolios under blanket lien agreements resulting in approximately $34.3 million of collateral to the FRB for these advances. At December 31, 2012 the Company had lines available with the FRB for $34.3 million. At December 31, 2012 the Company had no FRB advances outstanding.

At December 31, 2012, Crescent Mortgage had a mortgage loan warehouse line of credit from a correspondent with a $35.0 million credit limit, of which $33.1 million is still available. The facility is secured by Crescent Mortgage's residential mortgage loans held for sale and other assets.

Effective October 1, 2011, the Company modified a $3.0 million unsecured line of credit with a correspondent bank, of which $2.8 million and $3.0 million was outstanding at December 31, 2012 and December 31, 2011, respectively. The unsecured line of credit bears interest at prime plus 1.50% and the term expires October 1, 2013. In connection with this modification, the Company will make quarterly principal payments of $50,000 that began on October 1, 2011 and will continue on the same day of each quarter through and including July 1, 2013. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios and nonperforming asset ratios. As of December 31, 2012 the Company is in compliance with all of the covenants. At December 31, 2012, $2.8 million of this unsecured line of credit is included in Short-Term Borrowed Funds.

Capital Resources

The Company and the Bank 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 Bank must meet certain capital guidelines, which involve quantitative measures of the Company's and the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's 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 Bank 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 Bank 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 Bank 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, 2012, the Company and the Bank are considered "Well Capitalized" under regulatory capital adequacy guidelines.

The following schedule shows the Company's and the Bank's actual capital amounts and ratios at December 31, 2012 and 2011, respectively:

	At December 31,			
	2012		2011	
	Amount	**Ratio**	Amount	Ratio
	(Dollars in thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	**$ 82,839**	**13.11%**	65,876	10.48%
Total risk based capital (to risk weighted assets)	**98,030**	**15.52%**	83,357	13.27%
Tier 1 capital (to total average assets)	**82,839**	**9.65%**	65,876	7.94%
CresCom Bank				
Tier 1 capital (to risk weighted assets)	**85,537**	**13.57%**	68,240	10.88%
Total risk based capital (to risk weighted assets)	**100,714**	**15.97%**	85,706	13.67%
Tier 1 capital (to total average assets)	**85,537**	**10.01%**	68,240	8.18%

In June 2012, U.S. banking regulators issued the Basel III Notice of Proposed Rulemaking (NPR) to implement Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and changes required by the Financial Reform Act. The Basel III NPR proposes material changes to the deduction of certain assets from capital, new minimum capital ratios and buffer requirements, a Standardized Approach that provides a floor to the calculation of risk-weighted assets, and significant changes to the calculation of credit and counterparty credit risk.

The Basel III NPR addressing standardized risk-weighting of assets would significantly change the risk-weighting of certain assets for almost all U.S. financial institutions beginning in 2015. To what extent the NPR will be adopted as proposed is not known; however, management estimates that the Company would remain a well-capitalized institution under its interpretation of the proposed increased capital requirements and risk-weighted asset revisions if the proposal had been fully in effect as of December 31, 2012.

Many of the changes to capital deductions are subject to a transition period where the impact is recognized in 20% increments beginning on January 1, 2014 through January 1, 2018. The majority of the other aspects of the Basel III NPR were proposed to become effective January 1, 2013. However, this effective date was postponed in November 2012. The delay is expected to be a six-month time period. The phase-in period for the new minimum capital requirements and related buffers is proposed to occur between 2013 and 2019.

Management expects to comply with the final rules when issued and effective. To prepare for the implementation of the new capital rules, management continues to build capital through retained earnings and is evaluating strategies to maximize the Company's capital under the Basel III NPR.

Recently Adopted 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 April 2011 the FASB issued ASU 2011-02 to assist creditors with their determination of when a restructuring is a Troubled Debt Restructuring ("TDR"). The determination is based on whether the restructuring constitutes a concession and whether the debtor is experiencing financial difficulties as both events must be present. The new guidance was effective for the Company beginning January 1, 2012 and did not have a material effect on the Company's TDR determinations.

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the ASC was amended by ASU 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments were effective for the Company on January 1, 2012 and did not have a material effect on the financial statements.

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments were effective for the Company beginning January 1, 2012 and did not have a material effect on the financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and requires consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company on January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements. Companies should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect prior to the amendments while FASB finalizes it conclusions regarding future requirements.

Recently Issued Accounting Pronouncements

The Balance Sheet topic of the ASC was amended in December 2011 for companies with financial instruments and derivative instruments that offset or are subject to a master netting agreement. The amendments require disclosure of both gross information and net information about instruments and transactions eligible for offset or subject to an agreement similar to a master netting agreement. The amendments are effective for reporting periods beginning on or after January 1, 2013 and must be provided retrospectively for all comparative periods presented. The Company does not expect these amendments to have a material effect on its financial statements.

The FASB amended the Comprehensive Income topic of the ASC in February 2013. The amendments address reporting of amounts reclassified out of accumulated other comprehensive income. Specifically, the amendments do not change the current requirements for reporting net income of other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the fact of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments will be effective for the Company on a prospective basis for reporting periods beginning after December 15, 2013. Earlier adoption is permitted. The Company does not expect these amendments will have a material effect on its financial statements.

In February 2013 the FASB also amended the Financial Instruments topic of the ASC to address the scope and applicability of certain disclosures to nonpublic companies. The amendments clarify that the requirement to disclose "the level of the fair value hierarchy within the fair value measurements are categorized in their entirety (Level 1, 2, or 3)" does not apply to nonpublic entities for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed 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 Legislation

On July 21, 2010, the U.S. President signed into law the Dodd-Frank Act. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gave federal regulators new authority to take control of and liquidate financial firms. The Dodd-Frank Act also created a new independent federal regulator to administer federal consumer protection laws. Many of the provisions of the Dodd-Frank Act have delayed effective dates and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be completely determined at this time, it is expected that the legislation and implementing regulations will increase the Company's operating and compliance costs. The following discussion summarizes certain significant aspects of the Dodd-Frank Act:

- The Dodd-Frank Act requires the Federal Reserve Board to apply consolidated capital requirements to depository institution holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued

prior to May 19, 2010 by a bank holding company with less than $15 billion in assets such as the Company. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

- The Dodd-Frank Act permanently increased the maximum deposit insurance amount for financial institutions to $250,000 per depositor, and extended unlimited deposit insurance to noninterest bearing transaction accounts through December 31, 2012. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act required the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Effective July 21, 2011, the Dodd-Frank Act eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

- The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called “golden parachute” payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The new legislation also authorizes the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company’s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the institution is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

- Effective July 21, 2011, the Dodd-Frank Act prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating hereto.

- The Dodd-Frank Act authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

- Effective as of July 21, 2012, the Dodd-Frank Act expands the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act applies Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transaction that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. Historically, an exception has existed that exempts covered transactions between depository institutions and their financial subsidiaries from the 10% of capital and surplus limitation set forth in Section 23A. However, the Dodd-Frank Act eliminated this exception for covered transactions entered into after July 21, 2012. Effective as of July 21, 2011, the Dodd-Frank Act also prohibits an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

- The Dodd-Frank Act required that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. Effective October 1, 2011, the Federal Reserve Board set new caps on interchange fees at $0.21 per transaction, plus an additional five basis-point charge per transaction to help cover fraud losses. An additional $0.01 per transaction is allowed if

certain fraud-monitoring controls are in place. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than $10 billion, such as the Bank, the new restrictions could negatively impact bank card services income for smaller banks if the reductions that are required of larger banks cause industry-wide reduction of swipe fees.

- The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau ("CFPB"), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Depository institutions with less than $10 billion in assets, such as the Bank, will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act also authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Under the Dodd-Frank Act, financial institutions may not make a residential mortgage loan unless they make a "reasonable and good faith determination" that the consumer has a "reasonable ability" to repay the loan. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. On January 10, 2013, the CFPB published final rules to, among other things, define "qualified mortgage" and specify the types of income and assets that may be considered in the ability-to-repay determination, the permissible sources for verification, and the required methods of calculating the loan's monthly payments. For example, the rules extend the requirement that creditors verify and document a borrower's "income and assets" to include all "information" that creditors rely on in determining repayment ability. The rules also provide further examples of third-party documents that may be relied on for such verification, such as government records and check-cashing or funds-transfer service receipts. The new rules will take effect on January 10, 2014. The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

Management continues to review the provisions of the Dodd-Frank Act to assess its probable impact on our business, financial condition, and results of operations.

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on its financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank could have a material effect on their business.

Independent Auditor's Report

The Board of Directors
Carolina Financial Corporation
Charleston, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Carolina Financial Corporation and its Subsidiaries (the "Company") which comprise the consolidated statements of financial condition as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows and the related notes to the consolidated financial statements for each of the three years in the period ended December 31, 2012.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinion.

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 its Subsidiaries as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Charleston, South Carolina
March 15, 2013

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2012 AND 2011

	December 31, 2012	December 31, 2011
	(In thousands)	
ASSETS		
Cash and due from banks	$ **6,499**	4,109
Interest-bearing cash	**11,340**	16,679
Cash and cash equivalents	**17,839**	20,788
Securities available for sale (cost of $145,774 at December 31, 2012 and $140,312 at December 31, 2011)	**149,670**	136,944
Securities held to maturity (fair value of $5,549 at December 31, 2012 and $2,773 at December 31, 2011)	**9,166**	9,401
Federal Home Loan Bank stock, at cost	**6,413**	7,185
Other investments	**465**	465
Derivative assets	**6,542**	4,000
Loans held for sale	**144,849**	80,007
Loans receivable, net of allowance for loan losses of $9,520 at December 31, 2012 and $12,039 at December 31, 2011	**501,691**	513,335
Premises and equipment, net	**16,397**	16,078
Accrued interest receivable	**3,203**	3,086
Real estate acquired through foreclosure, net	**6,284**	6,097
Deferred tax assets, net	**6,782**	8,940
Income taxes receivable	**-**	6,202
Prepaid FDIC insurance	**2,035**	3,035
Mortgage servicing rights	**12,039**	6,452
Other assets	**5,349**	4,203
Total assets	$ **888,724**	826,218
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Noninterest-bearing deposits	$ **82,004**	62,906
Interest-bearing deposits	**571,243**	558,897
Total deposits	**653,247**	621,803
Short-term borrowed funds	**82,482**	63,484
Long-term debt	**64,840**	80,390
Derivative liabilities	**-**	1,234
Drafts outstanding	**3,010**	4,516
Advances from borrowers for insurance and taxes	**613**	509
Accrued interest payable	**1,599**	1,371
Income taxes payable	**3,459**	-
Mortgage buy-back reserve	**4,882**	3,623
Accrued expenses and other liabilities	**7,078**	3,633
Total liabilities	**821,210**	780,563
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, 2012 and 2011	**19**	19
Additional paid-in capital	**22,068**	21,982
Retained earnings, restricted	**45,752**	28,874
Accumulated other comprehensive loss, net of tax benefit	**(325)**	(5,220)
Total stockholders' equity	**67,514**	45,655
Total liabilities and stockholders' equity	$ **888,724**	826,218

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	For the Years Ended December 31,		
	2012	2011	2010
	(In thousands, except share data)		
Interest income			
Loans	$ **30,074**	31,790	37,367
Debt securities	**5,136**	6,518	9,364
Dividends	**107**	81	42
Interest-bearing cash	**41**	52	69
Total interest income	**35,358**	38,441	46,842
Interest expense			
Deposits	**4,178**	6,578	11,850
Short-term borrowed funds	**640**	1,045	708
Long-term debt	**2,695**	3,490	4,519
Total interest expense	**7,513**	11,113	17,077
Net interest income	**27,845**	27,328	29,765
Provision for loan losses	**2,707**	10,735	30,755
Net interest income (loss) after provision for loan losses	**25,138**	16,593	(990)
Noninterest income			
Net gain on sale of loans held for sale	**48,987**	17,340	23,481
Deposit service charges	**1,604**	1,610	1,765
Income from ATM and debit card transactions	**766**	574	377
Income from sales of non-depository products	**-**	624	884
Net loss on extinguishment of debt	**(1,591)**	(1,061)	(2,536)
Net (loss) gain on sale of securities	**(3,031)**	306	(1,955)
Other-than-temporary impairment of securities	**(913)**	(1,753)	(2,480)
Net loss on sale of real estate acquired through foreclosure	**(227)**	(1,037)	(108)
Net unrealized gain on derivatives	**3,776**	714	601
Net gain on sale of servicing assets	**-**	299	526
Other	**2,913**	2,105	1,045
Total noninterest income	**52,284**	19,721	21,600
Noninterest expense			
Salaries and employee benefits	**25,632**	19,981	20,594
Occupancy and equipment	**3,274**	3,200	3,439
Marketing and public relations	**1,360**	479	630
FDIC insurance	**1,076**	1,389	1,798
Expense from ATM and debit card transactions	**453**	450	360
Other real estate expense	**1,646**	2,425	1,725
Provision for mortgage loan repurchase losses	**2,189**	785	2,627
Legal expense	**1,978**	1,602	1,322
Other	**12,541**	7,102	6,575
Total noninterest expense	**50,149**	37,413	39,070
Income (loss) before income taxes	**27,273**	(1,099)	(18,460)
Income tax expense (benefit)	**10,395**	(128)	(5,872)
Net income (loss)	$ **16,878**	(971)	(12,588)
Earnings (loss) per common share:			
Basic	$ **8.80**	(0.51)	(6.58)
Diluted	$ **8.80**	(0.51)	(6.58)
Average common shares outstanding:			
Basic	**1,918,992**	1,918,992	1,913,240
Diluted	**1,918,992**	1,918,992	1,913,240

See accompanying notes to consolidated financial statements.

Carolina Financial Corporation
Consolidated Statements of Comprehensive Income (Loss) and Changes in Stockholders' Equity
For the Years Ended December 31, 2012, 2011 and 2010

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	For the Years Ended December 31,		
	2012	2011	2010
		(In thousands)	
Net income	**$ 16,878**	(971)	(12,588)
Other comprehensive income, net of tax:			
Unrealized gain on securities, net of tax of $1,708, $41 and $766 for the years ended December 31, 2012, 2011 and 2010, respectively	**2,970**	63	1,311
Reclassification adjustment for losses (gains) included in earnings, net of tax of $1,106, $(104) and $713 for the years ended December 31, 2012, 2011 and 2010, respectively	**1,925**	(202)	1,242
Other comprehensive income (loss), net of tax	**4,895**	(139)	2,553
Comprehensive income (loss)	**$ 21,773**	(1,110)	(10,035)

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
			(In thousands, except share data)			
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, net of tax					2,553	2,553
Balance, December 31, 2010	1,918,992	19	21,711	29,845	(5,081)	46,494
Stock-based compensation expense, net	-	-	271	-	-	271
Net loss	-	-	-	(971)	-	(971)
Other comprehensive loss, net of tax					(139)	(139)
Balance, December 31, 2011	1,918,992	19	21,982	28,874	(5,220)	45,655
Stock-based compensation expense, net	**-**	**-**	**86**	**-**	**-**	**86**
Net income	**-**	**-**	**-**	**16,878**	**-**	**16,878**
Other comprehensive income, net of tax					**4,895**	**4,895**
Balance, December 31, 2012	**1,918,992**	**$ 19**	**22,068**	**45,752**	**(325)**	**67,514**

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	For the Years Ended December 31,		
	2012	2011	2010
	(In thousands)		
Cash flows from operating activities:			
Net income (loss)	**$ 16,878**	(971)	(12,588)
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:			
Provision for loan losses	**2,707**	10,735	30,755
Deferred tax expense (benefit)	**(657)**	1,233	(1,470)
Amortization of unearned discount/premiums on investments, net	**1,361**	1,291	1,348
Amortization of deferred loan fees	**(5,328)**	(3,367)	(3,904)
Amortization of mortgage servicing rights	**1,464**	1,036	651
Loss (gain) on sale of available for sale securities, net	**3,031**	(306)	1,955
Gain on sale of loans held for sale, net	**(48,987)**	(17,340)	(23,481)
Originations of loans held for sale	**(2,313,236)**	(1,352,873)	(1,652,257)
Proceeds from sale of loans held for sale	**2,297,381**	1,372,821	1,667,033
Loss on extinquishment of debt	**1,591**	1,061	2,536
Mortgage loan buyback provision	**2,189**	785	2,627
Mortgage loan losses paid, net of recoveries	**(930)**	(2,438)	(382)
Gain on derivatives, net	**(3,776)**	(714)	(601)
Stock-based compensation	**86**	271	391
Depreciation	**833**	856	1,290
Loss on disposals of premises and equipment	**11**	55	3
Loss on sale of real estate acquired through foreclosure	**227**	1,037	108
Write-down of real estate acquired through foreclosure	**1,049**	1,966	2,063
Gain on sale of servicing assets	**-**	(299)	(526)
Proceeds from the sale of servicing assets	**-**	1,043	1,810
Originations of mortgage servicing assets	**(7,051)**	(2,983)	(5,387)
Decrease (increase) in:			
Accrued interest receivable	**(117)**	397	1,067
Income taxes receivable	**5,789**	(782)	(6,416)
Prepaid FDIC insurance	**1,000**	1,126	1,516
Other assets	**(1,146)**	3,475	(4,149)
Increase (decrease) in:			
Accrued interest payable	**228**	432	(545)
Income taxes payable	**3,459**	-	-
Accrued expenses and other liabilities	**3,445**	219	(955)
Cash flows provided by (used in) operating activities	**(38,499)**	17,766	2,492

Continued

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	For the Years Ended December 31,		
	2012	2011	2010
	(In thousands)		
Cash flows from investing activities:			
Activity in available-for-sale securities:			
Purchases	**$ (79,907)**	(36,655)	(83,078)
Maturities, payments and calls	**42,618**	44,052	41,887
Proceeds from sales	**27,735**	5,572	88,898
Activity in held-to-maturity securities-			
Maturities, payments and calls	**794**	1,357	21,633
(Increase) decrease in Federal Home Loan Bank stock	**772**	3,944	1,327
Decrease in loans receivable, net	**4,858**	53,283	65,695
Purchase of premises and equipment	**(1,182)**	(181)	(736)
Proceeds from disposals of premises and equipment	**19**	-	78
Proceeds from sale of real estate acquired through foreclosure	**7,944**	11,725	5,813
Cash flows provided by investing activities	**3,651**	83,097	141,517
Cash flows from financing activities:			
Net increase (decrease) in deposit accounts	**31,444**	(68,011)	(71,294)
Net decrease in Federal Home Loan Bank advances	**23,409**	(36,560)	(53,536)
Net decrease in other short-term borrowed funds	**(21,252)**	(1,425)	(15,103)
Principal repayment of subordinated debt	**(300)**	(300)	(225)
Net increase in drafts outstanding	**(1,506)**	1,371	28
Net increase in advances from borrowers for insurance and taxes	**104**	113	198
Cash flows used in financing activities	**31,899**	(104,812)	(139,932)
	(2,949)	(3,949)	4,077
Cash and cash equivalents, beginning of year	**20,788**	24,737	20,660
Cash and cash equivalents, end of year	**$ 17,839**	20,788	24,737
Supplemental disclosure			
Cash paid for:			
Interest on deposits and borrowed funds	**$ 7,285**	10,681	17,622
Income taxes paid, net of (refunds)	**1,424**	(810)	2,014
Non-cash investing and financing activities:			
Other-than-temporary impairment reflected through accumulated other comprehensive income	**87**	685	1,685
Other-than-temporary impairment reflected through the statement of operations	**913**	1,753	2,480
Transfer of loans receivable to real estate acquired through foreclosure	**9,407**	10,009	10,947
Transfer of held to maturity securities to available for sale securities	**-**	-	91,512
Unrealized gain in securities available for sale, net	**2,970**	63	1,311

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 bank holding company with two wholly-owned subsidiaries, CresCom Bank (the "Bank") and Carolina Services Corporation of Charleston ("Carolina Services"). Effective July 31, 2011, Carolina Financial combined its wholly-owned subsidiary bank, Community FirstBank of Charleston ("Community FirstBank"), with and into its other wholly-owned subsidiary bank, Crescent Bank. In conjunction with this internal reorganization, Crescent Bank's name was changed to CresCom Bank. Crescent Mortgage Company ("Crescent Mortgage"), formerly a wholly-owned subsidiary of Community FirstBank, became a wholly-owned subsidiary of CresCom Bank. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, CresCom 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, 2012, 2011 and 2010, 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, asserted and unasserted legal claims 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 Bank's 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 15, 2013, 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, 2012 and 2011 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 Bank is required to maintain average balances on hand or with the Federal

Reserve Bank. At December 31, 2012 and 2011, these reserve balances amounted to $4.7 million and $1.9 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.

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.

Troubled Debt Restructurings ("TDRs")
The Company designates loan modifications as TDRs when, for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of modification are initially classified as accruing TDRs at the date of modification, if the note is reasonably assured of repayment and performance is in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the modification date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accrual status when there is economic substance to the restructuring, there is well documented credit evaluation of the borrower's financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months).

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. 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 initially recorded at fair value less estimated selling costs at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, such properties are generally 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, 2012 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, 2012 was $396,000.

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. The Company's federal income tax returns were examined for the years 2008 through 2010. No changes were proposed.

Interest and penalties on income tax uncertainties are classified within income tax expense in the statement of operations. The Company paid $1,000 of penalties and $400 interest during fiscal 2012. The Company paid $7,000 of penalties and no interest during fiscal 2011. The Company had no interest or penalties during fiscal 2010.

It is management's belief that the realization of the remaining net deferred tax assets is more likely than not. Accordingly, no reserve was considered necessary.

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 was $4.9 million and $3.6 million at December 31, 2012 and 2011, respectively. For the years ended December 31, 2012, 2011 and 2010, the Company recorded mortgage repurchase reserve expense of $2.2 million, $785,000 and $2.6 million, respectively. The expense is reflected in noninterest expense in the accompanying consolidated statements of operations. In addition, the Company incurred mortgage repurchase losses, net of recoveries, for the years ended December 31, 2012, 2011 and 2010 of $930,000, $2.4 million and $383,000, 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 comprehensive income (loss). The Company's other comprehensive income (loss) for the years ended December 31, 2012, 2011 and 2010 and accumulated other comprehensive income (loss) as of December 31, 2012 and 2011 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, 2012 and 2011, the Company had two 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 2012 and 2011.

The Company adopted the 2006 Recognition and Retention Plan under which an aggregate of 60,000 shares of common stock have been reserved for issuance by the Company. 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, 6,500 shares of non-vested restricted common stock of the Company were granted to employees and non-employees of the Company at $8.11 per share. No restricted common stock of the Company was granted during fiscal 2012 and 2011. As of December 31, 2012, a total of 56,500 shares have been awarded under the plan, of which 50,600 shares have vested and 5,900 shares are unvested.

Additionally, the Company has adopted the 2002 Stock Option Plan under which an aggregate of 138,750 shares have been reserved for issuance by the Company upon the grant of stock options or limited rights, of which 8,240 are outstanding. The plan provided for the grant of options to key employees and Directors as determined by the Board of Directors. No additional options can be awarded under this plan. 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 expense recognition of employee stock option and restricted stock awards resulted in net expense of approximately $86,000, $271,000 and $391,000 during the twelve months ended December 31, 2012, 2011 and 2010, respectively.

A summary of the status of the Company's stock option plans at December 31, 2012, 2011 and 2010 and changes during the years then ended is presented below:

	At and For the Year Ended December 31,					
	2012		2011		2010	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	**140,480**	**$ 15.63**	144,980	$ 15.83	144,980	$ 15.83
Granted	**-**	**-**	-	-	-	-
Exercised	**-**	**-**	-	-	-	-
Forfeited or expired	**(132,240)**	**(15.00)**	(4,500)	(22.22)	-	-
Outstanding at end of year	**8,240**	**$ 23.29**	140,480	$ 15.63	144,980	$ 15.83
Options exercisable at end of year	**8,240**	**$ 23.29**	140,480	$ 15.63	144,570	$ 15.77

The following table summarizes information about the options outstanding at December 31, 2012:

	At December 31, 2012				
	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	4,000	1.3	$ 20.00	4,000	$ 20.00
$ 20.01 to $25.00	3,540	2.5	24.00	3,540	24.00
$ 35.00 to $40.00	700	3.8	38.50	700	38.50
	8,240	2.0	$ 23.29	8,240	$ 23.29

There were no options granted during the years ended December 31, 2012, 2011 and 2010. No stock options were exercised during the year ended December 31, 2012. Fair values have been retroactively restated for all stock dividends since the date the option was granted. As of December 31, 2012, there was approximately $55,000 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 one year. 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 (loss) as previously reported.

Recently Adopted 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 April 2011 the FASB issued ASU 2011-02 to assist creditors with their determination of when a restructuring is a Troubled Debt Restructuring ("TDR"). The determination is based on whether the restructuring constitutes a concession and whether the debtor is experiencing financial difficulties as both events must be present. The new guidance was effective for the Company beginning January 1, 2012 and did not have a material effect on the Company's TDR determinations.

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the ASC was amended by ASU 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments were effective for the Company on January 1, 2012 and did not have a material effect on the financial statements.

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments were effective for the Company beginning January 1, 2012 and did not have a material effect on the financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and requires consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company on January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements. Companies should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect prior to the amendments while FASB finalizes it conclusions regarding future requirements.

Recently Issued Accounting Pronouncements
The Balance Sheet topic of the ASC was amended in December 2011 for companies with financial instruments are derivative instruments that offset or are subject to a master netting agreement. The amendments require disclosure of both gross information and net information about instruments and transactions eligible for offset or subject to an agreement similar to a master netting agreement. The amendments are effective for reporting periods beginning on or after January 1, 2013 and must be provided retrospectively for all comparative periods presented. The Company does not expect these amendments to have a material effect on its financial statements.

The FASB amended the Comprehensive Income topic of the ASC in February 2013. The amendments address reporting of amounts reclassified out of accumulated other comprehensive income. Specifically, the amendments do not change the current requirements for reporting net income of other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the fact of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments will be effective for the Company on a prospective basis for reporting periods beginning after December 15, 2013. Earlier adoption is permitted. The Company does not expect these amendments will have a material effect on its financial statements.

In February 2013 the FASB also amended the Financial Instruments topic of the ASC to address the scope and applicability of certain disclosures to nonpublic companies. The amendments clarify that the requirement to disclose "the level of the fair value hierarchy within the fair value measurements are categorized in their entirety (Level 1, 2, or 3)" does not apply to nonpublic

entities for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed 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, 2012 and 2011 follows:

	At December 31,							
	2012				2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)							
Securities available-for-sale:								
Municipal securities	$ 17,630	252	(113)	17,769	1,118	19	-	1,137
GNMA	22,188	823	-	23,011	22,857	1,136	(2)	23,991
Mortgage-backed securities	105,956	3,025	(91)	108,890	116,337	2,646	(7,167)	111,816
Total securities available for sale	$ 145,774	4,100	(204)	149,670	140,312	3,801	(7,169)	136,944
Securities held-to-maturity:								
Asset-backed securities	$ 9,166	580	(4,197)	5,549	9,401	-	(6,628)	2,773
Total securities held to maturity	$ 9,166	580	(4,197)	5,549	9,401	-	(6,628)	2,773

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2012 follows:

		2012	
		Amortized Cost	Fair Value
		(In thousands)	
Securities available-for-sale:			
Six to ten years	$	7,894	7,958
After ten years		137,880	141,712
Total	$	145,774	149,670
Securities held-to-maturity:			
Six to ten years	$	-	-
After ten years		9,166	5,549
Total	$	9,166	5,549

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 2012, the Company sold 14 securities available-for-sale totaling $30.8 million. The Company received gross proceeds of $27.7 million related to the sale of these securities and recognized gross gains of $426,000 and gross losses of $3.5 million.

During 2011, the Company sold 5 securities available-for-sale totaling $5.3 million. The Company received gross proceeds of $5.6 million related to the sale of these securities and recognized gross gains of $357,000 and gross losses of $51,000.

At December 31, 2012, the Company has pledged $6.8 million of securities for FHLB 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, 2012 are as follows:

	At December 31, 2012								
	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:									
Municipal securities	**$ 8,554**	**8,441**	**(113)**	**-**	**-**	**-**	**8,554**	**8,441**	**(113)**
Mortgage-backed securities	**13,078**	**13,023**	**(55)**	**1,927**	**1,891**	**(36)**	**15,005**	**14,914**	**(91)**
Total	**$ 21,632**	**21,464**	**(168)**	**1,927**	**1,891**	**(36)**	**23,559**	**23,355**	**(204)**
Securities held-to-maturity:									
Asset-backed securities	**$ -**	**-**	**-**	**9,082**	**4,885**	**(4,197)**	**9,082**	**4,885**	**(4,197)**

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, 2011 are as follows:

	At December 31, 2011								
	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	$ 2,218	2,216	(2)	-	-	-	2,218	2,216	(2)
Mortgage-backed securities	11,944	11,767	(177)	27,939	20,949	(6,990)	39,883	32,716	(7,167)
Total	$ 14,162	13,983	(179)	27,939	20,949	(6,990)	42,101	34,932	(7,169)
Securities held-to-maturity:									
Asset-backed securities	$ -	-	-	9,401	2,773	(6,628)	9,401	2,773	(6,628)

At December 31, 2012 and 2011, the Company had 26 and 21, respectively, individual investments available-for-sale that were in an unrealized loss position. The unrealized losses on the Company's investments in GNMA securities, 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 OTTI expense of $625,000 related to 4 securities available for sale during fiscal 2012. These 4 securities available for sale were subsequently sold during fiscal 2012. In addition, OTTI expense totaling $288,000 was recorded related to 2 held-to-maturity securities during fiscal 2012. There is one additional held-to-maturity security that had OTTI expense recorded in prior years, but did not incur OTTI expense during fiscal 2012. Other than these 3 held-to-maturity securities, management believes that there are no other securities other-than-temporarily impaired at December 31, 2012. 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. Management continues to monitor these securities with a high degree of scrutiny. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of the securities may be sold or are other-than-temporarily impaired, which would require a charge to earnings in such periods.

The Company reviews its investment securities portfolio at least quarterly and more frequently when economic conditions warrant, assessing whether there is any indication of other-than-temporary impairment ("OTTI"). Factors considered in the review include estimated future cash flows, length of time and extent to which market value has been less than cost, the financial condition and near term prospect of the issuer, and our intent and ability to retain the security to allow for an anticipated recovery in market value. If the review determines that there is OTTI, then an impairment loss is recognized in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made, or a portion may be recognized in other comprehensive income. The fair value of investments on which OTTI is recognized then becomes the new cost basis of the investment.

The unrealized loss in asset-backed securities relates to valuations on 14 individual pooled trust preferred securities. The Company believes, based on industry analyst reports and third-party other-than-temporary loss impairment evaluations, that the deterioration in the value of these securities is attributable to a combination of the lack of liquidity in these securities, credit ratings and credit quality concerns.

The Company, as a member of the Federal Home Loan Bank ("FHLB") of Atlanta, is 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 $6.4 million and $7.2 million at December 31, 2012 and 2011, respectively.

Other investments at December 31, 2012 and 2011 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, 2012 and 2011 are as follows:

	At December 31,			
	2012		2011	
	Fair Value	Notional Value	Fair Value	Notional Value
	(In thousands)			
Derivative assets:				
Mortgage loan interest rate lock commitments	$ 4,783	289,584	2,832	218,465
Mortgage loan forward sales commitments	1,692	59,177	1,168	47,992
Mortgage-backed securities forward sales commitments	67	308,000	-	-
	$ 6,542	656,761	4,000	266,457
Derivative liabilities:				
Mortgage-backed securities forward sales commitments	$ -	-	1,234	167,000

The Company uses derivatives 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. Crescent Mortgage ALCO 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, 2012 and 2011 are summarized by category as follows:

	At December 31,			
	2012		2011	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars in thousands)			
Loans secured by real estate:				
One-to-four family	$ 146,333	27.66%	124,604	23.10%
Home equity	31,278	5.91%	35,173	6.52%
Commercial real estate	240,764	45.52%	250,560	46.46%
Construction and development	68,113	12.88%	75,985	14.09%
Consumer loans	3,762	0.71%	5,085	0.94%
Commercial business loans	38,714	7.32%	47,933	8.89%
Total gross loans receivable	528,964	100.00%	539,340	100.00%
Less:				
Undisbursed loans in process	17,690		13,898	
Allowance for loan losses	9,520		12,039	
Deferred fees, net	63		68	
Total loans receivable, net	$ 501,691		513,335	

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

	At December 31,			
	2012		2011	
	(Dollars in thousands)			
Variable rate loans	**$ 265,657**	**51.96%**	312,188	59.41%
Fixed rate loans	**245,617**	**48.04%**	213,254	40.59%
Total loans outstanding	**$ 511,274**	**100.00%**	525,442	100.00%

The following table presents activity in the allowance for credit losses. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for loan losses:	At December 31, 2012						
	Loans Secured by Real Estate						
	One-to-four family	**Home equity**	**Commercial real estate**	**Construction and Development**	**Consumer**	**Commercial business**	**Total**
				(In thousands)			
Balance at January 1, 2012	**$ 3,223**	**1,216**	**3,167**	**3,021**	**108**	**1,304**	**12,039**
Provision for loan losses	**1,487**	**54**	**761**	**125**	**(109)**	**389**	**2,707**
Charge-offs	**(2,680)**	**(319)**	**(1,432)**	**(1,506)**	**(84)**	**(1,169)**	**(7,190)**
Recoveries	**375**	**-**	**231**	**740**	**172**	**446**	**1,964**
Balance at December 31, 2012	**$ 2,405**	**951**	**2,727**	**2,380**	**87**	**970**	**9,520**

	At December 31, 2011						
	Loans Secured by Real Estate						
	One-to-four family	**Home equity**	**Commercial real estate**	**Construction and Development**	**Consumer**	**Commercial business**	**Total**
				(In thousands)			
Balance at January 1, 2011	$ 4,627	1,376	2,705	4,040	163	1,352	14,263
Provision for loan losses	1,669	51	3,828	4,821	125	241	10,735
Charge-offs	(3,837)	(211)	(3,548)	(6,043)	(221)	(929)	(14,789)
Recoveries	764	-	182	203	41	640	1,830
Balance at December 31, 2011	$ 3,223	1,216	3,167	3,021	108	1,304	12,039

	Total
Balance at January 1, 2010	$ 13,032
Provision for loan losses	30,755
Charge-offs	(29,786)
Recoveries	262
Balance at December 31, 2010	$ 14,263

	Loans Secured by Real Estate						
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Total
				(In thousands)			
At December 31, 2012:							
Allowance for loan losses ending balances:							
Individually evaluated for impairment	**$ 312**	**-**	**359**	**429**	**25**	**273**	**1,398**
Collectively evaluated for impairment	**2,093**	**951**	**2,368**	**1,951**	**62**	**697**	**8,122**
	$ 2,405	**951**	**2,727**	**2,380**	**87**	**970**	**9,520**
Loans receivable:							
Ending balances:							
Individually evaluated for impairment	**$ 7,392**	**-**	**18,177**	**3,265**	**74**	**3,535**	**32,443**
Collectively evaluated for impairment	**138,937**	**30,710**	**218,053**	**60,210**	**3,428**	**27,493**	**478,831**
Total loans receivable	**$ 146,329**	**30,710**	**236,230**	**63,475**	**3,502**	**31,028**	**511,274**
At December 31, 2011:							
Allowance for loan losses ending balances:							
Individually evaluated for impairment	$ 485	22	85	212	36	405	1,245
Collectively evaluated for impairment	2,738	1,194	3,082	2,809	72	899	10,794
	$ 3,223	1,216	3,167	3,021	108	1,304	12,039
Loans receivable:							
Ending balances:							
Individually evaluated for impairment	$ 10,571	326	27,203	13,747	96	5,640	57,583
Collectively evaluated for impairment	114,019	33,787	218,746	60,846	4,746	35,715	467,859
Total loans receivable	$ 124,590	34,113	245,949	74,593	4,842	41,355	525,442

The following table presents impaired loans individually evaluated for impairment in the segmented portfolio categories as of December 31, 2012. The recorded investment is defined as the original amount of the loan, net of any deferred costs and fees, less any principal reductions and direct charge-offs. Unpaid principal balance includes amounts previously included in charge-offs.

	At and for the Year Ended December 31, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In thousands)		
With no related allowance recorded:					
Loans secured by real estate:					
One-to-four family	$ 4,310	7,115	-	5,575	180
Home equity	-	319	-	257	2
Commercial real estate	13,891	14,746	-	16,142	945
Construction and development	658	921	-	5,393	222
Consumer loans	43	427	-	49	8
Commercial business loans	2,419	3,473	-	2,687	143
	21,321	27,001	-	30,103	1,500
With an allowance recorded:					
Loans secured by real estate:					
One-to-four family	3,082	3,282	312	2,863	19
Home equity	-	-	-	-	-
Commercial real estate	4,286	4,286	359	4,420	1
Construction and development	2,607	4,504	429	3,037	9
Consumer loans	31	31	25	28	1
Commercial business loans	1,116	1,116	273	1,247	1
	11,122	13,219	1,398	11,595	31
Total:					
Loans secured by real estate:					
One-to-four family	7,392	10,397	312	8,438	199
Home equity	-	319	-	257	2
Commercial real estate	18,177	19,032	359	20,562	946
Construction and development	3,265	5,425	429	8,430	231
Consumer loans	74	458	25	77	9
Commercial business loans	3,535	4,589	273	3,934	144
	$ 32,443	40,220	1,398	41,698	1,531

	At and for the Year Ended December 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In thousands)		
With no related allowance recorded:					
Loans secured by real estate:					
One-to-four family	$ 9,598	13,226	-	11,639	262
Home equity	-	-	-	308	13
Commercial real estate	26,987	29,774	-	23,285	557
Construction and development	13,234	19,359	-	17,473	380
Consumer loans	59	531	-	167	38
Commercial business loans	5,048	7,010	-	5,801	256
	54,926	69,900	-	58,673	1,506
With an allowance recorded:					
Loans secured by real estate:					
One-to-four family	973	990	485	244	32
Home equity	326	350	22	87	-
Commercial real estate	216	216	85	55	1
Construction and development	513	558	212	128	(8)
Consumer loans	37	39	36	10	1
Commercial business loans	592	603	405	151	3
	2,657	2,756	1,245	675	29
Total:					
Loans secured by real estate:					
One-to-four family	10,571	14,216	485	11,883	294
Home equity	326	350	22	395	13
Commercial real estate	27,203	29,990	85	23,340	558
Construction and development	13,747	19,917	212	17,601	372
Consumer loans	96	570	36	177	39
Commercial business loans	5,640	7,613	405	5,952	259
	$ 57,583	72,656	1,245	59,348	1,535

The Bank is not committed to advance additional funds in connection with impaired loans.

A loan is considered past due if the required principal and interest payment has not been received as of the due date. The following schedule is an aging of past due loans receivable by portfolio segment as of December 31, 2012 and 2011.

	At December 31, 2012						
	Real estate loans						
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Total
				(In thousands)			
30-59 days past due	**$ 300**	**-**	**1,142**	**173**	**106**	**378**	**2,099**
60-89 days past due	**611**	**546**	**2,227**	**317**	**-**	**21**	**3,722**
90 days or more past due	**4,247**	**-**	**5,534**	**3,092**	**26**	**1,136**	**14,035**
Total past due	**5,158**	**546**	**8,903**	**3,582**	**132**	**1,535**	**19,856**
Current	**141,171**	**30,164**	**227,327**	**59,893**	**3,370**	**29,493**	**491,418**
Total loans receivable	**$ 146,329**	**30,710**	**236,230**	**63,475**	**3,502**	**31,028**	**511,274**
Recorded investment greater than 90 days and still accruing	**$ -**	**-**	**-**	**-**	**-**	**-**	**-**

	At December 31, 2011						
	Real estate loans						
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Total
				(In thousands)			
30-59 days past due	$ 4,852	473	8,785	27	54	220	14,411
60-89 days past due	2,009	-	903	620	-	-	3,532
90 days or more past due	7,619	-	14,117	7,072	81	1,810	30,699
Total past due	14,480	473	23,805	7,719	135	2,030	48,642
Current	110,110	33,640	222,144	66,874	4,707	39,325	476,800
Total loans receivable	$ 124,590	34,113	245,949	74,593	4,842	41,355	525,442
Recorded investment greater than 90 days and still accruing	$ -	-	4,184	-	47	-	4,231

Loans are generally placed in nonaccrual status when the collection of principal and interest is 90 days or more past due, unless the obligation is both well-secured and in the process of collection. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest payments received while the loan is on nonaccrual is applied to the principal balance. No interest income was recognized on impaired loans subsequent to the nonaccrual status designation. A loan is returned to accrual status when the borrower makes consistent payments according to contractual terms and future payments are reasonably assured.

The following is a schedule of loans receivable, by portfolio segment, on nonaccrual at December 31, 2012 and 2011.

	At December 31,	
	2012	2011
Loans secured by real estate:	(In thousands)	
One-to-four family	**$ 4,817**	$ 8,861
Home equity	**-**	326
Commercial real estate	**5,956**	10,143
Construction and development	**3,251**	8,011
Consumer loans	**52**	72
Commercial business loans	**1,172**	2,518
	$ 15,248	$ 29,931

There were no loans past due 90 days or more and still accruing at December 31, 2012. There were $4.2 million of loans past due 90 days or more and still accruing at December 31, 2011.

The Company uses several metrics as credit quality indicators of current or potential risks as part of the ongoing monitoring of credit quality of its loan portfolio. The credit quality indicators are periodically reviewed and updated on a case-by-case basis. The Company uses the following definitions for the internal risk rating grades, listed from the least risk to the highest risk.

Outstanding: The borrower is typically a long established, well-seasoned company with a significant market position. It possesses unquestioned asset quality, liquidity, and excellent sales and earnings trends. Leverage, if present, is well below industry norms. Borrowers appear to have capacity to meet all of its obligations under almost any circumstances. The borrowing entity's management has extensive experience and depth.

Excellent: The borrower demonstrates a strong and liquid financial condition based upon current financial information and qualifies to borrow on an unsecured basis under most circumstances. If borrowing is secured, collateral is readily marketable and amply margined. Repayment sources are well defined and more than adequate. Credit checks and prior lending experiences with the company, if any, are fully satisfactory. The borrower's cash flow comfortably exceeds total current obligations.

Good: The borrower provides current financial information reflecting a satisfactory financial condition and reasonable debt service capacity. If borrowing is secured, collateral is marketable, adequately margined at the present time, and expected to afford coverage to maturity. Repayment sources are considered adequate, and repayment terms are appropriate. Credit checks and prior experience, if any, are satisfactory. The borrower is usually established and is attractive to other financial institutions. The borrower's balance sheet is stable and sales and earnings are steady and predictable.

Acceptable: While clearly an acceptable credit risk to the Company, the borrower will generally demonstrate a higher leveraged, less liquid balance sheet and capacity to service debt, while steady, may be less well-defined. Repayment terms may not be appropriate for individual transactions. Borrower is generally acceptable to other financial institutions; however, secured borrowing is the norm. Collateral marketability and margin are acceptable at the present time but may not continue to be so. Credit checks or prior experience, if any, reveals some, but not serious, slowness of paying. If a business, its management experience may be limited or have less depth than a satisfactory borrower. Sensitivity to economic or credit cycles exists, and staying power could be a problem.

Management Watch: Loans to borrowers with generally acceptable credit strength, but with manageable weaknesses or uncertainty evident in one or more factors. Earnings may be erratic, with marginal cash flows or declining sales. Borrowers reflect leveraged financial condition and marginal liquidity. The borrower's management may be new and a track record of performance has yet to be developed. Financial information may be incomplete and reliance on secondary repayment sources may be increasing.

Special Mention: While loans to a borrower in this rating category are currently protected (no loss of principal or interest is envisioned), they may pose undue or unwarranted credit risks if weaknesses are not checked or corrected. Weaknesses may be limited to one or several trends or developments. Weaknesses may include one or more of the following: a potentially over-extended financial condition, a questionable repayment program, an uncertain level of continuing employment or income, inadequate or deteriorating collateral, inadequate or untimely financial information, management competence or succession issues, or a high degree of vulnerability to outside forces.

Substandard: Assets in this category are inadequately protected by the current creditworthiness and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weakness that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the company will sustain some loss if the deficiencies are not corrected. Nonaccrual loans, reduced-earnings loans, and loans to borrowers engaged in bankruptcy proceedings are automatically rated Substandard or lower.

Doubtful: A loan rated Doubtful has all of the weaknesses inherent in one rated Substandard with the added characteristic that the weakness may make collection or liquidation in full, based on currently existing facts, highly improbable. A Doubtful rating generally is used when the amount of loss can be projected and that projection exceeds one-third of the balance of outstanding debt but does not exceed two-thirds of that balance. A Doubtful rating is generally applied when the likelihood of significant loss is high.

Loss: A Loss rating should be applied when the borrower's outstanding debt is considered uncollectible or of such little value that its continuance as a bankable asset is not warranted. This rating does not suggest that there is absolutely no recovery or salvage value, but that it is not practical or desirable to defer writing off the debt even though a partial recovery may be affected in the future.

The Company uses the following definitions:

Nonperforming: Loans on nonaccrual status plus loans greater than ninety days past due still accruing interest.

Performing: All current loans plus loans less than ninety days past due. The following is a schedule of the credit quality of loans receivable, by portfolio segment, as of December 31, 2012 and 2011.

	At December 31, 2012						
	Real estate loans						
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Total
	(In thousands)						
Internal Risk Rating Grades:							
Acceptable or better	**$ 123,047**	**29,871**	**153,649**	**37,694**	**3,467**	**21,974**	**369,702**
Management Watch	**15,073**	**375**	**50,629**	**17,285**	**-**	**5,535**	**88,897**
Special Mention	**3,476**	**-**	**23,745**	**5,391**	**-**	**2,000**	**34,612**
Substandard	**4,733**	**464**	**8,207**	**3,105**	**35**	**1,519**	**18,063**
Total loans receivable	**$ 146,329**	**30,710**	**236,230**	**63,475**	**3,502**	**31,028**	**511,274**
Performing	**$ 141,512**	**30,710**	**230,274**	**60,224**	**3,450**	**29,856**	**496,026**
Nonperforming:							
90 days or more and still accruing	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Nonaccrual	**4,817**	**-**	**5,956**	**3,251**	**52**	**1,172**	**15,248**
Total nonperforming	**4,817**	**-**	**5,956**	**3,251**	**52**	**1,172**	**15,248**
Total loans receivable	**$ 146,329**	**30,710**	**236,230**	**63,475**	**3,502**	**31,028**	**511,274**

	At December 31, 2011						
	Real estate loans						
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Total
	(In thousands)						
Internal Risk Rating Grades:							
Acceptable or better	$ 90,792	29,448	130,828	34,256	4,212	28,747	318,283
Management Watch	6,414	1,461	33,881	17,287	162	4,940	64,145
Special Mention	14,330	2,070	55,439	9,856	372	3,159	85,226
Substandard	13,054	1,134	25,801	13,194	96	4,509	57,788
Total loans receivable	$ 124,590	34,113	245,949	74,593	4,842	41,355	525,442
Performing	$ 115,729	33,787	231,622	66,582	4,723	38,837	491,280
Nonperforming:							
90 days or more and still accruing	-	-	4,184	-	47	-	4,231
Nonaccrual	8,861	326	10,143	8,011	72	2,518	29,931
Total nonperforming	8,861	326	14,327	8,011	119	2,518	34,162
Total loans receivable	$ 124,590	34,113	245,949	74,593	4,842	41,355	525,442

Troubled Debt Restructurings

The following is a schedule of troubled debt restructurings, by portfolio segment, as of December 31, 2012 and 2011.

	At December 31, 2012			
	Number of Contracts		Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
			(In thousands)	
Troubled Debt Restructurings:				
Loans secured by real estate:				
One-to-four family	**6**	**$**	**4,928**	**4,263**
Home equity	**-**		**-**	**-**
Commercial real estate	**4**		**6,313**	**5,751**
Construction and development	**9**		**5,732**	**2,938**
Consumer loans	**-**		**-**	**-**
Commercial business loans	**3**		**959**	**588**
	22	**$**	**17,932**	**13,540**

	At December 31, 2011			
	Number of Contracts		Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
			(In thousands)	
Troubled Debt Restructurings: That Subsequently Defaulted During the Period:				
Loans secured by real estate:				
One-to-four family	12	$	6,621	6,092
Home equity	-		-	-
Commercial real estate	17		20,942	20,867
Construction and development	14		11,063	10,336
Consumer loans	-		-	-
Commercial business loans	9		4,698	4,319
	52	$	43,324	41,614

During the year ended December 31, 2012, the Bank modified five loans that were considered troubled debt restructurings. We extended the terms for all five of these loans at market rates. No loans restructured in the twelve months prior to December 31, 2012 went into default during the year.

Loans serviced for the benefit of others under loan participation arrangements amounted to $15.9 million and $20.1 million at December 31, 2012 and 2011, respectively.

Activity in loans to officers, directors and other related parties for the years ended December 31, 2012 and 2011 is summarized as follows:

	At December 31,	
	2012	2011
	(In thousands)	
Balance at beginning of year	$ **19,702**	22,921
New loans	**4,619**	12,750
Repayments	**(11,356)**	(15,969)
Balance at end of year	$ **12,965**	19,702

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.

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, 2012 and 2011, the Company had commitments to extend credit in the amount of $31.9 million and $30.8 million, respectively. At December 31, 2012 and 2011, the Company had standby letters of credit in the amount of $396,000 and $481,000, 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, 2012, 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, 2012 was approximately $396,000.

NOTE 5 - PREMISES AND EQUIPMENT, NET

Premises and equipment, net at December 31, 2012 and 2011 consists of the following:

	At December 31,	
	2012	2011
	(In thousands)	
Land	$ **5,029**	5,029
Buildings	**11,277**	11,277
Furniture, fixtures and equipment	**7,345**	7,756
Construction in process	**44**	-
Total premises and equipment	**23,695**	24,062
Less: accumulated depreciation	**(7,298)**	(7,984)
Premises and equipment, net	$ **16,397**	16,078

Depreciation expense included in operating expenses for the years ended December 31, 2012, 2011 and 2010 amounted to $833,000, $856,000, and $1.3 million, respectively. There was no interest capitalized during fiscal 2012 and 2011.

NOTE 6 – REAL ESTATE ACQUIRED THROUGH FORECLOSURE

Transactions in other real estate owned for the years ended December 31, 2012 and 2011 are summarized below:

	At December 31,	
	2012	2011
	(In thousands)	
Balance at beginning of year	$ **6,097**	10,816
Additions	**9,407**	10,009
Sales	**(8,171)**	(12,762)
Write downs	**(1,049)**	(1,966)
Balance at end of year	$ **6,284**	6,097

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

	At December 31,	
	2012	2011
	(In thousands)	
Real estate loans:		
One-to-four family	$ **1,010**	1,192
Commercial real estate	**1,902**	819
Construction and development	**3,372**	4,086
	$ **6,284**	6,097

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 $2.2 billion and $1.1 billion, respectively, at December 31, 2012 and 2011.

The economic estimated fair values of mortgage servicing rights were $18.1 million and $10.9 million, respectively, at December 31, 2012 and 2011. The estimated fair value of servicing rights at December 31, 2012 were determined using discount rates ranging from 11.00% to 15.50%, prepayment speed assumptions ("PSA") ranging from 114.6 to 1,451.2, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of 1.24% as determined by a third party. The estimated fair value of servicing rights at December 31, 2011 were determined using discount rates ranging from 9.50% to 14.00%, prepayment speed assumptions ("PSA") ranging from 123.7 to 1,298.6, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of .86% as determined by a third party.

During 2011 and 2010, servicing rights related to approximately $124.6 million and $191.8 million, respectively, of unpaid loan principal serviced for others were sold. The Company received $1.1 million and $1.8 million, respectively, in net proceeds and recognized a gain in the accompanying consolidated statement of operations of $299,000 and $526,000, respectively. No servicing rights were sold during 2012.

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, 2012 and 2011:

	At December 31,	
	2012	2011
	(In thousands)	
MSR beginning balance	$ **6,452**	5,249
Amount capitalized	**7,051**	2,983
Amount sold	**-**	(744)
Amount amortized	**(1,464)**	(1,036)
MSR ending balance	$ **12,039**	6,452

There was no allowance for loss in fair value in mortgage servicing rights for the years ended December 31, 2012 and 2011.

The estimated amortization expense for mortgage servicing rights for the years ended December 31, 2013, 2014, 2015, 2016, 2017 and thereafter is $1.7 million, $1.5 million, $1.3 million, $1.1 million, $1.0 million and $5.4 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, 2012 and 2011, servicing related trust funds of approximately $27.1 million, and $10.7 million, respectively, representing both principal and interest due investors and escrows received from borrowers, are on deposit in custodial accounts and are included in noninterest-bearing deposits in the accompanying financial statements.

At December 31, 2012 and 2011, the Company had blanket bond and errors and omissions coverages of $5.0 million each.

NOTE 8 - DEPOSITS

Deposits outstanding by type of account at December 31, 2012 and 2011 are summarized as follows:

	At December 31,	
	2012	2011
	(In thousands)	
Noninterest-bearing demand accounts	$ **82,004**	62,906
Interest-bearing demand accounts	**51,490**	39,225
Savings accounts	**10,882**	8,006
Money market accounts	**207,299**	194,262
Certificates of deposit		
0.20% to 2.99%	**298,576**	313,520
3.00% to 4.99%	**2,996**	3,624
5.00% to 7.99%	**-**	260
Total certificates of deposit	**301,572**	317,404
Total deposits	$ **653,247**	621,803

The aggregate amount of certificates of deposit, excluding brokered deposits, with a minimum denomination of $100,000 was $86.0 million and $32.1 million at December 31, 2012 and 2011, respectively. The aggregate amount of brokered certificates of deposit was $29.9 million and $27.7 million at December 31, 2012 and 2011, respectively. The aggregate amount of institutional certificates of deposit was $40.0 million and $40.4 million at December 31, 2012 and 2011, respectively.

The amounts and scheduled maturities of certificates of deposit at December 31, 2012 and 2011 are as follows:

	At December 31,	
	2012	2011
	(In thousands)	
Maturing within one year	$ **220,024**	265,535
Maturing one through three years	**44,280**	44,602
Maturing after three years	**37,268**	7,267
	$ **301,572**	317,404

The Company has pledged $2.0 million of mortgage-backed securities as of December 31, 2012 to secure public agency funds.

NOTE 9 – SHORT-TERM BORROWED FUNDS

Short-term borrowed funds at December 31, 2012 and 2011 are summarized as follows:

	At December 31,			
	2012		2011	
	Balance	Interest Rate	Balance	Interest Rate
	(Dollars in thousands)			
Unsecured line of credit	$ 2,750	4.75%	200	4.75%
Short-term FHLB advances	77,500	0.16%-.82%	40,000	0.14%-.35%
Mortgage loan warehouse line of credit	1,932	2.5%-4.5%	2,584	3.5%-6.25%
TLGP	-	-	20,400	2.74%
Subordinated debenture, due 2020	300	2.81%	300	2.82%
Total short-term borrowed funds	$ 82,482		63,484	

Lines of credit with the FHLB of Atlanta are based upon FHLB-approved percentages of Bank assets, but must be supported by appropriate collateral to be available. The Company has 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 $151.8 million of collateral for these advances. In addition, at December 31, 2012, the Company has pledged $6.8 million of securities for these advances. Assuming sufficient collateral was available at December 31, 2012, the Company had maximum FHLB lines of $266.1 million based on FHLB limits. At December 31, 2012, collateral totaling $158.6 million was pledged to support FHLB advances. At December 31, 2012 the Company had FHLB advances of $115.0 million outstanding with excess collateral pledged to the FHLB during those periods that would support additional borrowings of approximately $43.6 million.

Lines of credit with the Federal Reserve Board ("FRB") are based on collateral pledged. The Company has pledged certain non-mortgage commercial, acquisition and development, and lot loan portfolios under blanket lien agreements resulting in approximately $34.3 million of collateral to the FRB for these advances. At December 31, 2012 the Company had lines available with the FRB for $34.3 million. At December 31, 2012 the Company had no FRB advances outstanding.

At December 31, 2012, Crescent Mortgage had a mortgage loan warehouse line of credit from a correspondent with a $35.0 million credit limit, of which $33.1 million is still available. The facility is secured by Crescent Mortgage's residential mortgage loans held for sale and other assets.

Effective October 1, 2011, the Company modified a $3.0 million unsecured line of credit with a correspondent bank, of which $2.8 million and $3.0 million was outstanding at December 31, 2012 and December 31, 2011, respectively. The unsecured line of credit bears interest at prime plus 1.50% and the term expires October 1, 2013. In connection with this modification, the Company will make quarterly principal payments of $50,000 that began on October 1, 2011 and will continue on the same day of each quarter through and including July 1, 2013. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios and nonperforming asset ratios. As of December 31, 2012 the Company is in compliance with all of the covenants.

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.

Certain borrowings were prepaid to manage the cost of funds and related interest rate sensitivity, resulting in a net loss on the extinguishment of debt of $1.6 million, $1.1 million and $2.5 million during 2012, 2011 and 2010, respectively.

NOTE 10 – LONG-TERM DEBT

Long-term debt at December 31, 2012 and 2011 are summarized as follows:

	December 31, 2012	
	Balance	Interest Rate
	(Dollars in thousands)	
Unsecured line of credit	**$ -**	**0.00%**
Long-term FHLB advances, due 2013 through 2021	**37,500**	**0.52%-4.00%**
Subordinated debentures, due 2016 through 2020	**11,875**	**1.84%-2.81%**
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**	**3.39%**
Total long-term debt	**$ 64,840**	

	December 31, 2011	
	Balance	Interest Rate
	(Dollars in thousands)	
Unsecured line of credit	$ 2,750	4.75%
Long-term FHLB advances, due 2013 through 2021	50,000	0.82%-4.23%
Subordinated debentures, due 2016 through 2020	12,175	1.90%-2.82%
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	3.45%
Total long-term debt	$ 80,390	

As of December 31, 2012, the principal amounts due on long-term debt in 2013, 2014, 2015, 2016, 2017 and thereafter were $82.5 million, $5.3 million, $2.8 million, $10.3 million, $300,000 and $46.1 million, respectively. As of December 31, 2012, there were no principal amounts callable by the FHLB on advances.

At December 31, 2012 and 2011, 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 3.39% to 3.75% at December 31, 2012 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 trust preferred securities for an indefinite period which can be no longer than twenty consecutive quarterly periods. At December 31, 2012, the Company has deferred these payments for nine quarters and still has eleven quarter of deferral available. These as well as 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, 2012 is approximately $1.2 million. Subsequent to December 31, 2012, the Company deferred an additional $118,000 on its outstanding subordinated debentures.

As currently defined by the FRB, the Company had $15.0 million of long-term debt that qualified as Tier 1 capital at December 31, 2012 and 2011, respectively. The Company had $7.3 million and $9.6 million of long-term debt that qualified as Tier 2 capital at December 31, 2012 and 2011, respectively.

The Company has $2.8 million outstanding on an unsecured line of credit with a correspondent bank. See Note 9 – Short-Term Borrowed Funds for additional disclosure. At December 31, 2012, all of the $2.8 million of this unsecured line of credit is included in Short-Term Borrowed Funds.

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 carry forwards. 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, 2012, 2011 and 2010 consists of the following:

	For the Year Ended December 31,		
	2012	2011	2010
Current income tax expense (benefit)		(In thousands)	
Federal	**$ 9,900**	(1,509)	(4,837)
State	**1,152**	148	435
	11,052	(1,361)	(4,402)
Deferred income tax expense (benefit)			
Federal	**(599)**	1,124	(1,433)
State	**(58)**	109	(37)
	(657)	1,233	(1,470)
Total income tax expense (benefit)	**$ 10,395**	(128)	(5,872)

A reconciliation from expected Federal tax expense to actual income tax expense for the years ended December 31, 2012, 2011 and 2010, using the base federal tax rates of 35%, 34% and 34%, respectively, follows:

	For the Year Ended December 31,		
	2012	2011	2010
		(In thousands)	
Computed federal income taxes (benefit)	**$ 9,546**	(374)	(6,276)
State income tax, net of federal benefit	**757**	170	263
Change in valuation allowance	**-**	-	(16)
Other, net	**92**	76	157
Total income tax expense (benefit)	**$ 10,395**	(128)	(5,872)

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, 2012 and 2011:

	At December 31,	
	2012	2011
Deferred tax assets:	(In thousands)	
Loan loss reserve	**$ 3,499**	$ 3,879
Loan fees	**(137)**	61
Unrealized loss on securities available for sale	**187**	3,001
Tax vs. book gain on loans held for sale	**803**	14
Debt issuance costs	**95**	93
Net operating loss carryforwards	**214**	286
Reserve for mortgage loan buy-back	**1,827**	1,310
OREO write-downs	**413**	345
Securities yield adjustments	**-**	158
Other	**422**	329
	7,323	9,476
Valuation allowance	**(271)**	(196)
Total gross deferred tax assets	**7,052**	9,280
Deferred tax liabilities:		
Depreciation	**(368)**	(387)
Stock-based compensation	**98**	47
Short-term disability accrual	**-**	-
Total gross deferred tax liabilities	**(270)**	(340)
Deferred tax assets, net	**$ 6,782**	8,940

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 $2.8 million and ($63,000), respectively, for the years ended December 31, 2012 and 2011, 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 $656,000 of deferred tax benefit and $1.5 million of deferred tax, respectively, for the years ended December 31, 2012 and 2011, respectively, is reflected as a deferred income tax expense 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. The Company's federal income tax returns were examined for the years 2008 through 2010. No changes were proposed.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The Company has entered into agreements to lease certain 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, 2012, 2011 and 2010 totaled $595,000, $562,000 and $556,000, respectively.

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

Year 1	$ 547
Year 2	417
Year 3	120
Year 4	80
Year 5	30
After Year 5	73
Total	$ 1,267

In the course of ordinary business, the Bank is, from time to time, named a party to legal actions and proceedings, primarily related to the collection of loans and foreclosed assets. In accordance with generally accepted accounting principles, the Company establishes reserves for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. When loss contingencies are not both probable and estimable, the Company does not establish reserves.

The Bank also has a claim against it relating to one of its former executive officers. Effective July 31, 2011, the Company combined its wholly-owned subsidiary bank, Community FirstBank, with and into its other wholly-owned subsidiary bank, Crescent Bank, effectuating an internal reorganization. The resultant bank was renamed CresCom Bank. The former executive officer had an employment agreement with Community FirstBank and claims the internal reorganization triggered the severance provisions of the employment agreement. The former executive officer initially claimed he is due an aggregate amount of approximately $1.8 million but has since amended his complaint seeking approximately $10 million in damages. The Company hired special counsel to review the claims made by the former executive officer. Based upon the review by special counsel, the Company strongly disagrees with the former executive officer's assertion that the internal reorganization triggered the severance provisions of the employment agreement and intends to vigorously defend its position, including potentially making certain counterclaims against the former executive officer. Management believes there is not sufficient information available at this time to make an evaluation as to the likelihood of an unfavorable outcome of this claim or to estimate the amount of potential loss, if any. Accordingly, no amounts have been accrued in the accompanying balance sheet as of December 31, 2012.

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.

FHLB 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. As such, the fair value adjustments for derivatives with fair values based on quoted market prices are recurring Level 1. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments. As such, the fair values of derivatives computed based on quoted market prices of comparable instruments are recurring Level 2.

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.

Mortgage Servicing Rights - 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.

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.

Off-Balance Sheet Financial Instruments – Contract values and fair values for off-balance sheet, credit-related financial instruments are based on estimated fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and counterparties' credit standing.

The carrying amount and estimated fair value of the Company's financial instruments at December 31, 2012 and 2011 are as follows:

	At December 31,			
	2012		2011	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets:	(In thousands)			
Cash and due from banks	**$ 6,499**	**6,499**	4,109	4,109
Interest-bearing cash	**11,340**	**11,340**	16,679	16,679
Securities available for sale	**149,670**	**149,670**	136,944	136,944
Securities held to maturity	**9,166**	**5,549**	9,401	2,773
Federal Home Loan Bank stock	**6,413**	**6,413**	7,185	7,185
Other investments	**465**	**465**	465	465
Derivative assets	**6,542**	**6,542**	4,000	4,000
Loans held for sale	**144,849**	**149,151**	80,007	81,924
Loans receivable, net	**501,691**	**502,735**	513,335	523,673
Accrued interest receivable	**3,203**	**3,203**	3,086	3,086
Mortgage servicing rights	**12,039**	**18,165**	6,452	9,748
Financial liabilities:				
Deposits	**653,247**	**654,090**	621,803	622,915
Short-term borrowed funds	**82,482**	**82,480**	63,484	66,350
Long-term debt	**64,840**	**58,874**	80,390	84,497
Derivative liabilities	**-**	**-**	1,234	1,234
Accrued interest payable	**1,599**	**1,599**	1,371	1,371

	Notional Amount	**Estimated Fair Value**	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:	(In thousands)			
Commitments to extend credit	**$ 31,916**	**-**	30,755	-
Standby letters of credit	**396**	**-**	481	-
Derivative assets:				
Mortgage loan interest rate lock commitments	**289,584**	**4,783**	218,465	2,832
Mortgage loan forward sales commitments	**59,177**	**1,692**	47,992	1,168
Mortgage-backed securities forward sales commitments	**308,000**	**67**	-	-
Derivative liabilities:				
Mortgage-backed securities forward sales commitments	**-**	**-**	167,000	1,234

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.

Following is a description of valuation methodologies used for assets recorded at fair value on a recurring and non-recurring basis.

Investment Securities Available for Sale
Measurement is on a recurring basis upon quoted market prices, if available. If quoted market 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 prepayment assumptions, projected credit losses, and liquidity. Level 1 securities include those traded on an active exchange or by dealers or brokers in active over-the-counter markets. Level 2 securities include securities issued by government sponsored enterprises, municipal enterprises, and mortgage-backed securities issued by government sponsored enterprises. Generally, these fair values are priced from established pricing models. At December 31, 2012 and 2011, the Company's investment securities available for sale are recurring Level 2.

Mortgage Loans Held for Sale
Mortgage loans held for sale are carried at the lower of cost or market value. The fair values of mortgage loans held for sale are based on commitments on hand from investors within the secondary market for loans with similar characteristics. As such, the fair value adjustments for mortgage loans held for sale is recurring Level 2.

Impaired Loans
Loans that are considered impaired are recorded at fair value on a non-recurring basis. Once a loan is considered impaired, the fair value is measured using one of several methods, including collateral liquidation value, market value of similar debt and discounted cash flows. Those impaired loans not requiring a specific charge against the allowance represent loans for which the fair value of the expected repayments or collateral meet or exceed the recorded investment in the loan. At December 31, 2012, substantially all of the total impaired loans were evaluated based on the fair value of the underlying collateral. When the Company records the fair value based on a current appraisal, the fair value measurement is considered a Level 2 measurement. When a current appraisal is not available or there is estimated further impairment below the current appraised value, the measurement is considered a Level 3 measurement.

Derivative Assets
Fair values are based on quoted market prices, where available. As such, the fair value adjustments for derivatives with fair values based on quoted market prices are recurring Level 1. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments. As such, the fair values of derivatives computed based on quoted market prices of comparable instruments are recurring Level 2.

Other Real Estate Owned (OREO)
Other real estate owned is adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO owned is carried at the lower of carrying value or fair value. Fair value is based on independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the other real estate owned as non-recurring Level 2. When an appraisal value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records that OREO as non-recurring Level 3.

Assets and liabilities measured at fair value on a recurring basis are as follows as of December 31, 2012 and 2011:

		Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
			(In thousands)	
December 31, 2012				
Available-for-sale investment securities:				
Municipals	$	**-**	**17,769**	**-**
GNMA		**-**	**23,011**	**-**
Mortgage-backed securities		**-**	**108,890**	**-**
Loans held for sale		**-**	**144,849**	**-**
Derivative assets:				
Mortgage loan interest rate lock commitments		**-**	**4,783**	**-**
Mortgage loan forward sales commitments		**-**	**1,692**	**-**
Mortgage-backed securities forward sales commitments		**-**	**67**	**-**
Total	$	**-**	**301,061**	**-**
December 31, 2011				
Available-for-sale investment securities:				
Municipals			1,137	
GNMA	$	-	23,991	-
Mortgage-backed securities		-	111,816	-
Loans held for sale		-	80,007	-
Derivative assets:				
Mortgage loan interest rate lock commitments		-	2,832	-
Mortgage loan forward sales commitments		-	1,168	-
Derivative liabilities-				
Mortgage-backed securities forward sales commitments		-	1,234	-
Total	$	-	222,185	-

Assets measured at fair value on a nonrecurring basis are as follows as of December 31, 2012 and 2011:

		Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
			(In thousands)	
December 31, 2012				
Impaired loans	**$**	**-**	**31,045**	**-**
Real estated owned		**-**	**6,284**	**-**
Total	**$**	**-**	**37,329**	**-**
December 31, 2011				
Impaired loans	$	-	56,338	-
Real estated owned		-	6,097	-
Total	$	-	62,435	-

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, 2012 and 2011, the Company had commitments to extend credit in the amount of $31.9 million and $30.8 million, respectively. At December 31, 2012 and 2011, the Company had standby letters of credit in the amount of $396,000 and $481,000, respectively.

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, 2012, 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, 2012 was approximately $396,000.

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.

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, 2012 and 2011, the Company's outstanding mortgage interest rate lock commitments totaled $289.6 million and $218.5 million, respectively. The Company uses mortgage loan forward 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, 2012 and 2011, the Company's outstanding mortgage loan forward sales commitments totaled $59.2 million and $48.0 million, respectively. At December 31, 2012 and 2011, the Company's outstanding mortgage-backed securities forward sales commitments totaled $308.0 million and $167.0 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,	
	2012	2011
	(In thousands)	
Commercial real estate loans, excluding owner occupied and unfunded commitments	**$ 174,680**	191,958
Loans secured by owner occupied commercial real estate	**122,498**	126,009
Unfunded commitments of commercial real estate	**9,172**	5,999
Total	**$ 306,350**	323,966

NOTE 15 - EMPLOYEE BENEFIT PLANS

The Company maintains a 401(k) plan that covers substantially all employees of CresCom Bank, Carolina Services ("CFC participants") and Crescent Mortgage ("CMC Participants"). Participants may contribute up to the maximum allowed by the regulation. During fiscal 2012 and 2011, 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, 2012, 2011 and 2010, the Company made matching contributions of $461,000, $424,000 and $448,000, respectively.

The Company has an arrangement with two executives whereby the Company made payments to an insurance company on behalf of the executives. The advance is treated as a loan to the executive 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, 2012 and 2011 is $813,000 and $1.1 million, respectively. The executive is entitled to the increase in cash value above the Company's original cash value insurance contributions. The executive pays 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 executive pays 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, 2012, 2011 and 2010:

	December 31,					
	2012		2011		2010	
	Basic	**Diluted**	Basic	Diluted	Basic	Diluted
Weighted average shares outstanding	**1,918,992**	**1,918,992**	1,918,992	1,918,992	1,913,240	1,913,240
Effect of dilutive securities - stock options	**-**	**-**	-	-	-	-
Average shares outstanding	**1,918,992**	**1,918,992**	1,918,992	1,918,992	1,913,240	1,913,240

The average market price used in calculating the dilutive securities under the treasury stock method for the years ended December 31, 2012, 2011 and 2010 was $15.12, $10.71, and $14.90, respectively. For the years ended December 31, 2012, 2011 and 2010, 8,240, 140,480 and 140,480 option shares, respectively, 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. 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 a valuation model.

NOTE 17 - CAPITAL REQUIREMENTS AND OTHER RESTRICTIONS

The Company and the Bank 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 Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory methods. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weighting and other factors. As of December 31, 2012, the most recent notification from federal banking agencies categorized the Company and the Bank as "well capitalized" under the regulatory framework. In order to be considered "adequately capitalized", the Company and the Bank 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 Bank 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, 2011, there have been no events or conditions that management believes have changed the Company's or the Bank's regulatory capital categories.

The actual capital amounts and ratios for the Company and the Bank at December 31, 2012 and 2011 are as follows:

	At December 31,			
	2012		2011	
	Amount	**Ratio**	Amount	Ratio
	(Dollars in thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	**$ 82,839**	**13.11%**	65,876	10.48%
Total risk based capital (to risk weighted assets)	**98,030**	**15.52%**	83,357	13.27%
Tier 1 capital (to total average assets)	**82,839**	**9.65%**	65,876	7.94%
CresCom Bank				
Tier 1 capital (to risk weighted assets)	**85,537**	**13.57%**	68,240	10.88%
Total risk based capital (to risk weighted assets)	**100,714**	**15.97%**	85,706	13.67%
Tier 1 capital (to total average assets)	**85,537**	**10.01%**	68,240	8.18%

A South Carolina state bank may not pay dividends from capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. Unless otherwise instructed by the South Carolina Board of Financial Institutions, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Board of Financial Institutions. However, given the restrictions imposed by the Bank's regulators, at December 31, 2012 the Bank cannot pay dividends without prior approval from the appropriate regulatory agencies. In addition, under the Federal Deposit Insurance Corporation Improvement Act, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. The FRB may also prevent the payment of a dividend by the Bank if it determines that the payment would be an unsafe and unsound banking practice.

In June 2012, U.S. banking regulators issued the Basel III Notice of Proposed Rulemaking (NPR) to implement Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and changes required by the Financial Reform Act. The Basel III NPR proposes material changes to the deduction of certain assets from capital, new minimum capital ratios and buffer requirements, a Standardized Approach that provides a floor to the calculation of risk-weighted assets, and significant changes to the calculation of credit and counterparty credit risk.

The Basel III NPR addressing standardized risk-weighting of assets would significantly change the risk-weighting of certain assets for almost all U.S. financial institutions beginning in 2015. To what extent the NPR will be adopted as proposed in not known; however, management estimates that the Company would remain a well-capitalized institution under its interpretation of the proposed increased capital requirements and risk-weighted asset revisions if the proposal had been fully in effect as of December 31, 2012.

Many of the changes to capital deductions are subject to a transition period where the impact is recognized in 20% increments beginning on January 1, 2014 through January 1, 2018. The majority of the other aspects of the Basel III NPR were proposed to become effective January 1, 2013. However, this effective date was postponed in November 2012. The delay is expected to be a six-month time period. The phase-in period for the new minimum capital requirements and related buffers is proposed to occur between 2013 and 2019.

Management expects to comply with the final rules when issued and effective. To prepare for the implementation of the new capital rules, management continues to build capital through retained earnings and is evaluating strategies to maximize the Company's capital under the Basel III NPR.

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 CresCom 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, 2012, 2011 and 2010:

For the Year Ended December 31, 2012	Community Banking	Mortgage Banking	Other	Eliminations	Total
			(In thousands)		
Interest income	$ 33,526	1,801	18	13	35,358
Interest expense	6,377	397	748	(9)	7,513
Net interest income (expense)	27,149	1,404	(730)	22	27,845
Provision for loan losses	2,707	-	-	-	2,707
Noninterest income (expense) from external customers	(2,435)	54,660	59	-	52,284
Intersegment noninterest income	-	618	5,813	(6,431)	-
Noninterest expense	22,433	21,972	5,744	-	50,149
Intersegment noninterest expense	4,853	1,099	-	(5,952)	-
Income (loss) before income taxes	(5,279)	33,611	(602)	(457)	27,273
Income tax expense (benefit)	(1,869)	12,603	(183)	(156)	10,395
Net income (loss)	$ (3,410)	21,008	(419)	(301)	16,878
Assets	$ 874,354	54,204	88,344	(128,178)	888,724
Loans receivable, net	501,445	853	-	(607)	501,691
Loans held for sale	117,803	27,046	-	-	144,849
Deposits	655,486	-	-	(2,239)	653,247
Borrowed funds	127,176	1,932	18,365	(151)	147,322

For the Year Ended December 31, 2011	Community Banking	Mortgage Banking	Other	Eliminations	Total
			(In thousands)		
Interest income	$ 37,483	952	17	(11)	38,441
Interest expense	10,262	136	726	(11)	11,113
Net interest income (expense)	27,221	816	(709)	-	27,328
Provision for loan losses	10,735	-	-	-	10,735
Noninterest income (expense) from external customers	6	19,521	194	-	19,721
Intersegment noninterest income	-	-	5,813	(5,813)	-
Noninterest expense	19,090	12,567	5,756	-	37,413
Intersegment noninterest expense	4,853	960	-	(5,813)	-
Income (loss) before income taxes	(7,451)	6,810	(458)	-	(1,099)
Income tax expense (benefit)	(2,513)	2,588	(203)	-	(128)
Net income (loss)	$ (4,938)	4,222	(255)	-	(971)
Assets	$ 816,257	28,773	70,800	(89,612)	826,218
Loans receivable, net	512,353	1,132	-	(150)	513,335
Loans held for sale	64,076	15,931	-	-	80,007
Deposits	624,443	-	-	(2,640)	621,803
Borrowed funds	122,876	2,584	18,565	(151)	143,874

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 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

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,	
	2012	2011
	(In thousands)	
Assets:		
Cash and cash equivalents	**$ 439**	375
Investment in bank subsidiaries	**85,213**	63,020
Investment in non-bank subsidiaries	**643**	439
Investment in unconsolidated statutory business trusts	**465**	465
Securities available for sale	**1**	1
Other assets	**213**	511
Total assets	**$ 86,974**	64,811
Liabilities and stockholders' equity:		
Accrued expenses and other liabilities	**1,245**	741
Short-term debt	**2,750**	200
Long-term debt	**15,465**	18,215
Stockholders' equity	**67,514**	45,655
Total liabilities and stockholders' equity	**$ 86,974**	64,811

Carolina Financial Corporation
Condensed Statements of Operations

	For the Year Ended December 31,		
	2012	2011	2010
		(In thousands)	
Dividend income from non-bank subsidiaries	**$ 150**	500	300
Interest income	**18**	17	18
Gain on sale of securities available for sale	**-**	143	1,042
Total income	**168**	660	1,360
Interest expense	**739**	714	697
General and administrative expenses	**451**	625	653
Total expenses	**1,190**	1,339	1,350
Income (loss) before income taxes and equity in undistributed earnings (losses) of subsidiaries	**(1,022)**	(679)	10
Income tax benefit	**(398)**	(474)	(99)
Income (loss) before equity in undistributed earnings of subsidiaries	**(624)**	(205)	109
Equity in undistributed earnings (losses) of Community FirstBank	**-**	-	(793)
Equity in undistributed earnings (losses) of Crescent Bank	**-**	-	(12,021)
Equity in undistributed earnings (losses) of CresCom Bank	**17,297**	(715)	-
Equity in undistributed earnings (losses) of Carolina Services	**205**	(51)	117
Total equity in undistributed earnings (losses) of subsidiaries	**17,502**	(766)	(12,697)
Net income (loss)	**$ 16,878**	(971)	(12,588)

Carolina Financial Corporation
Condensed Statements of Cash Flows

	For the Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
Cash flows from operating activities:			
Net income (loss)	**$ 16,878**	(971)	(12,588)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Equity in undistributed earnings (losses) in subsidiaries	**(17,502)**	766	12,697
Gain on sale of securities available for sale	**-**	(143)	(1,042)
Stock-based compensation	**86**	271	391
(Increase) decrease in other assets	**298**	(366)	144
Increase (decrease) in other liabilities	**504**	607	(251)
Net cash provided by (used in) operating activities	**264**	164	(649)
Cash flows from investing activities:			
Proceeds from the sale of securities available for sale	**-**	150	1,065
Equity investment in bank subsidiaries	**-**	(200)	(1,000)
Net cash provided by (used in) financing activities	**-**	(50)	65
Cash flows from financing activities -			
Principal repayment of short term debt	**(200)**	(50)	-
Net cash used in financing activities	**(200)**	(50)	-
Net increase (decrease) in cash and cash equivalents	**64**	64	(584)
Cash and cash equivalents, beginning of year	**375**	311	895
Cash and cash equivalents, end of year	**$ 439**	375	311

NOTE 20 – QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below represent the quarterly results of operations for the years ended December 31, 2012, 2011 and 2010 respectively:

	For the Year Ended December 31, 2012			
	First	**Second**	**Third**	**Fourth**
	(In thousands, except per share data)			
Total interest income	**$ 8,954**	**8,920**	**8,870**	**8,614**
Total interest expense	**2,036**	**1,887**	**1,819**	**1,771**
Net interest income	**6,918**	**7,033**	**7,051**	**6,843**
Provision for loan losses	**2,067**	**115**	**250**	**275**
Net interest income after provision for loan losses	**4,851**	**6,918**	**6,801**	**6,568**
Noninterest income	**9,632**	**11,136**	**13,962**	**17,554**
Noninterest expense	**11,007**	**15,258**	**12,007**	**11,877**
Income before taxes	**3,476**	**2,796**	**8,756**	**12,245**
Income tax expense	**1,376**	**1,202**	**3,308**	**4,509**
Net income	**$ 2,100**	**1,594**	**5,448**	**7,736**
Basic earnings per share	**$ 1.09**	**0.83**	**2.84**	**4.04**
Diluted earnings per share	**$ 1.09**	**0.83**	**2.84**	**4.04**

	For the Year Ended December 31, 2011			
	First	Second	Third	Fourth
	(In thousands, except per share data)			
Total interest income	$ 10,187	9,653	9,412	9,189
Total interest expense	3,167	2,892	2,631	2,423
Net interest income	7,020	6,761	6,781	6,766
Provision for loan losses	1,700	3,550	2,580	2,905
Net interest income after provision for loan losses	5,320	3,211	4,201	3,861
Noninterest income	4,848	4,776	5,799	4,298
Noninterest expense	8,973	8,613	10,270	9,557
Income (loss) before taxes	1,195	(626)	(270)	(1,398)
Income tax expense (benefit)	488	(147)	(53)	(416)
Net income (loss)	$ 707	(479)	(217)	(982)
Basic earnings (losses) per share	$ 0.37	(0.25)	(0.11)	(0.52)
Diluted earnings (losses) per share	$ 0.37	(0.25)	(0.11)	(0.52)

	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 loss per share	$ (0.14)	(1.88)	(1.33)	(3.23)
Diluted loss per share	$ (0.14)	(1.88)	(1.33)	(3.23)

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