

COMMUNITY FINANCIAL CORP /MD/
Form 10-Q
May 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2015

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 0-18279

The Community Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland

52-1652138

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(State of other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3035 Leonardtown Road, Waldorf, Maryland 20601
(Address of principal executive offices) (Zip Code)

(301) 645-5601

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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. (Check one):

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input checked="" type="checkbox"/>
Non-accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of April 30, 2015, the registrant had 4,717,716 shares of common stock outstanding.

THE COMMUNITY FINANCIAL CORPORATION

FORM 10-Q

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PART 1 - FINANCIAL INFORMATION**ITEM 1 – FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEETS**

(dollars in thousands)	March 31, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and due from banks	\$ 10,463	\$ 17,275
Federal funds sold	645	965
Interest-bearing deposits with banks	331	3,133
Securities available for sale (AFS), at fair value	40,435	41,939
Securities held to maturity (HTM), at amortized cost	80,653	84,506
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock - at cost	6,933	6,434
Loans held for sale	271	-
Loans receivable - net of allowance for loan losses of \$8,621 and \$8,481	881,452	862,409
Premises and equipment, net	21,274	20,586
Other real estate owned (OREO)	6,861	5,883
Accrued interest receivable	3,115	3,036
Investment in bank owned life insurance	27,226	27,021
Other assets	9,512	9,691
Total Assets	\$ 1,089,171	\$ 1,082,878
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	\$ 126,186	\$ 122,195
Interest-bearing deposits	728,305	747,189
Total deposits	854,491	869,384
Short-term borrowings	21,000	2,000
Long-term debt	70,659	74,672
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000
Subordinated notes - 6.25%	23,000	-
Accrued expenses and other liabilities	9,726	8,263
Total Liabilities	990,876	966,319
Stockholders' Equity		
Preferred Stock, Senior Non-Cumulative Perpetual, Series C - par value \$1,000; authorized and issued 20,000 at December 31, 2014 and none at March 31, 2015	-	20,000

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Common stock - par value \$.01; authorized - 15,000,000 shares; issued 4,730,314 and 4,702,715 shares, respectively	47		47	
Additional paid in capital	46,640		46,416	
Retained earnings	52,198		50,936	
Accumulated other comprehensive loss	(100)	(378)
Unearned ESOP shares	(490)	(462)
Total Stockholders' Equity	98,295		116,559	
Total Liabilities and Stockholders' Equity	\$ 1,089,171		\$ 1,082,878	

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(dollars in thousands, except per share amounts)	Three Months Ended March 31,	
	2015	2014
Interest and Dividend Income		
Loans, including fees	\$ 10,177	\$ 9,583
Taxable interest and dividends on investment securities	547	590
Interest on deposits with banks	4	2
Total Interest and Dividend Income	10,728	10,175
Interest Expense		
Deposits	988	1,208
Short-term borrowings	9	6
Long-term debt	668	527
Total Interest Expense	1,665	1,741
Net Interest Income	9,063	8,434
Provision for loan losses	178	203
Net Interest Income After Provision For Loan Losses	8,885	8,231
Noninterest Income		
Loan appraisal, credit, and miscellaneous charges	58	100
Gain on sale of asset	18	-
Net (losses) gains on sale of investment securities	(1) 24
Income from bank owned life insurance	205	151
Service charges	585	552
Gain on sale of loans held for sale	97	68
Total Noninterest Income	962	895
Noninterest Expense		
Salary and employee benefits	4,145	4,029
Occupancy expense	630	565
Advertising	103	122
Data processing expense	518	271
Professional fees	295	230
Depreciation of furniture, fixtures, and equipment	201	185
Telephone communications	46	50
Office supplies	39	80
FDIC Insurance	198	139
OREO valuation allowance and expenses	219	129
Other	549	531
Total Noninterest Expense	6,943	6,331
Income before income taxes	2,904	2,795
Income tax expense	1,083	1,074
Net Income	\$ 1,821	\$ 1,721

Preferred stock dividends	23	50
Net Income Available to Common Stockholders	\$ 1,798	\$ 1,671
Earnings Per Common Share		
Basic	\$ 0.38	\$ 0.36
Diluted	\$ 0.38	\$ 0.36
Cash dividends paid per common share	\$ 0.10	\$ 0.10

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(dollars in thousands)	Three Months Ended March 31,	
	2015	2014
Net Income	\$ 1,821	\$ 1,721
Net unrealized holding gains (losses) arising during period, net of tax expense (benefit) of \$181 and \$(39), respectively	278	(77)
Reclassification adjustment for gains included in net income, net of tax expense (benefit) of \$ - and \$(3) respectively	-	(5)
Comprehensive Income	\$ 2,099	\$ 1,639

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(dollars in thousands)	Three months ended March 31,	
	2015	2014
Cash Flows from Operating Activities		
Net income	\$ 1,821	\$ 1,721
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	178	203
Depreciation and amortization	349	312
Loans originated for resale	(4,215)	(2,769)
Proceeds from sale of loans originated for sale	4,021	2,367
Gain on sale of loans held for sale	(97)	(68)
Losses (gains) on sales of HTM investment securities	1	(16)
Gains on sales of AFS investment securities	-	(8)
Gain on sale of asset	(18)	-
Net amortization of premium/discount on investment securities	127	68
Increase in OREO valuation allowance	125	82
Increase in cash surrender of bank owned life insurance	(205)	(151)
(Increase) decrease in deferred income tax benefit	(118)	709
Increase in accrued interest receivable	(79)	(18)
Stock based compensation	54	136
Decrease in deferred loan fees	266	31
Increase (decrease) in accrued expenses and other liabilities	1,463	(1,099)
Decrease in other assets	279	834
Net Cash Provided by Operating Activities	3,952	2,334
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(22)	(22)
Proceeds from redemption or principal payments of AFS investment securities	1,937	2,621
Purchase of HTM investment securities	-	(750)
Proceeds from maturities or principal payments of HTM investment securities	3,706	3,048
Net increase of FHLB and FRB stock	(499)	(787)
Loans originated or acquired	(74,011)	(58,172)
Principal collected on loans	52,988	46,315
Purchase of premises and equipment	(1,040)	(545)
Proceeds from sale of OREO	452	-
Proceeds from sale of HTM investment securities	66	3,179
Proceeds from sale of AFS investment securities	-	2,056
Proceeds from disposal of asset	21	-
Net Cash Used in Investing Activities	(16,402)	(3,057)

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**(continued)**

(dollars in thousands)	Three months ended March 31,	
	2015	2014
Cash Flows from Financing Activities		
Net decrease in deposits	\$ (14,893)	\$ (12,176)
Proceeds from long-term debt	-	5,000
Payments of long-term debt	(4,013)	(13)
Net increase in short term borrowings	19,000	-
Exercise of stock options	-	85
Proceeds from Subordinated Notes	23,000	-
Redemption of Small Business Lending Fund Preferred Stock	(20,000)	-
Dividends Paid	(534)	(516)
Net change in unearned ESOP shares	(28)	-
Repurchase of common stock	(16)	-
Net Cash Provided by (Used in) Financing Activities	2,516	(7,620)
Decrease in Cash and Cash Equivalents	\$ (9,934)	\$ (8,343)
Cash and Cash Equivalents - January 1	21,373	24,519
Cash and Cash Equivalents - March 31	\$ 11,439	\$ 16,176
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for		
Interest	\$ 1,479	\$ 1,754
Income taxes	\$ 50	\$ 125
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	\$ 216	\$ 182
Transfer from loans to OREO	\$ 1,556	\$ 739

See notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 – BASIS OF PRESENTATION

The consolidated financial statements of The Community Financial Corporation (the “Company”) and its wholly owned subsidiary, Community Bank of the Chesapeake (the “Bank”), and the Bank’s wholly owned subsidiary, Community Mortgage Corporation of Tri-County, included herein are unaudited.

The consolidated financial statements reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company’s financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2014 have been derived from audited financial statements. There have been no significant changes to the Company’s accounting policies as disclosed in the 2014 Annual Report. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2015 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s 2014 Annual Report.

NOTE 2 – NATURE OF BUSINESS

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and King George and Fredericksburg, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

The Bank conducts business through its main office in Waldorf, Maryland, and eleven branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and King George and Fredericksburg, Virginia. The Company maintains five loan production offices (“LPOs”) in Annapolis, La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches. The Company opened its branch in Fredericksburg, Virginia in July 2014 and its LPO in Annapolis, Maryland in October 2014.

NOTE 3 – INCOME TAXES

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. The Company's income tax returns for the past three years are subject to examinations by tax authorities, and may change upon examination.

NOTE 4 - ACCUMULATED OTHER COMPREHENSIVE GAIN (LOSS)

The following tables present the components of comprehensive gain (loss) for the three months ended March 31, 2015 and 2014. The Company's comprehensive gain (loss) was solely related to securities for the three months ended March 31, 2015 and 2014.

(dollars in thousands)	Three Months Ended March 31, 2015			Three Months Ended March 31, 2014		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Net unrealized holding gains (losses) arising during period	\$ 459	\$ 181	\$ 278	\$ (116)	\$ (39)	\$ (77)
Reclassification adjustments	-	-	-	(8)	(3)	(5)
Other comprehensive gain (loss)	\$ 459	\$ 181	\$ 278	\$ (124)	\$ (42)	\$ (82)

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended March 31, 2015 and 2014.

(dollars in thousands)	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
	Net Unrealized Gains And Losses	Net Unrealized Gains And Losses
Beginning of period	\$ (378)	\$ (1,057)
Other comprehensive gain (loss) before reclassifications	278	(77)
Amounts reclassified from accumulated other comprehensive income	-	(5)
Net other comprehensive gain (loss)	278	(82)
End of period	\$ (100)	\$ (1,139)

NOTE 5 - EARNINGS PER SHARE ("EPS")

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. At both March 31, 2015 and 2014, there were 87,436 options, which were excluded from the calculation as their effect would be anti-dilutive, because the exercise price of the options were greater than the average market price of the common shares. The Company has not granted any stock options since 2007 and all options outstanding at March 31, 2015 were anti-dilutive. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

(dollars in thousands)	Three Months Ended	
	March 31,	
	2015	2014
Net Income	\$1,821	\$1,721
Less: dividends paid and accrued on preferred stock	(23)	(50)
Net income available to common shareholders	\$1,798	\$1,671
Average number of common shares outstanding	4,694,460	4,642,064
Effect of dilutive options	-	16,465
Average number of shares used to calculate diluted EPS	4,694,460	4,658,529

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NOTE 6 - STOCK-BASED COMPENSATION

The Company has stock-based incentive arrangements to attract and retain key personnel. In May 2005, the 2005 Equity Compensation Plan (the "Plan") was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service-based awards is recognized over the vesting period. Performance-based awards are recognized based on a vesting schedule, if applicable, and the probability of achieving goals specified at the time of the grant. The Plan expired on January 24, 2015 and a new Equity Compensation Plan was submitted and approved at the Company's Annual Meeting on May 4, 2015.

Stock-based compensation expense totaled \$54,000 and \$136,000 for the three months ended March 31, 2015 and 2014, respectively, which consisted of the vesting of grants of restricted stock. In addition, in 2014 stock-based compensation expense included the vesting of restricted stock units.

All outstanding options were fully vested and the Company has not granted any stock options since 2007. The fair value of the Company's outstanding employee stock options is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

The exercise price for options granted is set at the discretion of the committee administering the Plan, but is not less than the market value of the shares as of the date of grant. An option's maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize outstanding and exercisable options at March 31, 2015 and December 31, 2014.

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted- Average Contractual Life Remaining In Years
Outstanding at January 1, 2015	87,436	\$ 23.60	\$ -	
Exercised	-	-	-	
Forfeited	-	-		
Outstanding at March 31, 2015	87,436	\$ 23.60	\$ -	-

Exercisable at March 31, 2015	87,436	\$ 23.60	\$ -	-
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(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted- Average Contractual Life Remaining In Years
Outstanding at January 1, 2014	159,517	\$ 20.12	\$ 347	
Exercised	(45,163)	15.89	207	
Forfeited	(26,918)	15.89		
Outstanding at December 31, 2014	87,436	\$ 23.60	\$ -	-
Exercisable at December 31, 2014	87,436	\$ 23.60	\$ -	-

Options outstanding are all currently exercisable and are summarized as follows:

Shares Outstanding March 31, 2015	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
66,225	1 years	\$ 22.29
21,211	2 years	27.70
87,436		\$ 23.60

The aggregate intrinsic value of outstanding stock options and exercisable stock options was \$0 at March 31, 2015 and December 31, 2014. All options outstanding at March 31, 2015 and December 31, 2014 were anti-dilutive and therefore the intrinsic value was \$0. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was \$20.00 and \$20.07 per share at March 31, 2015 and December 31, 2014, respectively, and the exercise price multiplied by the number of in the money options outstanding.

The Company granted restricted stock and stock units in accordance with the Plan. The vesting period for granted restricted stock is between three and five years. As of March 31, 2015, unrecognized stock compensation expense was \$769,000. The following tables summarize the unvested restricted stock awards and units outstanding at March 31, 2015 and December 31, 2014, respectively. There were no outstanding stock units at March 31, 2015 and December 31, 2014, respectively.

	Restricted Stock Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2015	29,472	\$ 20.83

Granted	28,040	18.63
Vested	(20,465)	19.62
Nonvested at March 31, 2015	37,047	\$ 19.83

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at January 1, 2014	16,832	\$ 17.86	4,210	\$ 20.71
Granted	33,460	21.35	-	-
Vested	(20,820)	19.26	(4,210)	20.28
Nonvested at December 31, 2014	29,472	\$ 20.83	-	\$ -

NOTE 7 - GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES (“TRUPS”)

On June 15, 2005, Tri-County Capital Trust II (“Capital Trust II”), a Delaware business trust formed, funded and wholly owned by the Company, issued \$5.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the \$155,000 for Capital Trust II’s common securities, to purchase \$5.2 million of the Company’s junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as “Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures.” Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I (“Capital Trust I”), a Delaware business trust formed, funded and wholly owned by the Company, issued \$7.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company’s \$217,000 capital contribution for Capital Trust I’s common securities, to purchase \$7.2 million of the Company’s junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as “Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures.” Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

**NOTE 8 –
SUBORDINATED
NOTES**

On February 6, 2015 the Company issued \$23.0 million of unsecured 6.25% fixed to floating rate subordinated notes due February 15, 2025 (“subordinated notes”). On February 13, 2015, the Company used proceeds of the offering to redeem all \$20 million of the Company’s outstanding preferred stock issued under the Small Business Lending Fund (“SBLF”) program. The subordinated notes qualify as Tier 2 regulatory capital and replaced SBLF Tier 1 capital. The subordinated notes are not listed on any securities exchange or included in any automated dealer quotation system and there is no market for the notes. The notes are unsecured obligations and are subordinated in right of payment to all existing and future senior debt, whether secured or unsecured. The notes are not guaranteed obligations of any of the

Company's subsidiaries.

Interest will accrue at a fixed per annum rate of 6.25% from and including the issue date to but excluding February 15, 2020. From and including February 15, 2020 to but excluding the maturity date interest will accrue at a floating rate equal to the three-month LIBOR plus 479 basis points. Interest is payable on the notes on February 15 and August 15 of each year, commencing August 15, 2015, through February 15, 2020, and thereafter February 15, May 15, August 15 and November 15 of each year through the maturity date or earlier redemption date.

The subordinated notes may be redeemed in whole or in part on February 15, 2020 or on any scheduled interest payment date thereafter and upon the occurrence of certain special events. The redemption price is equal to 100% of the principal amount of the subordinated notes to be redeemed plus accrued and unpaid interest to the date of redemption. Any partial redemption will be made pro rata among all holders of the subordinated notes. The subordinated notes are not subject to repayment at the option of the holders. The subordinated notes may be redeemed at any time, if (1) a change or prospective change in law occurs that could prevent the Company from deducting interest payable on the notes for U.S. federal income tax purposes, (2) a subsequent event occurs that precludes the notes from being recognized as Tier 2 Capital for regulatory capital purposes, or (3) the Company is required to register as an investment company under the Investment Company Act of 1940, as amended.

NOTE 9 - OTHER REAL ESTATE OWNED (“OREO”)

OREO assets are presented net of valuation allowances. The Company considers OREO as classified assets for regulatory and financial reporting. An analysis of OREO activity follows.

(dollars in thousands)	Three Months Ended March 31,		Year Ended
	2015	2014	December 31, 2014
Balance at beginning of year	\$ 5,883	\$ 6,797	\$ 6,797
Additions of underlying property	1,556	739	2,742
Disposals of underlying property	(453)	-	(2,422)
Transfers of OREO to loans	-	-	(1,000)
Valuation allowance	(125)	(82)	(234)
Balance at end of period	\$ 6,861	\$ 7,454	\$ 5,883

During the three months ended March 31, 2015, additions of \$1.6 million consisted of \$784,000 for five residential properties, \$378,000 for three residential lots and \$400,000 for a commercial building. During the three months ended March 31, 2014, additions of \$739,000 consisted of a residential property of \$99,000 and a commercial building of \$640,000. The Company disposed of one residential property and two finished residential lots at no gain for the three months ended March 31, 2015. There were no disposals of OREO during the three months ended March 31, 2014. Additions to the valuation allowances of \$125,000 and \$82,000 were taken to adjust properties to current appraised values for the three months ended March 31, 2015 and 2014, respectively. OREO carrying amounts reflect management’s estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs.

Expenses applicable to OREO assets include the following.

(dollars in thousands)	Three Months Ended March 31,	
	2015	2014
Valuation allowance	\$ 125	\$ 82
Operating expenses	94	47
	\$ 219	\$ 129

NOTE 10 – SECURITIES

	March 31, 2015			
	Amortized	Gross	Gross	Estimated
(dollars in thousands)	Cost	Unrealized	Unrealized	Fair Value
		Gains	Losses	
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential Mortgage Backed Securities ("MBS")	\$27	\$ 4	\$ -	\$ 31
Residential Collateralized Mortgage Obligations ("CMOs")	36,316	104	439	35,981
Corporate equity securities	37	3	-	40
Bond mutual funds	4,221	162	-	4,383
Total securities available for sale	\$40,601	\$ 273	\$ 439	\$ 40,435
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs				
Residential MBS	\$18,783	\$ 763	\$ 25	\$ 19,521
Residential CMOs	59,784	513	301	59,996
Asset-backed securities issued by Others:				
Residential CMOs	1,336	-	124	1,212
Total debt securities held to maturity	79,903	1,276	450	80,729
U.S. government obligations	750	-	-	750
Total securities held to maturity	\$80,653	\$ 1,276	\$ 450	\$ 81,479

	December 31, 2014			
	Amortized	Gross	Gross	Estimated
(dollars in thousands)	Cost	Unrealized	Unrealized	Fair Value
		Gains	Losses	
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	\$33	\$ 4	\$ -	\$ 37
Residential CMOs	38,294	77	830	37,541
Corporate equity securities	37	3	-	40
Bond mutual funds	4,199	122	-	4,321
Total securities available for sale	\$42,563	\$ 206	\$ 830	\$ 41,939
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs				
Residential MBS	\$19,501	\$ 767	\$ 45	\$ 20,223
Residential CMOs	62,683	379	580	62,482
Asset-backed securities issued by Others:				
Residential CMOs	1,472	-	112	1,360
Total debt securities held to maturity	83,656	1,146	737	84,065

U.S. government obligations	850	-	-	850
Total securities held to maturity	\$84,506	\$ 1,146	\$ 737	\$ 84,915

At March 31, 2015, certain asset-backed securities with an amortized cost of \$18.5 million were pledged to secure certain deposits. At March 31, 2015, asset-backed securities with an amortized cost of \$2.2 million were pledged as collateral for advances from the Federal Home Loan Bank (“FHLB”) of Atlanta.

At March 31, 2015, 99% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by government sponsored entities ("GSEs") had an average life of 3.49 years and an average duration of 3.29 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 3.17 years and an average duration of 3.01 years and are guaranteed by their issuer as to credit risk.

At December 31, 2014, 99% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs had an average life of 3.66 years and average duration of 3.41 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 3.40 years and average duration of 3.21 years and are guaranteed by their issuer as to credit risk.

We believe that AFS securities with unrealized losses will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities until recovery of the market value which may be at maturity. We believe that the losses are the result of general perceptions of safety and creditworthiness of the entire sector and a general disruption of orderly markets in the asset class.

Management has the ability and intent to hold the HTM securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. Because our intention is not to sell the investments and it is not more likely than not that we will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, management considers the unrealized losses in the held-to-maturity portfolio to be temporary.

No charges related to other-than-temporary impairment were made during the three months ended March 31, 2015 and 2014.

During the three months ended March 31, 2015, the Company sold one HTM security with a carrying value of \$68,000 and recognized a loss of \$1,000. During the three months ended March 31, 2014, the Company recognized net gains on the sale of securities of \$24,000. The Company sold five AFS securities with a carrying value of \$2.1 million and ten HTM securities with aggregate carrying values of \$3.2 million, recognizing gains of \$8,000 and \$16,000, respectively. The sale of HTM securities were permitted under ASC 320 "Investments - Debt and Equity Securities." ASC 320 permits the sale of HTM securities for certain changes in circumstances. Securities were disposed of using the safe harbor rule that allows for the sale of HTM securities that have principal payments paid down to less than 15% of original purchased par. ASC 320 10-25-15 indicates that a sale of a debt security after a substantial portion of the principal has been collected is equivalent to holding the security to maturity. In addition, HTM securities were disposed of under ASC 320-10-25-6 due to a significant deterioration in the issues' creditworthiness and the increase in regulatory risk weights mandated for risk-based capital purposes.

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at March 31, 2015 were as follows:

March 31, 2015	Less Than 12		More Than 12		Total	
	Months		Months			
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	\$ -	\$ -	\$23,610	\$ 439	\$23,610	\$ 439

At March 31, 2015, the AFS investment portfolio had an estimated fair value of \$40.4 million, of which \$23.6 million of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses were CMOs issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were \$439,000 of the portfolio amortized cost of \$36.3 million. AFS asset-backed securities issued by GSEs with unrealized losses had an average life of 3.74 years and an average duration of 3.47 years. We believe that the securities will either recover in market value or be paid off as agreed.

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at December 31, 2014 were as follows:

December 31, 2014	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
(dollars in thousands)						
Asset-backed securities issued by GSEs	\$ 294	\$ -	\$26,856	\$ 830	\$27,150	\$ 830

At December 31, 2014, the AFS investment portfolio had an estimated fair value of \$41.9 million, of which \$27.2 million of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses were CMOs issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were \$830,000 of the portfolio amortized cost of \$38.3 million. AFS asset-backed securities issued by GSEs with unrealized losses had an average life of 3.77 years and an average duration of 3.46 years. We believe that the securities will either recover in market value or be paid off as agreed.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at March 31, 2015 were as follows:

March 31, 2015	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
(dollars in thousands)						
Asset-backed securities issued by GSEs	-	-	20,399	326	20,399	326
Asset-backed securities issued by other	-	-	1,211	124	1,211	124
	\$ -	\$ -	\$21,610	\$ 450	\$21,610	\$ 450

At March 31, 2015, the HTM investment portfolio had an estimated fair value of \$81.5 million, of which \$21.6 million of the securities had some unrealized losses from their amortized cost. Of these securities, \$20.4 million were asset-backed securities issued by GSEs and the remaining \$1.2 million were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were \$326,000 of the portfolio amortized cost of \$78.6 million. HTM asset-backed securities issued by GSEs with unrealized losses had an average life of 3.38 years and an average duration of 3.16 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were \$124,000 of the portfolio amortized cost of \$1.3 million. HTM asset-backed securities issued by others with unrealized losses have an average life of 4.41 years and an average duration of 3.65 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2014 were as follows:

December 31, 2014	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
(dollars in thousands)						
Asset-backed securities issued by GSEs	\$ 14,508	\$ 85	\$ 21,091	\$ 540	\$ 35,599	\$ 625
Asset-backed securities issued by other	-	-	1,291	112	1,291	112
	\$ 14,508	\$ 85	\$ 22,382	\$ 652	\$ 36,890	\$ 737

At December 31, 2014, the HTM investment portfolio had an estimated fair value of \$84.9 million, of which \$36.9 million of the securities had some unrealized losses from their amortized cost. Of these securities, \$35.6 million were asset-backed securities issued by GSEs and the remaining \$1.3 million were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were \$625,000 of the portfolio amortized cost of \$82.2 million. HTM asset-backed securities issued by GSEs with unrealized losses had an average life of 3.23 years and an average duration of 3.01 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were \$112,000 of the portfolio amortized cost of \$1.5 million. HTM asset-backed securities issued by others with unrealized losses have an average life of 4.27 years and an average duration of 3.62 years.

Credit Quality of Asset-Backed Securities

The tables below present the Standard & Poor's or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and others at March 31, 2015 and December 31, 2014 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed security downgrades by Standard and Poor's were treated as AAA based on regulatory guidance.

March 31, 2015		December 31, 2014	
Credit Rating	Amount	Credit Rating	Amount

(dollars in thousands)

AAA	\$114,579	AAA	\$119,762
BBB	-	BBB	68
BB	662	BB	695
CCC+	674	CCC+	709
Total	\$115,915	Total	\$121,234

NOTE 11 – LOANS

Loans consist of the following:

(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial real estate	\$ 588,193	\$ 561,080
Residential first mortgages	148,631	152,837
Construction and land development	37,349	36,370
Home equity and second mortgages	21,211	21,452
Commercial loans	68,504	73,625
Consumer loans	464	613
Commercial equipment	26,931	26,152
	891,283	872,129
Less:		
Deferred loan fees	1,210	1,239
Allowance for loan losses	8,621	8,481
	9,831	9,720
	\$ 881,452	\$ 862,409

At March 31, 2015, the Bank's allowance for loan losses totaled \$8.6 million, or 0.97% of loan balances, as compared to \$8.5 million, or 0.97% of loan balances, at December 31, 2014. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

Risk Characteristics of Portfolio Segments

The Company manages its credit products and exposure to credit losses (credit risk) by the following specific portfolio segments (classes), which are levels at which the Company develops and documents its allowance for loan loss methodology. These segments are:

Commercial Real Estate ("CRE")

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were below 5% of the CRE portfolio at March 31, 2015 and December 31, 2014. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

Loans secured by commercial real estate are larger and involve greater risks than one-to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy.

Residential First Mortgages

Residential first mortgage loans made by the Bank are generally long-term loans, amortized on a monthly basis, with principal and interest due each month. The contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank's experience indicates that real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank originates both fixed-rate and adjustable-rate residential first mortgages.

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank's adjustable rate residential first mortgage portfolio was \$25.7 million or 2.9% of total gross loans of \$891.3 million at March 31, 2015.

Construction and Land Development

The Bank offers loans for the construction of one-to-four family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals.

A decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project's value might be insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk has been heightened as the market value of residential property has declined.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business, the viability of the industry in which the consumer operates, the value of the collateral, and the borrower's ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable, or other security as determined by the Bank.

Commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself.

Consumer Loans

Consumer loans consist of loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer's equipment. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

Non-accrual and Past Due Loans

Non-accrual loans as of March 31, 2015 and December 31, 2014 were as follows:

(dollars in thousands)	March 31, 2015		December 31, 2014	
	Total Non-accrual Loans	Total Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	\$ 2,008	4	\$ 3,824	11
Residential first mortgages	530	2	533	2
Construction and land development	3,634	2	3,634	2
Home equity and second mortgages	395	6	399	6
Commercial loans	1,584	6	1,587	6
Consumer loans	-	-	-	-
Commercial equipment	284	4	286	4
	\$ 8,435	24	\$ 10,263	31

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) decreased \$1.9 million from \$10.3 million or 1.18% of total loans at December 31, 2014 to \$8.4 million or 0.95% of total loans at March 31, 2015. Non-accrual only loans are loans classified as non-accrual due to customer operating results or payment history. In accordance with the Company's policy, interest income is recognized on a cash basis for these loans. There were no non-accrual only loans at March 31, 2015 or at December 31, 2014.

Non-accrual loans at March 31, 2015 included \$7.1 million, or 84% of non-accrual loans, attributed to 10 loans representing three customer relationships classified as substandard. Non-accrual loans at December 31, 2014 included \$8.8 million, or 86% of nonperforming loans, attributed to 16 loans representing six customer relationships classified as substandard. Of these loans at March 31, 2015 and December 31, 2014, four loans totaling \$3.9 million represented a stalled residential development project. During the second quarter of 2014, the Bank deferred the collection of principal and interest for one year to enable the project to use available funds to build units and complete the project. The stalled development project loans are considered both troubled debt restructures ("TDRs") and non-accrual loans. Additionally at March 31, 2015 and December 31, 2014, the Bank had one TDR commercial real estate loan of \$1.0 million that is greater than 90 days delinquent. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to \$7.7 million and \$9.3 million at March 31, 2015 and December 31, 2014, respectively. Interest due but not recognized on these balances at March 31, 2015 and December 31, 2014 was \$694,000 and \$781,000, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to \$716,000 and \$1.0 million at March 31, 2015 and December 31, 2014, respectively. Interest due but not recognized on these balances at March 31, 2015 and December 31, 2014 was

\$64,000 and \$64,000, respectively.

An analysis of past due loans as of March 31, 2015 and December 31, 2014 was as follows:

March 31, 2015						
(dollars in thousands)	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	\$585,387	\$798	\$-	\$ 2,008	\$ 2,806	\$ 588,193
Residential first mortgages	147,617	351	133	530	1,014	148,631
Construction and land dev.	33,715	-	-	3,634	3,634	37,349
Home equity and second mtg.	20,569	247	-	395	642	21,211
Commercial loans	66,880	30	10	1,584	1,624	68,504
Consumer loans	463	1	-	-	1	464
Commercial equipment	26,602	45	-	284	329	26,931
Total	\$881,233	\$1,472	\$ 143	\$ 8,435	\$ 10,050	\$ 891,283

December 31, 2014						
(dollars in thousands)	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	\$556,584	\$-	\$672	\$ 3,824	\$ 4,496	\$ 561,080
Residential first mortgages	151,375	133	796	533	1,462	152,837
Construction and land dev.	32,736	-	-	3,634	3,634	36,370
Home equity and second mtg.	20,939	90	24	399	513	21,452
Commercial loans	71,952	86	-	1,587	1,673	73,625
Consumer loans	612	1	-	-	1	613
Commercial equipment	25,848	17	1	286	304	26,152
Total	\$860,046	\$ 327	\$1,493	\$ 10,263	\$ 12,083	\$ 872,129

There were no loans greater than 90 days still accruing interest at March 31, 2015 and at December 31, 2014.

Impaired Loans and Troubled Debt Restructures (“TDRs”)

Impaired loans, including TDRs, at March 31, 2015 and 2014 and at December 31, 2014 were as follows:

(dollars in thousands)	March 31, 2015						
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Three Month Average Recorded Investment	Three Month Interest Income Recognized
Commercial real estate	\$28,632	\$ 26,037	\$ 2,567	\$ 28,604	\$ 84	\$ 28,623	\$ 261
Residential first mortgages	3,387	2,878	509	3,387	75	3,397	35
Construction and land dev.	6,296	6,296	-	6,296	-	6,022	25
Home equity and second mtg.	689	630	-	630	-	639	5
Commercial loans	5,891	5,258	589	5,847	355	5,866	62
Commercial equipment	600	370	211	581	120	583	3
Total	\$45,495	\$ 41,469	\$ 3,876	\$ 45,345	\$ 634	\$ 45,130	\$ 391

(dollars in thousands)	December 31, 2014						
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial real estate	\$31,812	\$ 28,907	\$ 2,622	\$ 31,529	\$ 97	\$ 31,672	\$ 1,258
Residential first mortgages	3,407	2,526	881	3,407	76	3,426	155
Construction and land dev.	6,402	6,102	-	6,102	-	6,474	133
Home equity and second mtg.	708	649	-	649	-	630	19
Commercial loans	7,587	7,030	406	7,436	155	7,196	252
Consumer loans	-	-	-	-	-	-	-
Commercial equipment	605	373	213	586	123	623	23
Total	\$50,521	\$ 45,587	\$ 4,122	\$ 49,709	\$ 451	\$ 50,021	\$ 1,840

(dollars in thousands)	March 31, 2014					Three Month Average Recorded Investment	Three Month Interest Income Recognized
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance		
Commercial real estate	\$19,389	\$ 15,216	\$ 4,144	\$ 19,360	\$ 332	\$ 19,405	\$ 180
Residential first mortgages	3,572	2,705	867	3,572	98	3,597	37
Construction and land dev.	5,866	1,664	4,202	5,866	81	5,818	27
Home equity and second mtg.	381	308	73	381	33	333	1
Commercial loans	6,800	2,681	4,118	6,799	763	6,780	62
Consumer loans	15	15	-	15	-	17	-
Commercial equipment	339	227	80	307	80	310	3
Total	\$36,362	\$ 22,816	\$ 13,484	\$ 36,300	\$ 1,387	\$ 36,260	\$ 310

TDRs, included in the impaired loan schedules above, as of March 31, 2015 and December 31, 2014 were as follows:

(dollars in thousands)	March 31, 2015		December 31, 2014	
	Dollars	Number of Loans	Dollars	Number of Loans
Commercial real estate	\$ 13,880	13	\$ 10,438	9
Residential first mortgages	901	3	906	3
Construction and land development	4,409	4	4,376	4
Commercial loans	994	6	2,262	6
Commercial equipment	152	2	154	2
Total TDRs	\$ 20,336	28	\$ 18,136	24
Less: TDRs included in non-accrual loans	(4,868)	(5)	(4,887)	(5)
Total accrual TDR loans	\$ 15,468	23	\$ 13,249	19

The Bank added four and 15 TDRs totaling \$2.2 million and \$12.0 million during the three months ended March 31, 2015 and the year ended December 31, 2014, respectively. The Bank had specific reserves of \$481,000 on seven TDRs totaling \$2.9 million at March 31, 2015 and \$251,000 on five TDRs totaling \$2.5 million at December 31, 2014.

At March 31, 2015 and December 31, 2014, four loans totaling \$3.9 million represented a stalled residential development project. During the second quarter of 2014, the Bank deferred the collection of principal and interest for one year to enable the project to use available funds to build units and complete the project. The stalled development project loans are considered both troubled debt restructures (“TDRs”) and non-accrual loans. Additionally at March 31, 2015 and December 31, 2014, the Bank had one TDR commercial real estate loan of \$1.0 million that is greater than

90 days delinquent. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Interest income in the amount of \$145,000 and \$563,000 was recognized on TDR loans for the three months ended March 31, 2015 and the year ended December 31, 2014, respectively.

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the three months ended March 31, 2015 and 2014, respectively, and for the year ended December 31, 2014 and loan receivable balances at March 31, 2015 and 2014, respectively, and at December 31, 2014. An allocation of the allowance to one category of loans does not prevent the Company's ability to utilize the allowance to absorb losses in a different category. The loan receivables are disaggregated on the basis of the Company's impairment methodology.

(dollars in thousands)	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Three Months Ended March 31, 2015								
Allowance for loan losses:								
Balance at January 1,	\$ 4,076	\$ 1,092	\$ 1,071	\$ 173	\$ 1,677	\$ 3	\$ 389	\$ 8,481
Charge-offs	(46)	-	-	-	-	-	-	(46)
Recoveries	3	1	-	-	1	-	3	8
Provisions	315	(189)	28	35	62	(1)	(72)	178
Balance at March 31,	\$ 4,348	\$ 904	\$ 1,099	\$ 208	\$ 1,740	\$ 2	\$ 320	\$ 8,621
Ending balance:								
individually evaluated for \$ 84 impairment		\$ 75	\$ -	\$ -	\$ 355	\$ -	\$ 120	\$ 634
Ending balance:								
collectively evaluated for \$ 4,264 impairment	\$ 4,264	\$ 829	\$ 1,099	\$ 208	\$ 1,385	\$ 2	\$ 200	\$ 7,987
Loan receivables:								
Ending balance	\$ 588,193	\$ 148,631	\$ 37,349	\$ 21,211	\$ 68,504	\$ 464	\$ 26,931	\$ 891,283
Ending balance:								
individually evaluated for \$ 28,604 impairment	\$ 28,604	\$ 3,387	\$ 6,296	\$ 630	\$ 5,847	\$ -	\$ 581	\$ 45,345
Ending balance:								
collectively evaluated for \$ 559,589 impairment	\$ 559,589	\$ 145,244	\$ 31,053	\$ 20,581	\$ 62,657	\$ 464	\$ 26,350	\$ 845,938

(dollars in thousands)	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
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At and For the Year Ended December 31, 2014

Allowance for loan**losses:**

Balance at January 1,	\$ 3,525	\$ 1,401	\$ 584	\$ 249	\$ 1,916	\$ 10	\$ 453	\$ 8,138
Charge-offs	(350)	(94)	(992)	(59)	(1,134)	(3)	(10)	(2,642)
Recoveries	11	186	84	10	5	11	25	332
Provisions	890	(401)	1,395	(27)	890	(15)	(79)	2,653
Balance at December 31,	\$ 4,076	\$ 1,092	\$ 1,071	\$ 173	\$ 1,677	\$ 3	\$ 389	\$ 8,481
Ending balance:								
individually evaluated for \$97 impairment		\$ 76	\$ -	\$ -	\$ 155	\$ -	\$ 123	\$ 451
Ending balance:								
collectively evaluated for impairment	\$ 3,979	\$ 1,016	\$ 1,071	\$ 173	\$ 1,522	\$ 3	\$ 266	\$ 8,030

Loan receivables:

Ending balance	\$ 561,080	\$ 152,837	\$ 36,370	\$ 21,452	\$ 73,625	\$ 613	\$ 26,152	\$ 872,129
Ending balance:								
individually evaluated for impairment	\$ 31,529	\$ 3,407	\$ 6,102	\$ 649	\$ 7,436	\$ -	\$ 586	\$ 49,709
Ending balance:								
collectively evaluated for impairment	\$ 529,551	\$ 149,430	\$ 30,268	\$ 20,803	\$ 66,189	\$ 613	\$ 25,566	\$ 822,420

(dollars in thousands)	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
<u>At and For the Three Months Ended March 31, 2014</u>								
Allowance for loan losses:								
Balance at January 1,	\$ 3,525	\$ 1,401	\$ 584	\$ 249	\$ 1,916	\$ 10	\$ 453	\$ 8,138
Charge-offs	(21)	(94)	-	-	(35)	-	-	(150)
Recoveries	5	-	-	-	1	-	-	6
Provisions	101	(35)	(23)	91	233	(4)	(160)	203
Balance at March 31,	\$ 3,610	\$ 1,272	\$ 561	\$ 340	\$ 2,115	\$ 6	\$ 293	\$ 8,197
Ending balance:								
individually evaluated for impairment	\$ 332	\$ 98	\$ 81	\$ 33	\$ 763	\$ -	\$ 80	\$ 1,387
Ending balance:								
collectively evaluated for impairment	\$ 3,278	\$ 1,174	\$ 480	\$ 307	\$ 1,352	\$ 6	\$ 213	\$ 6,810
Loan receivables:								
Ending balance	\$ 504,564	\$ 158,080	\$ 30,611	\$ 21,699	\$ 80,297	\$ 691	\$ 23,741	\$ 819,683
Ending balance:								
individually evaluated for impairment	\$ 19,360	\$ 3,572	\$ 5,866	\$ 381	\$ 6,799	\$ 15	\$ 307	\$ 36,300
Ending balance:								
collectively evaluated for impairment	\$ 485,204	\$ 154,508	\$ 24,745	\$ 21,318	\$ 73,498	\$ 676	\$ 23,434	\$ 783,383

Credit Quality Indicators

Credit quality indicators as of March 31, 2015 and December 31, 2014 were as follows:

Credit Risk Profile by Internally Assigned Grade

(dollars in thousands)	Commercial Real Estate		Construction and Land Dev.	
	3/31/2015	12/31/2014	3/31/2015	12/31/2014
Unrated	\$ 69,313	\$ 74,955	\$ 4,063	\$ 3,108
Pass	483,661	451,256	26,990	27,160
Special mention	8,148	4,383	-	-
Substandard	27,071	30,486	6,296	6,102
Doubtful	-	-	-	-
Loss	-	-	-	-
Total	\$ 588,193	\$ 561,080	\$ 37,349	\$ 36,370

(dollars in thousands)	Commercial Loans		Commercial Equipment	
	3/31/2015	12/31/2014	3/31/2015	12/31/2014
Unrated	\$ 11,754	\$ 12,296	\$ 7,821	\$ 7,173
Pass	51,155	53,844	18,650	18,517
Special mention	149	49	-	-
Substandard	5,446	7,436	460	462
Doubtful	-	-	-	-
Loss	-	-	-	-
Total	\$ 68,504	\$ 73,625	\$ 26,931	\$ 26,152

Credit Risk Profile Based on Payment Activity

(dollars in thousands)	Residential First Mortgages		Home Equity and Second Mtg.		Consumer Loans	
	3/31/2015	12/31/2014	3/31/2015	12/31/2014	3/31/2015	12/31/2014
Performing	\$ 148,101	\$ 152,304	\$ 20,816	\$ 21,053	\$ 464	\$ 613
Nonperforming	530	533	395	399	-	-
Total	\$ 148,631	\$ 152,837	\$ 21,211	\$ 21,452	\$ 464	\$ 613

Summary of Total Classified Loans

(dollars in thousands)	3/31/2015	12/31/2014
By Internally Assigned Grade	\$ 39,272	\$ 44,486
By Payment Activity	1,662	2,249
Total Classified	\$ 40,934	\$ 46,735

A risk grading scale is used to assign grades to commercial real estate, construction and land development, commercial loans and commercial equipment loans. Loans are graded at inception, annually thereafter when financial statements are received and at other times when there is an indication that a credit may have weakened or improved. Only commercial loan relationships with an aggregate exposure to the Bank of \$750,000 or greater are subject to being risk rated.

Residential first mortgages, home equity and second mortgages and consumer loans are evaluated for creditworthiness in underwriting and are monitored based on borrower payment history. These loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned (“OAEM”) or higher risk rating due to a delinquent payment history.

Management regularly reviews credit quality indicators as part of its individual loan reviews and on a monthly and quarterly basis. The overall quality of the Bank’s loan portfolio is assessed using the Bank’s risk grading scale, the level and trends of net charge-offs, nonperforming loans and delinquencies, the performance of troubled debt restructured loans and the general economic conditions in the Company’s geographical market. This review process is assisted by frequent internal reporting of loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Credit quality indicators and allowance factors are adjusted based on management’s judgment during the monthly and quarterly review process.

Loans subject to risk ratings are graded on a scale of one to ten. The Company considers loans classified substandard, doubtful and loss as classified assets for regulatory and financial reporting.

Ratings 1 thru 6 - Pass

Ratings 1 thru 6 have asset risks ranging from excellent low risk to adequate. The specific rating assigned considers customer history of earnings, cash flows, liquidity, leverage, capitalization, consistency of debt service coverage, the nature and extent of customer relationship and other relevant specific business factors such as the stability of the industry or market area, changes to management, litigation or unexpected events that could have an impact on risks.

Rating 7 - OAEM (Other Assets Especially Mentioned) – Special Mention

These credits, while protected by the financial strength of the borrowers, guarantors or collateral, have reduced quality due to economic conditions, less than adequate earnings performance or other factors which require the lending officer to direct more than normal attention to the credit. Financing alternatives may be limited and/or command higher risk interest rates. OAEM loans are the first adversely classified assets on our watch list. These relationships will be reviewed at least quarterly.

Rating 8 - Substandard

Substandard assets are assets that are inadequately protected by the sound worth or paying capacity of the borrower or of the collateral pledged. These assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in

individual assets classified substandard. The loans may have a delinquent history or combination of weak collateral, weak guarantor strength or operating losses. When a loan is assigned to this category the Bank may estimate a specific reserve in the loan loss allowance analysis. These assets listed may include assets with histories of repossessions or some that are non-performing bankruptcies. These relationships will be reviewed at least quarterly.

Rating 9 - Doubtful

Doubtful assets have many of the same characteristics of Substandard with the exception that the Bank has determined that loss is not only possible but is probable and the risk is close to certain that loss will occur. When a loan is assigned to this category the Bank will identify the probable loss and the loan will receive a specific reserve in the loan loss allowance analysis. These relationships will be reviewed at least quarterly.

Rating 10 - Loss

Once an asset is identified as a definite loss to the Bank, it will receive the classification of "loss". There may be some future potential recovery; however it is more practical to write off the loan at the time of classification. Losses will be taken in the period in which they are determined to be uncollectable.

NOTE 12 - REGULATORY CAPITAL

On January 1, 2015, the Company and Bank became subject to the new Basel III Capital Rules with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. In July 2013, the Company's primary federal regulator, the Federal Reserve, published final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio ("Min. Ratio") of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer ("CCB") is also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased-in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets.

As of March 31, 2015, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the new Basel III Capital Rules. Management believes, as of March 31, 2015 and December 31, 2014, that the Company and the Bank met all capital adequacy requirements to which they were subject. The Company's and the Bank's actual regulatory capital amounts and ratios are presented in the following table.

Regulatory Capital and Ratios (dollars in thousands)	The Company		The Bank	
	March 31, 2015	December 31, 2014	March 31, 2015	December 31, 2014
Common Equity	\$98,295	\$ 96,559	\$128,907	\$ 126,838
Preferred Stock -SBLF	-	20,000	-	-
Total Stockholders' Equity	98,295	116,559	128,907	126,838
AOCI Losses (Gains)	100	378	100	378
Common Equity Tier 1 Capital	98,395	116,937	129,007	127,216
TRUPs	12,000	12,000	-	-
Tier 1 Capital	110,395	128,937	129,007	127,216
	8,621	8,537	8,621	8,537

Allowable Reserve for Credit Losses and Other
Adjustments

Subordinated Notes	23,000	-	-	-
Tier 2 Capital	\$142,016	\$ 137,474	\$137,628	\$ 135,753
Risk-Weighted Assets ("RWA")	\$938,617	\$ 903,931	\$936,284	\$ 902,136
Average Assets ("AA")	\$1,065,379	\$ 1,053,424	\$1,063,315	\$ 1,051,627

2019 Regulatory**Min. Ratio + CCB ⁽¹⁾**

Common Tier 1 Capital to RWA ⁽²⁾	7.00%	10.48%	12.94%	13.78%	14.10%
Tier 1 Capital to RWA	8.50	11.76	14.26	13.78	14.10
Tier 2 Capital to RWA	10.50	15.13	15.21	14.70	15.05
Tier 1 Capital to AA (Leverage)	n/a	10.36	12.24	12.13	12.10

⁽¹⁾ These are the fully phased-in ratios as of January 1, 2019 that include the minimum capital ratio ("Min. Ratio") + the capital conservation buffer ("CCB"). The phase-in period is more fully described in the footnote above.

⁽²⁾ The Common Tier 1 ratio became effective for regulatory reporting purposes when the Company and the Bank became subject to the new Basel III Capital Rules during the three months ended March 31, 2015.

NOTE 13 - FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, “*Fair Value Measurements*” and FASB ASC Topic 825, “*The Fair Value Option for Financial Assets and Financial Liabilities*”, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These hierarchy levels are:

Level 1 inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's monthly or quarterly valuation process.

There were no transfers between levels of the fair value hierarchy and the Company had no Level 3 fair value assets or liabilities for the three months ended March 31, 2015 and the year ended December 31, 2014, respectively.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by GSEs, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At March 31, 2015 and December 31, 2014, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned

OREO is adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of March 31, 2015 and December 31, 2014 measured at fair value on a recurring basis.

(dollars in thousands)	March 31, 2015			
	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	\$35,981	\$ -	\$35,981	\$ -
MBS	31	-	31	-
Corporate equity securities	40	-	40	-
Bond mutual funds	4,383	-	4,383	-
Total available for sale securities	\$40,435	\$ -	\$40,435	\$ -

(dollars in thousands)

December 31, 2014

Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	\$37,541	\$ -	\$37,541	\$ -
MBS	37	-	37	-
Corporate equity securities	40	-	40	-
Bond mutual funds	4,321	-	4,321	-
Total available for sale securities	\$41,939	\$ -	\$41,939	\$ -

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of March 31, 2015 and December 31, 2014 are included in the tables below.

(dollars in thousands)	March 31, 2015			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	\$2,483	\$ -	\$2,483	\$ -
Residential first mortgages	434	-	434	-
Commercial loans	234	-	234	-
Commercial equipment	91	-	91	-
Total loans with impairment	\$3,242	\$ -	\$3,242	\$ -
Other real estate owned	\$6,861	\$ -	\$6,861	\$ -

(dollars in thousands)	December 31, 2014			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	\$2,524	\$ -	\$2,524	\$ -
Residential first mortgage	805	-	805	-
Commercial loans	251	-	&n	