

CAROLINA FINANCIAL
CORPORATION

2013 ANNUAL REPORT

CAROLINA FINANCIAL CORPORATION AND SUBSIDIARIES
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Carolina Financial Corporation
Charleston, South Carolina

We have audited the accompanying consolidated balance sheets of Carolina Financial Corporation and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carolina Financial Corporation and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

A handwritten signature in cursive script that reads 'Elliott Davis, LLC'.

Charleston, South Carolina
February 26, 2014

CONSOLIDATED BALANCE SHEETS

	At December 31,	
	2013	2012
(In thousands)		
ASSETS		
Cash and due from banks	\$ 4,489	6,499
Interest-bearing cash	34,176	11,340
Cash and cash equivalents.....	38,665	17,839
Securities available-for-sale (cost of \$166,997 at December 31, 2013 and \$144,511 at December 31, 2012).....	167,535	148,407
Securities held-to-maturity (fair value of \$23,547 at December 31, 2013 and \$5,549 at December 31, 2012).....	24,554	9,166
Federal Home Loan Bank stock, at cost.....	4,103	6,413
Other investments.....	1,858	1,728
Derivative assets.....	1,412	6,542
Loans held for sale	36,897	144,849
Loans receivable, net of allowance for loan losses of \$8,091 at December 31, 2013 and \$9,520 at December 31, 2012	535,221	501,691
Premises and equipment, net.....	17,585	16,397
Accrued interest receivable	2,802	3,203
Real estate acquired through foreclosure, net.....	6,273	6,284
Deferred tax assets, net	7,419	6,782
Prepaid FDIC insurance	—	2,035
Mortgage servicing rights.....	10,908	12,039
Cash value life insurance.....	20,910	813
Other assets	5,442	4,536
Total assets.....	\$ 881,584	888,724
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Noninterest-bearing deposits.....	\$ 83,500	82,004
Interest-bearing deposits	614,081	571,243
Total deposits	697,581	653,247
Short-term borrowed funds	10,300	82,482
Long-term debt.....	74,540	64,840
Derivative liabilities	55	—
Drafts outstanding	2,703	3,010
Advances from borrowers for insurance and taxes	284	613
Accrued interest payable	311	1,599
Income taxes payable	749	3,459
Reserve for mortgage repurchase losses	6,109	4,882
Accrued expenses and other liabilities	6,725	7,078
Total liabilities	799,357	821,210
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; 4,015,204 and 3,837,984 issued and outstanding at December 31, 2013 and 2012, respectively.....	40	39
Additional paid-in capital.....	22,393	22,048
Retained earnings, restricted	62,169	45,752
Accumulated other comprehensive loss, net of tax benefit.....	(2,375)	(325)
Total stockholders' equity	82,227	67,514
Total liabilities and stockholders' equity	\$ 881,584	888,724

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years
Ended December 31,

2013 2012

(In thousands, except share data)

Interest income		
Loans.....	\$ 27,731	30,074
Debt securities.....	4,999	5,134
Dividends from FHLB.....	111	107
Interest-bearing cash.....	107	41
Total interest income.....	<u>32,948</u>	<u>35,356</u>
Interest expense		
Deposits.....	3,339	4,178
Short-term borrowed funds.....	239	640
Long-term debt.....	2,140	2,695
Total interest expense.....	<u>5,718</u>	<u>7,513</u>
Net interest income.....	27,230	27,843
Provision for loan losses.....	(860)	2,707
Net interest income after provision for loan losses.....	<u>28,090</u>	<u>25,136</u>
Noninterest income		
Net gain on sale of loans held for sale.....	29,914	52,763
Deposit service charges.....	1,558	1,604
Net loss on extinguishment of debt.....	(19)	(1,591)
Net loss on sale of securities.....	(1,125)	(3,031)
Other-than-temporary impairment of securities.....	—	(913)
Net unrealized gain on derivatives - interest rate swap.....	428	—
Net gain on sale of servicing assets.....	5,489	—
Net increase in cash value life insurance.....	374	2
Mortgage loan servicing income.....	6,583	4,085
Other.....	884	605
Total noninterest income.....	<u>44,086</u>	<u>53,524</u>
Noninterest expense		
Salaries and employee benefits.....	23,590	25,632
Occupancy and equipment.....	3,450	3,274
Marketing and public relations.....	1,088	1,360
FDIC insurance.....	588	1,076
Provision for mortgage loan repurchase losses.....	2,438	2,189
Legal expense.....	926	1,768
Other real estate expense, net.....	622	1,873
Mortgage subservicing expense.....	1,862	1,249
Amortization of mortgage servicing rights.....	2,444	1,464
Settlement of employment agreements.....	2,639	227
Other.....	6,325	11,275
Total noninterest expense.....	<u>45,972</u>	<u>51,387</u>
Income before income taxes.....	26,204	27,273
Income tax expense.....	9,386	10,395
Net income.....	<u>\$ 16,818</u>	<u>16,878</u>
Earnings per common share:		
Basic.....	<u>\$ 4.38</u>	<u>4.40</u>
Diluted.....	<u>\$ 4.25</u>	<u>4.40</u>
Average common shares outstanding:		
Basic.....	<u>3,841,230</u>	<u>3,837,984</u>
Diluted.....	<u>3,960,247</u>	<u>3,837,984</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Net income.....	\$ 16,818	16,878
Other comprehensive income (loss), net of tax:		
Unrealized gain (losses) on securities, net of tax of \$(1,703) and \$1,124 for the years ended December 31, 2013 and 2012, respectively.....	(2,963)	1,955
Reclassification adjustment for losses included in earnings, net of tax of \$411 and \$1,106 for the years ended December 31, 2013 and 2012, respectively...	714	1,925
Reclassification adjustment for other-than-temporary impairment on securities, net of tax of \$333 for the year ended December 31, 2012.....	—	580
Accretion of unrealized losses on held-to-maturity securities previously recognized in other comprehensive income net of tax of \$114 and \$250 for the years ended December 31, 2013 and 2012, respectively	199	435
Other comprehensive income (loss), net of tax.....	(2,050)	4,895
Comprehensive income.....	\$ 14,768	21,773

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Capital	Earnings	Income (Loss)	
	(In thousands, except share data)					
Balance, December 31, 2011	3,837,984	\$ 39	21,962	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	3,837,984	39	22,048	45,752	(325)	67,514
Restricted stock awards, net.....	172,900	1	(1)	—	—	—
Stock options exercised.....	4,320	—	43	—	—	43
Stock-based compensation expense, net	—	—	303	—	—	303
Net income	—	—	—	16,818	—	16,818
Dividends paid to stockholders	—	—	—	(401)	—	(401)
Other comprehensive loss, net of tax	—	—	—	—	(2,050)	(2,050)
Balance, December 31, 2013	4,015,204	\$ 40	22,393	62,169	(2,375)	82,227

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 16,818	16,878
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses.....	(860)	2,707
Deferred tax expense (benefit)	542	(657)
Amortization of unearned discount/premiums on investments, net.....	2,318	1,361
Amortization of deferred loan fees.....	(4,424)	(5,328)
Amortization of mortgage servicing rights.....	2,444	1,464
Loss on sale of available for sale securities, net.....	1,125	3,031
Gain on sale of loans held for sale, net.....	(29,914)	(52,763)
Originations of loans held for sale.....	(1,616,594)	(2,313,236)
Proceeds from sale of loans held for sale	1,760,073	2,297,381
Loss on extinguishment of debt.....	19	1,591
Provision for mortgage loan repurchase losses	2,438	2,189
Mortgage loan losses paid, net of recoveries.....	(1,211)	(930)
Unrealized gain on interest rate swap.....	(428)	—
Stock-based compensation	303	86
(Increase) decrease in cash surrender value of bank owned life insurance....	(267)	161
Depreciation	918	833
Loss (gain) on disposals of premises and equipment	(24)	11
Loss (gain) on sale of real estate acquired through foreclosure.....	(425)	227
Write-down of real estate acquired through foreclosure.....	849	1,049
Gain on sale of servicing assets.....	(5,489)	—
Proceeds from the sale of servicing assets.....	11,036	—
Originations of mortgage servicing assets.....	(6,860)	(7,051)
Decrease (increase) in:		
Accrued interest receivable.....	401	(117)
Income taxes receivable.....	—	5,789
Prepaid FDIC insurance.....	2,035	1,000
Other assets	(906)	(1,461)
Increase (decrease) in:		
Accrued interest payable.....	(1,288)	228
Income taxes payable.....	(3,038)	3,459
Accrued expenses and other liabilities.....	(353)	3,445
Cash flows provided by (used in) operating activities	129,238	(38,653)

Continued

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Cash flows from investing activities:		
Activity in available-for-sale securities:		
Purchases	\$ (177,284)	(79,869)
Maturities, payments and calls	51,180	42,618
Proceeds from sales	91,653	27,735
Activity in held-to-maturity securities:		
Purchases	(6,708)	—
Maturities, payments and calls	299	794
Increase in other investments	(130)	(38)
Decrease in Federal Home Loan Bank stock	2,310	772
(Increase) decrease in loans receivable, net	(32,386)	4,858
Purchase of premises and equipment	(2,136)	(1,182)
Proceeds from disposals of premises and equipment	54	19
Proceeds from sale of real estate acquired through foreclosure	3,727	7,944
Purchase of bank owned life insurance	(20,053)	—
Distribution of bank owned life insurance	223	154
Cash flows provided by (used in) investing activities	<u>(89,251)</u>	<u>3,805</u>
Cash flows from financing activities:		
Net increase in deposit accounts	44,334	31,444
Net (decrease) increase in Federal Home Loan Bank advances	(47,519)	23,409
Net decrease in other short-term borrowed funds	(4,682)	(21,252)
Principal repayment of subordinated debt	(10,300)	(300)
Net decrease in drafts outstanding	(307)	(1,506)
Net (decrease) increase in advances from borrowers for insurance and taxes	(329)	104
Cash dividends paid on common stock	(401)	—
Proceeds from exercise of stock options	43	—
Cash flows (used in) provided by financing activities	<u>(19,161)</u>	<u>31,899</u>
Net increase (decrease) in cash and cash equivalents	20,826	(2,949)
Cash and cash equivalents, beginning of year	17,839	20,788
Cash and cash equivalents, end of year	<u>\$ 38,665</u>	<u>17,839</u>
Supplemental disclosure		
Cash paid for:		
Interest on deposits and borrowed funds	<u>\$ 7,006</u>	<u>7,285</u>
Income taxes paid, net of (refunds)	<u>11,556</u>	<u>1,424</u>
Noncash investing and financing activities:		
Other-than-temporary impairment reflected through accumulated other comprehensive income	—	87
Other-than-temporary impairment reflected through the statement of operations	—	913
Transfer of loans receivable to real estate acquired through foreclosure	<u>4,140</u>	<u>9,407</u>
Transfer of available-for-sale securities to held-to-maturity securities	<u>8,649</u>	<u>—</u>

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, 2012, 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, 2013 and 2012, 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 the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure except for the following:

On January 15, 2014, the Board of Directors of the Company declared a two-for-one stock split to stockholders of record as of February 10, 2014, payable on February 28, 2014. All share, earnings per share, and per share data have been retroactively adjusted in the consolidated balance sheets, earnings per share, and stockholders’ equity disclosures to reflect this stock split for all periods presented in accordance with generally accepted accounting principles.

On January 15, 2014, the Board of Directors declared a \$.05 dividend to stockholders of record dated March 26, 2014, payable on April 11, 2014.

On January 15, 2014, the Company entered into a contract to sell approximately \$147.6 million in unpaid principal of loans serviced for an estimated gain on sale of servicing assets of \$767,000. The Company expects to close the servicing sale during the first quarter of 2014.

On February 21, 2014, the Bank completed the acquisition of the St. George office of First Federal of South Carolina in a transaction that had been announced on August 28, 2013. The Bank added approximately \$24.5 million in deposits and \$11.2 million in loans receivable as a result of this branch acquisition.

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, 2013 and 2012 consists of 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, 2013 and 2012, these reserve balances amounted to \$8.3 million and \$4.7 million, respectively.

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 the category of the investment 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. Loans held for sale are recorded at either fair value, if elected, or the lower of cost or fair value on an individual loan basis. Origination fees and costs for loans held for sale recorded at lower of cost or market are capitalized in the basis of the loan and are included in the calculation of realized gains and losses upon sale. Origination fees and costs are recognized in earnings at the time of origination for loans held for sale that are recorded at fair value. Fair value is derived from observable current market prices, when available, and includes loan servicing value. When observable market prices are not available, the Company uses judgment and estimates fair value using internal models, in which the Company uses its best estimates of assumptions it believes would be used by market participants in estimating fair value. Adjustments to reflect unrealized gains and losses resulting from changes in fair value and realized gains and losses upon ultimate sale of the loans are classified as noninterest income in the consolidated statements of operations.

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.

Derivatives

The accounting for changes in fair value (i.e., unrealized gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding it. If certain conditions are met, entities may elect to designate a derivative instrument as a hedge of exposures to changes in fair values, cash flows, or foreign currencies. If the hedged exposure is a fair value exposure, the unrealized gain or loss on the derivative instrument is recognized in earnings in the period of change, together with the offsetting unrealized loss or gain on the hedged item attributable to the risk being hedged as a component of other noninterest income on the consolidated statements of operations. If the hedged exposure is a cash flows exposure, the effective portion of the gain or loss on the hedged item is reported initially as a component of accumulated other comprehensive income (loss), net of the tax impact, and subsequently reclassified into earnings when the hedged transaction affects earnings. Any amounts excluded from the assessment of hedge effectiveness, as well as the ineffective portion of the gain or loss on the derivative instrument, are reported in earnings immediately as a component of other noninterest income on the consolidated statements of operations. If the derivative instrument is not designated as a hedge, the gain or loss on the derivative instrument is recognized in earnings as a component of other noninterest income on the consolidated statements of operations in the period of change.

The primary uses of derivative instruments are related to the mortgage banking activities of the Company. As such, the Company holds derivative instruments, which consist of rate lock agreements related to expected funding of fixed-rate mortgage loans to customers (“interest rate lock commitments”) and forward commitments to sell mortgage-backed securities and individual fixed-rate mortgage loans (“forward commitments”). The Company’s objective in obtaining the forward commitments is to mitigate the interest rate risk associated with the interest rate lock commitments and the mortgage loans that are held for sale. Derivatives related to these commitments are recorded as either a derivative asset or a derivative liability in the balance sheet and are measured at fair value. Both the interest rate lock commitments and the forward commitments are reported at fair value, with adjustments recorded in current period earnings in net gain on sale of loans held for sale within noninterest income section of the consolidated statements of operations.

Derivative instruments not related to mortgage banking activities, including interest rate swap agreements, that do not satisfy the hedge accounting requirements, are recorded at fair value and changes in fair value are recognized in noninterest income in the consolidated statements of operations.

When using derivatives to hedge fair value and cash flows risks, the Company exposes itself to potential credit risk from the counterparty to the hedging instrument. This credit risk is normally a small percentage of the notional amount and fluctuates as interest rates change. The Company analyzes and approves credit risk for all potential derivative counterparties prior to execution of any derivative transaction. The Company seeks to minimize credit risk by dealing with highly rated counterparties and by obtaining collateralization for exposures above certain predetermined limits. If significant counterparty risk is determined, the Company would adjust the fair value of the derivative recorded asset balance to consider such risk.

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 in noninterest income. Amortization of mortgage servicing rights and mortgage servicing costs are charged to expense when incurred.

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, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Gains and losses on the sale of assets acquired through foreclosure and related revenue and expenses of these assets are included in noninterest expense in other real estate expenses, net.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are

credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as 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. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. These analyses involve a high degree of judgment in estimating the amount of loss associated with specific loans, including estimating the amount and timing of future cash flows and collateral values. Impaired loans are evaluated for impairment using the discounted cash flow methodology or based on the net realizable value of the underlying collateral. Impaired loans are individually reviewed on a quarterly basis to determine the level of impairment.

Factors considered by management in determining impaired loans include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

If a loan has impairment, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Substantially all loans were considered collateral-dependent as of December 31, 2013 and 2012. For collateral-dependent loans, the measurement of impairment was based on the net investment of the loan compared to the fair value of the collateral less estimated selling costs. In most cases, the fair value of the collateral was based on appraised value, when appropriate, the fair value was based on the probable sales price of the collateral when sale of the collateral was imminent or contracted sales price if the collateral is subject to a binding sales contract as of the end of the quarter.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The Company considers the actual loss history experience over the trailing twelve quarters to determine the historical loss experience used in the general component. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries for the most recent twelve quarters; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

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, 2013 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, 2013 was \$526,000.

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 \$2,700 of penalties and \$2,700 of interest during fiscal 2013. The Company paid \$1,000 of penalties and \$400 interest during fiscal 2012.

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 \$6.1 million and \$4.9 million at December 31, 2013 and 2012, respectively. For the years ended December 31, 2013, and 2012, the Company recorded a provision for mortgage repurchase reserve expense of \$2.4 million, and \$2.2 million respectively. The provision for mortgage repurchase reserve of \$2.4 million during 2013 consisted of \$1.0 million for current year sales and \$1.4 million related to changes in estimates of prior year sales. The provision expense for mortgage repurchase reserve of \$2.2 million during 2012 consisted of \$1.4 million for current year sales and \$800,000 related to changes in estimates of prior year sales.

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, 2013, and 2012 of \$1.2 million and \$930,000, respectively which were charged against the reserve amount. 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, requiring 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. The Company's other comprehensive income (loss) for the years ended December 31, 2013, and 2012 and accumulated other comprehensive income (loss) as of December 31, 2013 and 2012 are comprised solely of unrealized gains (losses) on certain investment securities net of the related tax effect.

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 Compensation Plans

The Company issues stock options and restricted stock under various plans to directors, officers and other key employees. The Company accounts for its stock compensation plans in accordance with ASC Topics 718 and 505. Under those provisions, the Company has adopted a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized on a straight-line basis over the service period, which is usually the vesting period, taking into account retirement eligibility. As a result, compensation expense relating to stock options and restricted stock is reflected in net income as part of "salaries and employee benefits" on the consolidated statements of operations.

Earnings Per Share

Basic earnings per share ("EPS") represents income available to common stockholders' divided by the weighted-average number of shares outstanding during the year. Diluted earnings per share reflects additional shares that would have been outstanding if dilutive potential shares had been issued. Potential shares that may be issued by the Company relate solely to outstanding stock options, restricted stock (non-vested shares), and warrants, and are determined using the treasury stock method. Under the treasury stock method, the number of incremental shares is determined by assuming the issuance of stock for the outstanding stock options and warrants, reduced by the number of shares assumed to be repurchased from the issuance

proceeds, using the average market price for the year of the Company's stock. Weighted-average shares for the basic and diluted EPS calculations have been reduced by the average number of unvested restricted shares.

On January 15, 2014, the Board of Directors of the Company declared a two-for-one stock split to stockholders of record dated February 10, 2014, payable on February 28, 2014. As such, all share, earnings per share, and per share data have been retroactively adjusted to reflect this stock split for all periods presented in accordance with generally accepted accounting principles.

Reclassification

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

Recently Issued Accounting Pronouncements

The 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 were effective for reporting periods beginning on or after January 1, 2013 and required retrospective presentation for all comparative periods presented. Additionally, in January 2013 the FASB clarified that the amendments apply only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in U.S. GAAP or subject to a master netting arrangement or similar agreement. These amendments did not have a material effect on the Company's 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 or 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 face 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.

In April 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments will be effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company does not expect these amendments to have any effect on its financial statements.

In December 2013, the FASB amended the Master Glossary of the FASB Codification to define "Public Business Entity" to minimize the inconsistency and complexity of having multiple definitions of, or a diversity in practice as to what constitutes, a nonpublic entity and public entity within U.S. GAAP. The amendment does not affect existing requirements, however will be used by the FASB, the Private Company Council ("PCC"), and the Emerging Issues Task Force ("EITF") in specifying the scope of future financial accounting and reporting guidance. The Company does not expect this amendment to have any effect on its financial statements.

In January 2014, the FASB amended the Receivables—Troubled Debt Restructurings by Creditors subtopic of the Codification to address the reclassification of consumer mortgage loans collateralized by residential real estate upon foreclosure. The amendments clarify the criteria for concluding that an in substance repossession or foreclosure has occurred,

and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. The amendments also outline interim and annual disclosure requirements. The amendments will be effective for the Company's annual reporting periods beginning after December 15, 2014. Companies are allowed to use either a modified retrospective transition method or a prospective transition method when adopting this update. Early adoption is permitted. 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, 2013 and 2012 follows:

	At December 31,							
	2013				2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:	(In thousands)							
Municipal securities.....	\$ 39,790	99	(1,390)	38,499	17,630	252	(113)	17,769
US government agencies	5,199	—	(24)	5,175	—	—	—	—
Mortgage-backed securities:								
Agency	68,813	1,433	(317)	69,929	76,775	2,443	(9)	79,209
Non-agency	53,195	826	(89)	53,932	50,106	1,405	(82)	51,429
Total mortgage-backed securities	122,008	2,259	(406)	123,861	126,881	3,848	(91)	130,638
Total	\$ 166,997	2,358	(1,820)	167,535	144,511	4,100	(204)	148,407
Securities held-to-maturity:								
Municipal securities.....	\$ 15,488	30	(341)	15,177	—	—	—	—
Asset-backed securities.....	9,066	2,107	(2,803)	8,370	9,166	580	(4,197)	5,549
Total	\$ 24,554	2,137	(3,144)	23,547	9,166	580	(4,197)	5,549

The asset-backed securities portfolio is collateralized with trust preferred securities issued by other financial institutions in pooled issuances.

The following table presents unrealized losses related to the trust preferred securities that were recognized within other comprehensive income at the time of transfer to held-to-maturity as well as the unrealized gains and losses that are not presented in other comprehensive income for December 31, 2013 and 2012.

At December 31, 2013										
	Purchased Face Value	Cumulative OTTI	Carrying Value	Recognized in OCI		Amortized Cost	Not Recognized in OCI		Estimated Fair Value	Collateralization Percentage
				Gross Unrealized			Gross Unrealized			
				Gains	Losses		Gains	Losses		
(In thousands)										
Held-to-Maturity:										
Trust Preferred Securities										
Total A-Class.....	\$ 2,841	—	2,841	—	(586)	2,255	354	(99)	2,510	164% - 164%
Total B-Class.....	11,804	(2,635)	9,169	—	(2,569)	6,600	1,190	(2,704)	5,086	94% - 98%
Total C-Class.....	2,688	(1,340)	1,348	—	(1,137)	211	563	—	774	83% - 83%
	<u>\$ 17,333</u>	<u>(3,975)</u>	<u>13,358</u>	<u>—</u>	<u>(4,292)</u>	<u>9,066</u>	<u>2,107</u>	<u>(2,803)</u>	<u>8,370</u>	
At December 31, 2012										
	Purchased Face Value	Cumulative OTTI	Carrying Value	Recognized in OCI		Amortized Cost	Not Recognized in OCI		Estimated Fair Value	Collateralization Percentage
				Gross Unrealized			Gross Unrealized			
				Gains	Losses		Gains	Losses		
(In thousands)										
Held-to-Maturity:										
Trust Preferred Securities										
Total A-Class.....	\$ 3,733	—	3,733	—	(614)	3,119	—	(230)	2,889	157.2%-157.2%
Total B-Class.....	11,318	(2,635)	8,683	—	(2,680)	6,003	405	(3,967)	2,441	73.6%-91.8%
Total C-Class.....	2,581	(1,340)	1,241	—	(1,197)	44	175	—	219	75.9%-75.9%
	<u>\$ 17,632</u>	<u>(3,975)</u>	<u>13,657</u>	<u>—</u>	<u>(4,491)</u>	<u>9,166</u>	<u>580</u>	<u>(4,197)</u>	<u>5,549</u>	

The pooled trust preferred securities consisted of positions in seven different securities. The underlying issuers in the pools were primarily financial institutions and to a lesser extent, insurance companies and real estate investment trusts. The Company owns both senior and mezzanine tranches in pooled trust preferred securities; however, the Company does not own any income notes. The senior and mezzanine tranches of trust preferred collateralized debt obligations generally have some protection from defaults in the form of over-collateralization and excess spread revenues, along with waterfall structures that redirect cash flows in the event certain coverage test requirements are failed. Generally, senior tranches have the greatest protection, with mezzanine tranches subordinated to the senior tranches, and income notes subordinated to the mezzanine tranches. Unrealized Losses recognized in other comprehensive income relate to unrealized losses at the time of transfer from available-for-sale to held-to-maturity and are accreted in accordance with generally accepted accounting principles.

As of December 31, 2013, \$1.3 million of the pooled trust preferred securities were investment grade, \$1.0 million were split-rated, and \$6.8 million were below investment grade. As of December 31, 2012, \$2.0 million of the pooled trust preferred securities were investment grade, \$1.0 million were split-rated, and the remaining \$6.2 million were below investment grade. In terms of risk based capital calculation, the Company allocates additional risk-based capital to the below investment grade securities.

As of December 31, 2013, senior tranches represent \$2.3 million of the Company's pooled securities, while mezzanine tranches represented \$6.8 million. All of the \$6.8 million in mezzanine tranches are still subordinate to senior tranches as the senior notes have not been paid to a zero balance. As of December 31, 2012, senior tranches represent \$3.1 million of the Company's pooled securities, while mezzanine tranches represented \$6.1 million. All of the \$6.1 million in mezzanine tranches are still subordinate to senior tranches as the senior notes have not been paid to a zero balance.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2013 follows:

	2013	
	Amortized Cost	Fair Value
	(In thousands)	
Securities available-for-sale:		
Three to five years	\$ —	—
Six to ten years.....	14,350	14,235
After ten years.....	<u>152,647</u>	<u>153,300</u>
Total.....	<u>\$ 166,997</u>	<u>167,535</u>
Securities held-to-maturity:		
Three to five years	\$ 989	890
Six to ten years.....	3,563	3,413
After ten years.....	<u>20,002</u>	<u>19,244</u>
Total.....	<u>\$ 24,554</u>	<u>23,547</u>

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 2013, the Company sold 56 securities available-for-sale totaling \$92.8 million. The Company received gross proceeds of \$91.7 million related to the sale of these securities and recognized gross gains of \$473,000 and gross losses of \$1.6 million.

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.

At December 31, 2013, the Company has pledged \$12.3 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, 2013 are as follows:

	At December 31, 2013								
	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)								
Available-for-sale:									
Municipal securities.....	\$ 27,108	25,917	(1,191)	3,157	2,958	(199)	30,265	28,875	(1,390)
US government agencies ...	5,199	5,175	(24)	—	—	—	5,199	5,175	(24)
Mortgage-backed securities:									
Agency.....	27,140	26,823	(317)	—	—	—	27,140	26,823	(317)
Non-agency.....	<u>15,006</u>	<u>14,951</u>	<u>(55)</u>	<u>3,660</u>	<u>3,626</u>	<u>(34)</u>	<u>18,666</u>	<u>18,577</u>	<u>(89)</u>
Total mortgage-backed securities.....	<u>42,146</u>	<u>41,774</u>	<u>(372)</u>	<u>3,660</u>	<u>3,626</u>	<u>(34)</u>	<u>45,806</u>	<u>45,400</u>	<u>(406)</u>
Total.....	<u>\$ 74,453</u>	<u>72,866</u>	<u>(1,587)</u>	<u>6,817</u>	<u>6,584</u>	<u>(233)</u>	<u>81,270</u>	<u>79,450</u>	<u>(1,820)</u>
Held-to-maturity-									
Municipal securities.....	\$ 11,945	11,734	(211)	2,177	2,047	(130)	14,122	13,781	(341)
Asset-backed securities.....	—	—	—	<u>7,398</u>	<u>4,595</u>	<u>(2,803)</u>	<u>7,398</u>	<u>4,595</u>	<u>(2,803)</u>
Total.....	<u>\$ 11,945</u>	<u>11,734</u>	<u>(211)</u>	<u>9,575</u>	<u>6,642</u>	<u>(2,933)</u>	<u>21,520</u>	<u>18,376</u>	<u>(3,144)</u>

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)								
Available-for-sale:									
Municipal securities.....	\$ 8,554	8,441	(113)	—	—	—	8,554	8,441	(113)
Mortgage-backed securities:									
Agency	4,587	4,578	(9)	—	—	—	4,587	4,578	(9)
Non-agency	8,491	8,445	(46)	1,927	1,891	(36)	10,418	10,336	(82)
Total mortgage-backed securities	13,078	13,023	(55)	1,927	1,891	(36)	15,005	14,914	(91)
Total	<u>\$ 21,632</u>	<u>21,464</u>	<u>(168)</u>	<u>1,927</u>	<u>1,891</u>	<u>(36)</u>	<u>23,559</u>	<u>23,355</u>	<u>(204)</u>
Held-to-maturity-Asset-backed securities	<u>\$ —</u>	<u>—</u>	<u>—</u>	<u>9,082</u>	<u>4,885</u>	<u>(4,197)</u>	<u>9,082</u>	<u>4,885</u>	<u>(4,197)</u>

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.

At December 31, 2013 and 2012, the Company had 58 and 26, respectively, individual investments available-for-sale that were in an unrealized loss position. The unrealized losses on the Company's investments in US government-sponsored agencies, municipal securities and mortgage-backed securities (agency and non-agency) summarized above were attributable primarily to changes in interest rates. Management has performed various analyses, including cash flows, and determined that no OTTI expense was necessary during 2013.

At December 31, 2013, the Company had four trust preferred securities within the held-to-maturity portfolio that were in an unrealized loss position. The asset-backed securities portfolio is collateralized with trust preferred securities issued by other financial institutions in pooled issuances.

To determine the fair value, cash flow models for trust preferred securities are provided by a third-party pricing service. Impairment testing is performed on a quarterly basis using a detailed cash flow analysis for each security. The major assumptions used during the impairment test are described in the subsequent paragraph.

In 2009, the Company adopted a four year "burst" scenario for its modeled default rates (2010 - 2013) that replicated the default rates for the banking industry from the four peak years of the Savings and Loan crisis, which then reduced to 0.25% annually. 2013 was the last year of the elevated default rate. The constant default rate used by the Company is now 0.25% annually. All issuers that were currently in deferral were presumed to be in default. Additionally, all defaults are assumed to have a 15% recovery after two years and 1% of the pool is presumed to prepay annually. If this analysis results in a present value of expected cash flows that is less than the book value of a security (that is, a credit loss exists), an OTTI is considered to have occurred. If there is no credit loss, any impairment is considered temporary. The cash flow analysis we performed used discount rates equal to the credit spread at the time of purchase for each security and then added the current 3-month LIBOR forward interest rate curve.

During 2012, the Company 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 was no OTTI recognized for 2013.

The following table presents the cumulative credit related OTTI related to securities held-to-maturity taken as well as the activity for the period ended December 31, 2013 and 2012 for the trust preferred securities.

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
	(In thousands)	
Balance at beginning of year	\$ 3,975	3,687
Additions for credit losses on securities for which OTTI was not previously recognized.....	—	—
Additions for additional credit losses on securities for which OTTI was previously recognized	—	288
Balance at end of year.....	<u>\$ 3,975</u>	<u>3,975</u>

Management believes that there are no additional securities other-than-temporarily impaired at December 31, 2013. 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, 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 \$4.1 million and \$6.4 million at December 31, 2013 and 2012, respectively.

Other investments at December 31, 2013 and 2012 consisted primarily of \$465,000 invested in capital stock of statutory business trusts (See Note 10 – Long-term debt) as well as \$1.2 million in a CRA fund.

NOTE 3 – DERIVATIVES

The derivative positions of the Company at December 31, 2013 and 2012 are as follows:

	<u>At December 31,</u>			
	<u>2013</u>		<u>2012</u>	
	<u>Fair Value</u>	<u>Notional Value</u>	<u>Fair Value</u>	<u>Notional Value</u>
	(In thousands)			
Derivative assets:				
Mortgage loan interest rate lock commitments	\$ —	—	4,783	289,584
Mortgage loan forward sales commitments	106	20,516	1,692	59,177
Mortgage-backed securities forward sales commitments.....	878	88,000	67	308,000
Interest rate swaps	428	20,000	—	—
	<u>\$ 1,412</u>	<u>128,516</u>	<u>6,542</u>	<u>656,761</u>
Derivative liabilities:				
Mortgage loan interest rate lock commitments	\$ 55	103,614	—	—

The primary uses of derivative instruments are related to the mortgage banking activities of the Company. As such, the Company holds derivative instruments, which consist of rate lock agreements related to expected funding of fixed-rate mortgage loans to customers (interest rate lock commitments) and forward commitments to sell mortgage-backed securities and individual fixed-rate mortgage loans. The Company's objective in obtaining the forward commitments is to mitigate the interest rate risk associated with the interest rate lock commitments and the mortgage loans that are held for sale. Derivatives related to these commitments are recorded as either a derivative asset or a derivative liability in the balance sheet and are measured at fair value. Both the interest rate lock commitments and the forward commitments are reported at fair value, with adjustments recorded in current period earnings in net unrealized gain (loss) on derivatives within the noninterest income of the consolidated statements of operations.

Derivative instruments not related to mortgage banking activities, including financial futures commitments and interest rate swap agreements that do not satisfy the hedge accounting requirements are recorded at fair value and are classified with resultant changes in fair value being recognized in noninterest income in the consolidated statement of operations.

When using derivatives to hedge fair value and cash flow risks, the Company exposes itself to potential credit risk from the counterparty to the hedging instrument. This credit risk is normally a small percentage of the notional amount and fluctuates as interest rates change. The Company analyzes and approves credit risk for all potential derivative counterparties prior to execution of any derivative transaction. The Company seeks to minimize credit risk by dealing with highly rated counterparties and by obtaining collateralization for exposures above certain predetermined limits. If significant counterparty risk is determined, the Company would adjust the fair value of the derivative recorded asset balance to consider such risk.

NOTE 4 - LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2013 and 2012 are summarized by category as follows:

	At December 31,			
	2013		2012	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars in thousands)			
Loans secured by real estate:				
One-to-four family	\$ 184,210	32.60%	146,333	27.66%
Home equity	23,661	4.19%	31,278	5.91%
Commercial real estate	253,035	44.79%	240,764	45.52%
Construction and development	67,056	11.87%	68,113	12.88%
Consumer loans	3,060	0.54%	3,762	0.71%
Commercial business loans	33,938	6.01%	38,714	7.32%
Total gross loans receivable	<u>564,960</u>	<u>100.00%</u>	<u>528,964</u>	<u>100.00%</u>
Less:				
Undisbursed loans in process	21,550		17,690	
Allowance for loan losses	8,091		9,520	
Deferred fees, net	98		63	
Total loans receivable, net	<u>\$ 535,221</u>		<u>501,691</u>	

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

	At December 31,			
	2013		2012	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars in thousands)			
Variable rate loans	\$ 219,589	40.41%	265,657	51.96%
Fixed rate loans	323,821	59.59%	245,617	48.04%
Total loans outstanding	<u>\$ 543,410</u>	<u>100.00%</u>	<u>511,274</u>	<u>100.00%</u>

The following table presents activity in the allowance for loan 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, 2013							
	Loans Secured by Real Estate							
	One- to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	Unallocated	Total
Balance at January 1, 2013	\$3,193	276	3,315	1,792	82	862	—	9,520
Provision for loan losses	(991)	(18)	(317)	281	(58)	(491)	734	(860)
Charge-offs	(168)	(28)	(269)	(765)	(35)	(410)	—	(1,675)
Recoveries	438	1	126	110	53	378	—	1,106
Balance at December 31, 2013	<u>\$2,472</u>	<u>231</u>	<u>2,855</u>	<u>1,418</u>	<u>42</u>	<u>339</u>	<u>734</u>	<u>8,091</u>

At December 31, 2012

	Loans Secured by Real Estate							Unallocated	Total
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business			
Balance at January 1, 2012	\$ 3,978	550	3,283	2,695	210	1,323	—	12,039	
Provision for loan losses	1,520	45	1,233	(137)	(216)	262	—	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	\$ 3,193	276	3,315	1,792	828	62	—	9,520	

	Loans Secured by Real Estate							Unallocated	Total
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business			
(In thousands)									

At December 31, 2013:
Allowance for loan losses ending balances:

Individually evaluated for impairment	\$ 103	—	55	165	20	6	—	349
Collectively evaluated for impairment	2,369	231	2,800	1,253	22	333	734	7,742
	<u>\$ 2,472</u>	<u>231</u>	<u>2,855</u>	<u>1,418</u>	<u>42</u>	<u>339</u>	<u>734</u>	<u>8,091</u>

Loans receivable ending balances:

Individually evaluated for impairment	\$ 6,220	125	17,008	1,493	40	2,560	—	27,446
Collectively evaluated for impairment	177,516	23,217	230,859	58,611	2,775	22,986	—	515,964
Total loans receivable ...	<u>\$ 183,736</u>	<u>23,342</u>	<u>247,867</u>	<u>60,104</u>	<u>2,815</u>	<u>25,546</u>	<u>—</u>	<u>543,410</u>

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	2,881	276	2,956	1,363	57	589	—	8,122
	<u>\$ 3,193</u>	<u>276</u>	<u>3,315</u>	<u>1,792</u>	<u>82</u>	<u>862</u>	<u>—</u>	<u>9,520</u>

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 ...	<u>\$ 146,329</u>	<u>30,710</u>	<u>236,230</u>	<u>63,475</u>	<u>3,502</u>	<u>31,028</u>	<u>—</u>	<u>511,274</u>

The following table presents impaired loans individually evaluated for impairment in the segmented portfolio categories as of December 31, 2013 and 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, 2013				
	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.....	\$ 5,713	7,682	—	5,783	184
Home equity	125	472	—	177	10
Commercial real estate	16,695	17,240	—	18,761	531
Construction and development	1,227	3,887	—	1,960	13
Consumer loans.....	20	404	—	23	1
Commercial business loans	2,554	3,599	—	2,984	114
	<u>26,334</u>	<u>33,284</u>	<u>—</u>	<u>29,688</u>	<u>853</u>
With an allowance recorded:					
Loans secured by real estate:					
One-to-four family.....	507	607	103	469	13
Home equity	—	—	—	—	—
Commercial real estate	313	313	55	59	20
Construction and development	266	266	165	33	10
Consumer loans.....	20	20	20	26	—
Commercial business loans	6	6	6	9	—
	<u>1,112</u>	<u>1,212</u>	<u>349</u>	<u>596</u>	<u>43</u>
Total:					
Loans secured by real estate:					
One-to-four family.....	6,220	8,289	103	6,252	197
Home equity	125	472	—	177	10
Commercial real estate	17,008	17,553	55	18,820	551
Construction and development	1,493	4,153	165	1,993	23
Consumer loans.....	40	424	20	49	1
Commercial business loans	2,560	3,605	6	2,993	114
	<u>\$ 27,446</u>	<u>34,496</u>	<u>349</u>	<u>30,284</u>	<u>896</u>

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
	<u>21,321</u>	<u>27,001</u>	<u>—</u>	<u>30,103</u>	<u>1,500</u>
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
	<u>11,122</u>	<u>13,219</u>	<u>1,398</u>	<u>11,595</u>	<u>31</u>
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
	<u>\$ 32,443</u>	<u>40,220</u>	<u>1,398</u>	<u>41,698</u>	<u>1,531</u>

The Company is committed to advance up to \$230,000 of additional funds in connection with impaired loans as of December 31, 2013. The Company was not committed to advance additional funds in connection with impaired loans as of December 31, 2012.

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, 2013 and 2012.

At December 31, 2013							
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	\$ 231	—	273	53	—	—	557
60-89 days past due	1,034	—	—	—	—	—	1,034
90 days or more past due	3,440	125	5,074	1,477	7	431	10,554
Total past due	4,705	125	5,347	1,530	7	431	12,145
Current	179,031	23,217	242,520	58,574	2,808	25,115	531,265
Total loans receivable	<u>\$183,736</u>	<u>23,342</u>	<u>247,867</u>	<u>60,104</u>	<u>2,815</u>	<u>25,546</u>	<u>543,410</u>
Recorded investment greater than 90 days and still accruing	\$ —	—	—	—	—	—	—

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	<u>\$146,329</u>	<u>30,710</u>	<u>236,230</u>	<u>63,475</u>	<u>3,502</u>	<u>31,028</u>	<u>511,274</u>
Recorded investment greater than 90 days and still accruing	\$ —	—	—	—	—	—	—

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 are on nonaccrual are 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, 2013 and 2012.

	At December 31,	
	2013	2012
Loans secured by real estate:	(In thousands)	
One-to-four family.....	\$ 3,902	4,817
Home equity	125	—
Commercial real estate	5,114	5,956
Construction and development	1,481	3,251
Consumer loans	20	52
Commercial business loans.....	437	1,172
	\$ 11,079	15,248

There were no loans past due 90 days or more and still accruing at December 31, 2013 or 2012.

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, 2013 and 2012.

	At December 31, 2013						
	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	\$168,441	23,102	189,413	38,425	2,776	20,084	442,241
Management Watch	9,437	115	41,856	20,138	19	4,739	76,304
Special Mention	1,679	—	10,633	295	—	286	12,893
Substandard	4,179	125	5,965	1,246	20	437	11,972
Total loans receivable	<u>\$183,736</u>	<u>23,342</u>	<u>247,867</u>	<u>60,104</u>	<u>2,815</u>	<u>25,546</u>	<u>543,410</u>
Performing	\$179,834	23,217	242,753	58,623	2,795	25,109	532,331
Nonperforming:							
90 days or more and still accruing	—	—	—	—	—	—	—
Nonaccrual	3,902	125	5,114	1,481	20	437	11,079
Total nonperforming	<u>3,902</u>	<u>125</u>	<u>5,114</u>	<u>1,481</u>	<u>20</u>	<u>437</u>	<u>11,079</u>
Total loans receivable	<u>\$183,736</u>	<u>23,342</u>	<u>247,867</u>	<u>60,104</u>	<u>2,815</u>	<u>25,546</u>	<u>543,410</u>

At December 31, 2012

	Real estate loans						Total
	One-to-four family	Home equity	Commercial real estate	Construction and Development	Consumer	Commercial business	
(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	<u>\$146,329</u>	<u>30,710</u>	<u>236,230</u>	<u>63,475</u>	<u>3,502</u>	<u>31,028</u>	<u>511,274</u>
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	<u>4,817</u>	<u>—</u>	<u>5,956</u>	<u>3,251</u>	<u>52</u>	<u>1,172</u>	<u>15,248</u>
Total loans receivable	<u>\$146,329</u>	<u>30,710</u>	<u>236,230</u>	<u>63,475</u>	<u>3,502</u>	<u>31,028</u>	<u>511,274</u>

Troubled Debt Restructurings

The following is a schedule of loans designated as troubled debt restructurings, by portfolio segment, during the years ended December 31, 2013 and 2012.

During the year ended December 31, 2013

	Number of Contracts	Pre-Modification	Post-Modification
		Outstanding Recorded Investment	Outstanding Recorded Investment
(In thousands)			
Troubled Debt Restructurings:			
Loans secured by real estate:			
One-to-four family	—	\$ —	—
Home equity	—	—	—
Commercial real estate	—	—	—
Construction and development	—	—	—
Consumer loans	—	—	—
Commercial business loans	<u>1</u>	<u>6</u>	<u>6</u>
	<u>1</u>	<u>\$ 6</u>	<u>6</u>

	During the year ended December 31, 2012		
	Number of Contracts	Pre- Modification Outstanding Recorded Investment (In thousands)	Post- Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Loans secured by real estate:			
One-to-four family.....	—	\$ —	—
Home equity	—	—	—
Commercial real estate	3	1,362	1,362
Construction and development	—	—	—
Consumer loans.....	—	—	—
Commercial business loans	2	158	158
	<u>5</u>	<u>\$ 1,520</u>	<u>1,520</u>

During the year ended December 31, 2013, the Bank modified one loan that was considered a trouble debt restructuring. The Bank extended terms for this loan at a market rate. 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, 2013 or 2012 went into default during the period ended December 31, 2013 or 2012.

At December 31, 2013, there were \$24.1 million in loans designated as troubled debt restructurings of which \$16.3 million were accruing. At December 31, 2012, there were \$27.9 million in loans designated as troubled debt restructurings of which \$17.2 million were accruing.

Loans serviced for the benefit of others under loan participation arrangements amounted to \$2.3 million and \$15.9 million at December 31, 2013 and 2012, respectively.

Activity in loans to officers, directors and other related parties for the years ended December 31, 2013 and 2012 is summarized as follows:

	At December 31,	
	2013	2012
	(In thousands)	
Balance at beginning of year.....	\$ 12,965	19,702
New loans.....	3,470	4,619
Repayments	(3,503)	(11,356)
Balance at end of year	<u>\$ 12,932</u>	<u>12,965</u>

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, 2013 and 2012, the Company had commitments to extend credit in the amount of \$48.6 million and \$31.9 million, respectively. At December 31, 2013 and 2012, the Company had standby letters of credit in the amount of \$526,000 and \$396,000, 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, 2013, 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, 2013 was approximately \$526,000.

NOTE 5 - PREMISES AND EQUIPMENT, NET

Premises and equipment, net at December 31, 2013 and 2012 consists of the following:

	At December 31,	
	2013	2012
	(In thousands)	
Land.....	\$ 5,304	5,029
Buildings.....	11,658	11,277
Furniture, fixtures and equipment.....	8,023	7,345
Construction in process.....	599	44
Total premises and equipment.....	<u>25,584</u>	<u>23,695</u>
Less: accumulated depreciation.....	(7,999)	(7,298)
Premises and equipment, net.....	<u>\$ 17,585</u>	<u>16,397</u>

Depreciation expense included in operating expenses for the years ended December 31, 2013 and 2012 amounted to \$918,000 and \$833,000, respectively. The construction in process related to technology related equipment that will be transferred into furniture, fixture and equipment during 2014. Remaining estimated costs for completion of the construction in process are expected to be approximately \$100,000. There was no interest capitalized during fiscal 2013 and 2012.

NOTE 6 – REAL ESTATE ACQUIRED THROUGH FORECLOSURE

Transactions in other real estate owned for the years ended December 31, 2013 and 2012 are summarized below:

	At December 31,	
	2013	2012
	(In thousands)	
Balance at beginning of year.....	\$ 6,284	6,097
Additions.....	4,140	9,407
Sales.....	(3,302)	(8,171)
Write downs.....	(849)	(1,049)
Balance at end of year.....	<u>\$ 6,273</u>	<u>6,284</u>

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

	At December 31,	
	2013	2012
	(In thousands)	
Real estate loans:		
One-to-four family.....	\$ 959	1,010
Commercial real estate	1,781	1,902
Construction and development	3,533	3,372
	<u>\$ 6,273</u>	<u>6,284</u>

NOTE 7 – MORTGAGE SERVICING RIGHTS

Mortgage loans serviced for others are not included in the accompanying statements of financial condition. The value of mortgage servicing rights is included on the Company’s consolidated balance sheets. The unpaid principal balances of loans serviced for others were \$2.0 billion and \$2.2 billion, respectively, at December 31, 2013 and 2012.

The economic estimated fair values of mortgage servicing rights were \$17.7 million and \$18.1 million, respectively, at December 31, 2013 and 2012. The estimated fair value of servicing rights at December 31, 2013 were determined using discount rates ranging from 11.66% to 12.66% , prepayment speed assumptions (“PSA”) ranging from 116.6 to 138.2, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of .90% as determined by a third party. 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 145.1, depending upon the stratification of the specific servicing right, and a weighted average delinquency rate of 1.24% as determined by a third party.

During 2013 servicing rights related to approximately \$972.9 million of unpaid loan principal serviced for others were sold. The Company received \$11.0 million in net proceeds and recognized a gain in the accompanying consolidated statement of operations of \$5.5 million. 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, 2013 and 2012:

	December 31,	
	2013	2012
	(In thousands)	
MSR beginning balance.....	\$ 12,039	6,452
Amount capitalized.....	6,860	7,051
Amount sold	(5,547)	—
Amount amortized	(2,444)	(1,464)
MSR ending balance.....	<u>\$ 10,908</u>	<u>12,039</u>

There was no allowance for loss in fair value in mortgage servicing rights for the years ended December 31, 2013 and 2012.

The estimated amortization expense for mortgage servicing rights for MSRs owned at December 31, 2013, for the years ended December 31, 2014, 2015, 2016, 2017, 2018 and thereafter is \$1.1 million, \$1.0 million, \$990,000, \$950,000, \$890,000 and \$6.0 million, respectively. The estimated amortization expense is based on current information regarding future 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, 2013 and 2012, servicing related trust funds of approximately \$19.9 million, and \$27.1 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, 2013 and 2012, 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, 2013 and 2012 are summarized as follows:

	At December 31,	
	2013	2012
	(In thousands)	
Noninterest-bearing demand accounts	\$ 83,500	82,004
Interest-bearing demand accounts.....	92,067	51,490
Savings accounts.....	17,816	10,882
Money market accounts.....	220,915	207,299
Certificates of deposit:		
Less than \$100,000.....	195,239	215,549
\$100,000 or more.....	88,044	86,023
Total certificates of deposit.....	283,283	301,572
Total deposits.....	\$ 697,581	653,247

The aggregate amount of brokered certificates of deposit was \$61.8 million and \$29.9 million at December 31, 2013 and 2012, respectively. Brokered certificates of deposit are included in the table above under certificates of deposit less than \$100,000. The aggregate amount of institutional certificates of deposit was \$40.0 million at December 31, 2013 and 2012. Interest expenses related to certificates of deposit over \$100,000 was \$664,000 and \$462,000 for the years ended December 31, 2013 and 2012, respectively.

The amounts and scheduled maturities of certificates of deposit at December 31, 2013 and 2012 are as follows:

	At December 31,	
	2013	2012
	(In thousands)	
Maturing within one year.....	\$ 144,119	220,024
Maturing one through three years.....	53,231	44,280
Maturing after three years.....	85,933	37,268
	\$ 283,283	301,572

The Company has pledged \$4.9 million of mortgage-backed securities as of December 31, 2013 to secure public agency funds.

NOTE 9 – SHORT-TERM BORROWED FUNDS

Short-term borrowed funds at December 31, 2013 and 2012 are summarized as follows:

	At December 31,			
	2013		2012	
	Balance	Interest Rate	Balance	Interest Rate
	(Dollars in thousands)			
Unsecured line of credit	\$ —	—	2,750	4.75%
Short-term FHLB advances	10,000	0.36%	77,500	0.16%-.82%
Mortgage loan warehouse line of credit.....	—	—	1,932	2.5%-4.5%
Subordinated debenture, due 2020.....	300	2.70%	300	2.81%
Total short-term borrowed funds.....	\$ 10,300		82,482	

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 \$237.3 million of collateral for these advances. In addition, at December 31, 2013, the Company has pledged \$12.3 million of securities for these advances. At December 31, 2013, collateral totaling \$249.6 million was pledged to support FHLB advances. At December 31, 2013 the Company had FHLB advances of \$67.5 million outstanding with excess collateral pledged to the FHLB during those periods that would support additional borrowings of approximately \$88.6 million.

Lines of credit with the Federal Reserve Bank (“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 \$52.0 million of collateral to the FRB for these advances. At December 31, 2013 the Company had lines available with the FRB for \$38.7 million. At December 31, 2013 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 was still available. The facility was secured by Crescent Mortgage’s residential mortgage loans held for sale and other assets. During 2013, this credit line was paid in full and not renewed by the Company. Crescent Mortgage currently is self-funding its mortgage production.

Effective October 1, 2012, the Company modified a \$3.0 million unsecured line of credit with a correspondent bank, of which \$2.8 million was outstanding at December 31, 2012. During 2013, the unsecured credit line was paid in full and not renewed.

The Company has a subordinated debenture totaling \$1.9 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 \$19,000, and \$1.6 million during 2013, and 2012, respectively.

NOTE 10 – LONG-TERM DEBT

Long-term debt at December 31, 2013 and 2012 are summarized as follows:

	<u>December 31, 2013</u>	
	<u>Balance</u>	<u>Interest Rate</u>
	(Dollars in thousands)	
Long-term FHLB advances, due 2015 through 2021.....	\$ 57,500	0.42%-4.00%
Subordinated debentures, due 2016 through 2020.....	1,575	2.70%
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	3.29%
Total long-term debt.....	<u>\$ 74,540</u>	
	<u>December 31, 2012</u>	
	<u>Balance</u>	<u>Interest Rate</u>
	(Dollars in thousands)	
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.....	<u>\$ 64,840</u>	

As of December 31, 2013, the principal amounts due on long-term debt in 2014, 2015, 2016, 2017, 2018 and thereafter were \$0, \$7.8 million, \$10.3 million, \$5.3 million, \$5.3 million and \$45.8 million, respectively. As of December 31, 2013, there were no principal amounts callable by the FHLB on advances.

At December 31, 2013 and 2012, 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 3.29% to 3.75% at December 31, 2013 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 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 deferred these payments for nine quarters and had eleven quarters of deferral available. These as well as any future deferred distributions continue to accrue interest. Distributions on the trust preferred securities are cumulative. Therefore, in accordance with generally accepted accounting principles, the Company continued to accrue the monthly cost of the trust preferred securities as it has since issuance. The balance of deferred payments at December 31, 2012 was approximately \$1.2 million. During 2013, the Company cured all deferred payments and interest and resumed scheduled payments on the trust preferred securities.

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, 2013 and 2012, respectively. The Company had \$975,000 and \$7.3 million of long-term debt that qualified as Tier 2 capital at December 31, 2013 and 2012, respectively.

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, 2013 and 2012 consists of the following:

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Current income tax expense		
Federal	\$ 7,673	9,900
State	1,171	1,152
	<u>8,844</u>	<u>11,052</u>
Deferred income tax expense (benefit)		
Federal	754	(599)
State	(212)	(58)
	<u>542</u>	<u>(657)</u>
Total income tax expense	<u>\$ 9,386</u>	<u>10,395</u>

A reconciliation from expected Federal tax expense to actual income tax expense for the years ended December 31, 2013 and 2012 using the base federal tax rates of 35% follows:

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Computed federal income taxes.....	\$ 9,171	9,546
State income tax, net of federal benefit	623	757
Tax exempt interest.....	(305)	(47)
Other, net	(103)	139
Total income tax expense	<u>\$ 9,386</u>	<u>10,395</u>

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, 2013 and 2012:

	At December 31,	
	2013	2012
	(In thousands)	
Deferred tax assets:		
Loan loss reserve	\$ 2,810	3,499
Unrealized loss on securities available for sale	1,365	187
Tax vs. book gain on loans held for sale.....	—	803
Debt issuance costs.....	95	95
Net operating loss carryforwards.....	220	214
Reserve for mortgage repurchase losses.....	2,291	1,827
OREO write-downs	466	413
Stock based compensation.....	121	98
Reserve for miscellaneous losses.....	375	387
Other.....	716	35
	<u>8,459</u>	<u>7,558</u>
Valuation allowance	<u>(172)</u>	<u>(271)</u>
Total gross deferred tax assets	<u>8,287</u>	<u>7,287</u>
Deferred tax liabilities:		
Depreciation	(633)	(368)
Loan fees	(235)	(137)
Total gross deferred tax liabilities.....	<u>(868)</u>	<u>(505)</u>
Deferred tax assets, net	<u>\$ 7,419</u>	<u>6,782</u>

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 \$1.2 million and \$2.8 million, respectively, for the years ended December 31, 2013 and 2012, 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, 2013 and 2012, 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, 2013, and 2012 totaled \$653,000, and \$595,000, respectively.

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

Year 1	\$	604
Year 2		421
Year 3		353
Year 4		252
Year 5		252
After Year 5		265
Total.....	\$	<u>2,147</u>

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.

During 2012, the Company had disputes over employment agreements with two former executive officers. The Company incurred expenses related to the settlement of the disputed employment agreements of \$2.6 million and \$227,000 for the periods ended December 31, 2013 and 2012, respectively. All amounts related to the settlement of these agreements have expensed as of December 31, 2013.

NOTE 13 – SHARE-BASED COMPENSATION

Compensation cost is recognized for stock options and restricted stock awards issued to employees. Compensation cost is measured as the fair value of these awards on their date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used as the fair value of restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period for stock option awards and as the restriction period for restricted stock awards. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

As stated in Note 1, On January 15, 2014, the Board of Directors of the Company declared a two-for-one stock split to stockholders of record dated February 10, 2014, payable on February 28, 2014. All share, earnings per share, and per share data have been retroactively adjusted to reflect this stock split for all periods presented in accordance with generally accepted accounting principles.

The Company has adopted the 2002 Stock Option Plan under which an aggregate of 277,500 shares have been reserved for issuance by the Company upon the grant of stock options or limited rights, of which 11,160 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 Company adopted the 2006 Recognition and Retention Plan under which an aggregate of 120,000 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. No restricted common stock of the Company was granted during fiscal 2012 and 2013 from this plan. As of December 31, 2013, a total of 113,000 shares have been awarded under the plan, of which 107,800 shares have vested and 5,200 shares are unvested.

The Company has adopted a 2013 Equity Incentive Plan under which an aggregate of 500,000 shares of common stock have been reserved for issuance by the Company. The plan provides for the grant of stock options and restricted stock awards to our officers, employees, directors, advisors, and consultants. The options are granted at an exercise price at least equal to the fair value of the common stock at the date of grant and expire ten years from the date of the grant. The vesting period for both option grants and restricted stock grants will vary based on the timing of the grant. As of December 31, 2013 a total of 178,900 shares were issued as restricted stock and 52,054 as stock options.

The expense recognition of employee stock option and restricted stock awards resulted in net expense of approximately \$303,000, and \$86,000 during the twelve months ended December 31, 2013, and 2012, respectively.

Information regarding the 2013 grants as well as other relevant disclosure related to the share-based compensation plans of the Company is presented below.

Stock Options

Activity in the Company's stock option plans is summarized in the following table. All information has been retroactively adjusted for stock splits.

	At and For the Years Ended December 31,			
	2013		2012	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	16,480	\$ 11.65	280,960	7.82
Granted	52,054	10.00	—	—
Exercised	(4,320)	10.15	—	—
Forfeited or expired	(1,000)	(12.00)	(264,480)	(7.50)
Outstanding at end of year	63,214	\$ 10.40	16,480	11.65
Options exercisable at end of year	11,560	\$ 12.19	16,480	11.65

The aggregate intrinsic value of 63,214 and 16,480 stock options outstanding at December 31, 2013 and 2012 was \$346,000 and \$0, respectively.

Information pertaining to options outstanding at December 31, 2013, is as follows:

	At December 31, 2013				
	Options Outstanding			Options Exercisable	
Exercise Prices	Number Outstanding	Weighted Avg. Remaining Years Contractual Life	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
\$10.00	56,054	8.7	\$ 10.00	4,000	\$ 10.00
\$12.00	6,160	1.5	12.00	6,160	12.00
\$19.25	1,000	2.8	19.25	1,400	19.25
	63,214	7.9	\$ 10.34	11,560	\$ 12.19

At December 31, 2012

Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Avg. Remaining Years Contractual Life	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
\$10.00	8,000	1.3	\$ 10.00	8,000	\$ 10.00
\$12.00	7,080	2.5	12.00	7,080	12.00
\$19.25	1,400	3.8	19.25	1,400	19.25
	<u>16,480</u>	<u>2.0</u>	<u>\$ 11.65</u>	<u>16,480</u>	<u>\$ 11.65</u>

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting period. The following weighted-average assumptions were used in valuing options issued during 2013:

	<u>2013</u>
Dividend yield	0%
Expected life	6.5 years
Expected volatility	35%
Risk-free interest rate	1.04%

As of December 31, 2013, there was \$125,000 of total unrecognized compensation cost related to non-vested stock option grants under the plans. The cost is expected to be recognized over a weighted-average period of 1.3 years as of December 31, 2013. No options vested during the years end December 31, 2013 or 2012.

Restricted Stock

The Company from time-to-time also grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the stockholders of the Company by providing economic value directly related to increases in the value of the Company's stock. The value of the stock awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expense, equal to the total value of such awards, ratably over the vesting period of the stock grants.

All restricted stock agreements are conditioned upon continued employment. Termination of employment prior to a vesting date, as described below, would terminate any interest in non-vested shares. Prior to vesting of the shares, as long as employed by the Company, the key employees and non-employee directors will have the right to vote such shares and to receive dividends paid with respect to such shares. All restricted shares will fully vest in the event of change in control of the Company.

Nonvested restricted stock for the year ended December 31, 2013 is summarized in the following table. All information has been retroactively adjusted for stock splits.

Restricted stock	Shares	Weighted Average Grant-Date Fair Value
Nonvested at January 1	11,600	\$ 4.06
Granted	178,900	10.59
Vested	(10,300)	6.31
Forfeited.....	(6,000)	10.00
Nonvested at December 31	<u>174,200</u>	<u>\$ 10.58</u>

The vesting schedule of these shares as of December 31, 2013 is as follows:

	<u>Shares</u>
2014.....	37,900
2015.....	37,900
2016.....	35,300
2017.....	60,300
2018.....	2,800
Thereafter.....	—
	<u>174,200</u>

As of December 31, 2013, there was \$972,000 of total unrecognized compensation cost related to nonvested restricted stock granted under the plans. The cost is expected to be recognized over a weighted-average period of 3.39 years as of December 31, 2013. The total fair value of shares vested during the years ended December 31, 2013 and 2012 was approximately \$100,832 and \$0, respectively.

NOTE 14 – 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.

The Company determines the fair value of its financial instruments based on the fair value hierarchy established under ASC 820-10, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the financial instrument's fair value measurement in its entirety. There are three levels of inputs that may be used to measure fair value. The three levels of inputs of the valuation hierarchy are defined below:

- Level 1** Quoted prices (unadjusted) in active markets for identical assets and liabilities for the instrument or security to be valued. Level 1 assets include marketable equity securities as well as U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2** Observable inputs other than Level 1 quoted prices, such as quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active, or model-based valuation techniques for which all significant assumptions are derived principally from or corroborated by observable market data. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined by using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. U.S. Government sponsored agency securities, mortgage-backed securities issued by U.S. Government sponsored enterprises and agencies, obligations of states and municipalities, collateralized mortgage obligations issued by U.S. Government sponsored enterprises, and mortgage loans held-for-sale are generally included in this category. Certain private equity investments that invest in publicly traded companies are also considered Level 2 assets.

Level 3 Unobservable inputs that are supported by little, if any, market activity for the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow models and similar techniques, and may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability. These methods of valuation may result in a significant portion of the fair value being derived from unobservable assumptions that reflect The Company's own estimates for assumptions that market participants would use in pricing the asset or liability. This category primarily includes collateral-dependent impaired loans, other real estate, certain equity investments, and certain private equity investments.

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 approximates 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 approximates fair value.

Mortgage loans held for sale – Mortgage loans held for sale are recorded at either fair value, if elected, or the lower of cost or fair value on an individual loan basis. Origination fees and costs for loans held for sale recorded at lower of cost or market are capitalized in the basis of the loan and are included in the calculation of realized gains and losses upon sale. Origination fees and costs are recognized in earnings at the time of origination for loans held for sale that are recorded at fair value. Fair value is derived from observable current market prices, when available, and includes loan servicing value. When observable market prices are not available, the Company uses judgment and estimates fair value using internal models, in which the Company uses its best estimates of assumptions it believes would be used by market participants in estimating fair value. Mortgage loans held for sale are classified within Level 2 of the valuation hierarchy.

Loans receivable - For variable rate loans that reprice frequently and have no significant change in credit risk, estimated fair values are based on carrying values and are classified as Level 2. 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 and are classified as Level 2. 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 and are classified as Level 2. Estimated fair values on impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. 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, 2013 and 2012, substantially all of the total impaired loans were evaluated based on the fair value of the underlying collateral. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs.

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 asset and liabilities – The primary use of derivative instruments are related to the mortgage banking activities of the Company. The Company's wholesale mortgage banking subsidiary enters into interest rate lock commitments related to expected funding of residential mortgage loans at specified times in the future. Interest rate lock commitments that relate to the origination of mortgage loans that will be held-for-sale are considered derivative instruments under applicable accounting guidance. As such, The Company records its interest rate lock commitments and forward loan sales commitments at fair value, determined as the amount that would be required to settle each of these derivative financial instruments at the balance sheet date. In the normal course of business, the mortgage subsidiary enters into contractual interest rate lock commitments to extend credit, if approved, at a fixed interest rate and with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within the time frames established by the mortgage banking subsidiary. Market risk arises if interest rates move adversely between the time of the interest rate lock by the borrower and the sale date of the loan to an investor. To mitigate the effect of the interest rate risk inherent in providing interest rate lock commitments to borrowers, the mortgage banking subsidiary enters into best efforts forward sales contracts with third party investors. The forward sales contracts lock in a price for the sale of loans similar to the specific interest rate lock commitments. Both the interest rate lock commitments to the borrowers and the forward sales contracts to the investors that extend through to the date the loan may close are derivatives, and accordingly, are marked to fair value through earnings. In estimating the fair value of an interest rate lock commitment, the Company assigns a probability to the interest rate lock commitment based on an expectation that it will be exercised and the loan will be funded. The fair value of the interest rate lock commitment is derived from the fair value of related mortgage loans, which is based on observable market data and includes the expected net future cash flows related to servicing of the loans. The fair value of the interest rate lock commitment is also derived from inputs that include guarantee fees negotiated with the agencies and private investors, buy-up and buy-down values provided by the agencies and private investors, and interest rate spreads for the difference between retail and wholesale mortgage rates. Management also applies fall-out ratio assumptions for those interest rate lock commitments for which we do not close a mortgage loan. The fall-out ratio assumptions are based on the mortgage subsidiary's historical experience, conversion ratios for similar loan commitments, and market conditions. While fall-out tendencies are not exact predictions of which loans will or will not close, historical performance review of loan-level data provides the basis for determining the appropriate hedge ratios. In addition, on a periodic basis, the mortgage banking subsidiary performs analysis of actual rate lock fall-out experience to determine the sensitivity of the mortgage pipeline to interest rate changes from the date of the commitment through loan origination, and then period end, using applicable published mortgage-backed investment security prices. The expected fall-out ratios (or conversely the "pull-through" percentages) are applied to the determined fair value of the unclosed mortgage pipeline in accordance with GAAP. Changes to the fair value of interest rate lock commitments are recognized based on interest rate changes, changes in the probability that the commitment will be exercised, and the passage of time. The fair value of the forward sales contracts to investors considers the market price movement of the same type of security between the trade date and the balance sheet date. These instruments are defined as Level 2 within the valuation hierarchy.

Derivative instruments not related to mortgage banking activities, including financial futures commitments and interest rate swap agreements that do not satisfy the hedge accounting requirements are recorded at fair value and are classified with resultant changes in fair value being recognized in noninterest income in the consolidated statement of operations. Fair values for these instruments are based on quoted market prices, when available. As such, the fair value adjustments for derivatives with fair values based on quoted market prices are recurring Level 1.

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, 2013 and 2012 are as follows:

	At December 31, 2013				
	Carrying Amount	Fair Value			
		Total	Level 1	Level 2	Level 3
(In thousands)					
Financial assets:					
Cash and due from banks	\$ 4,489	4,489	4,489	—	—
Interest-bearing cash	34,176	34,176	34,176	—	—
Securities available for sale	167,535	167,535	—	167,535	—
Securities held to maturity	24,554	23,547	—	15,177	8,370
Federal Home Loan Bank stock	4,103	4,103	—	—	4,103
Other investments	1,858	1,858	—	—	1,858
Derivative assets	1,412	1,412	428	984	—
Loans held for sale	36,897	37,041	—	37,041	—
Loans receivable, net	535,221	524,142	—	497,045	27,097
Accrued interest receivable	2,802	2,802	—	2,802	—
Mortgage servicing rights	10,908	17,718	—	17,718	—
Financial liabilities:					
Deposits	697,581	696,674	—	696,674	—
Short-term borrowed funds	10,300	10,300	—	10,300	—
Long-term debt	74,540	71,462	—	71,462	—
Derivative liabilities	55	55	—	55	—
Accrued interest payable	311	311	—	311	—

	At December 31, 2012				
	Carrying Amount	Fair Value			
		Total	Level 1	Level 2	Level 3
(In thousands)					
Financial assets:					
Cash and due from banks	\$ 6,499	6,499	6,499	—	—
Interest-bearing cash	11,340	11,340	11,340	—	—
Securities available-for-sale	148,407	148,407	—	148,407	—
Securities held-to-maturity	9,166	5,549	—	—	5,549
Federal Home Loan Bank stock	6,413	6,413	—	—	6,413
Other investments	1,728	1,728	—	—	1,728
Derivative assets	6,542	6,542	—	6,542	—
Loans held for sale	144,849	149,151	—	149,151	—
Loans receivable, net	501,691	502,735	—	471,690	31,045
Accrued interest receivable	3,203	3,203	—	3,203	—
Mortgage servicing rights	12,039	18,165	—	18,165	—
Financial liabilities:					
Deposits	653,247	654,090	—	654,090	—
Short-term borrowed funds	82,482	82,480	—	82,480	—
Long-term debt	64,840	58,874	—	58,874	—
Derivative liabilities	—	—	—	—	—
Accrued interest payable	1,599	1,599	—	1,599	—

	At December 31,			
	2013		2012	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:		(In thousands)		
Commitments to extend credit	\$ 38,595	—	31,916	—
Standby letters of credit	526	—	396	—
Derivative assets:				
Mortgage loan interest rate lock commitments.....	—	—	289,584	4,783
Mortgage loan forward sales commitments....	20,516	106	59,177	1,692
Mortgage-backed securities forward sales commitments.....	88,000	878	308,000	67
Interest rate swaps	20,000	428	—	—
Derivative liabilities -				
Mortgage loan interest rate lock commitments.....	103,614	55	—	—

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.

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. At December 31, 2013 and 2012, the Company's investment securities available-for-sale are recurring Level 2.

Mortgage loans held for sale

Mortgage loans held for sale are recorded at either fair value, if elected, or the lower of cost or fair value on an individual loan basis. Origination fees and costs for loans held for sale recorded at lower of cost or market are capitalized in the basis of the loan and are included in the calculation of realized gains and losses upon sale. Origination fees and costs are recognized in earnings at the time of origination for loans held for sale that are recorded at fair value. Fair value is derived from observable current market prices, when available, and includes loan servicing value. When observable market prices are not available, the Company uses judgment and estimates fair value using internal models, in which the Company uses its best estimates of assumptions it believes would be used by market participants in estimating fair value. Mortgage loans held for sale are classified within Level 2 of the valuation hierarchy.

Brokered Deposit

Fair Value accounting was elected for a brokered deposit entered into during 2013 as part of the Company's interest rate risk management. Fair value of the brokered deposit is derived from quoted market prices. 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.

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, 2013, substantially all of the total impaired loans were evaluated based on the fair value of the underlying collateral. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs.

Derivative Assets and Liabilities

The primary use of derivative instruments is related to the mortgage banking activities of the Company. The Company's wholesale mortgage banking subsidiary enters into interest rate lock commitments related to expected funding of residential mortgage loans at specified times in the future. Interest rate lock commitments that relate to the origination of mortgage loans that will be held-for-sale are considered derivative instruments under applicable accounting guidance. As such, The Company records its interest rate lock commitments and forward loan sales commitments at fair value, determined as the amount that would be required to settle each of these derivative financial instruments at the balance sheet date. In the normal course of business, the mortgage subsidiary enters into contractual interest rate lock commitments to extend credit, if approved, at a fixed interest rate and with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within the time frames established by the mortgage banking subsidiary. Market risk arises if interest rates move adversely between the time of the interest rate lock by the borrower and the sale date of the loan to an investor. To mitigate the effect of the interest rate risk inherent in providing interest rate lock commitments to borrowers, the mortgage banking subsidiary enters into best efforts forward sales contracts with third party investors. The forward sales contracts lock in a price for the sale of loans similar to the specific interest rate lock commitments. Both the interest rate lock commitments to the borrowers and the forward sales contracts to the investors that extend through to the date the loan may close are derivatives, and accordingly, are marked to fair value through earnings. In estimating the fair value of an interest rate lock commitment, the Company assigns a probability to the interest rate lock commitment based on an expectation that it will be exercised and the loan will be funded. The fair value of the interest rate lock commitment is derived from the fair value of related mortgage loans, which is based on observable market data and includes the expected net future cash flows related to servicing of the loans. The fair value of the interest rate lock commitment is also derived from inputs that include guarantee fees negotiated with the agencies and private investors, buy-up and buy-down values provided by the agencies and private investors, and interest rate spreads for the difference between retail and wholesale mortgage rates. Management also applies fall-out ratio assumptions for those interest rate lock commitments for which we do not close a mortgage loan. The fall-out ratio assumptions are based on the mortgage subsidiary's historical experience, conversion ratios for similar loan commitments, and market conditions. While fall-out tendencies are not exact predictions of which loans will or will not close, historical performance review of loan-level data provides the basis for determining the appropriate hedge ratios. In addition, on a periodic basis, the mortgage banking subsidiary performs analysis of actual rate lock fall-out experience to determine the sensitivity of the mortgage pipeline to interest rate changes from the date of the commitment through loan origination, and then period end, using applicable published mortgage-backed investment security prices. The expected fall-out ratios (or conversely the "pull-through" percentages) are applied to the determined fair value of the unclosed mortgage pipeline in accordance with GAAP. Changes to the fair value of interest rate lock commitments are recognized based on interest rate changes, changes in the probability that the commitment will be exercised, and the passage of time. The fair value of the forward sales contracts to investors considers the market price movement of the same type of security between the trade date and the balance sheet date. These instruments are defined as Level 2 within the valuation hierarchy.

Derivative instruments not related to mortgage banking activities, including financial futures commitments and interest rate swap agreements that do not satisfy the hedge accounting requirements are recorded at fair value and are classified with resultant changes in fair value being recognized in noninterest income in the consolidated statement of operations. Fair values for these instruments are based on quoted market prices, when available. As such, the fair value adjustments for derivatives with fair values based on quoted market prices in an active market are recurring Level 1.

Other Real Estate Owned (OREO)

OREO is carried at the lower of carrying value or fair value on a non-recurring basis. Fair value is based upon independent appraisals or management's estimation of the collateral and is considered a Level 3 measurement. When the OREO value is based upon a current appraisal or when a current appraisal is not available or there is estimated further impairment, the measurement is considered a Level 3 measurement.

Assets and liabilities measured at fair value on a recurring basis are as follows as of December 31, 2013 and 2012:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
		(In thousands)	
December 31, 2013			
Available-for-sale investment securities:			
Municipal securities	\$ —	38,499	—
US government agencies	—	5,175	—
Mortgage-backed securities:			
Agency	—	69,929	—
Non-agency	—	53,932	—
Loans held for sale	—	37,041	—
Derivative assets:			
Mortgage loan interest rate lock commitments	—	—	—
Mortgage loan forward sales commitments	—	106	—
Mortgage-backed securities forward sales commitments	—	878	—
Interest rate swaps	428	—	—
Brokered deposits	—	4,948	—
Derivative liabilities:			
Mortgage loan interest rate lock commitments	—	55	—
Total	<u>\$ 428</u>	<u>210,563</u>	<u>—</u>
December 31, 2012			
Available-for-sale investment securities:			
Municipal securities	\$ —	17,769	—
US government agencies	—	—	—
Mortgage-backed securities:			
Agency	—	79,209	—
Non-agency	—	51,429	—
Loans held for sale	—	149,151	—
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	<u>\$ —</u>	<u>304,100</u>	<u>—</u>

Assets measured at fair value on a nonrecurring basis are as follows as of December 31, 2013 and 2012:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
		(In thousands)	
December 31, 2013			
Impaired loans:			
Loans secured by real estate:			
One-to-four family	\$ —	—	6,117
Home equity	—	—	125
Commercial real estate	—	—	16,953
Construction and development.....	—	—	1,328
Consumer loans	—	—	20
Commercial business loans.....	—	—	2,554
Real estate owned:			
One-to-four family.....	—	—	959
Commercial real estate	—	—	1,781
Construction and development	—	—	3,533
Total	\$ —	—	33,370

December 31, 2012

Impaired loans:

Loans secured by real estate:

One-to-four family	\$ —	—	7,080
Home equity	—	—	—
Commercial real estate	—	—	17,818
Construction and development.....	—	—	2,836
Consumer loans	—	—	49
Commercial business loans	—	—	3,262

Real estate owned:

One-to-four family.....	—	—	1,010
Commercial real estate	—	—	1,902
Construction and development	—	—	3,372
Total	\$ —	—	37,329

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.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2013 and December 31, 2012, the significant unobservable inputs used in the fair value measurements were as follows:

December 31, 2013 and 2012			
	Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired Loans	Appraisal Value	Appraisals and or sales of comparable properties	Appraisals discounted 10% to 20% for sales commissions and other holding costs
Real estate owned	Appraisal Value/ Comparison Sales/ Other estimates	Appraisals and or sales of comparable properties	Appraisals discounted 10% to 20% for sales commissions and other holding costs

NOTE 15 - 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, 2013 and 2012, the Company had commitments to extend credit in the amount of \$48.6 million and \$31.9 million, respectively. At December 31, 2013 and 2012, the Company had standby letters of credit in the amount of \$526,000 and \$396,000, 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, 2013, 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, 2013 was approximately \$526,000.

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, 2013 and 2012, the Company's outstanding mortgage interest rate lock commitments totaled \$103.6 and \$289.6 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 economically hedge a percentage of the Company's pipeline of mortgage loan interest rate lock commitments and loans held for sale. At December 31, 2013 and 2012, the Company's outstanding mortgage loan forward sales commitments totaled \$20.5 million and \$59.2 million, respectively. At December 31, 2013 and 2012, the Company's outstanding mortgage-backed securities forward sales commitments totaled \$88.0 million and \$308.0 million, respectively. The Company's derivative positions are marked to market as shown in Note 3 - Derivatives.

Derivative instruments not related to mortgage banking activities, including financial futures commitments and interest rate swap agreements that do not satisfy the hedge accounting requirements are recorded at fair value and are classified with resultant changes in fair value being recognized in noninterest income in the consolidated statement of operations. As of December 31, 2013, the Company's outstanding interest rate swap totaled \$20.0 million. The interest rate swap was entered into by the Company during 2013. As such, there was no amount outstanding for interest rate swaps during 2012. 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,	
	2013	2012
	(In thousands)	
Commercial real estate loans, excluding owner-occupied and unfunded commitments.....	\$ 190,934	174,680
Loans secured by owner-occupied commercial real estate.....	115,413	122,498
Unfunded commitments of commercial real estate.....	12,120	9,172
Total.....	\$ 318,467	306,350

NOTE 16 - 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 2013 and 2012, 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, 2013, and 2012, the Company made matching contributions of \$500,000 and \$461,000, 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, 2013 and 2012 is \$535,000 and \$813,000, 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. 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.

The Company incurred an aggregate premium of \$108,000 and \$133,000 paid on behalf of the executives for the period ended December 31, 2013 and 2012, respectively.

NOTE 17 - EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income 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 per share include the effects of outstanding stock options and restricted stock 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 and vesting were used to acquire shares of common stock at the average market price during the reporting period.

As stated in Note 1, on January 15, 2014, the Board of Directors of the Company declared a two-for-one stock split to stockholders of record dated February 10, 2014, payable on February 28, 2014. All share, earnings per share, and per share data have been retroactively adjusted to reflect this stock split for all periods presented in accordance with generally accepted accounting principles.

The following is a summary of the reconciliation of average shares outstanding for the years ended December 31, 2013 and 2012:

	December 31,			
	2013		2012	
	Basic	Diluted	Basic	Diluted
Weighted average shares outstanding	3,841,230	3,841,230	3,837,984	3,837,984
Effect of dilutive securities	—	119,017	—	—
Average shares outstanding	<u>3,841,230</u>	<u>3,960,247</u>	<u>3,837,984</u>	<u>3,837,984</u>

The average market price used in calculating the dilutive securities under the treasury stock method for the years ended December 31, 2013 and 2012 was \$13.15 and \$7.56, respectively. For the years ended December 31, 2013 and 2012, 71,274 and 16,480 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 were deemed not to be 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 18 - 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, 2013, 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 4%, 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, 2013, 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 as well as minimum amounts for each regulatory defined category for the Company and the Bank at December 31, 2013 and 2012 are as follows:

	<u>Actual</u>		<u>Required to be Categorized Adequately Capitalized</u>		<u>Required to be Categorized Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Dollars in thousands)						
December 31, 2013						
Carolina Financial Corporation						
Tier 1 capital (to risk weighted assets)	\$ 99,602	15.42%	25,834	4.00%	N/A	N/A
Total risk based capital (to risk weighted assets).....	108,650	16.82%	51,668	8.00%	N/A	N/A
Tier 1 capital (to total average assets)	99,602	11.15%	35,732	4.00%	N/A	N/A
CresCom Bank						
Tier 1 capital (to risk weighted assets)	98,301	15.26%	25,763	4.00%	38,645	6.00%
Total risk based capital (to risk weighted assets).....	107,327	16.66%	51,526	8.00%	64,408	10.00%
Tier 1 capital (to total average assets)	98,301	11.01%	35,706	4.00%	44,632	5.00%
December 31, 2012						
Carolina Financial Corporation						
Tier 1 capital (to risk weighted assets)	\$ 82,839	13.11%	25,266	4.00%	N/A	N/A
Total risk based capital (to risk weighted assets).....	98,030	15.52%	50,532	8.00%	N/A	N/A
Tier 1 capital (to total average assets)	82,839	9.65%	34,322	4.00%	N/A	N/A
CresCom Bank						
Tier 1 capital (to risk weighted assets)	85,537	13.57%	25,222	4.00%	37,833	6.00%
Total risk based capital (to risk weighted assets).....	100,714	15.97%	50,445	8.00%	63,056	10.00%
Tier 1 capital (to total average assets)	85,537	10.01%	34,171	4.00%	42,713	5.00%

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. 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.

On July 2, 2013, the Federal Reserve adopted a final rule for the Basel III capital framework and, on July 9, 2013, the OCC also adopted a final rule and the FDIC adopted the same provisions in the form of an “interim” final rule. The rule will apply to all national and state banks and savings associations and most bank holding companies and savings and loan holding companies, which we collectively refer to herein as “covered” banking organizations. Bank holding companies with less than \$500 million in total consolidated assets are not subject to the final rule, nor are savings and loan holding companies substantially engaged in commercial activities or insurance underwriting. In certain respects, the rule imposes more stringent requirements on “advanced approaches” banking organizations—those organizations with \$250 billion or more in total consolidated assets, \$10 billion or more in total foreign exposures, or that have opted in to the Basel II capital regime. The requirements in the rule will begin to phase on January 1, 2014, for advanced approaches banking organizations, and on January 1, 2015, for other covered banking organizations. The requirements in the rule will be fully phased in by January 1, 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.

During the year ended December 31, 2013, the Company paid dividend payments of \$401,000 to stockholders. There were no dividend payments in 2012.

NOTE 19 – SUPPLEMENTAL SEGMENT INFORMATION

The Company has three reportable segments: community banking, wholesale mortgage 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 generated 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, 2013 and 2012:

<u>For the Year Ended December 31, 2013</u>	<u>Community Banking</u>	<u>Mortgage Banking</u>	<u>Other</u>	<u>Eliminations</u>	<u>Total</u>
			(In thousands)		
Interest income.....	\$ 31,200	1,637	17	94	32,948
Interest expense	<u>4,965</u>	<u>84</u>	<u>675</u>	<u>(6)</u>	<u>5,718</u>
Net interest income (expense).....	26,235	1,553	(658)	100	27,230
Provision for loan losses	(900)	40	—	—	(860)
Noninterest income (expense) from external customers.....	2,678	41,332	76	—	44,086
Intersegment noninterest income	—	488	5,812	(6,300)	—
Noninterest expense.....	17,724	22,452	5,360	436	45,972
Intersegment noninterest expense	<u>4,853</u>	<u>1,037</u>	<u>—</u>	<u>(5,890)</u>	<u>—</u>
Income (loss) before income taxes	7,236	19,844	(130)	(746)	26,204
Income tax expense (benefit).....	<u>2,273</u>	<u>7,441</u>	<u>(219)</u>	<u>(109)</u>	<u>9,386</u>
Net income (loss).....	<u>\$ 4,963</u>	<u>12,403</u>	<u>89</u>	<u>(637)</u>	<u>16,818</u>
Assets.....	\$ 873,104	61,846	101,497	(154,863)	881,584
Loans receivable, net	532,616	3,374	—	(769)	535,221
Loans held for sale.....	753	36,144	—	—	36,897
Deposits	701,110	—	—	(3,529)	697,581
Borrowed funds	69,376	—	15,465	(1)	84,840
<u>For the Year Ended December 31, 2012</u>	<u>Community Banking</u>	<u>Mortgage Banking</u>	<u>Other</u>	<u>Eliminations</u>	<u>Total</u>
			(In thousands)		
Interest income.....	\$ 33,524	1,801	18	13	35,356
Interest expense	<u>6,377</u>	<u>397</u>	<u>748</u>	<u>(9)</u>	<u>7,513</u>
Net interest income (expense).....	27,147	1,404	(730)	22	27,843
Provision for loan losses	2,707	—	—	—	2,707
Noninterest income (expense) from external customers.....	(2,668)	56,133	59	—	53,524
Intersegment noninterest income	—	618	5,813	(6,431)	—
Noninterest expense.....	22,198	23,445	5,744	—	51,387
Intersegment noninterest expense	<u>4,853</u>	<u>1,099</u>	<u>—</u>	<u>(5,952)</u>	<u>—</u>
Income (loss) before income taxes	(5,279)	33,611	(602)	(457)	27,273
Income tax expense (benefit).....	<u>(1,869)</u>	<u>12,603</u>	<u>(183)</u>	<u>(156)</u>	<u>10,395</u>
Net income (loss).....	<u>\$ (3,410)</u>	<u>21,008</u>	<u>(419)</u>	<u>(301)</u>	<u>16,878</u>
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

NOTE 20 - 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,	
	2013	2012
	(In thousands)	
Assets:		
Cash and cash equivalents	\$ 334	439
Investment in bank subsidiary	95,928	85,213
Investment in non-bank subsidiaries.....	971	643
Investment in unconsolidated statutory business trusts	465	465
Securities available for sale	1	1
Other assets.....	165	213
Total assets	<u>\$ 97,864</u>	<u>86,974</u>
Liabilities and stockholders' equity:		
Accrued expenses and other liabilities.....	172	1,245
Short-term debt	—	2,750
Long-term debt	15,465	15,465
Stockholders' equity.....	82,227	67,514
Total liabilities and stockholders' equity	<u>\$ 97,864</u>	<u>86,974</u>

Carolina Financial Corporation Condensed Statements of Operations

	For the Years Ended December 31,	
	2013	2012
	(In thousands)	
Dividend income from non-bank subsidiaries	\$ —	150
Dividend income from banking subsidiary	4,400	—
Interest income.....	17	18
Total income.....	<u>4,417</u>	<u>168</u>
Interest expense	670	739
General and administrative expenses.....	435	451
Total expenses	<u>1,105</u>	<u>1,190</u>
Income (loss) before income taxes and equity in undistributed earnings of subsidiaries.....	3,312	(1,022)
Income tax benefit	(414)	(398)
Income (loss) before equity in undistributed earnings of subsidiaries.....	<u>3,726</u>	<u>(624)</u>
Equity in undistributed earnings of CresCom Bank	12,764	17,297
Equity in undistributed earnings of Carolina Services.....	328	205
Total equity in undistributed earnings of subsidiaries	<u>13,092</u>	<u>17,502</u>
Net income.....	<u>\$ 16,818</u>	<u>16,878</u>

Carolina Financial Corporation
Condensed Statements of Cash Flows

**For the Years
Ended December 31,**

	2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 16,818	16,878
Adjustments to reconcile net income to net cash provided by operating activities:.....		
Equity in undistributed earnings in subsidiaries	(13,092)	(17,502)
Stock-based compensation.....	303	86
Decrease in other assets	171	298
(Decrease) increase in other liabilities	(1,197)	504
Net cash provided by operating activities	3,003	264
Cash flows from financing activities:		
Principal repayment of short term debt	(2,750)	(200)
Proceeds from exercise of stock options	43	
Cash dividends paid on common stock	(401)	—
Net cash used in financing activities.....	(3,108)	(200)
Net increase (decrease) in cash and cash equivalents	(105)	64
Cash and cash equivalents, beginning of year	439	375
Cash and cash equivalents, end of year	\$ 334	439



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DOWNTOWN CHARLESTON

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Charleston, SC 29407

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James Island, SC 29412

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Mt. Pleasant, SC 29464

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Summerville, SC 29483

NORTH CHARLESTON

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North Charleston, SC 29420

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Myrtle Beach, SC 29577

NORTH MYRTLE BEACH

700 Main Street
N. Myrtle Beach, SC 29582

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Conway, SC 29526

GARDEN CITY

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Garden City, SC 29576

LITCHFIELD/PAWLEYS ISLAND

13021 Ocean Highway
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ST. GEORGE

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