FIRST COMMUNITY CORP /SC/
Form 10-K
March 21, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)
x **Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2013

Or

o **Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from to

Commission file number: 000-28344

First Community Corporation

(Exact name of registrant as specified in its charter)

South Carolina (State or other jurisdiction of incorporation or organization)	**57-1010751** (I.R.S. Employer Identification No.)
5455 Sunset Blvd., **Lexington, South Carolina** (Address of principal executive offices)	**29072** (Zip Code)

803-951-2265

Registrant’s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common stock, $1.00 par value per share	The NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes o No x

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

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

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

As of June 30, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $44,811,719 based on the closing sale price of $9.20 on June 30, 2013, as reported on The NASDAQ Capital Market. 6,610,487 shares of the issuer's common stock were issued and outstanding as of March 21, 2014.

Documents Incorporated by Reference

Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2014.	Part III (Portions of Items 10-14)

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CAUTIONARY STATEMENT REGARDING

FORWARD-LOOKING STATEMENTS

This report, including information included or incorporated by reference in this document, contains statements which constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may relate to, among other matters, the financial condition, results of operations, plans, objectives, future performance, and business of our Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words "may," "would," "could," "should," "will," "expect," "anticipate," "predict," "project," "potential," "continue," "as "intend," "plan," "forecast," "goal," and "estimate," as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitation, those described under the heading "Risk Factors" in this Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission (the "SEC") and the following:

- credit losses as a result of, among other potential factors, declining real estate values, increasing interest rates, increasing unemployment, or changes in payment behavior or other factors;
- the amount of our loan portfolio collateralized by real estate and weaknesses in the real estate market;
- restrictions or conditions imposed by our regulators on our operations;
- the adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;
- expected revenue synergies and cost savings from the acquisition of Savannah River Financial Corporation may not be fully realized;
- examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;
- reduced earnings due to higher other-than-temporary impairment charges resulting from additional decline in the value of our securities portfolio, specifically as a result of increasing default rates, and loss severities on the underlying real estate collateral;
- increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- general economic conditions resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in access to funding or increased regulatory requirements with regard to funding;
- increased cybersecurity risk, including potential business disruptions or financial losses;
- changes in deposit flows;
- changes in technology;
- our current and future products, services, applications and functionality and plans to promote them;

- changes in monetary and tax policies;
- changes in accounting policies and practices;
- the rate of delinquencies and amounts of loans charged-off;
- the rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;
- our ability to maintain appropriate levels of capital, including levels of capital required under the capital rules implementing Basel III;
- our ability to attract and retain key personnel;
- our ability to retain our existing clients, including our deposit relationships;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- loss of consumer confidence and economic disruptions resulting from terrorist activities; and
- other risks and uncertainties described under "Risk Factors" below.

Because of these and other risks and uncertainties, our actual future results may be materially different from the results indicated by any forward-looking statements. For additional information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A of this Annual Report on Form 10-K. In addition, our past results of operations do not necessarily indicate our future results. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We undertake no obligation to update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

All forward-looking statements in this report are based on information available to us as of the date of this report. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations will be achieved. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

PART I

Item 1. Business.

General

First Community Corporation (the "Company"), a bank holding company registered under the Bank Holding Company Act of 1956, as amended, was incorporated under the laws of South Carolina in 1994 primarily to own and control all of the capital stock of First Community Bank (the "Bank"), which commenced operations in August 1995. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions (the "S.C. Board").

On February 1, 2014, we completed our acquisition of Savannah River Financial Corporation ("Savannah River") and its wholly-owned subsidiary, Savannah River Banking Company. Under the terms of the Agreement and Plan of Merger, Savannah River shareholders received either $11.00 in cash or 1.0618 shares of the Company's common stock, or a combination thereof, for each Savannah River share they owned immediately prior to the merger, subject to the limitation that 60% of the outstanding shares of Savannah River common stock were exchanged for cash and 40% of the outstanding shares of Savannah River common stock were exchanged for shares of the Company's common stock. The Company issued 1,274,330 shares of common stock in the merger. This acquisition added two additional branches to our branch network, one located in Aiken, South Carolina and the other in Augusta, Georgia.

On October 1, 2004, we completed our acquisition of DutchFork Bancshares, Inc. and its wholly-owned subsidiary, Newberry Federal Savings Bank. During the second quarter of 2006, we completed our acquisition of DeKalb Bankshares, Inc., the holding company for The Bank of Camden. On September 15, 2008, we completed the acquisition of two financial planning and investment advisory firms, EAH Financial Group and Pooled Resources, LLC. The Bank expanded its residential mortgage business unit with the acquisition of the assets of Palmetto South Mortgage Corporation ("Palmetto South"), effective July 31, 2011. Palmetto South, which operates as a division of the Bank, offers mortgage loan products for home purchase or refinance in the South Carolina market area.

We engage in a commercial banking business from our main office in Lexington, South Carolina and our 13 full-service offices located in Lexington (two), Forest Acres, Irmo, Cayce-West Columbia, Gilbert, Chapin, Northeast Columbia, Prosperity, Newberry, Aiken, and Camden, South Carolina, and Augusta, Georgia. We offer a wide-range of traditional banking products and services for professionals and small-to medium-sized businesses, including consumer and commercial, mortgage, brokerage and investment, and insurance services. We also offer online banking to our customers.

Our stock trades on The NASDAQ Capital Market under the symbol “FCCO”.

Location and Service Area

The Bank is engaged in a general commercial and retail banking business, emphasizing the needs of small-to-medium sized businesses, professional concerns and individuals, primarily in Richland, Lexington, Kershaw and Newberry Counties of South Carolina and the surrounding areas.. These counties, which we refer to as the "Midlands" region of South Carolina, had an estimated aggregate population of 764,155 (July 2012 estimates based on survey changes to 2010 U.S. Census data) and total deposits of approximately $15.8 billion as of June 30, 2013 according to the most recent data published by the FDIC. Lexington County, which is home to six of our Bank's branch offices, had a population of 270,406 (according July 2012 estimates) and total deposits of $3.4 billion as of June 30, 2013. As of June 30, 2013, approximately $267 million, or 52.4%, of our total deposits were located in Lexington County. Richland County, in which we have two branches, is the largest county in South Carolina with a population of 393,830 (according July 2012 estimates) and total deposits of $11.3 billion as of June 30, 2013. Columbia, which is located within Richland County, is South Carolina's capital city and is geographically positioned in the center of the state between the industrialized Upstate region of South Carolina and the coastal city of Charleston. Intersected by three major interstate highways (I-20, I-77 and I-26), Columbia's strategic location has contributed greatly to its commercial appeal and growth. With the acquisition of Savannah River Financial Corporation we added a branch in Aiken South Carolian and a branch in Augusta, (Richmond County) Georgia. The three county area of Aiken (South Carolina), Richmond County (Georgia) and Columbia County (Georgia). This three county area we refer to as the Central Savannah River Area market (CSRA) had an aggregate estimated population of 497,026 (July 2012 estimates based on survey changes to 2010 U.S. Census data). Aiken County, which has one Bank branch offices, had a population of 162,812 (according July 2012 estimates) and total deposits of $1.9 billion as of June 30, 2013. The Augusta Branch located in Richmond County GA has a population of 202,587 (according to July 2012 estimates) and total deposits of $3.2 billion.

We believe that we serve attractive banking markets with long-term growth potential and a well educated employment base that helps to support our diverse and relatively stable local economy. According to 2010 U.S. Census Data, Aiken, Richmond (Georgia), Lexington, Richland, Kershaw and Newberry counties had median household incomes of $44,399, $38,952, $52,205, $47,922, $44,064 and $41,815, respectively, compared to $43,939 for South Carolina and 449,604 in Georgia as a whole. The principal components of the economy within our market areas are service industries, government and education, and wholesale and retail trade. The largest employers in Midlands market area, each of which employs in excess of 3,000 people, are Fort Jackson Army Post, the University of South Carolina, Palmetto Health Alliance, Blue Cross Blue Shield and Lexington Medical center. In addition, Amazon has built a distribution center that is expected to employ approximately 2,000 in our market area. The largest employers in our CSRA market area, each of which employs in excess of 3,000 people are, Fort Gordon Army Base, Georgia Regents University, Georgia Regents Health System, University Hospital and Savannah River Nuclear Solutions. The

Company believes that this diversified economic base has reduced, and will likely continue to reduce, economic volatility in our market areas. Our markets have experienced steady economic and population growth over the past 10 years, and we expect that the area, as well as the service industry needed to support it, will continue to grow.

Banking Services

We offer a full range of deposit services that are typically available in most banks and thrift institutions, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to our principal market area at rates competitive to those offered in the area. In addition, we offer certain retirement account services, such as Individual Retirement Accounts (“IRAs”). All deposit accounts are insured by the FDIC up to the maximum amount allowed by law (currently, $250,000, subject to aggregation rules).

We also offer a full range of commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and the purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. We also make real estate construction and acquisition loans. We originate fixed and variable rate mortgage loans, substantially all of which are sold into the secondary market. Our lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower’s relationship to the bank), in general, we are subject to a loans-to-one-borrower limit of an amount equal to 15% of the Bank’s unimpaired capital and surplus, or 25% of the unimpaired capital and surplus if the excess over 15% is approved by the board of directors of the Bank and is fully secured by readily marketable collateral. As a result, our lending limit will increase or decrease in response to increases or decreases in the Bank’s level of capital. Based upon the capitalization of the Bank at December 31, 2013, the maximum amount we could lend to one borrower is $10.3 million. In addition, we may not make any loans to any director, officer, employee, or 10% shareholder of the Company or the Bank unless the loan is approved by our board of directors and is made on terms not more favorable to such person than would be available to a person not affiliated with the Bank.

Other bank services include internet banking, cash management services, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, and automatic drafts for various accounts. We offer non-deposit investment products and other investment brokerage services through a registered representative with an affiliation through LPL Financial. We are associated with Jeannie, Star, and Plus networks of automated teller machines and MasterCard debit cards that may be used by our customers throughout South Carolina and other regions. We also offer VISA and MasterCard credit card services through a correspondent bank as our agent.

We currently do not exercise trust powers, but we can begin to do so with the prior approval of our primary banking regulators, the FDIC and the S.C. Board.

Competition

The banking business is highly competitive. We compete as a financial intermediary with other commercial banks, savings and loan associations, credit unions and money market mutual funds operating in Richland, Lexington, Kershaw and Newberry Counties and elsewhere. As of June 30, 2013, there were 25 financial institutions operating approximately 198 offices in Lexington, Richland, Kershaw and Newberry Counties. With the acquisition of Savannah River Financial Corporation we added a branch in Aiken, South Carolina and one in Augusta, Georgia. These two counties along with Columbia county which is contiguous to Richmond County make up the area we refer to as CSRA market. There are 21 financial institutions in this market operating 134 branches. The competition among the various financial institutions is based upon a variety of factors, including interest rates offered on deposit accounts, interest rates charged on loans, credit and service charges, the quality of services rendered, the convenience of banking facilities and, in the case of loans to large commercial borrowers, relative lending limits. Size gives larger banks certain advantages in competing for business from large corporations. These advantages include higher lending limits and the ability to offer services in other areas of South Carolina. As a result, we do not generally attempt to compete for the banking relationships of large corporations, but concentrate our efforts on small-to-medium sized businesses and individuals. We believe we have competed effectively in this market by offering quality and personal service. In addition, many of our non-bank competitors are not subject to the same extensive federal regulations that govern bank holding companies and federally insured banks.

Market Share

As of June 30, 2013, the most recent date for which market data is available, total deposits in the Bank's primary market area, Lexington, Richland, Kershaw and Newberry Counties, were over $15.8 billion. At June 30, 2013, our deposits represented 3.24% of the market. With the acquisition of Savannah River Financial Corporation we added a branch in Aiken, South Carolina and one in Augusta, Georgia (Richmond County). The CSRA market has total deposits of $7.6 billion and our branch deposits represent 1.71% of the market.

Employees

As of December 31, 2013, we had 171 full-time employees. We believe that our relations with our employees are good.

SUPERVISION AND REGULATION

Both the Company and the Bank are subject to extensive state and federal banking laws and regulations that impose specific requirements or restrictions on and provide for general regulatory oversight of virtually all aspects of our operations. These laws and regulations are generally intended to protect depositors, not shareholders. The following summary is qualified by reference to the statutory and regulatory provisions discussed. Changes in applicable laws or regulations may have a material effect on our business and prospects. Our operations may be affected by legislative changes and the policies of various regulatory authorities. We cannot predict the effect that fiscal or monetary policies, economic control, or new federal or state legislation may have on our business and earnings in the future.

We own 100% of the outstanding capital stock of the Bank, and, therefore, we are considered to be a bank holding company under the federal Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act"). As a result, we are primarily subject to the supervision, examination and reporting requirements of the Board of Governors of the Federal Reserve (the "Federal Reserve") under the Bank Holding Company Act and its regulations promulgated there under. Moreover, as a bank holding company of a bank located in South Carolina, we also are subject to the South Carolina Banking and Branching Efficiency Act.

Recent Legislative and Regulatory Developments. Markets in the U.S. and elsewhere experienced extreme volatility and disruption beginning in the latter half of 2007 that has continued since then. These circumstances have exerted significant downward pressure on prices of equity securities and virtually all other asset classes, and have resulted in substantially increased market volatility, severely constrained credit and capital markets, particularly for financial institutions, and has caused an overall loss of investor confidence. Loan portfolio performances have deteriorated at many institutions resulting from, among other factors, a weak economy and a decline in the value of the collateral supporting their loans. Dramatic slowdowns in the housing industry, due in part to falling home prices and increasing foreclosures and unemployment, have created strains on financial institutions. Many borrowers are now unable to repay their loans, and the collateral securing these loans has, in some cases, declined below the loan balance. In response to the challenges facing the financial services sector, the following regulatory and governmental actions have recently been enacted.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. On July 21, 2010, President Obama signed into law The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") which, among other things, changes the oversight and supervision of financial institutions, includes new minimum capital requirements, creates a new federal agency to regulate consumer financial products and services and implements changes to corporate governance and compensation practices. The Dodd-Frank Act is focused in large part on the financial services industry, particularly bank holding companies with consolidated assets of $50 billion or more, and contains a number of provisions that will affect us, including:

- Minimum Leverage and Risk-Based Capital Requirements. Under the Dodd-Frank Act, the appropriate federal banking agencies are required to establish minimum leverage and risk-based capital requirements on a consolidated basis for all insured depository institutions and bank holding companies, which can be no less than the currently applicable leverage and risk-based capital requirements for depository institutions. As a result, the Company and the Bank will be subject to at least the same capital requirements and must include the same components in regulatory capital.
- Deposit Insurance Modifications. The Dodd-Frank Act modifies the FDIC's assessment base upon which deposit insurance premiums are calculated. The new assessment base will equal our average total consolidated assets minus the sum of our average tangible equity during the assessment period. The Dodd-Frank Act also permanently raises the standard maximum insurance amount to $250,000.
- Creation of New Governmental Authorities. The Dodd-Frank Act creates various new governmental authorities such as the Financial Stability Oversight Council and the Consumer Financial Protection Bureau (the "CFPB"), an independent regulatory authority housed within the Federal Reserve. The CFPB has broad authority to regulate the offering and provision of consumer financial products. The CFPB officially came into being on July 21, 2011, and rulemaking authority for a range of consumer financial protection laws (such as the Truth in Lending Act, the Electronic Funds Transfer Act and the Real Estate Settlement Procedures Act, among others) transferred from the Federal Reserve and other federal regulators to the CFPB on that date. The Dodd-Frank Act gives the CFPB authority to supervise and examine depository institutions with more than $10 billion in assets for compliance with these federal consumer laws, although the authority to supervise and examine depository institutions with $10 billion or less in assets, such as the Bank, for compliance with federal consumer laws will remain largely with those institutions' primary regulators. However, the CFPB may participate in examinations of these smaller institutions on a "sampling basis" and may refer potential enforcement actions against such institutions to their primary regulators. The CFPB also has supervisory and examination authority over certain nonbank institutions that offer consumer financial products.

The Dodd-Frank Act identifies a number of covered nonbank institutions, and also authorizes the CFPB to identify additional institutions that will be subject to its jurisdiction. Accordingly, the CFPB may participate in examinations of the Bank, which currently has assets of less than $10 billion, and could supervise and examine our other direct or indirect subsidiaries that offer consumer financial products or services. In addition, the act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the CFPB, and state attorneys general are permitted to enforce consumer protection rules adopted by the CFPB against certain institutions.

The Dodd-Frank Act also authorized the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Under the Dodd-Frank Act, financial institutions may not make a residential mortgage loan unless they make a "reasonable and good faith determination" that the consumer has a "reasonable ability" to repay the loan. The act allows borrowers to raise certain defenses to foreclosure but provides a full or partial safe harbor from such defenses for loans that are "qualified mortgages." On January 10, 2013, the CFPB published final rules to, among other things, specify the types of income and assets that may be considered in the ability-to-repay determination, the permissible sources for verification, and the required methods of calculating the loan's monthly payments. Since then the CFPB made certain modifications to these rules. The rules extend the requirement that creditors verify and document a borrower's "income and assets" to include all "information" that creditors rely on in determining repayment ability. The rules also provide further examples of third-party documents that may be relied on for such verification, such as government records and check-cashing or funds-transfer service receipts. The new rules were effective beginning on January 10, 2014. The rules also define "qualified mortgages," imposing both underwriting standards - for example, a borrower's debt-to-income ratio may not exceed 43% - and limits on the terms of their loans. Points and fees are subject to a relatively stringent cap, and the terms include a wide array of payments that may be made in the course of closing a loan. Certain loans, including interest-only loans and negative amortization loans, cannot be qualified mortgages.

- Executive Compensation and Corporate Governance Requirements. The Dodd-Frank Act requires public companies to include, at least once every three years, a separate non-binding "say on pay" vote in their proxy statement by which shareholders may vote on the compensation of the company's named executive officers. In addition, if such companies are involved in a merger, acquisition, or consolidation, or if they propose to sell or dispose of all or substantially all of their assets, shareholders have a right to an advisory vote on any golden parachute arrangements in connection with such transaction (frequently referred to as "say-on-golden parachute" vote). Other provisions of the act may impact our corporate governance. For instance, the act requires the SEC to adopt rules:

  - prohibiting the listing of any equity security of a company that does not have an independent compensation committee; and
  - requiring all exchange-traded companies to adopt clawback policies for incentive compensation paid to executive officers in the event of accounting restatements based on material non-compliance with financial reporting requirements.

The Dodd-Frank Act also authorizes the SEC to issue rules allowing shareholders to include their own nominations for directors in a company's proxy solicitation materials. Many provisions of the act require the adoption of additional rules to implement the changes. In addition, the act mandates multiple studies that could result in additional legislative action. Governmental intervention and new regulations under these programs could materially and adversely affect our business, financial condition and results of operations.

Basel Capital Standards. In December 2010, the Basel Committee on Banking Supervision, an international forum for cooperation on banking supervisory matters, announced the "Basel III" capital standards, which substantially revised the existing recommended capital requirements for banking organizations. Modest revisions were made in June 2011. The Basel III standards operate in conjunction with portions of standards previously released by the Basel Committee and commonly known as "Basel II" and "Basel 2.5." On June 7, 2012, the Federal Reserve, the Office of the Comptroller of the Currency (the "OCC"), and the FDIC requested comment on these proposed rules that, taken together, would implement the Basel regulatory capital reforms through what we refer to herein as the "Basel III capital framework."

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. The requirements in the rule begin to phase in on January 1, 2015 for covered banking organizations such as the Company. The requirements in the rule will be fully phased in by January 1, 2019.

The rule imposes higher risk-based capital and leverage requirements than those currently in place. Specifically, the rule imposes the following minimum capital requirements:

- a new common equity Tier 1 risk-based capital ratio of 4.5%;

- a Tier 1 risk-based capital ratio of 6% (increased from the current 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from current requirements); and
- a leverage ratio of 4% (currently 3% for depository institutions with the highest supervisory composite rating and 4% for other depository institutions).

Under the rule, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as non-cumulative perpetual preferred stock. The rule permits bank holding companies with less than $15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a “capital conservation buffer” on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets.

The current capital rules require certain deductions from or adjustments to capital. The final rule retains many of these deductions and adjustments and also provides for new ones. As a result, deductions from Common Equity Tier 1 capital will be required for goodwill (net of associated deferred tax liabilities); intangible assets such as non-mortgage servicing assets and purchased credit card relationships (net of associated deferred tax liabilities); deferred tax assets that arise from net operating loss and tax credit carryforwards (net of any related valuations allowances and net of deferred tax liabilities); any gain on sale in connection with a securitization exposure; any defined benefit pension fund net asset (net of any associated deferred tax liabilities) held by a bank holding company (this provision does not apply to a bank or savings association); the aggregate amount of outstanding equity investments (including retained earnings) in financial subsidiaries; and identified losses. Other deductions will be necessary from different levels of capital.

Additionally, the final rule provides for the deduction of three categories of assets: (i) deferred tax assets arising from temporary differences that cannot be realized through net operating loss carrybacks (net of related valuation allowances and of deferred tax liabilities), (ii) mortgage servicing assets (net of associated deferred tax liabilities) and (iii) investments in more than 10% of the issued and outstanding common stock of unconsolidated financial institutions (net of associated deferred tax liabilities). The amount in each category that exceeds 10% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. The remaining, non-deducted amounts are then aggregated, and the amount by which this total amount exceeds 15% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. Amounts of minority investments in consolidated subsidiaries that exceed certain limits and investments in unconsolidated financial institutions may also have to be deducted from the category of capital to which such instruments belong.

Accumulated other comprehensive income (AOCI) is presumptively included in Common Equity Tier 1 capital and could operate to reduce this category of capital. The final rule provides a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. The final rule also has the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

The ultimate impact of the rule on the Company and the Bank is currently being reviewed and is dependent upon when certain requirements of the rule will be fully phased in. While the rule contains several provisions that would affect the mortgage lending business, at this point we cannot determine the ultimate effect that the rule will have upon our earnings or financial position.

Volcker Rule. Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” prohibits any bank, bank holding company, or affiliate (referred to collectively as “banking entities”) from engaging in two types of activities: “proprietary trading” and the ownership or sponsorship of private equity or hedge funds that are referred to as “covered funds.” On December 10, 2013, our primary federal regulators, the Federal Reserve and the FDIC, together with other federal banking agencies and the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule. The deadline for compliance with the Volcker Rule is July 21, 2015.

Proprietary trading includes the purchase or sale as principal of any security, derivative, commodity future, or option on any such instrument for the purpose of benefitting from short-term price movements or realizing short-term profits. Exceptions apply, however. Trading in U.S. Treasuries, obligations or other instruments issued by a government sponsored enterprise, state or municipal obligations, or obligations of the FDIC is permitted. A banking entity also may trade for the purpose of managing its liquidity, provided that it has a bona fide liquidity management plan. Trading activities as agent, broker or custodian; through a deferred compensation or pension plan; as trustee or fiduciary on behalf of customers; in order to satisfy a debt previously contracted; or in repurchase and securities lending agreements are permitted. Additionally, the Volcker Rule permits banking entities to engage in trading that takes the form of risk-mitigating hedging activities.

The covered funds that a banking entity may not sponsor or hold on ownership interest in are, with certain exceptions, funds that are exempt from registration under the Investment Company Act of 1940 because they either have 100 or fewer investors or are owned exclusively by “qualified investors” (generally, high net worth individuals or entities). Wholly owned subsidiaries, joint ventures and acquisition vehicles, foreign pension or retirement funds, insurance company separate accounts (including bank-owned life insurance), public welfare investment funds, and entities formed by the FDIC for the purpose of disposing of assets are not covered funds, and a bank may invest in them. Most securitizations also are not treated as covered funds.

The regulation as issued on December 10, 2013, treated collateralized debt obligations backed by trust preferred securities as covered funds and accordingly subject to divestiture. In an interim final rule issued on January 14, 2014, the agencies exempted collateralized debt obligations (“CDOs”) issued before May 19, 2010, that were backed by trust preferred securities issued before the same date by a bank with total consolidated assets of less than $15 billion or by a mutual holding company and that the bank holding the CDO interest had purchased before December 10, 2013, from the Volcker Rule prohibition. This exemption does not extend to CDOs backed by trust-preferred securities issued by an insurance company.

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

Permitted Activities. Under the Bank Holding Company Act, a bank holding company is generally permitted to engage in, or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in, the following activities:

- banking or managing or controlling banks;

- furnishing services to or performing services for our subsidiaries; and

- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking.

Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

- factoring accounts receivable;
- making, acquiring, brokering or servicing loans and usual related activities;
- leasing personal or real property;

- operating a non-bank depository institution, such as a savings association;
- trust company functions;
- financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- performing selected insurance underwriting activities.

As a bank holding company, we also can elect to be treated as a "financial holding company," which would allow us to engage in a broader array of activities. In sum, a financial holding company can engage in activities that are financial in nature or incidental or complimentary to financial activities, including insurance underwriting, sales and brokerage activities, providing financial and investment advisory services, underwriting services and limited merchant banking activities. We have not sought financial holding company status, but may elect such status in the future as our business matures. If we were to elect in writing for financial holding company status, each insured depository institution we control would have to be well capitalized, well managed and have at least a satisfactory rating under the Community Reinvestment Act ("CRA") (discussed below).

The Federal Reserve has the authority to order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness or stability of it or any of its bank subsidiaries.

Change in Control. In addition, and subject to certain exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with regulations promulgated thereunder, require Federal Reserve approval prior to any person or company acquiring "control" of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control will be rebuttably presumed to exist if a person acquires more than 33% of the total equity of a bank or bank holding company, of which it may own, control or have the power to vote not more than 15% of any class of voting securities.

Source of Strength. There are a number of obligations and restrictions imposed by law and regulatory policy on bank holding companies with regard to their depository institution subsidiaries that are designed to minimize potential loss to depositors and to the FDIC insurance funds in the event that the depository institution becomes in danger of defaulting under its obligations to repay deposits. Under a policy of the Federal Reserve, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), to avoid receivership of its insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become “undercapitalized” within the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency up to the lesser of (i) an amount equal to 5% of the institution’s total assets at the time the institution became undercapitalized, or (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan.

The Federal Reserve also has the authority under the Bank Holding Company Act to require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve's determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal law grants federal bank regulatory authorities’ additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition.

In addition, the "cross guarantee" provisions of the Federal Deposit Insurance Act ("FDIA") require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated by the FDIC as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. The FDIC's claim for damages is superior to claims of shareholders of the insured depository institution or its holding company, but is subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institutions.

The FDIA also provides that amounts received from the liquidation or other resolution of any insured depository institution by any receiver must be distributed (after payment of secured claims) to pay the deposit liabilities of the institution prior to payment of any other general or unsecured senior liability, subordinated liability, general creditor or shareholder. This provision would give depositors a preference over general and subordinated creditors and shareholders in the event a receiver is appointed to distribute the assets of our Bank.

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Capital Requirements. The Federal Reserve imposes certain capital requirements on the bank holding company under the Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of "qualifying" capital to risk-weighted assets. These requirements are essentially the same as those that apply to the Bank and are described below under "First Community Bank—Capital Regulations." Subject to our capital requirements and certain other restrictions, we are able to borrow money to make a capital contribution to the Bank, and these loans may be repaid from dividends paid from the Bank to the Company. Our ability to pay dividends depends on, among other things, the Bank's ability to pay dividends to us, which is subject to regulatory restrictions as described below in "First Community Bank—Dividends." We are also able to raise capital for contribution to the Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

Dividends. Since the Company is a bank holding company, its ability to declare and pay dividends is dependent on certain federal and state regulatory considerations, including the guidelines of the Federal Reserve. The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. The Federal Reserve's policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

In addition, since the Company is legal entity separate and distinct from the Bank and does not conduct stand-alone operations, its ability to pay dividends depends on the ability of the Bank to pay dividends to it, which is also subject to regulatory restrictions as described below in "First Community Bank – Dividends."

South Carolina State Regulation. As a South Carolina bank holding company under the South Carolina Banking and Branching Efficiency Act, we are subject to limitations on sale or merger and to regulation by the S.C. Board. We are not required to obtain the approval of the S.C. Board prior to acquiring the capital stock of a national bank, but we must notify them at least 15 days prior to doing so. We must receive the S.C. Board's approval prior to engaging in the acquisition of a South Carolina state chartered bank or another South Carolina bank holding company.

First Community Bank

On October 1, 2012, the Bank converted from a national bank charter to a South Carolina state bank charter and the bank name was changed from First Community Bank, NA to First Community Bank. Subsequent to the conversion to a state bank charter, the Bank's primary federal regulator is the FDIC. In addition, the Bank is regulated and examined by the S.C. Board. Deposits in the Bank are insured by the FDIC up to a maximum amount of $250,000, pursuant to the provisions of the Dodd-Frank Act. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. In addition, the FDIC provided unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts through December 31, 2012 through the Transaction Account Guarantee program. The Transaction Account Guarantee program expired as of January 1, 2013 and these accounts are now insured up to the maximum $250,000 noted above.

The S.C. Board and the FDIC regulate or monitor virtually all areas of the Bank's operations, including:

- security devices and procedures;
- adequacy of capitalization and loss reserves;
- loans;
- investments;
- borrowings;
- deposits;
- mergers;
- issuances of securities;
- payment of dividends;
- interest rates payable on deposits;
- interest rates or fees chargeable on loans;
- establishment of branches;
- corporate reorganizations;
- maintenance of books and records; and
- adequacy of staff training to carry on safe lending and deposit gathering practices.

The FDIC requires that the Bank maintain specified capital ratios of capital to assets and imposes limitations on the Bank's aggregate investment in real estate, bank premises, and furniture and fixtures. Two categories of regulatory capital are used in calculating these ratios—Tier 1 capital and total capital. Tier 1 capital generally includes common equity, retained earnings, a limited amount of qualifying preferred stock, and qualifying minority interests in consolidated subsidiaries, reduced by goodwill and certain other intangible assets, such as core deposit intangibles, and certain other assets. Total capital generally consists of Tier 1 capital plus Tier 2 capital, which includes the allowance for loan losses, preferred stock that did not qualify as Tier 1 capital, certain types of subordinated debt and a limited amount of other items.

The Bank is required to calculate three ratios: the ratio of Tier 1 capital to risk-weighted assets, the ratio of total capital to risk-weighted assets, and the "leverage ratio," which is the ratio of Tier 1 capital to assets on a non-risk-adjusted basis. For the two ratios of capital to risk-weighted assets, certain assets, such as cash and U.S. Treasury securities, have a zero risk weighting. Others, such as commercial and consumer loans, have a 100% risk weighting. Some assets, notably purchase- money loans secured by first-liens on residential real property, are risk-weighted at 50%. Assets also include amounts that represent the potential funding of off-balance sheet obligations such as loan commitments and letters of credit. These potential assets are assigned to risk categories in the same manner as funded assets. The total assets in each category are multiplied by the appropriate risk weighting to determine risk-adjusted assets for the capital calculations.

The minimum capital ratios for both the Company and the Bank are generally 8% for total capital, 4% for Tier 1 capital and 4% for leverage. To be eligible to be classified as “well capitalized,” the Bank must generally maintain a total capital ratio of 10% or more, a Tier 1 capital ratio of 6% or more, and a leverage ratio of 5% or more. Certain implications of the regulatory capital classification system are discussed in greater detail below.

Prompt Corrective Action. The FDICIA established a "prompt corrective action" program in which every bank is placed in one of five regulatory categories, depending primarily on its regulatory capital levels. The FDIC and the other federal banking regulators are permitted to take increasingly severe action as a bank's capital position or financial condition declines below the "Adequately Capitalized" level described below. Regulators are also empowered to place in receivership or require the sale of a bank to another depository institution when a bank's leverage ratio reaches two percent. Better capitalized institutions are generally subject to less onerous regulation and supervision than banks with lesser amounts of capital. The FDIC's regulations set forth five capital categories, each with specific regulatory consequences. The categories are:

- Well Capitalized—The institution exceeds the required minimum level for each relevant capital measure. A well capitalized institution is one (i) having a total capital ratio of 10% or greater, (ii) having a Tier 1 capital ratio of 6% or greater, (iii) having a leverage capital ratio of 5% or greater and (iv) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.

- Adequately Capitalized—The institution meets the required minimum level for each relevant capital measure. No capital distribution may be made that would result in the institution becoming undercapitalized. An adequately capitalized institution is one (i) having a total capital ratio of 8% or greater, (ii) having a Tier 1 capital ratio of 4% or greater and (iii) having a leverage capital ratio of 4% or greater or a leverage capital ratio of 3% or greater if the institution is rated composite 1 under the CAMELS (Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk) rating system.

- Undercapitalized—The institution fails to meet the required minimum level for any relevant capital measure. An undercapitalized institution is one (i) having a total capital ratio of less than 8% or (ii) having a Tier 1 capital ratio of less than 4% or (iii) having a leverage capital ratio of less than 4%, or if the institution is rated a composite 1 under the CAMEL rating system, a leverage capital ratio of less than 3%.

- Significantly Undercapitalized—The institution is significantly below the required minimum level for any relevant capital measure. A significantly undercapitalized institution is one (i) having a total capital ratio of less than 6% or (ii) having a Tier 1 capital ratio of less than 3% or (iii) having a leverage capital ratio of less than 3%.

- Critically Undercapitalized—The institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2%.

If the FDIC determines, after notice and an opportunity for hearing, that the bank is in an unsafe or unsound condition, the regulator is authorized to reclassify the bank to the next lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition.

If a bank is not well capitalized, it cannot accept brokered deposits without prior regulatory approval. In addition, a bank that is not well capitalized cannot offer an effective yield in excess of 75 basis points over interest paid on deposits of comparable size and maturity in such institution's normal market area for deposits accepted from within its normal market area, or national rate paid on deposits of comparable size and maturity for deposits accepted outside the bank's normal market area. Moreover, the FDIC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be categorized as undercapitalized. Undercapitalized institutions are subject to growth limitations (an undercapitalized institution may not acquire another institution, establish additional branch offices or engage in any new line of business unless determined by the appropriate federal banking agency to be consistent with an accepted capital restoration plan, or unless the FDIC determines that the proposed action will further the purpose of prompt corrective action) and are required to submit a capital restoration plan. The agencies may not accept a capital restoration plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with the capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of an amount equal to 5.0% of the depository institution's total assets at the time it became categorized as undercapitalized or the amount that is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is categorized as significantly undercapitalized.

Significantly undercapitalized categorized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become categorized as adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. The appropriate federal banking agency may take any action authorized for a significantly undercapitalized institution if an undercapitalized institution fails to submit an acceptable capital restoration plan or fails in any material respect to implement a plan accepted by the agency. A critically undercapitalized institution is subject to having a receiver or conservator appointed to manage its affairs and for loss of its charter to conduct banking activities.

An insured depository institution may not pay a management fee to a bank holding company controlling that institution or any other person having control of the institution if, after making the payment, the institution, would be undercapitalized. In addition, an institution cannot make a capital distribution, such as a dividend or other distribution that is in substance a distribution of capital to the owners of the institution if following such a distribution the institution would be undercapitalized. Thus, if payment of such a management fee or the making of such would cause a bank to become undercapitalized, it could not pay a management fee or dividend to the bank holding company.

As of December 31, 2013, the Bank was deemed to be "well capitalized."

As further described under "*Recent Legislative and Regulatory Initiatives to Address the Financial and Economic Crises – Basel Capital Standards*," the Basel Committee released in June 2011 a revised framework for the regulation of capital and liquidity of internationally active banking organizations. The new framework is generally referred to as "Basel III". As discussed above, when full phased in, Basel III will require certain bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. On July 7, 2013, the Federal Reserve adopted a final rule implementing the Basel III standards and complementary parts of Basel II and Basel 2.5. 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.

Standards for Safety and Soundness. The Federal Deposit Insurance Act also requires the federal banking regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset growth. The agencies also must prescribe standards for asset quality, earnings, and stock valuation, as well as standards for compensation, fees and benefits. The federal banking agencies have adopted regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness to implement these required standards. These guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Under the regulations, if the FDIC determines that the Bank fails to meet any standards prescribed by the guidelines, the agency may require the Bank to submit to the agency an acceptable plan to achieve compliance with the standard, as required by the FDIC. The final regulations establish deadlines for the submission and review of such safety and soundness compliance plans.

Regulatory Examination. The FDIC also requires the Bank to prepare annual reports on the Bank's financial condition and to conduct an annual audit of its financial affairs in compliance with its minimum standards and procedures.

All insured institutions must undergo regular on-site examinations by their appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the appropriate federal banking agency against each institution or affiliate as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC, their federal regulatory agency, and state supervisor when applicable. The FDIC has developed a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition or any other report of any insured depository institution. The federal banking regulatory agencies prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to the following:

- internal controls;
- information systems and audit systems;
- loan documentation;
- credit underwriting;

- interest rate risk exposure; and
- asset quality.

Transactions with Affiliates and Insiders. The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. Various legal limitations restrict the Bank from lending or otherwise supplying funds to the Company or its non-bank subsidiaries. The Company and the Bank are subject to Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Board Regulation W.

Section 23A of the Federal Reserve Act places limits on the amount of loans or extensions of credit to, or investments in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of the Bank's capital and surplus. Furthermore, within the foregoing limitations as to amount, each covered transaction must meet specified collateral requirements. The Bank is forbidden to purchase low quality assets from an affiliate.

The Dodd-Frank Act expanded the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act will apply Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transaction that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The current exemption from Section 23A for transactions with financial subsidiaries will be eliminated. The Dodd Frank Act will additionally prohibit an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

Section 23B of the Federal Reserve Act, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve decides to treat these subsidiaries as affiliates. The regulation also limits the amount of loans that can be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unrelated third parties and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Dividends. The Company's principal source of cash flow, including cash flow to pay dividends to its shareholders, is dividends it receives from the Bank. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the S.C. Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the S.C. Board. The FDIC also has the authority under federal law to enjoin a bank from engaging in what in its opinion constitutes an unsafe or unsound practice in conducting its business, including the payment of a dividend under certain circumstances.

Branching. Under current South Carolina law, the Bank may open branch offices throughout South Carolina with the prior approval of the S.C. Board. In addition, with prior regulatory approval, the Bank is able to acquire existing banking operations in South Carolina. Furthermore, federal legislation permits interstate branching, including out-of-state acquisitions by bank holding companies, interstate branching by banks, and interstate merging by banks. The Dodd-Frank Act removes previous state law restrictions on de novo interstate branching in states such as South Carolina. This change permits out-of-state banks to open de novo branches in states where the laws of the state where the de novo branch to be opened would permit a bank chartered by that state to open a de novo branch.

Anti-Tying Restrictions. Under amendments to the Bank Holding Company Act and Federal Reserve regulations, a bank is prohibited from engaging in certain tying or reciprocity arrangements with its customers. In general, a bank may not extend credit, lease, sell property, or furnish any services or fix or vary the consideration for these on the condition that (i) the customer obtain or provide some additional credit, property, or services from or to the bank, the bank holding company or subsidiaries thereof or (ii) the customer may not obtain some other credit, property, or services from a competitor, except to the extent reasonable conditions are imposed to assure the soundness of the credit extended. Certain arrangements are permissible: a bank may offer combined-balance products and may otherwise offer more favorable terms if a customer obtains two or more traditional bank products; and certain foreign transactions are exempt from the general rule. A bank holding company or any bank affiliate also is subject to anti-tying requirements in connection with electronic benefit transfer services.

Community Reinvestment Act. The CRA requires that the FDIC evaluate the record of the Bank in meeting the credit needs of its local community, including low and moderate income neighborhoods. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on our Bank.

The Gramm-Leach-Bliley Act (the “GLBA”) made various changes to the CRA. Among other changes, CRA agreements with private parties must be disclosed and annual CRA reports must be made available to a bank’s primary federal regulator. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the GLBA may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a satisfactory CRA rating in its latest CRA examination.

Financial Subsidiaries. Under the GLBA, subject to certain conditions imposed by their respective banking regulators, national and state-chartered banks are permitted to form “financial subsidiaries” that may conduct financial or incidental activities, thereby permitting bank subsidiaries to engage in certain activities that previously were impermissible. The GLBA imposes several safeguards and restrictions on financial subsidiaries, including that the parent bank’s equity investment in the financial subsidiary be deducted from the bank’s assets and tangible equity for purposes of calculating the bank’s capital adequacy. In addition, the GLBA imposes new restrictions on transactions between a bank and its financial subsidiaries similar to restrictions applicable to transactions between banks and non-bank affiliates.

Consumer Protection Regulations. Activities of the Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank’s loan operations are also subject to federal laws applicable to credit transactions, such as:

- the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and

• the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations of the Bank also are subject to:

• the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and

• the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that Act, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Enforcement Powers. The Bank and its "institution-affiliated parties," including its management, employee's agent's independent contractors and consultants, such as attorneys and accountants, and others who participate in the conduct of the financial institution's affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a government agency. These practices can include the failure of an institution to timely file required reports or the filing of false or misleading information or the submission of inaccurate reports. Civil penalties may be as high as $1,000,000 a day for such violations. Criminal penalties for some financial institution crimes have been increased to twenty years. In addition, regulators are provided with greater flexibility to commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance. Furthermore, banking agencies' powers to issue cease-and-desist orders have been expanded. Such orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

Anti-Money Laundering. Financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. The Company and the Bank are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and "knowing your customer" in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and recent laws provide law enforcement authorities with increased access to financial information maintained by banks. Anti-money laundering obligations have been substantially strengthened as a result of the USA Patriot Act, enacted in 2001 and renewed in 2006. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications. The regulatory authorities have been active in imposing cease and desist orders and money penalty sanctions against institutions found to be violating these obligations.

USA PATRIOT Act/Bank Secrecy Act. Financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. The USA PATRIOT Act, amended, in part, the Bank Secrecy Act and provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering by enhancing anti-money laundering and financial transparency laws, as well as enhanced information collection tools and enforcement mechanics for the U.S. government, including: (i) requiring standards for verifying customer identification at account opening; (ii) rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (iii) reports by nonfinancial trades and businesses filed with the U.S. Treasury Department's Financial Crimes Enforcement Network for transactions exceeding $10,000; and (iv) filing suspicious activities reports if a bank believes a customer may be violating U.S. laws and regulations and requires enhanced due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications.

Under the USA PATRIOT Act, the Federal Bureau of Investigation ("FBI") can send to the banking regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. The Bank can be requested, to search its records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report and contact the FBI.

The Office of Foreign Assets Control ("OFAC"), which is a division of the U.S. Department of the Treasury (the "Treasury"), is responsible for helping to insure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Privacy and Credit Reporting. Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers. It is the Bank's policy not to disclose any personal information unless required by law. The OCC and the federal banking agencies have prescribed standards for maintaining the security and confidentiality of consumer information. The Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach.

Like other lending institutions, the Bank utilizes credit bureau data in its underwriting activities. Use of such data is regulated under the Federal Credit Reporting Act on a uniform, nationwide basis, including credit reporting, prescreening, sharing of information between affiliates, and the use of credit data. The Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act") permits states to enact identity theft laws that are not inconsistent with the conduct required by the provisions of the FACT Act.

Check 21. The Check Clearing for the 21st Century Act gives "substitute checks," such as a digital image of a check and copies made from that image, the same legal standing as the original paper check. Some of the major provisions include:

- allowing check truncation without making it mandatory;

- demanding that every financial institution communicate to accountholders in writing a description of its substitute check processing program and their rights under the law;

- legalizing substitutions for and replacements of paper checks without agreement from consumers;

- retaining in place the previously mandated electronic collection and return of checks between financial institutions only when individual agreements are in place;

- requiring that when accountholders request verification, financial institutions produce the original check (or a copy that accurately represents the original) and demonstrate that the account debit was accurate and valid; and

- requiring the re-crediting of funds to an individual's account on the next business day after a consumer proves that the financial institution has erred.

Effect of Governmental Monetary Policies. Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve have major effects upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

Insurance of Accounts and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC insured institutions. It also may prohibit any FDIC insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving the bank's regulatory authority an opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

FDIC insured institutions are required to pay a Financing Corporation assessment to fund the interest on bonds issued to resolve thrift failures in the 1980s. The Financing Corporation quarterly assessment for the fourth quarter of 2013 equaled 1.75 basis points for each $100 of average consolidated total assets minus average tangible equity. These assessments, which may be revised based upon the level of deposits, will continue until the bonds mature in the years 2017 through 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is not aware of any practice, condition or violation that might lead to termination of the Bank's deposit insurance.

Incentive Compensation. In June 2010, the Federal Reserve, the FDIC and the OCC issued a comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Item 1A. Risk Factors.

Our business, financial condition, and results of operations could be harmed by any of the following risks, or other risks that have not been identified or which we believe are immaterial or unlikely. Shareholders should carefully consider the risks described below in conjunction with the other information in this Form 10-K and the information incorporated by reference in this Form 10-K, including our consolidated financial statements and related notes.

General Business Risks

Negative developments in the financial industry, the domestic and international credit markets, and the economy in general pose significant challenges for our industry and us and could adversely affect our business, financial condition and results of operations.

Negative developments that began in the latter half of 2007 and that have continued since then in the global credit and securitization markets have resulted in unprecedented volatility and disruption in the financial markets and a general economic downturn, both nationally and in our primary markets in South Carolina, North Carolina, and Georgia. As a result of this "credit crunch," commercial as well as consumer loan portfolio performances deteriorated at many institutions, and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. As a result, we may face the following risks:

- economic conditions that negatively affect housing prices and the job market may cause the credit · quality of our loan portfolios to deteriorate;
- market developments that affect consumer confidence may cause adverse changes in payment patterns by our customers, causing increases in delinquencies and default rates on loans and other credit facilities;
- the processes that we use to estimate our allowance for loan and lease losses and reserves may no longer be reliable because they rely on judgments, such as forecasts of economic conditions, that may no longer be capable of accurate estimation;

- the value of our securities portfolio may decline; and
- we face increased regulation of our industry, and the costs of compliance with such regulation may increase.

These conditions or similar ones may continue to persist or worsen, causing us to experience continuing or increased adverse effects on our business, financial condition, results of operations and the price of our common stock.

Our decisions regarding credit risk and reserves for loan losses may materially and adversely affect our business.

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

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

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

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

There is no precise method of predicting credit losses; therefore, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. Additions to the allowance for loan losses would result in a decrease of our net income, and possibly our capital.

Federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Any increase in the amount of our provision or loans charged-off as required by these regulatory agencies could have a negative effect on our operating results.

We may have higher loan losses than we have allowed for in our allowance for loan losses.

Our actual loan losses could exceed our allowance for loan losses. Our average loan size continues to increase and reliance on our historic allowance for loan losses may not be adequate. As of December 31, 2013, approximately 79.56% of our loan portfolio (excluding loans held for sale) is composed of construction (5.44%), commercial mortgage (68.39%) and commercial loans (5.73%). Repayment of such loans is generally considered more subject to market risk than residential mortgage loans. Industry experience shows that a portion of loans will become delinquent and a portion of loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including among other things, changes in market conditions affecting the value of loan collateral and problems affecting the credit of our borrowers.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2013, approximately 92.02% of our loans (excluding loans held for sale) had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A continued weakening of the real estate market in our primary market area could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which could be exacerbated by potential climate change and may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

We have a concentration of credit exposure in commercial real estate and challenges faced by the commercial real estate market could adversely affect our business, financial condition, and results of operations.

As of December 31, 2013, we had approximately $250.1 million in loans outstanding to borrowers whereby the collateral securing the loan was commercial real estate, representing approximately 71.9 % of our total loans outstanding as of that date. Approximately 30.3%, or $75.7 million, of this real estate are owner-occupied properties. Commercial real estate loans are generally viewed as having more risk of default than residential real estate loans. They are also typically larger than residential real estate loans and consumer loans and depend on cash flows from the owner's business or the property to service the debt. Cash flows may be affected significantly by general economic conditions, and a downturn in the local economy or in occupancy rates in the local economy where the property is located could increase the likelihood of default. Because our loan portfolio contains a number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in our level of non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the related provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

Our commercial real estate loans have grown 7.9%, or $17.4 million, since December 31, 2012. The banking regulators are giving commercial real estate lending greater scrutiny, and may require banks with higher levels of commercial real estate loans to implement more stringent underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital levels as a result of commercial real estate lending growth and exposures.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At December 31, 2013, commercial business loans comprised 5.73% of our total loan portfolio. Our commercial business loans are originated primarily based on the identified cash flow and general liquidity of the borrower and secondarily on the underlying collateral provided by the borrower and/or repayment capacity of any guarantor. The borrower's cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use. In addition, business assets may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business. Accordingly, the repayment of commercial business loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral value provided by the borrower and liquidity of the guarantor.

Changes in the financial markets could impair the value of our investment portfolio.

The investment securities portfolio is a significant component of our total earning assets. Total investment securities averaged $223.5 million in 2013, as compared to $204.9 million in 2012. This represents 38.5% and 37.0% of the average earning assets for the year ended December 31, 2013 and 2012, respectively. At December 31, 2013, the portfolio was 38.9% of earning assets. Turmoil in the financial markets could impair the market value of our investment portfolio, which could adversely affect our net income and possibly our capital.

As of December 31, 2013 and 2012, our securities, all of which are classified as “Available for Sale”, which have unrealized losses were not considered to be “other than temporarily impaired,” and we believe it is more likely than not we will be able to hold these until they mature or recover our current book value. We currently maintain substantial liquidity which supports our intent and ability to hold these investments until they mature, or until there is a market price recovery. However, if we were to cease to have the ability and intent to hold these investments until maturity or the market prices do not recover, and we were to sell these securities at a loss, it could adversely affect our net income and possibly our capital.

Economic challenges, especially those affecting Lexington, Richland, Newberry, and Kershaw Counties and the surrounding areas, may reduce our customer base, our level of deposits, and demand for financial products such as loans.

Our success significantly depends upon the growth in population, income levels, deposits, and housing starts in our markets of Lexington, Richland, Newberry, and Kershaw Counties and the surrounding area. The current economic downturn has negatively affected the markets in which we operate and, in turn, the size and quality of our loan portfolio. If the communities in which we operate do not grow or if prevailing economic conditions locally or nationally remain unfavorable, our business may not succeed. A continuation of the economic downturn or prolonged recession would likely result in reductions in the size of our loan portfolio and the continued deterioration of the quality of our loan portfolio and could reduce our level of deposits, which in turn would hurt our business. Interest received on loans represented approximately 80.7% of our interest income for the year ended December 31, 2013. If the economic downturn continues or a prolonged economic recession occurs in the economy as a whole, there may be less demand for new loans and borrowers will be less likely to repay their loans as scheduled. Moreover, in many cases the value of real estate or other collateral that secures our loans has been adversely affected by the economic conditions and could continue to be negatively affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. A continued economic downturn could, therefore, result in losses that materially and adversely affect our business.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the markets in which we operate negatively impact this important customer sector, our results of operations and financial condition and the value of our common stock may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

If we fail to effectively manage credit risk and interest rate risk, our business and financial condition will suffer.

We must effectively manage credit risk. There are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting and guidelines, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers and risks resulting from uncertainties as to the future value of collateral. There is no assurance that our credit risk monitoring and loan approval procedures are or will be adequate or will reduce the inherent risks associated with lending. Our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of our loan portfolio. Any failure to manage such credit risks may materially adversely affect our business and our consolidated results of operations and financial condition.

We must also effectively manage interest rate risk. Because mortgage loans typically have much longer maturities than deposits or other types of funding, rising interest rates can raise the cost of funding relative to the value of the mortgage. We manage this risk in part by holding adjustable rate mortgages in portfolios and through other means. Conversely, the value of our mortgage servicing assets may fall when interest rates fall, as borrowers refinance into lower-yield loans. Given current rates, material reductions in rates may not be probable, but as rates rise, then the risk increases. There can be no assurance that we will successfully manage the lending and servicing businesses through all future interest-rate environments.

Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC-insured depository institutions, such as the bank, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. Recent market developments and bank failures significantly depleted the FDIC's Deposit Insurance Fund and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, banks are now assessed deposit insurance premiums based on the bank's average consolidated total assets, and the FDIC has modified certain risk-based adjustments, which increase or decrease a bank's overall assessment rate. This has resulted in increases to the deposit insurance assessment rates and thus raised deposit premiums for many insured depository institutions. If these increases are insufficient for the Deposit Insurance Fund to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could reduce our profitability, may limit our ability to pursue certain business opportunities or otherwise negatively impact our operations.

Changes in prevailing interest rates may reduce our profitability.

Our results of operations depend in large part upon the level of our net interest income, which is the difference between interest income from interest- earning assets, such as loans and mortgage-backed securities ("MBSs"), and interest expense on interest-bearing liabilities, such as deposits and other borrowings. Depending on the terms and maturities of our assets and liabilities, we believe it is more likely than not a significant change in interest rates could have a material adverse effect on our profitability. Many factors cause changes in interest rates, including governmental monetary policies and domestic and international economic and political conditions. While we intend to manage the effects of changes in interest rates by adjusting the terms, maturities, and pricing of our assets and liabilities, our efforts may not be effective and our financial condition and results of operations could suffer.

Our acquisition of Savannah River may present certain risks to our business and operations.

On February 1, 2014, we completed our acquisition of Savannah River, the bank holding company for Savannah River Banking Company. The acquisition presents the following risks, among others:

- the possibility that expected benefits may not materialize in the timeframe expected or at all, or may be more costly to achieve;
- that the Company's and Savannah River's respective businesses may not perform as expected due to transaction-related uncertainty or other factors;
- that the parties are unable to successfully implement integration strategies, due to challenges associated with integrating complex systems, technology, banking centers, and other assets of Savannah River in a manner that minimizes any adverse effect on customers, suppliers, employees, and other constituencies and integrating Savannah River's workforce while maintaining focus on providing consistent, high quality customer service;
- reputational risks and the reaction of the companies' customers to the transaction; and
- the acquisition may require diversion of the attention of the Company's management and other key employees from ongoing business activities, including the pursuit of other opportunities that could be beneficial to the Company.

We will face risks with respect to expansion through future acquisitions or mergers.

From time to time, we may seek to acquire other financial institutions or parts of those institutions. We may also expand into new markets or lines of business or offer new products or services. These activities would involve a number of risks, including:

- the potential inaccuracy of the estimates and judgments used to evaluate credit, operations, management, and market risks with respect to a target institution;
- the time and costs of evaluating new markets, hiring or retaining experienced local management, and opening new offices and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse effects on our results of operations; and
- the risk of loss of key employees and customers.

We may be exposed to difficulties in combining the operations of Savannah River and the Company, which may prevent us from achieving the expected benefits from our merger activities.

We may not be able to fully achieve the strategic objectives and operating efficiencies that we anticipate in our merger activities, including our acquisition of Savannah River. Inherent uncertainties exist in integrating the operations of two companies. In addition, the markets and industries in which the Company and Savannah River operate are highly competitive. We may lose customers as a result of the merger. We also may lose key personnel as a result of the merger. We may not have discovered all known and unknown factors during the due diligence period. These factors could produce unintended and unexpected consequences for us. Undiscovered factors as a result of the merger, pursued by non-related third party entities, could bring civil, criminal, and financial liabilities against us, our management, and the management of those entities acquired. These factors could contribute to the Company not achieving the expected benefits from the merger within desired time frames.

New or acquired banking office facilities and other facilities may not be profitable.

We may not be able to identify profitable locations for new banking offices. The costs to start up new banking offices or to acquire existing branches, and the additional costs to operate these facilities, may increase our non-interest expense and decrease our earnings in the short term. If branches of other banks become available for sale, we may acquire those offices. It may be difficult to adequately and profitably manage our growth through the establishment or purchase of additional banking offices and we can provide no assurance that any such banking offices will successfully attract enough deposits to offset the expenses of their operation. In addition, any new or acquired banking offices will be subject to regulatory approval, and there can be no assurance that we will succeed in securing such approval.

We are dependent on key individuals, and the loss of one or more of these key individuals could curtail our growth and adversely affect our prospects.

Michael C. Crapps, our president and chief executive officer, has extensive and long-standing ties within our primary market area and substantial experience with our operations, and he has contributed significantly to our business. If we lose the services of Mr. Crapps, he would be difficult to replace and our business and development could be materially and adversely affected.

Our success also depends, in part, on our continued ability to attract and retain experienced loan originators, as well as other management personnel. Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel, or the loss of the services of several of such key personnel, could adversely affect our business strategy and seriously harm our business, results of operations, and financial condition.

Our historical operating results may not be indicative of our future operating results.

We may not be able to sustain our historical rate of growth, and, consequently, our historical results of operations will not necessarily be indicative of our future operations. Various factors, such as economic conditions, regulatory and legislative considerations, and competition, may also impede our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected because a high percentage of our operating costs are fixed expenses.

We could experience a loss due to competition with other financial institutions.

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

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge as part of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Technological developments have allowed competitors, including some non-depository institutions, to compete more effectively in local markets and have expanded the range of financial products, services and capital available to our target customers. If we are unable to implement, maintain and use such technologies effectively, we may not be able to offer products or achieve cost-efficiencies necessary to compete in the industry. In addition, some of these competitors have fewer regulatory constraints and lower cost structures.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by the bank cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the bank. Any such losses could have a material adverse affect on our financial condition and results of operations.

Our underwriting decisions may materially and adversely affect our business.

While we generally underwrite the loans in our portfolio in accordance with our own internal underwriting guidelines and regulatory supervisory guidelines, in certain circumstances we have made loans which exceed either our internal underwriting guidelines, supervisory guidelines, or both. As of December 31, 2013, approximately $7.0 million of our loans, or 10.1% of our bank's regulatory capital, had loan-to-value ratios that exceeded regulatory supervisory guidelines, of which 8 loans totaling approximately $1.2 million had loan-to-value ratios of 100% or more. In addition, supervisory limits on commercial loan to value exceptions are set at 30% of our bank's capital. At December 31, 2013, $4.9 million of our commercial loans, or 7.1% of our bank's regulatory capital, exceeded the supervisory loan to value ratio. The number of loans in our portfolio with loan-to-value ratios in excess of supervisory guidelines, our internal guidelines, or both could increase the risk of delinquencies and defaults in our portfolio.

We depend on the accuracy and completeness of information about clients and counterparties and our financial condition could be adversely affected if we rely on misleading information.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, we may assume that a customer's audited financial statements conform with GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

A failure in or breach of our operational or security systems or infrastructure, or those of our third party vendors and other service providers or other third parties, including as a result of cyber attacks, could disrupt our businesses, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs, and cause losses.

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

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

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

Negative public opinion surrounding our Company and the financial institutions industry generally could damage our reputation and adversely impact our earnings.

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

The change of control rules under Section 382 of the Internal Revenue Code could limit our ability to use net operating loss carryforwards to reduce future taxable income, if we were to undergo a change of control.

We have net operating loss (“NOL”) carryforwards for federal and state income tax purposes which, generally, can be used to reduce future taxable income. Our use of our NOL carryforwards would be limited, however, under Section 382 of the Internal Revenue Code, if we were to undergo a change in ownership of more than 50% of our capital stock over a three-year period as measured under Section 382 of the Internal Revenue Code. These complex changes of ownership rules generally focus on ownership changes involving shareholders owning directly or indirectly 5% or more of our stock, including certain public “groups” of shareholders as set forth under Section 382 of the Internal Revenue Code, including those arising from new stock issuances and other equity transactions.

Whether a change in ownership occurs in the future is largely outside of our control, and there can be no assurance that such a change will not occur. If we experience an ownership change, the resulting annual limit on the use of our NOL carryforwards (which generally would equal the product of the applicable federal long-term tax-exempt rate, multiplied by the value of our capital stock immediately before the ownership change, then increased by certain existing gains recognized within five years after the ownership change if we have a net built-in gain in our assets at the time of the ownership change) could result in a meaningful increase in our federal and state income tax liability in future years. Whether an ownership change occurs by reason of public trading in our stock is largely outside our control, and the determination of whether an ownership change has occurred is complex. No assurance can be given that we will not in the future undergo an ownership change that would have an adverse effect on the value of our stock.

Legal and Regulatory Risks

We are subject to extensive regulation that could restrict our activities, have an adverse impact on our operations, and impose financial requirements or limitations on the conduct of our business.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. We are subject to Federal Reserve regulation. Our Bank is subject to extensive regulation, supervision, and examination by our primary federal regulator, the FDIC, the regulating authority that insures customer deposits. Also, as a member of the Federal Home Loan Bank (the “FHLB”), our Bank must comply with applicable regulations of the Federal Housing Finance Board and the FHLB. Regulation by these agencies is intended primarily for the protection of our depositors and the deposit insurance fund and not for the benefit of our shareholders. Our Bank’s activities are also regulated under consumer protection laws applicable to our lending, deposit, and other activities. A sufficient claim against us under these laws could have a material adverse effect on our results of operations.

Further, changes in laws, regulations and regulatory practices affecting the financial services industry could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could also result in heightened regulatory scrutiny and in sanctions by regulatory agencies (such as a memorandum of understanding, a written supervisory agreement or a cease and desist order), civil money penalties and/or reputation damage. Any of these consequences could restrict our ability to expand our business or could require us to raise additional capital or sell assets on terms that are not advantageous to us or our shareholders and could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, such violations may occur despite our best efforts.

The Dodd-Frank Act may have a material adverse effect on our operations.

On July 21, 2010, President Obama signed into law the Dodd-Frank Act, which imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on our business are:

- changes to regulatory capital requirements;
- exclusion of hybrid securities, including trust preferred securities, issued on or after May 19, 2010 from Tier 1 capital;
- creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the CFPB, which develops and enforces rules for bank and non-bank providers of consumer financial products);
- potential limitations on federal preemption;
- changes to deposit insurance assessments;
- regulation of debit interchange fees we earn;
- changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies in order to be implemented, some but not all of which have been proposed or finalized by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until after implementation. Certain changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to investors in our common stock.

New capital rules that were recently issued generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

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." These rules substantially amend the regulatory risk-based capital rules applicable to us. The rules phase in over time beginning in 2015 and will become fully effective in 2019. The rules apply to the Company as well as to the Bank.

The final rules increase capital requirements and generally include two new capital measurements that will affect us, a risk-based common equity Tier 1 ratio and a capital conservation buffer. Common Equity Tier 1 (“CET1”) capital is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including non-cumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital and must be phased out over a period of nine years beginning in 2014. The rules permit bank holding companies with less than $15 billion in assets (such as us) to continue to include trust preferred securities and non-cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not CET1. Tier 2 capital consists of instruments that have historically been placed in Tier 2, as well as cumulative perpetual preferred stock.

The final rules adjust all three categories of capital by requiring new deductions from and adjustments to capital that will result in more stringent capital requirements and may require changes in the ways we do business. Among other things, the current rule on the deduction of mortgage servicing assets from Tier 1 capital has been revised in ways that are likely to require a greater deduction than we currently make and that will require the deduction to be made from CET1. This deduction phases in over a three-year period from 2015 through 2017. We closely monitor our mortgage servicing assets, and we expect to maintain our mortgage servicing asset at levels below the deduction thresholds by a combination of sales of portions of these assets from time to time either on a flowing basis as we originate mortgages or through bulk sale transactions. Additionally, any gains on sale from mortgage loans sold into securitizations must be deducted in full from CET1. This requirement phases in over three years from 2015 through 2017. Under the earlier rule and through 2014, no deduction is required.

Beginning in 2015, the minimum capital requirements for the Company and the Bank will be (i) a CET1 ratio of 4.5%, (ii) a Tier 1 capital (CET1 plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement will remain at the 4% level now required. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the CET1, Tier 1 and total capital requirements, resulting in a require CET1 ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions. While the final rules will result in higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to us.

In addition to the higher required capital ratios and the new deductions and adjustments, the final rules increase the risk weights for certain assets, meaning that we will have to hold more capital against these assets. For example, commercial real estate loans that do not meet certain new underwriting requirements must be risk-weighted at 150%, rather than the current 100%. There are also new risk weights for unsettled transactions and derivatives. We also will be required to hold capital against short-term commitments that are not unconditionally cancelable; currently, there are no capital requirements for these off-balance sheet assets. All changes to the risk weights take effect in full in 2015.

In addition, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

The federal banking agencies are likely to issue new liquidity standards that could result in our having to lengthen the term of our funding, restructure our business lines by forcing us to seek new sources of liquidity for them, and/or increase our holdings of liquid assets.

As part of the Basel III capital process, the Basel Committee on Banking Supervision has finalized a new liquidity standard, a liquidity coverage ratio, which requires a banking organization to hold sufficient "high quality liquid assets" to meet liquidity needs for a 30 calendar day liquidity stress scenario. A net stable funding ratio, which imposes a similar requirement over a one-year period, is under consideration. The U.S. banking regulators have said that they intend to adopt such liquidity standards, although they have not yet proposed a rule. New rules could restrict our operations by compelling us to reduce our holdings of illiquid assets and adversely affect our results and financial condition.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the “Patriot Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

Federal, state and local consumer lending laws may restrict our ability to originate certain mortgage loans or increase our risk of liability with respect to such loans and could increase our cost of doing business.

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered “predatory.” These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. Loans with certain terms and conditions and that otherwise meet the definition of a “qualified mortgage” may be protected from liability to a borrower for failing to make the necessary determinations. In either case, we may find it necessary to tighten our mortgage loan underwriting standards in response to the CFPB rules, which may constrain our ability to make loans consistent with our business strategies. It is our policy not to make predatory loans and to determine borrowers' ability to repay, but the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

The CFBP recently issued “ability-to-repay” and “qualified mortgage” rules that may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results, and financial condition.

On January 10, 2013, the CFPB issued a final rule to implement the “qualified mortgage” provisions of the Dodd-Frank Act requiring mortgage lenders to consider consumers’ ability to repay home loans before extending them credit. The CFPB’s “qualified mortgage” rule, which became effective on January 10, 2014, describes certain minimum requirements for lenders making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders will be presumed to have complied with the ability-to-repay rule if they issue “qualified mortgages,” which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default and the absence of ability-to-repay status can be used against a lender in foreclosure proceedings. Any loans that we make outside of the “qualified mortgage” criteria could expose us to an increased risk of liability and reduce or delay our ability to foreclose on the underlying property. It is difficult to predict how the CFPB’s “qualified mortgage” rule will impact us when it takes effect, but any decreases in loan origination volume or increases in compliance and foreclosure costs caused by the rule could negatively affect our business, operating results and financial condition.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the CRA and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

The Federal Reserve may require us to commit capital resources to support the Bank.

The Federal Reserve requires a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Under the “source of strength” doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. In addition, the Dodd-Frank Act directs the federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as a source of strength for the institution. Under these requirements, in the future, we could be required to provide financial assistance to our Bank if the Bank experiences financial distress.

A capital injection may be required at times when we do not have the resources to provide it, and therefore we may be required to borrow the funds. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the holding company in order to make the required capital injection becomes more difficult and expensive and will adversely impact the holding company's cash flows, financial condition, results of operations and prospects.

The downgrade of the U.S. credit rating could negatively impact our business, results of operations and financial condition.

Recent U.S. debt ceiling and budget deficit concerns together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns in the U.S. Although U.S. lawmakers passed legislation to raise the federal debt ceiling in 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from "AAA" to "AA+" in August 2011. The impact of any further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness could adversely affect the U.S. and global financial markets and economic conditions. In January 2013, the U.S. government adopted legislation to suspend the debt limit until May 19, 2013. In October 2013, the debt ceiling was suspended until February 7, 2014. Moody's and Fitch have each warned that they may downgrade the U.S. government's rating if the federal debt is not stabilized. A downgrade of the U.S. government's credit rating or a default by the U.S. government to satisfy its debt obligations likely would create broader financial turmoil and uncertainty, which would weigh heavily on the global banking system. It is possible that any such impact could have a material adverse effect on our business, results of operations and financial condition.

Failure to comply with government regulation and supervision could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation.

Our operations are subject to extensive regulation by federal, state, and local governmental authorities. Given the current disruption in the financial markets, we expect that the government will continue to pass new regulations and laws that will impact us. Compliance with such regulations may increase our costs and limit our ability to pursue business opportunities. Failure to comply with laws, regulations, and policies could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation. While we have policies and procedures in place that are designed to prevent violations of these laws, regulations, and policies, there can be no assurance that such violations will not occur.

We are party to various lawsuits incidental to our business. Litigation is subject to many uncertainties such that the expenses and ultimate exposure with respect to many of these matters cannot be ascertained.

From time to time, customers and others make claims and take legal action pertaining to our performance of fiduciary responsibilities. Whether customer claims and legal actions are legitimate or unfounded, if such claims and legal actions are not resolved in our favor, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Risks Related to an Investment in Our Common Stock

Our ability to pay cash dividends is limited, and we may be unable to pay future dividends even if we desire to do so.

The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. The Federal Reserve's policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

Our ability to pay cash dividends may be limited by regulatory restrictions, by our Bank's ability to pay cash dividends to the Company and by our need to maintain sufficient capital to support our operations. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the S.C. Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the S.C. Board. If our Bank is not permitted to pay cash dividends to the Company, it is unlikely that we would be able to pay cash dividends on our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, and if declared by our board of directors. Although we have historically paid cash dividends on our common stock, we are not required to do so and our board of directors could reduce or eliminate our common stock dividend in the future.

Our stock price may be volatile, which could result in losses to our investors and litigation against us.

Our stock price has been volatile in the past and several factors could cause the price to fluctuate substantially in the future. These factors include but are not limited to: actual or anticipated variations in earnings, changes in analysts' recommendations or projections, our announcement of developments related to our businesses, operations and stock performance of other companies deemed to be peers, new technology used or services offered by traditional and non-traditional competitors, news reports of trends, irrational exuberance on the part of investors, new federal banking regulations, and other issues related to the financial services industry. Our stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices. Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Moreover, in the past, securities class action lawsuits have been instituted against some companies following periods of volatility in the market price of its securities. We could in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources from our normal business.

Future sales of our stock by our shareholders or the perception that those sales could occur may cause our stock price to decline.

Although our common stock is listed for trading on the NASDAQ Capital Market, the trading volume in our common stock is lower than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

Economic and other circumstances may require us to raise capital at times or in amounts that are unfavorable to us. If we have to issue shares of common stock, they will dilute the percentage ownership interest of existing shareholders and may dilute the book value per share of our common stock and adversely affect the terms on which we may obtain additional capital.

We may need to incur additional debt or equity financing in the future to make strategic acquisitions or investments or to strengthen our capital position. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control and our financial performance. We cannot provide assurance that such financing will be available to us on acceptable terms or at all, or if we do raise additional capital that it will not be dilutive to existing shareholders.

If we determine, for any reason, that we need to raise capital, subject to applicable NASDAQ rules, our board generally has the authority, without action by or vote of the shareholders, to issue all or part of any authorized but unissued shares of stock for any corporate purpose, including issuance of equity-based incentives under or outside of our equity compensation plans. Additionally, we are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. The market price of our common stock could decline as a result of sales by us of a large number of shares of common stock or preferred stock or similar securities in the market or from the perception that such sales could occur. If we issue preferred stock that has a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred stock with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of our common stock could be adversely affected. Any issuance of additional shares of stock will dilute the percentage ownership interest of our shareholders and may dilute the book value per share of our common stock. Shares we issue in connection with any such offering will increase the total number of shares and may dilute the economic and voting ownership interest of our existing shareholders.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

Lexington Property. The principal place of business of both the Company and our Bank is located at 5455 Sunset Boulevard, Lexington, South Carolina 29072. This site, which is also the Bank's main office branch, is a 2.29 acre plot of land. The site was purchased for $576 thousand and the building costs were approximately $1.0 million. The branch operates in an 8,500 square foot facility located on this site.

In October 2000, the Bank acquired an additional 2.0 acres adjacent to the existing facility for approximately $300 thousand. This site was designed to allow for a 24,000 to 48,000 square foot facility at some future date. The Bank completed construction and occupied the 28,000 square foot administrative center in July 2006. The total construction cost for the building was approximately $3.4 million. The Lexington property is owned by the Bank.

Forest Acres Property. We operate a branch office facility at 4404 Forest Drive, Columbia, South Carolina 29206. The Forest Acres site is .71 acres. The banking facility is approximately 4,000 square feet with a total cost of land and facility of approximately $920 thousand. This property is owned by the Bank.

Irmo Property. We operate a branch office facility at 1030 Lake Murray Boulevard, Irmo, South Carolina 29063. The Irmo site is approximately one acre. The banking facility is approximately 3,200 square feet with a total cost of land and facility of approximately $1.1 million. This property is owned by the Bank.

Cayce/West Columbia Property. We operate a branch office facility at 506 Meeting Street, West Columbia, South Carolina, 29169. The Cayce/West Columbia site is approximately 1.25 acres. The banking facility is approximately 3,800 square feet with a total cost of land and facility of approximately $935 thousand. This property is owned by the Bank.

Gilbert Property. We operate a branch office at 4325 Augusta Highway Gilbert, South Carolina 29054. The facility is an approximate 3,000 square foot facility located on an approximate one acre lot. The total cost of the land and facility was approximately $768 thousand. This property is owned by the Bank.

Chapin Office. We operate a branch office facility at 137 Amicks Ferry Rd., Chapin, South Carolina 29036. The facility is approximately 3,000 square feet and is located on a three acre lot. The total cost of the facility and land was approximately $1.3 million. This property is owned by the Bank.

Northeast Columbia. We operate a branch office facility at 9822 Two Notch Rd., Columbia, South Carolina 29223. The facility is approximately 3,000 square feet and is located on a one acre lot. The total cost of the facility and land was approximately $1.2 million. This property is owned by the Bank.

Prosperity Property. We operate a branch office at 101 N. Wheeler Avenue, Prosperity, South Carolina 29127. This office was acquired in connection with the DutchFork merger. The banking facility is approximately 1,300 square feet and is located on a .31 acre lot. The total cost of the facility and land was approximately $175 thousand. This property is owned by the Bank. On December 27, 2012, we purchased 1.23 acres directly adjacent to the existing branch for $222 thousand. This additional land, along with existing property, will be used to replace the existing facility.

Wilson Road. We operate a branch office at 1735 Wilson Road, Newberry, South Carolina 29108. The banking office was acquired in connection with the DutchFork merger. This banking facility is approximately 12,000 square feet and is located on a 1.56 acre lot. Adjacent to the branch facility is a 13,000 square foot facility which was formerly utilized as the DutchFork operations center. The total cost of the facility and land was approximately $3.3 million. This property is owned by the Bank.

Redbank Property. We operate a branch office facility at 1449 Two Notch Road, Lexington, South Carolina 29073. This branch opened for operation on February 3, 2005. The facility is approximately 3,000 square feet and is located on a one acre lot. The total cost of the facility and land was approximately $1.3 million. This property is owned by the Bank.

Camden Property. We operate a branch office facility at 631 DeKalb Street, Camden, South Carolina 29020. This office was acquired in connection with the DeKalb merger. The facility is approximately 11,247 square feet and is located on a two acre lot. The total cost of the facility and land was approximately $2.2 million. This property is owned by the Bank.

Columbia Property. On October 1, 2013 we acquired a building located at 1213 Lady Street, Columbia, South Carolina. The facility is approximately 20,000 square feet and is currently being renovated for a branch site and additional office space. The cost of the building was $1.1 million. Renovation costs are expected to be approximately $1.8 million.

Blythewood Property. On December 30, 2013, we acquired a 1.27 acre site located on Blythewood Road, Blythewood, South Carolina. The site is to be used for building a branch office. The contract for the building construction has not yet been negotiated. The cost of the property was $775 thousand.

Aiken Property: On February 1, 2014, through our acquisition of Savannah River Banking Company we acquired a branch located at 407 Silver Bluff Road, Aiken South Carolina, The facility is approximately 3,884 square feet and is located on a 1.15 acre lot. The total cost of the facility and land was $1.4 million. The property is owned by the Bank.

Augusta Property: On February 1, 2014, through our acquisition of Savannah River Banking Company we acquired a branch located at 3638 Walton Way Extension, Augusta, Georgia. The facility is approximately 17,400 square feet and is located on a 1.84 acre lot. The total cost of the facility and land was $5.3 million. The property is owned by the Bank.

Augusta Lot: On February 1, 2014, through our acquisition of Savannah River Financial Corporation we acquired a 1.91 acre lot located 3602 Exchange Lane, Augusta, Georgia. The total value of the lot was $1.2 million. The property is owned by the Corporation and is excess land adjacent to our Augusta Branch. It is anticipated that this property will be listed for sale.

Item 3. Legal Proceedings.

In the ordinary course of operations, we may be a party to various legal proceedings from time to time. We do not believe that there is any pending or threatened proceeding against us, which, if determined adversely, would have a material effect on our business, results of operations, or financial condition.

Item 4. Mine Safety Disclosures.

None.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

As of March 15, 2013, there were approximately 1,502 shareholders of record of our common stock. On January 15, 2003, our stock began trading on The NASDAQ Capital Market under the trading symbol of “FCCO.” The following table sets forth the high and low sales price information as reported by NASDAQ in 2013 and 2012, and the dividends per share declared on our common stock in each such quarter. All information has been adjusted for any stock splits and stock dividends effected during the periods presented.

	High	Low	Dividends
2013			
Quarter ended March 31, 2013	$9.25	$8.21	$ 0.05
Quarter ended June 30, 2013	$10.00	$8.80	$ 0.05
Quarter ended September 30, 2013	$11.16	$8.44	$ 0.06
Quarter ended December 31, 2013	$10.50	$9.95	$ 0.06
2012			
Quarter ended March 31, 2012	$8.00	$5.98	$ 0.04
Quarter ended June 30, 2012	$8.80	$7.65	$ 0.04
Quarter ended September 30, 2012	$8.60	$7.84	$ 0.04
Quarter ended December 31, 2012	$8.68	$8.15	$ 0.04

Notwithstanding the foregoing, the future dividend policy of the Company is subject to the discretion of the board of directors and will depend upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. Our ability to pay dividends is generally limited by the ability of the Bank to pay dividends to us. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the S.C. Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the S.C. Board.

Item 6. Selected Financial Data

	As of or For the Years Ended December 31,				
(Dollars in thousands except per share amounts)	2013	2012	2011	2010	2009
Balance Sheet Data:					
Total assets	$633,309	$602,925	$593,887	$599,023	$605,827
Loans held for sale	3,790	9,658	3,725	—	—
Loans	347,597	332,111	324,311	329,954	344,187
Deposits	497,071	474,977	464,585	455,344	449,576
Total common shareholders’ equity	52,671	54,183	36,759	30,762	30,501
Total shareholders’ equity	52,671	54,183	47,896	41,797	41,440
Average shares outstanding, basic	5,285	4,144	3,287	3,262	3,252
Average shares outstanding, diluted	5,334	4,172	3,287	3,262	3,252
Results of Operations:					
Interest income	$21,783	$23,002	$25,526	$27,511	$30,981
Interest expense	3,734	5,428	7,209	9,374	13,104
Net interest income	18,049	17,574	18,317	18,137	17,877
Provision for loan losses	528	496	1,420	1,878	3,103
Net interest income after provision for loan losses	17,521	17,078	16,897	16,259	14,774
Non-interest income	8,118	7,929	5,710	3,017	3,543
Securities gains	73	26	575	827	1,489
Non-interest expenses	20,422	19,445	18,401	17,684	16,580
Impairment of goodwill	—	—	—	—	27,761
Income (loss) before taxes	5,290	5,588	4,781	2,419	(24,535)
Income tax expense	1,153	1,620	1,457	565	696
Net income (loss)	4,137	3,968	3,324	1,854	(25,231)
Amortization of warrants	—	72	102	96	89
Preferred stock dividends, including discount accretion and redemption costs	—	604	568	568	567
Net income (loss) available to common shareholders	4,137	3,292	2,654	1,190	(25,887)
Per Share Data:					
Basic earnings (loss) per common share	$0.78	$0.79	$0.81	$0.36	$(7.95)
Diluted earnings (loss) per common share	0.78	0.79	0.81	0.36	(7.95)
Book value at period end	9.93	10.37	11.11	9.41	9.38
Tangible book value at period end	9.83	10.23	10.83	9.14	8.92
Dividends per common share	0.22	0.16	0.16	0.16	0.24
Asset Quality Ratios:					
Non-performing assets to total assets(4)	1.39 %	1.45 %	2.16 %	2.20 %	1.38 %
Non-performing loans to period end loans	1.56 %	1.44 %	1.67 %	1.90 %	1.50 %
Net charge-offs to average loans	0.27 %	0.17 %	0.50 %	0.54 %	0.84 %
Allowance for loan losses to period-end total loans	1.21 %	1.39 %	1.45 %	1.49 %	1.41 %
Allowance for loan losses to non-performing assets	48.07 %	52.77 %	35.83 %	37.39 %	58.21 %
Selected Ratios:					
Return on average assets:					
GAAP earnings (loss)	0.66 %	0.55 %	0.44 %	0.20 %	(3.90)%
Operating earnings(3)	0.66 %	0.55 %	0.44 %	0.20 %	0.39 %
Return on average common equity:					
GAAP earnings (loss)	7.68 %	7.40 %	7.98 %	3.73 %	(49.66)%
Operating earnings (loss)(3)	7.68 %	7.40 %	7.98 %	3.73 %	4.98 %
Return on average tangible common equity:					

GAAP earnings (loss)	7.78	%	7.55	%	8.16	%	3.87	%	(89.13	)%
Operating earnings (loss) (3)	7.78	%	7.55	%	8.16	%	3.87	%	8.94	%
Efficiency Ratio(1)	76.69	%	74.89	%	75.58	%	73.07	%	73.47	%
Noninterest income to operating revenue(2)	31.22	%	31.16	%	25.55	%	17.48	%	21.97	%
Net interest margin (tax equivalent)	3.18	%	3.22	%	3.33	%	3.26	%	3.10	%
Equity to assets	8.32	%	8.99	%	8.06	%	6.97	%	6.84	%
Tangible common shareholders' equity to tangible assets	8.23	%	8.88	%	6.04	%	5.00	%	4.80	%
Tier 1 risk-based capital	17.60	%	17.33	%	15.33	%	13.73	%	12.41	%
Total risk-based capital	18.68	%	18.58	%	17.25	%	14.99	%	13.56	%
Leverage	10.77	%	10.63	%	9.40	%	8.79	%	8.41	%
Average loans to average deposits (5)	69.17	%	70.33	%	70.59	%	73.53	%	76.99	%

(1) The efficiency ratio is a key performance indicator in our industry. The ratio is computed by dividing non-interest expense, less goodwill impairment, by the sum of net interest income on a tax equivalent basis and non-interest income, net of any securities gains or losses and OTTI on securities. It is a measure of the relationship between operating expenses and earnings.

(2) Operating revenue is defined as net interest income plus noninterest income.

(3) Constitutes a non-GAAP financial measure. Please see "Reconciliation of Non-GAAP Financial Measures" below.

(4) Includes non-accrual loans, loans > 90 days delinquent and still accruing interest and OREO.

(5) Includes loans held for sale.

Reconciliations

The following is a reconciliation for the five years ended December 31, 2013, of net income (loss) as reported for generally accepted accounting principles ("GAAP") and the non-GAAP measure referred to throughout our discussion of "operating earnings."

	December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Net income (loss), as reported (GAAP)	$4,137	$3,968	$3,324	$1,854	$(25,231)
Add: Income tax expense (benefit)	1,153	1,620	1,457	565	696
	5,290	5,588	4,781	2,419	(24,535)
Non-operating items:					
Goodwill impairment charge	—	—	—	—	27,761
Pre-tax operating earnings	5,290	5,588	4,781	2,419	3,226
Related income tax expense	1,153	1,620	1,457	565	696
Operating earnings, (net income, excluding non operating items)	$4,137	$3,968	$3,324	$1,854	$2,530

The following is a reconciliation for the five years ended December 31, 2013, of non-interest expense as reported for GAAP and the non-GAAP measure referred to throughout our discussion regarding non-interest expense.

(Dollars in thousands)	2013	2012	2011	2010	2009
Non-interest expense, as reported (GAAP)	$20,422	$19,445	$18,401	$17,684	$44,341
Non-operating items:					
Impairment of goodwill	—	—	—	—	27,761
Operating non-interest expense	$20,422	$19,445	$18,401	$17,684	$16,580

Our management believes that the non-GAAP measures above are useful because they enhance the ability of investors and management to evaluate and compare our operating results from period to period in a meaningful manner. These non-GAAP measures should not be considered as an alternative to any measure of performance as promulgated under GAAP. Non-GAAP measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the Company's results as reported under GAAP.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The Company is headquartered in Lexington, South Carolina and the bank holding company for the Bank. We operate from our main office in Lexington, South Carolina, and our 13 full-service offices located in Lexington (two), Forest Acres, Irmo, Cayce-West Columbia, Gilbert, Chapin, Northeast Columbia, Prosperity, Newberry, Camden, and Aiken, South Carolina and Augusta, Georgia. During the second quarter of 2006, we completed our acquisition of DeKalb Bankshares, Inc., the holding company for The Bank of Camden. The merger added one office in Kershaw County located in the Midlands of South Carolina. During the fourth quarter of 2004, we completed our first acquisition when we merged with DutchFork Bancshares, Inc., the holding company for Newberry Federal Savings Bank. The merger added three offices in Newberry County. In 2007, our College Street office in Newberry was consolidated with our Wilson Road Office in Newberry. On September 15, 2008, the Company completed the acquisition of two financial planning and investment advisory firms, EAH Financial Group and Pooled Resources, LLC. In addition, the Bank expanded its residential mortgage business unit with the acquisition of the assets of Palmetto South, effective July 31, 2011. Palmetto South, which operates as a division of the Bank, offers mortgage loan products for home purchase or refinance in the South Carolina market area. On February 1, 2014 we closed our merger with Savannah River Financial Corporation (Savannah River), the holding company for Savannah River Banking Company (See recent developments below). This acquisition added two branches to our existing branch network, one located in Aiken, SC and one located in Augusta, GA. We engage in a general commercial and retail banking business characterized by personalized service and local decision making, emphasizing the banking needs of small to medium-sized businesses, professional concerns and individuals.

The following discussion describes our results of operations for 2013, as compared to 2012 and 2011, and also analyzes our financial condition as of December 31, 2013, as compared to December 31, 2012. Like most community banks, we derive most of our income from interest we receive on our loans and investments. A primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits.

We have included a number of tables to assist in our description of these measures. For example, the "Average Balances" table shows the average balance during 2013, 2012 and 2011 of each category of our assets and liabilities, as well as the yield we earned or the rate we paid with respect to each category. A review of this table shows that our loans typically provide higher interest yields than do other types of interest earning assets, which is why we intend to channel a substantial percentage of our earning assets into our loan portfolio. Similarly, the "Rate/Volume Analysis" table helps demonstrate the impact of changing interest rates and changing volume of assets and liabilities during the years shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included a "Sensitivity Analysis Table" to help explain this. Finally, we have included a number of tables that provide detail about our investment securities, our loans, and our deposits and other borrowings.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings. In the following section we have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses and the allocation of this allowance among our various categories of loans.

In addition to earning interest on our loans and investments, we earn income through fees and other expenses we charge to our customers. We describe the various components of this noninterest income, as well as our noninterest expense, in the following discussion. The discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

Recent Developments

On February 1, 2014, we completed our acquisition of Savannah River and its wholly-owned subsidiary, Savannah River Banking Company. Under the terms of the Agreement and Plan of Merger, Savannah River shareholders received either \$11.00 in cash or 1.0618 shares of the Company's common stock, or a combination thereof, for each Savannah River share they owned immediately prior to the merger, subject to the limitation that 60% of the outstanding shares of Savannah River common stock were exchanged for cash and 40% of the outstanding shares of Savannah River common stock were exchanged for shares of the Company's common stock. The Company issued 1,274,200 shares of common stock in the merger.

Critical Accounting Policies

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the notes to our consolidated financial statements in this report.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the credit worthiness of borrowers, the estimated value of the underlying collateral, the assumptions about cash flow, determination of loss factors for estimating credit losses, the impact of current events, and conditions, and other factors impacting the level of probable inherent losses. Under different conditions or using different assumptions, the actual amount of credit losses incurred by us may be different from management’s estimates provided in our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

Income taxes are provided for the tax effects of the transactions reported in our consolidated financial statements and consist of taxes currently due plus deferred taxes related to differences between the tax basis and accounting basis of certain assets and liabilities, including available-for-sale securities, allowance for loan losses, write downs of OREO properties, accumulated depreciation, net operating loss carry forwards, accretion income, deferred compensation, intangible assets, and pension plan and post-retirement benefits. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. A valuation allowance is recorded when it is "more likely than not" that a deferred tax asset will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. We file a consolidated federal income tax return for our subsidiary bank. At December 31, 2013, we are in a net deferred tax asset position.

We evaluate securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the outlook for receiving the contractual cash flows of the investments, (4) the anticipated outlook for changes in the general level of interest rates, and (5) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or for a debt security whether it is more-likely-than-not that the Company will be required to sell the debt security prior to recovering its fair value (See Note 4 to the Consolidated Financial Statements).

Results of Operations

Our net income available to common shareholders was $4.1 million, or $0.78 diluted earnings per common share, for the year ended December 31, 2013, as compared to net income available to common shareholders of $3.3 million, or $0.79 diluted earnings per common share, for the year ended December 31, 2012. During 2013, we continued to reduce our overall cost of funds by reducing funding from certificates of deposits. The decline in certificate of deposit balances was more than offset by a 16.3% increase in transaction, money market and savings account balances. We were able to grow loans (excluding loans held for sale) by $15.5 million from December 31, 2012 to December 31, 2013 despite the continued slow economic environment. Average loan balances increased during 2013 to $344.1 million compared to $331.6 million in 2012.

Net interest income increased $475 thousand from $17.6 million in 2012 to $18.0 million in 2013. The increase in net interest income is primarily due to the increase in average earning assets. The net interest margin, on a tax equivalent basis, during 2013 was 3.18% as compared to 3.22% during 2012. See below under “Net Interest Income” and “Market Risk and Interest Rate Sensitivity” for a further discussion about the effect of the change in net interest margin. Net interest spread, the difference between the yield on earning assets and the rate paid on interest-bearing liabilities, was 2.94% in 2013 as compared to 2.95% in 2012. The provision for loan losses was $528 thousand in 2013 as compared to $496 thousand in 2012. Although the provision for loan losses increased slightly in 2013 from 2012, our credit quality measures have improved overall during the last two years as evidenced by the decrease in provision for loan losses from $1.4 million in 2011. Non-interest income was $8.2 million in 2013 as compared to $8.0 million in 2012. This increase was primarily due to increased income from investment advisory fees and no OTTI recorded for 2013. This was offset by a slowdown in mortgage banking income as a result of rising mortgage loan rates, particularly in the last half of 2013. Non-interest expense increased to $20.4 million in 2013 as compared to $19.4 million in 2012. The increase includes $539 thousand in merger related expenses related to the previously discussed acquisition of Savannah River which closed on February 1, 2014. In addition, salary and employee benefit expense increased by $861 thousand in 2013 as compared to 2012. Offsetting these increases in non-interest expense was a decrease in other real estate expenses of $502 thousand in 2013 as compared to 2012.

Net interest income decreased $743 thousand in 2012 from $18.3 million in 2011. The decrease in net interest income was a result of continued historically low interest rates throughout 2011 and 2012. The modest growth in our earning asset levels between the two periods was not enough to offset the lower interest rate environment. The net interest margin, on a tax equivalent basis, during 2012 was 3.22% as compared to 3.33% during 2011. Net interest spread was 2.95% in 2012 as compared to 3.11% in 2011. The provision for loan losses was $496 thousand in 2012 as compared to $1.4 million in 2011. The reduction in the provision for loan losses reflects lower net charge-offs and the previously stated improvement in credit quality measures in 2012. Non-interest income was $8.0 million in 2012 as compared to $6.3 million in 2011. This increase was primarily due to increased mortgage origination fees as a result of the expansion of this business through the acquisition of Palmetto South in the second half of 2011. Non-interest expense increased to $19.4 million in 2012 as compared to $18.4 million in 2011. As discussed below under “Non-interest income and expense,” the increase is primarily attributable to increases in salary and benefits of $1.6 million in 2012 as compared to 2011.

Net Interest Income

Net interest income is our primary source of revenue. Net interest income is the difference between income earned on assets and interest paid on deposits and borrowings used to support such assets. Net interest income is determined by the rates earned on our interest-earning assets and the rates paid on our interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities.

Net interest income totaled $18.0 million in 2013, $17.6 million in 2012 and $18.3 million in 2011. The yield on earning assets was 3.75%, 4.15%, and 4.64% in 2013, 2012 and 2011, respectively. The rate paid on interest-bearing liabilities was 0.81%, 1.20%, and 1.53% in 2013, 2012, and 2011, respectively. The fully taxable equivalent net interest margin was 3.18% in 2013, 3.22% in 2012 and 3.33% in 2011. Our loan to deposit ratio on average during 2013 was 69.2%, as compared to 70.3% during 2012 and 70.6% during 2011. Loans typically provide a higher yield than other types of earning assets, and, thus, one of our goals continues to grow the loan portfolio as a percentage of earning assets in order to improve the overall yield on earning assets and the net interest margin. At December 31, 2013, the loan (including held for sale) to deposit ratio was 70.7%.

The net interest margin decreased in 2013 as compared to 2012. Since early 2008, interest rates have been at historic lows. The yield on earning assets decreased by 40 basis points and our cost of funds decreased by 39 basis points in 2013 as compared to 2012. Continued historically low interest rates have impacted our ability to reduce funding cost in relation to the decline in earning asset yields. During 2013, we continued to control the growth of our balance sheet and shift the mix of funding to lower cost sources (non-interest bearing transaction accounts, interest-bearing transaction accounts, money-market accounts and savings deposits). During 2013, the average balance in these accounts increased by $53.0 million as compared to 2012. During the same period, our funding from time deposits decreased by $27.0 million. Our average borrowings, which are typically a higher cost funding source, decreased $2.9 million in 2013 as compared to 2012. The change in the mix of funding sources has lessened the impact of the significant decline in our yield on earning assets. Throughout 2013, time deposits and borrowed funds represented 51.9% of our total interest bearing funding sources, and, in 2012, these balances represented 59.9% of our interest bearing funding sources.

The net interest margin decreased in 2012 as compared to 2011. The yield on earning assets decreased by 49 basis points and our cost of funds decreased by 33 basis points in 2012 as compared to 2011. This resulted in a decrease in our net interest spread of 16 basis points in 2012 as compared to 2011. During 2012, the average balance in lower cost sources of funding, as described above, increased by $26.0 million as compared to 2011. The change in the mix of funding sources lessened the impact of the significant decline in our yield on earning assets between 2012 and 2011. Our average borrowings and time deposits decreased $36.9 million in 2012 as compared to 2011. Throughout 2012, time deposits and borrowed funds represented 59.9% of our total interest bearing funding sources, and, in 2011, these balances represented 65.1% of our interest bearing funding sources.

Average Balances, Income Expenses and Rates. The following table depicts, for the periods indicated, certain information related to our average balance sheet and our average yields on assets and average costs of liabilities. Such yields are derived by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been derived from daily averages.

	Year ended December 31,								
	2013			2012			2011		
(Dollars in thousands)	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets									
Earning assets									
Loans(1)	$344,110	$17,581	5.11%	$331,564	$18,361	5.54%	$329,534	$19,110	5.80%
Securities	223,540	4,136	1.85%	204,926	4,557	2.22%	205,744	6,342	3.08%
Other short-term investments(2)	13,649	66	0.48%	17,234	84	0.49%	15,178	74	0.49%
Total earning assets	581,299	21,783	3.75%	553,724	23,002	4.15%	550,456	25,526	4.64%
Cash and due from banks	8,546			8,643			7,992		
Premises and equipment	17,509			17,388			17,759		
Intangible assets	641			832			740		
Other assets	22,290			25,556			31,791		
Allowance for loan losses	(4,483)			(4,843)			(4,823)		
Total assets	$625,802			$601,300			$603,915		
Liabilities									
Interest-bearing liabilities(2)									
Interest-bearing transaction accounts	100,808	111	0.11%	$89,734	151	0.17%	$83,625	270	0.32%
Money market accounts	74,514	171	0.23%	52,575	153	0.29%	48,802	209	0.43%
Savings deposits	47,296	53	0.11%	39,020	49	0.13%	32,093	48	0.15%
Time deposits	171,436	1,458	0.85%	198,392	2,769	1.40%	219,737	4,046	1.84%
Other borrowings	69,022	1,941	2.81%	71,926	2,306	3.21%	87,460	2,636	3.01%
Total interest-bearing liabilities	463,076	3,734	0.81%	451,647	5,428	1.20%	471,717	7,209	1.53%
Demand deposits	103,467			91,737			82,572		
Other liabilities	5,422			5,469			5,286		
Shareholders' equity	53,837			52,447			44,340		
Total liabilities and shareholders' equity	$625,802			$601,300			$603,915		
Net interest spread			2.94%			2.95%			3.11%
Net interest income/margin		$18,049	3.10%		$17,574	3.17%		$18,317	3.33%
Net interest margin (tax equivalent)(3)			3.18%			3.22%			3.33%

(1) All loans and deposits are domestic. Average loan balances include non-accrual loans and loans held for sale.

(2) The computation includes federal funds sold, securities purchased under agreement to resell and interest bearing deposits.

(3) Based on 32.5% marginal tax rate.

The following table presents the dollar amount of changes in interest income and interest expense attributable to changes in volume and the amount attributable to changes in rate. The combined effect in both volume and rate, which cannot be separately identified, has been allocated proportionately to the change due to volume and due to rate.

	2013 versus 2012 Increase (decrease) due to			2012 versus 2011 Increase (decrease) due to		
(In thousands)	Volume	Rate	Net	Volume	Rate	Net
Assets						
Earning assets						
Loans	$677	$(1,457)	$(780)	$117	$(866)	$(749)
Investment securities	390	(811)	(421)	(25)	(1,759)	(1,784)
Other short-term investments	(17)	(1)	(18)	10	0	10
Total earning assets	1,108	(2,327)	(1,219)	151	(2,674)	(2,523)
Interest-bearing liabilities						
Interest-bearing transaction accounts	17	(57)	(40)	18	(137)	(119)
Money market accounts	36	(18)	18	18	(74)	(56)
Savings deposits	10	(6)	4	9	(8)	1
Time deposits	(338)	(973)	(1,311)	(366)	(911)	(1,277)
Other short-term borrowings	(90)	(275)	(365)	(515)	186	(329)
Total interest-bearing liabilities	134	(1,828)	(1,694)	(323)	(1,457)	(1,780)
Net interest income			$475			$(743)

Market Risk and Interest Rate Sensitivity

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. The risk of loss can be measured in either diminished current market values or reduced current and potential net income. Our primary market risk is interest rate risk. We have established an Asset/Liability Management Committee ("ALCO") to monitor and manage interest rate risk. The ALCO monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on our net interest income. The ALCO has established policy guidelines and strategies with respect to interest rate risk exposure and liquidity.

A monitoring technique employed by us is the measurement of our interest sensitivity "gap," which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Also, asset/liability modeling is performed to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity or by adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in the same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. Neither the "gap" analysis or asset/liability modeling are precise indicators of our interest sensitivity position due to the many factors that affect net interest income including, the timing, magnitude and frequency of interest rate changes as well as changes in the volume and mix of earning assets and interest-bearing liabilities.

The following table illustrates our interest rate sensitivity at December 31, 2013.

Interest Sensitivity Analysis

(Dollars in thousands)	Within One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Assets					
Earning assets					
Loans(1)	$116,196	$106,629	$92,677	$26,689	$342,191
Loans Held for Sale	3,790	—	—	—	3,790
Securities(2)	76,255	38,106	23,310	90,633	228,304
Federal funds sold, securities purchased under agreements to resell and other earning assets	8,601	—	—	—	8,601
Total earning assets	204,842	144,735	115,987	117,322	582,886
Liabilities					
Interest bearing liabilities					
Interest bearing deposits					
NOW accounts	21,417	35,378	14,701	29,403	100,899
Money market accounts	18,331	25,664	7,333	21,997	73,325
Savings deposits	10,227	7,670	5,114	28,123	51,134
Time deposits	78,873	53,163	28,468	11	160,515
Total interest-bearing deposits	128,848	121,875	55,616	79,534	385,873
Other borrowings	43,150	2,104	32,106	63	77,423
Total interest-bearing liabilities	171,998	123,979	87,722	79,597	463,296
Period gap	$32,844	$20,756	$28,265	$37,725	$119,590
Cumulative gap	$32,844	$53,600	$81,865	$119,590	$119,590
Ratio of cumulative gap to total earning assets	5.64 %	9.20 %	14.05 %	20.52 %	20.52 %

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(1) Loans classified as non-accrual as of December 31, 2013 are not included in the balances.
(2) Securities based on amortized cost.

We entered into a five year interest rate swap agreement on October 8, 2008 that expired on October 8, 2013. The swap agreement had a $10.0 million notional amount. We received a variable rate of interest on the notional amount based on a three month LIBOR rate and pay a fixed rate interest of 3.66%. The contract was entered into to protect us from the negative impact of rising interest rates. Our exposure to credit risk was limited to the ability of the counterparty to make potential future payments required pursuant to the agreement. Our exposure to market risk of loss was limited to the changes in the market value of the swap between reporting periods. At December 31, 2012, the fair value of the contract was a negative $338 thousand. The fair value adjustment during each reporting period is recognized in other income. For the years ended December 31, 2013, 2012 and 2011, the adjustment reflected in earnings amounted to ($2) thousand, $(58) thousand and $(166) thousand, respectively. The fair value of the contract was the present value, over the remaining term of the contract, of the difference between the estimated swap rate and the fixed rate of 3.66%.

Through simulation modeling, we monitor the effect that an immediate and sustained change in interest rates of 100 basis points and 200 basis points up and down will have on net-interest income over the next 12 months. Based on the many factors and assumptions used in simulating the effect of changes in interest rates, the following table estimates the hypothetical percentage change in net interest income at December 31, 2013 and 2012 over the subsequent 12 months. At December 31, 2013, we are slightly asset sensitive. As a result, our modeling reflects improvement in our net interest income in a rising rate environment. In a declining rate environment, the model reflects a significant decline in net interest income. This primarily results from the current level of interest rates being paid on our interest bearing transaction accounts as well as money market accounts. The interest rates on these accounts are at a level where they cannot be repriced in proportion to the change in interest rates. The increase and decrease of 100 and 200 basis points assume a simultaneous and parallel change in interest rates along the entire yield curve.

Net Interest Income Sensitivity

Change in short-term interest rates	Hypothetical percentage change in net interest income December 31,	
	2013	2012
+200bp	2.54 %	6.52 %
+100bp	1.22 %	3.83 %
Flat	—	—
-100bp	-6.23 %	-9.05 %
-200bp	-11.05 %	-13.58 %

We also perform a valuation analysis projecting future cash flows from assets and liabilities to determine the Present Value of Equity ("PVE") over a range of changes in market interest rates. The sensitivity of PVE to changes in interest rates is a measure of the sensitivity of earnings over a longer time horizon. At December 31, 2013 and 2012, the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be (3.31)% and 7.53%, respectively. During 2013 and 2012, the decline in the PVE resulting from rising rates primarily a result of the increase in rates in the five to ten year part of the curve in 2013. This resulted in slowing down the level of prepayments on our mortgage backed securities portfolio and therefore, extending the expected life of this portfolio.

Provision and Allowance for Loan Losses

At December 31, 2013, the allowance for loan losses amounted to $4.2 million, or 1.21% of loans (excludes loans held for sale), as compared $4.6 million, or 1.39% of loans, at December 31, 2012. Our provision for loan loss was $528 thousand for the year ended December 31, 2013, as compared to $496 thousand and $1.4 million for the years ended December 31, 2012 and 2011, respectively. The provision is made based on our assessment of general loan loss risk and asset quality. The allowance for loan losses represents an amount which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight and concentrations of credit. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period, especially considering the overall weakness in the commercial real estate market in our market areas.

We perform an analysis quarterly to assess the risk within the loan portfolio. The portfolio is segregated into similar risk components for which historical loss ratios are calculated and adjusted for identified changes in current portfolio characteristics. Historical loss ratios are calculated by product type and by regulatory credit risk classification (See Note 5 – Loans). The annualized weighted average loss ratios over the last 24 months for loans classified substandard, special mention and pass have been approximately 3.08%, 1.20% and 0.08%, respectively. The allowance consists of an allocated and unallocated allowance. The allocated portion is determined by types and ratings of loans within the portfolio. The unallocated portion of the allowance is established for losses that exist in the remainder of the portfolio and compensates for uncertainty in estimating the loan losses. As a result of the economic downturn beginning in 2008 and continuing through 2013, real estate values have been dramatically impacted. With our loan portfolio consisting of a large percentage of real estate secured loans we, like most financial institutions, continue to experience higher delinquencies and problem loans from pre 2008 historical levels. Non-performing assets were $12.8 million (2.16% of total assets) at December 31, 2011, $8.8 million (1.45% of total assets) at December 31, 2012, and $8.8 million (1.39% of total assets) at December 31, 2013. We believe these ratios are favorable in comparison to current industry results nationally and specifically in our local markets. As noted below in the “Allocation of the Allowance for Loan Losses” table, the unallocated portion of the allowance as a percentage of the total allowance has grown over the last several years. The allocated portion of the allowance is based on historical loss experience as well as certain qualitative factors as explained above. The qualitative factors have been established based on certain assumptions made as a result of the current economic conditions and are adjusted as conditions change to be directionally consistent with these changes. The unallocated portion of the allowance is composed of factors based on management’s evaluation of various conditions that are not directly measured in the estimation of probable losses through the experience formula or specific allowances. The unallocated allowance of the portfolio is primarily identified through discussions with senior credit management and through consideration of various portfolio specifics and other uncertainties outside of our markets that could impact the risk inherent in the portfolio. These include factors such as uncertainty as to a sustainable economic recovery, ongoing global economic conditions and sustained levels of high national unemployment. Given these uncertainties in economic conditions and particularly real estate valuations, we do not believe it would be prudent to reduce substantially the overall level of our allowance at this time. The unallocated portion as a percentage of the loan portfolio has grown recently, primarily as a result of higher historical loss periods dropping out of our overall analysis accompanied by a relatively flat loan portfolio. As economic conditions show sustainable improvement, we believe the unallocated portion of the allowance should decrease as a percentage of the total allowance. In the near term, however, this percentage may continue to increase slightly.

Our Company has a significant portion of its loan portfolio with real estate as the underlying collateral. At December 31, 2013 and 2012, approximately 92.0% of the loan portfolio had real estate collateral (see Note 15 to financial statements for concentrations of credit). When loans, whether commercial or personal, are granted, they are based on the borrower's ability to generate repayment cash flows from income sources sufficient to service the debt. Real estate is generally taken to reinforce the likelihood of the ultimate repayment and as a secondary source of repayment. During this economic cycle many borrowers' traditional income sources have been impacted negatively and real estate values have dropped significantly. We continue to work closely with all our borrowers that are experiencing economic problems as a result of this cycle and believe we have the processes in place to monitor and identify problem credits. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period. The allowance is also subject to examination and testing for adequacy by regulatory agencies, which may consider such factors as the methodology used to determine adequacy and the size of the allowance relative to that of peer institutions. Such regulatory agencies could require us to adjust our allowance based on information available to them at the time of their examination.

At December 31, 2013, 2012, and 2011, we had non-accrual loans in the amount of $5.4 million, $4.7 million and $5.4 million, respectively. Nonaccrual loans at December 31, 2013 consisted of 44 loans. All of these loans are considered to be impaired, are substantially all real estate-related, and have been measured for impairment under the fair value of the collateral method. We consider a loan to be impaired when, based upon current information and events, it is believed that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Such fair values are obtained using independent appraisals, which we consider to be level 3 inputs. The aggregate amount of impaired loans was $6.0 million and $6.2 million for the years ending December 31, 2013 and 2012, respectively. The non-accrual loans range in size from $1 thousand to $1.3 million. The largest relationship is in the amount of $1.3 million with a mortgage on an owner occupied commercial business located in the midlands of South Carolina.

In addition to the non-accrual loans that are considered to be impaired, we have 4 totaling $576 thousand that are classified as troubled debt restructurings but are accruing loans as of December 31, 2013. The largest relationship consists of 1 loan totaling $265.6 thousand. There were $1.6 million, $2.6 million, and $3.2 million in loans delinquent 30 to 89 days at December 31, 2013, 2012 and 2011, respectively. There were $2 thousand, $55 thousand and $25 thousand in loans greater than 90 days delinquent and still accruing interest at December 31, 2013, 2012 and 2011, respectively.

Our management continuously monitors non-performing, classified and past due loans to identify deterioration regarding the condition of these loans. We have identified four relationships in the amount of $5.0 million, which are current as to principal and interest at December 31, 2013 and not included in non-performing assets, that could be potential problem loans. The largest of these loans is secured by commercial and residential real estate and the current debt service is being funded primarily by the borrower's personal cash flow. The other three loan relationships range in size from $550 thousand to $772 thousand. They have been identified as potential problems based on our review that their traditional sources of cash flow may have been impacted and that they may ultimately not be able to service the debt. These loans are continually monitored and are considered in our overall evaluation of the adequacy of our allowance for loan losses.

The following table summarizes the activity related to our allowance for loan losses.

Allowance for Loan Losses

(Dollars in thousands)	2013	2012	2011	2010	2009
Average loans and loans held for sale outstanding	$344,110	$331,564	$329,534	$337,143	$337,743
Loans and loans held for sale outstanding at period end	$351,387	$341,769	$328,036	$329,954	$344,187
Total nonaccrual loans	$5,406	$4,715	$5,403	$5,890	$4,136
Loans past due 90 days and still accruing	$2	$55	$25	$373	$1,022
Beginning balance of allowance	$4,621	$4,699	$4,911	$4,854	$4,581
Loans charged-off:					
Construction and development loans	—	—	—	—	1,402
1-4 family residential mortgage	47	112	186	1,273	450
Non-farm non-residential mortgage	897	200	777	223	117
Multifamily residential	—	93	84	—	—
Home equity	67	—	285	187	107
Commercial	—	258	265	125	700
Installment & credit card	37	44	62	91	174
Overdrafts	42	35	37	50	34
Total loans charged-off	1,090	742	1,696	1,949	2,984
Recoveries:					
1-4 family residential mortgage	72	86	5	43	9
Non-farm non-residential mortgage	—	—	—	2	8
Home equity	—	3	5	9	4
Commercial	47	42	31	32	73
Installment & credit card	28	25	10	19	54
Overdrafts	13	12	13	23	6
Total recoveries	160	168	64	128	154
Net loans charged off	930	574	1,632	1,821	2,830
Provision for loan losses	528	496	1,420	1,878	3,103
Balance at period end	$4,219	$4,621	$4,699	$4,911	$4,854
Net charge -offs to average loans and loans held for sale	0.27 %	0.17 %	0.50 %	0.54 %	0.84 %
Allowance as percent of total loans	1.21 %	1.39 %	1.45 %	1.49 %	1.41 %
Non-performing loans as % of total loans	1.56 %	1.44 %	1.67 %	1.90 %	1.50 %
Allowance as % of non-performing loans	78.01 %	96.88 %	86.60 %	78.41 %	94.11 %

The following table presents an allocation of the allowance for loan losses at the end of each of the past five years. The allocation is calculated on an approximate basis and is not necessarily indicative of future losses or allocations. The entire amount is available to absorb losses occurring in any category of loans.

Allocation of the Allowance for Loan Losses

	2013		2012		2011		2010		2009	
Dollars in thousands	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category
Commercial, Financial and Agricultural	$233	5.7 %	$338	6.3 %	$331	6.4 %	$681	6.2 %	$634	6.6 %
Real Estate Construction	26	5.5 %	—	3.9 %	—	3.6 %	905	3.2 %	1,331	5.8 %
Real Estate Mortgage:										
Commercial	1,117	68.4 %	1,322	68.2 %	1,475	67.9 %	1,404	66.2 %	1,522	62.2 %
Residential	291	10.8 %	235	11.7 %	514	11.8 %	465	14.1 %	243	14.8 %
Consumer	192	9.6 %	417	9.9 %	578	10.3 %	414	10.3 %	133	10.6 %
Unallocated	2,360	N/A	2,309	N/A	1,801	N/A	1,042	N/A	991	N/A
Total	$4,219	100.0 %	$4,621	100.0 %	$4,699	100.0 %	$4,911	100.0 %	$4,854	100.0 %

Accrual of interest is discontinued on loans when we believe, after considering economic and business conditions and collection efforts that a borrower’s financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. At the time a loan is placed in nonaccrual status, all interest, which has been accrued on the loan but remains unpaid, is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

Noninterest Income and Expense

Noninterest Income. A significant source of noninterest income is service charges on deposit accounts. We also originate fixed rate residential loans on a servicing released basis in the secondary market. These loans are fixed rate residential loans that are originated in our name. These loans have locked in price commitments to be purchased by investors at the time of closing. Therefore, these loans present very little market risk for the Company. We typically deliver to, and receive funding from, the investor within 30 days. Other sources of noninterest income are derived from investment advisory fees and commissions on non-deposit investment products, bankcard fees, ATM/debit card fees, commissions on check sales, safe deposit box rent, wire transfer and official check fees. Non-interest income increased to $8.2 million in 2013 from $8.0 million in 2012. Deposit service charges decreased by $55 thousand in 2013 as compared to 2012, primarily as a result of the impact of changes to Regulation E that became effective July 1, 2010. It is expected that this regulatory change, along with other changes related to overdraft protection programs including mandated limitations on the number of items an institution can charge within established time frames, as well as the order in which items presented for payment must be processed on accounts, could reduce deposit service charge fees in the future. Mortgage origination fees decreased by $475 thousand to $3.8 million in 2013 from $4.2 million in 2012. During the third quarter of 2013, mortgage interest rates began to rise and, as a result, mortgage loan production began to slow down. We believe, on an industry wide basis, the refinance activity will continue to decrease in volume. The outcome of this change may result in less overall volume with a higher component of purchase transactions. Monthly new purchase money mortgage production increased slightly during the third and fourth quarters of 2013 as compared to the monthly production in the first six months of 2013 but not to a level that offset the decline in refinance activity. The decline in mortgage banking income was offset by an increase in investment advisory fees and non-deposit commissions. For 2013, these fees amounted to $972 thousand as compared to $651 thousand in 2012. Assets under management at December 31, 2013 were approximately $145.0 million as compared to approximately $120 million at December 31, 2012. We did not recognize any OTTI in 2013 as compared to $200 thousand recognized in 2012. As described below, we began selling certain private label mortgage-backed securities ("PLMBS") rated below investment grade in 2011 and into 2012. During the last six months of 2013, we sold the remaining four PLMBS in our portfolio. Due to a significant recovery in the value of one of these securities, the net loss on the sale of the four below investment grade securities was $433 thousand. The net gain on sale of securities for 2013 amounted to $73 thousand. As of December 31, 2013, there are no securities rated below investment grade in our investment portfolio. During 2013, we prepaid $2.0 million in Federal home Loan Bank advances and incurred a prepayment penalty of $142 thousand. This compares to prepayment penalties of $217 thousand in 2012.

Non-interest income increased from $6.3 million in 2011 to $8.0 million in 2012. Deposit service charges decreased by $248 thousand in 2012 as compared to 2011, primarily as a result of changes to Regulation E that became effective July 1, 2010 requiring that customers affirmatively opt in to our overdraft protection program. To the extent customers who had previously utilized this product did not opt in, these changes resulted in reduced fees from ATM and point of sale transactions. Mortgage origination fees increased by $2.2 million to $4.2 million in 2012 from $2.0 million in 2011. As previously noted, the addition of Palmetto South as of July 31, 2011 was a significant contributor to the increased mortgage fees in the third and fourth quarters of 2011 and throughout the entire year of 2012. Historically low interest rates continued to impact the level of refinancing activity during 2012. Investment advisory fees and non-deposit commissions decreased to $651 thousand in 2012 as compared to $767 thousand in 2011.

During the years ended December 31, 2012 and 2011, we sold certain non-agency mortgage-backed securities ("MBSs") that were rated below investment grade. In 2012, we sold eight below investment grade non-agency MBSs and one investment grade corporate security with a total book value of approximately $11.7 million. The loss on the sales amounted to approximately $2.1 million and was offset by gains of the approximate same amount from the sale of certain agency MBSs and municipal securities. The sales in 2011 also related primarily to the sale of certain non-agency MBSs that had been downgraded to below investment grade. The sales of below investment grade and the other investment securities resulted in net gains of $26 thousand and $575 thousand in 2012 and 2011, respectively. The proceeds were reinvested in our investment portfolio, primarily in securities with a risk rating of 20% or less. During the year ended December 31, 2012, we incurred OTTI charges of $200 thousand (credit component) on certain non-agency MBSs that were sold as part of the transactions noted above. This compares to OTTI charges in 2011 of $297 thousand (see Note 4 — Investment Securities to our Consolidated Financial Statements for further information). During the year ended December 31, 2012 and 2011, we prepaid FHLB advances in the amount of $6.0 million and $10.7 million, respectively. We incurred losses in the amount of $217 thousand and $188 thousand during 2012 and 2011, respectively, as a result of the prepayment of these advances.

During 2012, we recorded a negative fair value adjustment on an interest rate swap with a notional amount of $10.0 million in the amount of $58 thousand as compared to a negative $166 thousand in 2011. The interest rate swap was entered into in 2008 to protect assets and liabilities from the negative impact in a rising interest rate environment (See "Market Risk and Interest Rate Sensitivity" discussion). This swap expired on October 8, 2013.

Noninterest Expense. In the very competitive financial services industry, we recognize the need to place a great deal of emphasis on expense management and continually evaluate and monitor growth in discretionary expense categories in order to control future increases. Noninterest expense increased from $19.4 million in 2012 to $20.4 million in 2013. Salary and benefit expense increased $861 thousand from $11.2 million in the 2012 to $12.0 million in 2013. At December 31, 2012, we had 158 full time equivalent employees as compared to 171 full time employees at December 31, 2013. The increase in 13 employees includes existing positions that were vacant at December 31, 2012. These additions plus normal salary adjustments substantially account for the increase in salary and benefit expense in 2013 as compared to 2012. FDIC insurance assessments decreased $180 thousand in 2013 as compared 2012. The termination of the Formal Agreement between the Bank and the OCC in May of 2012 resulted in lower FDIC premium assessments beginning June 2012. Other real estate expenses decreased by $502 thousand in 2013, as compared to 2012. These lower expenses are reflective of the lower level of real estate acquired in satisfaction of debts (OREO) on our balance sheet as compared to the levels in 2010 through 2012. During the fourth quarter of 2013, we incurred merger-related expenses of $539 thousand related to the acquisition of Savannah River which was consummated on February 1, 2014. Additional merger-related expenses will be realized in the first quarter of 2014. There were no merger expenses in 2012. Shareholder expenses increased $37 thousand from $135 thousand in 2012 to $172 thousand in 2013. This increase is primarily a result of cost associated with the required full implementation of the SEC's eXtensible Business Reporting Language (otherwise known as "XBRL") filing requirement in 2013. Expenses "Other" increased by $305 thousand from $557 thousand in 2012 to $862 million in 2013. Beginning in 2013, we outsourced to a third party the printing and mailing of these monthly and daily statements. This outsourcing arrangement allows us to reduce and over time control the associated printing and mailing cost due to the volume discount that the third party is able to obtain. The cost for this during the 2013 was approximately $77 thousand and is included in the other miscellaneous expense category. In 2012, these related costs were included primarily in supplies and postage. Also included in the increase of other miscellaneous expense is approximately $83 thousand in higher cost associated with loan closing and data collection.

Noninterest expense increased from $18.4 million in 2011 to $19.4 million in 2012. Salary and benefit expense increased $1.7 million from $9.5 million in the 2011 to $11.2 million in 2012. At December 31, 2011, we had 157 full time equivalent employees as compared to 158 full time employees at December 31, 2012. As a result of the Palmetto South acquisition in the third quarter of 2011, we added approximately 10 full time equivalent employees. The compensation paid to most of these employees is variable based on mortgage origination fees generated. Having the Palmetto South employees for the entire year of 2012, normal salary adjustments and increased health insurance cost account for the majority of the increase in salary and benefit cost in 2012 as compared to 2011. FDIC insurance assessments decreased $292 thousand in 2012 as compared 2011. During the second quarter of 2011, the FDIC changed the assessment from a deposit base to an asset based calculation. The impact to community banks in our asset range was to generally lower the amount of our assessment. This change in assessment, in addition to the lifting of the previously mentioned formal agreement in May of 2012, resulted in the lower FDIC premiums in 2012. Other real estate expenses increased by $170 thousand in 2012, as compared to 2011. This increase results from a write-down on real estate previously acquired for a potential future branch site to its estimated fair value. The write down on this property was $170 thousand.

The following table sets forth for the periods indicated the primary components of noninterest expense:

	Year ended December 31,		
(In thousands)	2013	2012	2011
Salary and employee benefits	$12,013	$11,152	$9,520
Occupancy	1,384	1,358	1,289
Equipment	1,206	1,168	1,147
Marketing and public relations	541	478	452
ATM/debit card processing	451	479	472
Supplies	115	138	178
Telephone	321	297	307
Courier	68	72	66
Correspondent services	176	168	193
FDIC/FICO premium	417	597	889
Insurance	258	209	213
Other real estate expenses	508	1,010	840
Professional fees	549	745	1,040
Loss on limited partnership interest	211	194	119
Postage	174	172	174
Director fees	297	312	319
Amortization of intangibles	160	204	517
Shareholder expense	172	135	135
Merger expense	539	—	—
Other	862	557	531
	$20,422	$19,445	$18,401

Income Tax Expense

Income tax expense for 2013 was $1.2 million as compared to income tax expense for the year ended December 31, 2012 of $1.6 million and $1.5 million for the year ended December 31, 2011 (see note -14 "Income Taxes" to the Consolidated Financial Statements for additional information). We recognize deferred tax assets 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 the deferred tax asset to the level that it is more likely than not that the tax benefit will be realized. At December 31, 2012, there was a deferred tax valuation allowance of $132 thousand primarily related to a capital loss carryforward that was thought likely to expire prior to being realized. During 2013, we were able to realize a capital gain that allowed us to reverse the previously established valuation reserve. As of December 31, 2013, we have a tax net loss carryforward of approximately $979 thousand. The carryforward expires in 2031. See Note 14, Income Taxes, to the financial statements for a reconciliation of the tax expense. It is anticipated that our effective tax rate for 2014 will be between 30% and 32%.

Financial Position

Assets totaled $633.3 million at December 31, 2013 as compared to $602.9 million at December 31, 2012, an increase of $30.4 million. Over the last three years, we have successfully controlled balance sheet growth by paying down FHLB advances as they mature or prepaying the advances when the pricing and our liquidity were favorable. In addition, we have controlled our pricing on time deposits as we have experienced continued growth in pure deposits (deposits excluding time deposits). Loans at December 31, 2012 were $332.1 million as compared to $347.6 million (excluding loans held for sale) at December 31, 2013. We funded in excess of $59.7 million of loan production in 2013. At December 31, 2012, loans (excluding loans held for sale) accounted for 59.9% of earning assets, as compared to 59.5% at December 31, 2013. The loan-to-deposit ratio at December 31, 2012 was 69.9% as compared to 70.0% at December 31, 2013. Loans originated and held for sale are generally held for less than thirty days and have locked in purchase commitments by investors prior to closing. At December 31, 2013, loans held for sale amounted to $3.8 million as compared to $9.7 at December 31, 2012. Investment securities were $206.0 million at December 31, 2012 as compared to $227.0 million at December 31, 2013. Short-term federal funds sold and interest-bearing bank balances were $7.2 million at December 31, 2012 compared to $5.9 million at December 31, 2013. During 2013, we sold the remaining four non-agency MBSs that had previously been downgraded by the rating agencies to below investment grade. At December 31, 2013, we have no securities rated below investment grade on our balance sheet (see Note 4, Investment Securities, for further information). Deposits increased by $22.1 million to $497.1 million at December 31, 2013 as compared to $475.0 million at December 31, 2012. At December 31, 2013 and 2012, we had no brokered certificates of deposits. As previously discussed, in 2013, we continued to focus on growing our "pure" deposit while controlling our pricing on time deposits. This strategy has allowed us to improve our funding mix and our overall cost of funds. As a result non-interest bearing, NOW, money market and savings deposits grew by $47.1 million in 2013 while time deposits declined by $25.0 million. Federal Home Loan Bank advances increased by $7.0 million, from $36.3 million at December 31, 2012, to $43.3 million at December 31, 2013. This increase results from our obtaining $9.0 million in overnight advances during December 2013. It is anticipated that these advances will be paid down in the first quarter of 2014.

Shareholders' equity totaled $54.2 million at December 31, 2012, as compared to $52.7 million at December 31, 2013. The decline in shareholder's equity is a result of the change in "Accumulated Other Comprehensive Income (Loss) (AOCI)." This change is due to rising interest rates during 2013 and the resulting unrealized loss on our investment portfolio that is recorded in AOCI. AOCI was $2.4 million at December 31, 2012 as compared to $(2.5) million at December 31, 2013. The impact of this change was somewhat offset by retained earnings less dividends paid to shareholders in 2013. On July 27, 2012, the Company closed a public offering of common stock. The offering resulted in the issuance of a total of 1.875 million shares of common stock at $8.00 per share, resulting in gross proceeds of $15 million. Net proceeds were approximately $13.8 million after deducting underwriting, discount, commissions and other estimated expenses. The proceeds were used to repurchase the 11,350 outstanding shares of the Company's Fixed

Rate Cumulative Perpetual Preferred Stock, Series T (the “Series T Preferred Stock”) originally issued to the Treasury in 2008 pursuant to the TARP Capital Purchase Program. In addition, on October 25, 2012, the Treasury accepted our bid to repurchase the warrant to purchase 195,915 shares of the Company’s common stock (the “CPP Warrant”) issued to the Treasury pursuant to the TARP Capital Purchase Program. The repurchase price was $297,500. The repurchase of the CPP Warrant was closed on November 1, 2012. The net proceeds were also used to redeem the $2.5 million of outstanding subordinated debt at par on November 15, 2012, which was originally issued in November 2011. Net income available to common shareholders less dividend payments to common shareholders resulted in retained deficit decreasing to $14.9 million as of December 31, 2012. Due to the low interest rate environment and the continued reduction in below investment grade securities, accumulated other comprehensive income increased from $1.3 million at December 31, 2011 to $2.4 million at December 31, 2012.

Earning Assets

Loans and loans held for sale

Loans typically provide higher yields than the other types of earning assets. During 2013, loans accounted for 59.2% of average earning assets. The loan portfolio (including held-for-sale) averaged $331.6 million in 2012 as compared to $344.1 million in 2013. Quality loan portfolio growth continued to be a strategic focus in 2013 and thereafter. Associated with the higher loan yields are the inherent credit and liquidity risks, which we attempt to control and counterbalance. One of our goals as a community bank has, and continues to be, to grow our assets through quality loan growth by providing credit to small and mid-size businesses, as well as individuals within the markets we serve. In 2013, we funded new loans (excluding loans originated for sale) of approximately $59.7 million as compared to $49.7 million in 2012. Loan production and portfolio growth rates continue to be impacted by the current slow economic cycle, as borrowers are less inclined to leverage their corporate and personal balance sheets. However, we remain committed to meeting the credit needs of our local markets. A continuation of the slow recovery from recessionary national and local economic conditions, as well as deterioration of asset quality within our Company, could significantly impact our ability to grow our loan portfolio. Significant increases in regulatory capital expectations beyond the traditional “well capitalized” ratios and significantly increased regulatory burdens could impede our ability to leverage our balance sheet and expand the loan portfolio.

The following table shows the composition of the loan portfolio by category:

	December 31,				
(In thousands)	2013	2012	2011	2010	2009
Commercial, financial & agricultural	$19,925	$20,924	$20,608	$20,555	$22,758
Real estate:					
Construction	18,933	13,052	11,767	10,540	19,972
Mortgage—residential	37,579	38,892	38,337	46,684	50,985
Mortgage—commercial	237,701	226,575	220,288	218,298	214,178
Consumer:					
Home equity	25,659	27,173	27,976	27,747	28,824
Other	7,800	5,495	5,335	6,130	7,470
Total gross loans	347,597	332,111	324,311	329,954	344,187
Allowance for loan losses	(4,219)	(4,621)	(4,699)	(4,911)	(4,854)
Total net loans	$343,378	$327,490	$319,612	$325,043	$339,333

In the context of this discussion, a real estate mortgage loan is defined as any loan, other than loans for construction purposes, secured by real estate, regardless of the purpose of the loan. We follow the common practice of financial institutions in the Company’s market area of obtaining a security interest in real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase the magnitude of the real estate loan components. Generally, we limit the loan-to-value ratio to 80%. The principal components of our loan portfolio at year-end 2013 and 2012 were commercial mortgage loans in the amount of $237.7 million and $226.6 million, representing 68.4% and 68.1% of the portfolio, respectively. Significant portions of these commercial mortgage loans are made to finance owner-occupied real estate. We continue to maintain a conservative philosophy regarding our underwriting guidelines, and believe it will reduce the risk elements of the loan portfolio through strategies that diversify the lending mix.

The repayment of loans in the loan portfolio as they mature is a source of liquidity. The following table sets forth the loans maturing within specified intervals at December 31, 2013.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

(in thousands)	December 31, 2013			
	One Year or Less	Over one Year Through Five Years	Over Five years	Total
Commercial, financial and agricultural	$6,192	$12,967	$766	$19,925
R/E-Construction	11,468	6,346	1,119	18,933
All other loan	58,561	197,329	52,849	308,739
	$76,221	$216,642	$54,734	$347,597
	Loans maturing after one year with:			
		Variable Rate		$40,269
		Fixed Rate		231,107
				$271,376

The information presented in the above table is based on the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity.

Investment Securities

The investment securities portfolio is a significant component of our total earning assets. Total investment securities averaged $223.5 million in 2013, as compared to $204.9 million in 2012. This represents 38.5% and 37.0% of the average earning assets for the year ended December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, our investment securities portfolio amounted to $227.0 million and $206.0 million, respectively.

Beginning in 2008 and continuing into 2013, the bond markets and many institutional holders of bonds came under a great deal of stress partially as a result of increasing delinquencies in the mortgage lending market. As of December 31, 2013, we own total MBSs and collateralized mortgage obligations (“CMOs”) with an amortized cost of $120.9 million and an approximate fair value of $119.7 million. These included securities with an amortized cost of $119.9 million and approximate fair value of $118.7 million issued by government sponsored enterprises (“GSEs”). The contractual cash flows of the investments are guaranteed by the GSE. Accordingly, it is expected that the securities would not be settled at a price less than our amortized cost. Also included in our MBS and CMO portfolio are nine PLMBSs with an amortized cost of $1.0 million and approximate fair value of $949 thousand at December 31, 2013. All of the PLMBSs held at December 31, 2013 are rated investment grade.

We held no other debt securities rated below investment grade at December 31, 2013. At December 31, 2013, the estimated weighted average life of the investment portfolio was approximately 7.2 years, duration of approximately 4.1 years, and a weighted average tax equivalent yield of approximately 2.63%.

We held no other debt securities rated below investment grade at December 31, 2012. At December 31, 2012, the estimated weighted average life of the investment portfolio was approximately 6.1 years, duration of approximately 3.5 years, and a weighted average tax equivalent yield of approximately 2.0%.

The following table shows the investment portfolio composition.

	December 31,		
(Dollars in thousands)	2013	2012	2011
Securities available-for-sale at fair value:			
U.S. Government sponsored enterprises	$3,246	$1,534	$34
Small Business Administration pools	56,120	54,993	36,479
Mortgage-backed securities	119,676	112,144	141,631
State and local government	42,998	32,373	20,488
Preferred stock	417	447	21
Corporate bonds	1,021	1,010	1,415
Other	877	944	964
Total	$224,355	$203,445	$201,032

We hold other investments carried at cost which represents our investment in FHLB stock. This investment amounted to $2.7 million and $2.5 million, at December 31, 2013 and 2012, respectively.

Investment Securities Maturity Distribution and Yields

The following table shows, at amortized cost, the expected maturities and average yield of securities held at December 31, 2013:

(In thousands)

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
Available-for-sale:	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Government sponsored enterprises	$—	0.0 %	$15	4.97%	$3,373	2.62%	$—	—
Small Business Administration pools	—	—	16,996	1.54%	22,800	2.39%	16,798	1.74%
Mortgage-backed securities	3,602	1.71%	72,641	2.07%	28,785	2.44%	15,898	3.08%
State and local government	—	0.00%	410	5.76%	4,368	2.77%	40,270	4.41%
Corporate	1,000	4.00%	—	0.00%	—	—	—	—
Other	1,288	4.00%	60	1.25%	—	0.00%	—	0.00%
Total investment securities available-for-sale	$5,890	2.60%	$90,122	1.99%	$59,326	2.31%	$72,966	3.51%

(1) Yield calculated on tax equivalent basis

Short-Term Investments

Short-term investments, which consist of federal funds sold, securities purchased under agreements to resell and interest bearing deposits, averaged $13.6 million in 2013, as compared to $17.2 million in 2012. We maintain the majority of our short term overnight investments in our account at the Federal Reserve rather than in federal funds at various correspondent banks due to the lower regulatory capital risk weighting. At December 31, 2013, short-term investments including funds on deposit at the Federal Reserve totaled $5.9 million. These funds are an immediate source of liquidity and are generally invested in an earning capacity on an overnight basis.

Deposits and Other Interest-Bearing Liabilities

Deposits. Average deposits were $497.5 million during 2013, compared to $471.5 million during 2012. Average interest-bearing deposits were $394.1 million during 2013, as compared to $379.7 million during 2012.

The following table sets forth the deposits by category:

	December 31, 2013		2012		2011	
(In thousands)	Amount	% of Deposits	Amount	% of Deposits	Amount	% of Deposits
Demand deposit accounts	$111,198	22.4 %	$97,526	20.5 %	$83,572	18.0 %
NOW accounts	100,899	20.3 %	96,971	20.4 %	88,330	19.0 %
Money market accounts	73,325	14.7 %	53,903	11.4 %	48,153	10.4 %
Savings accounts	51,134	10.3 %	41,100	8.7 %	34,048	7.3 %
Time deposits less than $100,000	96,096	19.3 %	111,316	23.4 %	128,616	27.7 %
Time deposits more than $100,000	64,419	13.0 %	74,161	15.6 %	81,866	17.6 %
	$497,071	100.0 %	$474,977	100.0 %	$464,585	100.0 %

Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Core deposits, which exclude time deposits of $100,000 or more, provide a relatively stable funding source for the loan portfolio and other earning assets. Core deposits were $432.7 million and $400.8 million at December 31, 2013 and 2012, respectively.

A stable base of deposits is expected to continue be the primary source of funding to meet both our short-term and long-term liquidity needs in the future. The maturity distribution of time deposits is shown in the following table.

Maturities of Certificates of Deposit and Other Time Deposit of $100,000 or more

	December 31, 2013				
(In thousands)	Within Three Months	After Three Through Six Months	After Six Through Twelve Months	After Twelve Months	Total
Time deposits of $100,000 or more	$5,033	$10,869	$11,297	$37,220	$64,419

There were no other time deposits of $100,000 or more at December 31, 2013.

Borrowed funds. Borrowed funds consist of securities sold under agreements to repurchase, FHLB advances and long-term debt as a result of issuing $15.5 million in trust preferred securities. Short-term borrowings in the form of securities sold under agreements to repurchase averaged $17.9 million, $15.4 million and $15.9 million during 2013, 2012 and 2011, respectively. The maximum month-end balances during 2013, 2012 and 2011 were $18.9 million, $17.3 million and $18.1 million, respectively. The average rates paid during these periods were 0.21%, 0.23% and 0.25%, respectively. The balances of securities sold under agreements to repurchase were $18.6 million and $15.9 million at December 31, 2013 and 2012, respectively. The repurchase agreements all mature within one to four days and are generally originated with customers that have other relationships with the company and tend to provide a stable and predictable source of funding. As a member of the FHLB, the Bank has access to advances from the FHLB for various terms and amounts. During 2013 and 2012, the average outstanding advances amounted to $35.6 million and $38.8 million, respectively.

The following is a schedule of the maturities for FHLB Advances as of December 31, 2013 and 2012:

	December 31,			
(In thousands)	2013		2012	
Maturing	Amount	Rate	Amount	Rate
2014	$9,000	.35 %	—	—
2015	2,000	4.22%	4,000	4.22%
2017	20,000	3.98%	—	—
2018	12,000	4.45%	—	—
After five years	325	1.00%	32,344	4.13%
	$43,325	3.35%	$36,344	4.14%

In addition to the above borrowings, we issued $15.0 million in trust preferred securities on September 16, 2004. The securities accrue and pay distributions quarterly at a rate of three month LIBOR plus 257 basis points. The debt may be redeemed in full anytime with notice and matures on September 16, 2034

Capital Adequacy and Dividends

Total shareholders' equity as of December 31, 2013 was $52.7 million as compared to $54.2 million as of December 31, 2012. As previously noted, in 2012, we closed on a public offering of common stock which resulted in the issuance of a total of 1.875 million shares of common stock at $8.00 per share, resulting in gross proceeds of $15 million. Net proceeds were approximately $13.8 million after deducting underwriting, discount, commissions and other estimated expenses. The proceeds were used to repurchase all 11,350 outstanding shares of our Series T Preferred Stock and repurchase the CPP Warrant which were issued in November 2008. Proceeds were also used to redeem the $2.5 million of outstanding subordinated debt at par on November 15, 2012, which was originally issued in November 2011. In 2013, the retention of earnings available to common shareholders less dividend payments on our common stock, less the decrease in AOCI, accounted for the $1.5 million decrease in shareholders' equity. AOCI decreased $4.9 million from a positive $2.4 million at December 31, 2012 to $(2.5) million at December 31, 2013. The change is related to the change in the fair value of our securities portfolio as a result of rising interest rates. In 2013, we paid a dividend of $0.05 per share for the first two quarters and $0.06 per share in the third and fourth quarters. During each quarter of 2012, we paid a dividend on our common stock of $0.04 per share.

In addition, a dividend reinvestment plan was implemented in the third quarter of 2003. The plan allows existing shareholders the option of reinvesting cash dividends as well as making optional purchases of up to $5,000 in the purchase of common stock per quarter.

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio for the three years ended December 31, 2013.

	2013	2012	2011
Return on average assets	0.66 %	0.55 %	0.44 %
Return on average common equity	7.68 %	7.40 %	7.98 %
Equity to assets ratio(1)	8.32 %	8.99 %	8.06 %
Dividend Payout Ratio	27.67%	15.25%	15.79%

(1) For year 2011 includes Series T perpetual preferred stock issued November 21, 2008

Following a 2012 on-site examination of the Bank, the OCC notified the Bank that, effective June 28, 2012, the Bank was no longer subject to the Formal Agreement that it entered into with the OCC in 2010. The OCC also notified the Bank that, effective June 28, 2012, it was no longer subject to the Individual Minimum Capital Ratios established for the Bank on February 24, 2010, which had required the Bank to maintain a Tier 1 leverage capital ratio of at least 8.00%, a Tier 1 risk-based capital ratio of at least 10.00%, and a total risk-based capital ratio of at least 12.00%. In addition, the Federal Reserve Bank of Richmond notified the Company that, effective July 10, 2012, the Company was no longer subject to the MOU that it had entered into with the Federal Reserve Bank of Richmond in December of 2011.

In July 2013, the FDIC approved a final rule to implement the Basel III regulatory capital reforms among other changes required by the Dodd-Frank Act. The framework requires banking organizations to hold more and higher quality capital, which acts as a financial cushion to absorb losses, taking into account the impact of risk. The approved rule includes a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% as well as a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking institutions. For the largest, most internationally active banking organizations, the rule includes a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures. In terms of quality of capital, the final rule emphasizes common equity tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. It also changes the methodology for calculating risk-weighted assets to enhance risk sensitivity. The changes begin to take effect for the Bank in January 2015. The ultimate impact of the new capital standards on the Company and the Bank is currently being reviewed.

The Company and the Bank exceeded their regulatory capital ratios at December 31, 2013 and 2012, as set forth in the following table:

(In thousands)	Required Amount	%	Actual Amount	%	Excess Amount	%
The Bank:						
December 31, 2013						
Risk Based Capital						
Tier 1	$15,592	4.00%	$65,656	16.8%	$50,064	12.8%
Total Capital	31,185	8.00%	69,875	17.9%	38,690	9.9 %
Tier 1 Leverage	25,501	4.00%	65,656	10.3%	40,155	6.3 %
December 31, 2012						
Risk Based Capital						
Tier 1	$14,605	4.00%	$61,588	16.9%	$46,983	12.9%
Total Capital	29,209	8.00%	66,158	18.1%	36,949	10.1%
Tier 1 Leverage	23,824	4.00%	61,588	10.3%	37,764	6.3 %
The Company:						
December 31, 2013						
Risk Based Capital						
Tier 1	$15,629	4.00%	$68,755	17.6%	$53,126	13.6%
Total Capital	31,257	8.00%	72,974	18.7%	41,717	10.7%
Tier 1 Leverage	25,535	4.00%	68,755	10.8%	43,220	6.8 %
December 31, 2012						
Risk Based Capital						
Tier 1	$14,628	4.00%	$63,381	17.3%	$48,753	13.3%
Total Capital	29,258	8.00%	67,963	18.7%	38,705	10.7%
Tier 1 Leverage	23,806	4.00%	63,381	10.6%	39,575	6.6 %

Since the Company is a bank holding company, its ability to declare and pay dividends is dependent on certain federal and state regulatory considerations, including the guidelines of the Federal Reserve. The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. The Federal Reserve's policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

In addition, since the Company is legal entity separate and distinct from the Bank and does not conduct stand-alone operations, its ability to pay dividends depends on the ability of the Bank to pay dividends to it, which is also subject to regulatory restrictions. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the S.C. Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the S.C. Board. The FDIC also has the authority under federal law to enjoin a bank from engaging in what in its opinion constitutes an unsafe or unsound practice in conducting its business, including the payment of a dividend under certain circumstances.

Liquidity Management

Liquidity management involves monitoring sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity represents our ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of the investment portfolio is very predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to nearly the same degree of control. Asset liquidity is provided by cash and assets which are readily marketable, or which can be pledged, or which will mature in the near future. Liability liquidity is provided by access to core funding sources, principally the ability to generate customer deposits in our market area. In addition, liability liquidity is provided through the ability to borrow against approved lines of credit (federal funds purchased) from correspondent banks and to borrow on a secured basis through securities sold under agreements to repurchase. The Bank is a member of the FHLB and has the ability to obtain advances for various periods of time. These advances are secured by securities pledged by the Bank or assignment of loans within the Bank’s portfolio.

With the successful completion of the common stock offering in 1995, the secondary offerings completed in 1998 and 2012, the trust preferred offering completed in September 2004, the acquisition of DutchFork in October 2004, the acquisition of DeKalb in June 2006, we have maintained a high level of liquidity and adequate capital along with retained earnings, less the 2009 and 2008 net loss, sufficient to fund the operations of the Bank for at least the next 12 months. We anticipate that the Bank will remain a well capitalized institution for at least the next 12 months. The loss related to goodwill impairment in 2009 was a noncash charge and had no impact on regulatory capital or tangible equity. Total shareholders’ equity was 8.32% of total assets at December 31, 2013 and 8.99% at December 31, 2012. Funds sold and short-term interest bearing deposits are our primary source of immediate liquidity and averaged $13.6 million and $17.2 million during the year ended December 31, 2013 and 2012, respectively. The Bank maintains federal funds purchased lines, in the amount of $10.0 million each with two financial institutions, although these were not utilized in 2013. The FHLB has approved a line of credit of up to 25% of the Bank’s assets, which would be collateralized by a pledge against specific investment securities and or eligible loans. We regularly review the liquidity position of the Company and have implemented internal policies establishing guidelines for sources of asset based liquidity and limit the total amount of purchased funds used to support the balance sheet and funding from non-core sources. We believe that our existing stable base of core deposits, along with continued growth in this deposit base, will enable us to meet our long term liquidity needs successfully.

We believe our liquidity remains adequate to meet operating and loan funding requirements and that our existing stable base of core deposits, along with continued growth in this deposit base, will enable us to meet our long-term and short-term liquidity needs successfully.

Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with GAAP, are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used by the company for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions are used to manage customers’ requests for funding. Please refer to Note 16 of the Company’s financial statements for a discussion of our off-balance sheet arrangements.

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the company and the bank are primarily monetary in nature. Therefore, interest rates have a more significant effect on our performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, we continually seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Item 8. Financial Statements and Supplementary Data.

Additional information required under this Item 8 may be found under the Notes to Financial Statements under Note 24.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of First Community Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal controls over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework issued in 1992.

Based on that assessment, we believe that, as of December 31, 2013, our internal control over financial reporting is effective based on those criteria.

This annual report does not include an attestation report of our registered public accounting firm regarding our internal control over financial reporting. Management's report on internal control over financial reporting was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

/s/ Michael C. Crapps	/s/ Joseph G. Sawyer
Chief Executive Officer and President	*Senior Vice President and Chief Financial Officer*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors

First Community Corporation

Lexington, South Carolina

We have audited the accompanying consolidated balance sheets of First Community Corporation and Subsidiary (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 First Community Corporation and Subsidiary, as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ Elliott Davis, LLC

Columbia, South Carolina

March 21, 2014

FIRST COMMUNITY CORPORATION

Consolidated Balance Sheets

	December 31,	
(Dollars in thousands, except par values)	2013	2012
ASSETS		
Cash and due from banks	$8,239	$11,517
Interest-bearing bank balances	5,668	6,779
Federal funds sold and securities purchased under agreements to resell	259	412
Investment securities - available for sale	224,355	203,445
Other investments, at cost	2,674	2,527
Loans held for sale	3,790	9,658
Loans	347,597	332,111
Less, allowance for loan losses	4,219	4,621
Net loans	343,378	327,490
Property, furniture and equipment - net	19,444	17,258
Bank owned life insurance	11,072	10,868
Other real estate owned	3,370	3,987
Intangible assets	—	160
Goodwill	571	571
Other assets	10,489	8,253
Total assets	$633,309	$602,925
LIABILITIES		
Deposits:		
Non-interest bearing demand	$111,198	$97,526
NOW and money market accounts	174,224	150,874
Savings	51,134	41,100
Time deposits less than $100,000	96,096	111,182
Time deposits $100,000 and over	64,419	74,295
Total deposits	497,071	474,977
Securities sold under agreements to repurchase	18,634	15,900
Federal Home Loan Bank Advances	43,325	36,344
Junior subordinated debt	15,464	15,464
Other liabilities	6,144	6,057
Total liabilities	580,638	548,742
Commitments and Contingencies (Note 15)		
SHAREHOLDERS' EQUITY		
Preferred stock, par value $1.00 per share; 10,000,000 shares authorized; 0 issued and outstanding at December 31, 2013 and 2012	—	—
Common stock, par value $1.00 per share; 10,000,000 shares authorized; issued and outstanding 5,302,674 at December 31, 2013 and 5,227,300 at December 31, 2012	5,303	5,227
Common stock warrants issued	48	50
Nonvested restricted stock	(444)	(152)
Additional paid in capital	62,214	61,615
Accumulated deficit	(11,923)	(14,915)
Accumulated other comprehensive income (loss)	(2,527)	2,358
Total shareholders' equity	52,671	54,183
Total liabilities and shareholders' equity	$633,309	$602,925

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Income

(Dollars in thousands except per share amounts)	Year Ended December 31, 2013	2012	2011
Interest income:			
Loans, including fees	$17,581	$18,361	$19,110
Investment securities - taxable	3,046	3,832	6,291
Investment securities - non taxable	1,090	725	51
Other short term investments	66	84	74
Total interest income	21,783	23,002	25,526
Interest expense:			
Deposits	1,793	3,122	4,573
Securities sold under agreement to repurchase	37	35	40
Other borrowed money	1,904	2,271	2,596
Total interest expense	3,734	5,428	7,209
Net interest income	18,049	17,574	18,317
Provision for loan losses	528	496	1,420
Net interest income after provision for loan losses	17,521	17,078	16,897
Non-interest income:			
Deposit service charges	1,507	1,562	1,810
Mortgage banking income	3,767	4,242	1,973
Investment advisory fees and non-deposit commissions	972	651	767
Gain on sale of securities	73	26	575
Loss on sale of other assets	(1)	(89)	(155)
Other-than-temporary-impairment write-down on securities	—	(200)	(297)
Fair value loss adjustments on interest rate swap	(2)	(58)	(166)
Loss on early extinguishment of debt	(142)	(217)	(188)
Other	2,017	2,038	1,966
Total non-interest income	8,191	7,955	6,285
Non-interest expense:			
Salaries and employee benefits	12,013	11,152	9,520
Occupancy	1,384	1,358	1,289
Equipment	1,206	1,168	1,147
Marketing and public relations	541	478	452
FDIC Insurance assessments	417	597	889
Other real estate expense	508	1,010	840
Amortization of intangibles	160	204	517
Merger expenses	539	—	—
Other	3,654	3,478	3,747
Total non-interest expense	20,422	19,445	18,401
Net income before tax	5,290	5,588	4,781
Income tax expense	1,153	1,620	1,457
Net income	$4,137	$3,968	$3,324
Preferred stock dividends	—	557	670
Preferred stock redemption costs	—	119	—
Net income available to common shareholders	$4,137	$3,292	$2,654
Basic earnings per common share	$0.78	$0.79	$0.81

Diluted earnings per common share	$0.78	$0.79	$0.81

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Comprehensive Income (loss)

(Dollars in thousands)	Year ended December 31, 2013	2012	2011
Net income	$4,137	$3,968	$3,324
Other comprehensive income (loss):			
Unrealized gain (loss) during the period on available for sale securities, net of tax of $2,557, $471 and $1,964, respectively	(4,837)	914	3,751
Less: Reclassification adjustment for gain included in net income, net of tax of $25, $9, and $201, respectively	(48)	(17)	(374)
Reclassification adjustment for other-than-temporary-impairment on securities net of tax benefit of $0, $68 and $104, respectively	—	132	193
Other comprehensive income (loss)	(4,885)	1,029	3,570
Comprehensive income (loss)	$(748)	$4,997	$6,894

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Changes in Shareholders' Equity

(Dollars and shares in thousands)	Preferred Stock	Common Stock Number Shares Issued	Common Stock	Common Stock Warrants	Additional Paid-in Capital	Nonvested Restricted Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2010	$11,035	$3,270	$3,270	$509	$48,956	$—	$(19,732)	$ (2,241)	$41,797
Net income							3,324		3,324
Other comprehensive income net of tax of $2,061								3,570	3,570
Issuance of stock warrants				51					51
Issuance of restricted stock		23	23		133	(65)			91
Amortization of compensation on restricted stock						65			65
Dividends:									
Common ($0.16 per share)							(525)		(525)
Preferred stock	102						(670)		(568)
Dividend reinvestment plan		15	15		76				91
Balance, December 31, 2011	11,137	3,308	3,308	560	49,165	—	(17,603)	1,329	47,896
Net income							3,968		3,968
Other comprehensive income net of tax of $561								1,029	1,029
Repurchase of stock warrants				(510)	212				(298)
Issuance of restricted stock		33	33		239	(272)			—
Amortization of compensation on restricted stock						120			120
Issuance of common stock net of expenses of $1,200		1,875	1,875		11,917				13,792
Dividends: Common ($0.16 per share)							(605)		(605)
Preferred stock							(475)		(475)
	(11,285)								(11,285)

Redemption of preferred stock									
Accretion and redemption costs	148						(200)		(52)
Dividend reinvestment plan		11	11		82				93
Balance, December 31, 2012	$—	5,227	$5,227	$50	$61,615	$(152)	$(14,915)	$ 2,358	$54,183
Net income							4,137		4,137
Other comprehensive loss net of tax of $2,532								(4,885)	(4,885)
Exercise of stock warrants		3	3	(2)	—				1
Issuance of restricted stock		60	60		493	(553)			—
Amortization of compensation on restricted stock						261			261
Dividends:									
Common ($0.22 per share)							(1,145)		(1,145)
Dividend reinvestment plan		13	13		106				119
Balance, December 31, 2013	$—	5,303	$5,303	$48	$62,214	$(444)	$(11,923)	($ 2,527)	$52,671

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Cash Flows

(Amounts in thousands)	Year Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income	$4,137	$3,968	$3,324
Adjustments to reconcile net income to net cash provided in operating activities			
Depreciation	859	862	841
Premium amortization	4,050	3,112	1,968
Provision for loan losses	528	496	1,420
Writedowns of other real estate owned	87	317	261
Loss on sale of other real estate owned	6	89	155
Originations of HFS loans	(123,404)	(134,275)	(60,488)
Sales of HFS loans	129,272	128,342	56,763
Amortization of intangibles	160	204	517
Gain on sale of securities	(73)	(26)	(575)
Other-than-temporary-impairment charges on securities	—	200	297
Net decrease in fair value option instruments and derivatives	2	58	166
Writedown of land	110	170	—
Loss on early extinguishment of debt	142	217	188
Decrease in other assets	301	2,260	1,214
Increase in accounts payable	87	38	496
Net cash provided in operating activities	16,264	6,032	6,547
Cash flows from investing activities:			
Proceeds from sale of securities available-for-sale	12,884	55,791	54,714
Purchase of investment securities available-for-sale	(94,907)	(103,245)	(103,040)
Maturity/call of investment securities available-for-sale	49,526	43,144	40,441
Proceeds from sale of other investments	257	3,221	1,289
(Increase) decrease in loans	(17,585)	(11,312)	241
Proceeds from sale of other real estate owned	1,684	5,728	3,020
Proceeds from sale of land	—	—	10
Purchase of property and equipment	(3,306)	(806)	(308)
Net cash used in investing activities	(51,447)	(7,479)	(3,633)
Cash flows from financing activities:			
Increase in deposit accounts	22,094	10,392	9,242
Advances from the Federal Home Loan Bank	25,500	1,500	7,500
Repayment of advances from the Federal Home Loan Bank	(18,660)	(9,235)	(31,921)
Increase in securities sold under agreements to repurchase	2,734	2,284	929
Decrease in other borrowings	—	—	(120)
Proceeds from issuance of subordinated note payable	—	—	2,500
Repayment of subordinated note payable	—	(2,500)	—
Proceeds from sale Common Stock	—	13,792	—
Redemption of Preferred Stock	—	(11,073)	—
Repurchase of stock warrants	—	(510)	—
Dividend reinvestment plan	119	93	182
Dividends paid: Common Stock	(1,145)	(605)	(525)
Preferred Stock	—	(475)	(670)
Net cash provided (used) in financing activities	30,642	3,663	(12,883)

Net increase (decrease) in cash and cash equivalents	(4,541)	2,216	(9,969)
Cash and cash equivalents at beginning of year	18,708	16,492	26,461
Cash and cash equivalents at end of year	$14,167	$18,708	$16,492
Supplemental disclosure:			
Cash paid during the period for: Interest	$4,069	$6,023	$7,706
Taxes	$210,000	$—	$—
Non-cash investing and financing activities:			
Unrealized (loss) gain on securities available-for-sale	$(4,885)	$1,029	$3,570
Transfer of loans to foreclosed property	$1,160	$2,770	$3,889

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Notes to Consolidated Financial Statements

Note 1—ORGANIZATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of First Community Corporation (the "Company") and its wholly owned subsidiary, First Community Bank (the "Bank"). The Company owns all of the common stock of FCC Capital Trust I. All material intercompany transactions are eliminated in consolidation. The Company was organized on November 2, 1994, as a South Carolina corporation, and was formed to become a bank holding company. The Bank opened for business on August 17, 1995. FCC Capital Trust I is an unconsolidated special purpose subsidiary organized for the sole purpose of issuing trust preferred securities.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. The estimation process includes management's judgment as to future losses on existing loans based on an internal review of the loan portfolio, including an analysis of the borrower's current financial position, the consideration of current and anticipated economic conditions and the effect on specific borrowers. In determining the collectability of loans management also considers the fair value of underlying collateral. Various regulatory agencies, as an integral part of their examination process, review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors it is possible that the allowance for loan losses could change materially.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, due from banks, interest-bearing bank balances, federal funds sold and securities purchased under agreements to resell. Generally federal funds are sold for a one-day period and securities purchased under agreements to resell mature in less than 90 days.

Investment Securities

Investment securities are classified as either held-to-maturity, available-for-sale or trading securities. In determining such classification, securities that the Company has the positive intent and ability to hold to maturity are classified as held-to maturity and are carried at amortized cost. Securities classified as available-for-sale are carried at estimated fair values with unrealized gains and losses included in shareholders' equity on an after tax basis. Trading securities are carried at estimated fair value with unrealized gains and losses included in Non-interest income (See Note 4).

Gains and losses on the sale of available-for-sale securities and trading securities are determined using the specific identification method. Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are judged to be other than temporary are written down to fair value and charged to income in the Consolidated Statement of Income.

Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

*Mortgage Loans Held for S*ale

The Company originates fixed rate residential loans on a servicing released basis in the secondary market. Loans closed but not yet settled with an investor, are carried in the Company's loans held for sale portfolio. These loans are fixed rate residential loans that have been originated in the Company's name and have closed. Virtually all of these loans have commitments to be purchased by investors at a locked in price with the investors on the same day that the loan was locked in with the Company's customers. Therefore, these loans present very little market risk for the Company.

The Company usually delivers to, and receives funding from, the investor within 30 days. Commitments to sell these loans to the investor are considered derivative contracts and are sold to investors on a "best efforts" basis. The Company is not obligated to deliver a loan or pay a penalty if a loan is not delivered to the investor. As a result of the short-term nature of these derivative contracts, the fair value of the mortgage loans held for sale in most cases is the same as the value of the loan amount at its origination. These loans are classified as Level 2.

Loans and Allowance for Loan Losses

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest is recognized over the term of the loan based on the loan balance outstanding. Fees charged for originating loans, if any, are deferred and offset by the deferral of certain direct expenses associated with loans originated. The net deferred fees are recognized as yield adjustments by applying the interest method.

The allowance for loan losses is maintained at a level believed to be adequate by management to absorb potential losses in the loan portfolio. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, past loss experience, economic conditions and volume, growth and composition of the portfolio.

The Company considers a loan to be impaired when, based upon current information and events, it is believed that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans that are considered impaired are accounted for at the lower of carrying value or fair value. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, generally when a loan becomes 90 days past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received first to principal and then to interest income.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property 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 39 years for buildings and up to 10 years for furniture, fixtures and equipment.

Goodwill and Other Intangible Assets

Goodwill represents the cost in excess of fair value of net assets acquired (including identifiable intangibles) in purchase transactions. Other intangible assets represent premiums paid for acquisitions of core deposits (core deposit intangibles). Core deposit intangibles are being amortized on a straight-line basis over seven years. Goodwill and identifiable intangible assets are reviewed for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The annual valuation is performed on September 30 of each year.

Other Real Estate Owned

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is carried at the lower of cost (principal balance at date of foreclosure) or fair value minus estimated cost to sell. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses to maintain such assets, subsequent changes in the valuation allowance, and gains or losses on disposal are included in other expenses.

Comprehensive Income

The Company reports comprehensive income in accordance with ASC 220, "Comprehensive Income." ASC 220 requires that all items that are required to be reported under accounting standards as comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The disclosures requirements have been included in the Company's consolidated statements of comprehensive income.

Mortgage Origination Fees

Mortgage origination fees relate to activities comprised of accepting residential mortgage applications, qualifying borrowers to standards established by investors and selling the mortgage loans to the investors under pre-existing commitments. The loans are funded by the investor at closing and the related fees received by the Company for these services are recognized at the time the loan is closed.

Advertising Expense

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising expenses totaled $513.4 thousand, $444.5 thousand, and $436.2 thousand for the years ended December 31, 2013, 2012 and 2011, respectively.

Income Taxes

A deferred income tax liability or asset is recognized for the estimated future effects attributable to differences in the tax bases of assets or liabilities and their reported amounts in the financial statements as well as operating loss and tax credit carry forwards. The deferred tax asset or liability is measured using the enacted tax rate expected to apply to taxable income in the period in which the deferred tax asset or liability is expected to be realized.

In 2006, the FASB issued guidance related to Accounting for Uncertainty in Income Taxes. This guidance clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB ASC topic 740-10, “Income Taxes”. It also prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise’s tax return.

Stock Based Compensation Cost

The Company accounts for stock based compensation under the fair value provisions of the accounting literature. Compensation expense is recognized in salaries and employee benefits.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The fair value of each grant is estimated on the date of grant using the Black-Sholes option pricing model. No options were granted in 2013, 2012 or 2011.

Earnings Per Common Share

Basic earnings per common share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average number of shares of common stock and common stock equivalents. Common stock equivalents consist of stock options and warrants and are computed using the treasury stock method.

Segment Information

ASC Topic 280-10, "Segment Reporting," requires selected segment information of operating segments based on a management approach. The Company operates as one business segment.

Recently Issued Accounting Standards

In December 2011, the Property, Plant and Equipment topic of the ASC was amended to provide guidance on derecognizing in substance real estate when a parent ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. Typically a company will continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments were effective for reporting periods beginning after June 15, 2012 and did not have a material effect on the Company's financial statements.

In July 2012, the Intangibles topic was amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that indefinite-lived intangible assets are impaired. If it is determined to be more likely than not that indefinite-lived intangible assets are impaired, then the entity is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The amendments did not have a material effect on the Company's financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. 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 were effective for the Company on a prospective basis for reporting periods beginning after December 15, 2012. These amendments did not have a material effect on the Company’s financial statements.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In February 2013, the FASB amended the Liabilities topic to address obligations resulting from joint and several liability arrangements. The guidance addresses recognition of financial commitments arising from joint and several liability arrangements. Specifically, the amendments require recognition of financial commitments arising from loans, contracts, and legal rulings if the Company can be held liable for the entire claim. The amendments will be effective for the Company for reporting periods beginning after December 15, 2013. 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 July 2013, the FASB issued guidance that permits the Fed Funds Effective Swap Rate (“Overnight Index Swap Rate” or “OIS”) to be used as a U.S. benchmark interest rate for hedge accounting purposes, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The guidance will be effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2014, the FASB amended the Investments—Equity Method and Joint Ventures topic of the Codification to address accounting for investments in qualified affordable housing projects. If certain conditions are met, the amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects by amortizing the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizing the net investment performance in the income statement as a component of income tax expense (benefit). If those conditions are not met, the investment should be accounted for as an equity method investment or a cost method investment in accordance with existing accounting guidance. The amendments will be effective for the Company for interim and annual reporting periods beginning after December 15, 2014 and should be applied retrospectively for all periods presented. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 for interim and annual reporting periods beginning after December 15, 2014-public companies. 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.

Risk and Uncertainties

In the normal course of 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 reprice at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment portfolios that results from borrowers' or issuer's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans and investments and the valuation of real estate held by the Company.

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

Reclassifications

Certain captions and amounts in the 2012 and 2011 consolidated financial statements were reclassified to conform to the 2013 presentation.

Note 3—BUSINESS COMBINATIONS

The Bank expanded its residential mortgage business unit with the acquisition of the assets of Palmetto South Mortgage Corporation ("Palmetto South"), effective July 31, 2011. Palmetto South, which operates as a division of the Bank, offers mortgage loan products for home purchase or refinance in the South Carolina market area. The acquisition price will be paid during a three year earn out period with the actual amount calculated based on the achievement of certain profitability metrics. The earn out terms over the three year period provide for contingent consideration which ranges from $0 to $1.2 million based upon annual net income. Management anticipates the amount will be approximately $600 thousand based upon recent past operating results and as such a contingent liability was recognized for this amount when considering business combination accounting rules. The purchase price of operating assets was $22 thousand. This acquisition was not considered material to the financial statements.

Note 4—INVESTMENT SECURITIES

The amortized cost and estimated fair values of investment securities are summarized below:

AVAILABLE-FOR-SALE:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2013:				
Government sponsored enterprises	$3,388	$ 1	$ 143	$3,246
Mortgage-backed securities	120,925	757	2,006	119,676
Small Business Administration pools	56,595	376	851	56,120
State and local government	45,048	96	2,146	42,998
Corporate and other securities	2,348	21	54	2,315
	$228,304	$ 1,251	$ 5,200	$224,355
December 31, 2012:				
Government sponsored enterprises	$1,522	$ 12	$ —	$1,534
Mortgage-backed securities	110,425	2,343	624	112,144
Small Business Administration pools	54,148	1,008	163	54,993
State and local government	31,483	936	46	32,373