FIRST COMMUNITY CORP /SC/
Form 10-Q
August 12, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ____

**Commission File No. 000-28344**

**FIRST COMMUNITY CORPORATION**
(Exact name of registrant as specified in its charter)

| South Carolina | 57-1010751 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

5455 Sunset Boulevard, Lexington, South Carolina 29072

(Address of principal executive offices) (Zip Code)

(803) 951-2265

(Registrant’s telephone number, including area code)

(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 x 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 (§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). x 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.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: On August 12, 2015, 6,679,938 shares of the issuer's common stock, par value $1.00 per share, were issued and outstanding.

**TABLE OF CONTENTS**


| | | |
|---|---|---|
| **PART I - FINANCIAL INFORMATION** | | 3 |
| **Item 1.** | **Financial Statements** | 3 |
| | Consolidated Balance Sheets | 3 |
| | Consolidated Statements of Income | 4 |
| | Consolidated Statements of Comprehensive Income (Loss) | 6 |
| | Consolidated Statements of Changes in Shareholders' Equity | 7 |
| | Consolidated Statements of Cash Flows | 8 |
| | Notes to Consolidated Financial Statements | 9 |
| **Item 2.** | **Management's Discussion and Analysis of Financial Condition and Results of Operations** | 40 |
| **Item 3.** | **Quantitative and Qualitative Disclosures About Market Risk** | 57 |
| **Item 4.** | **Controls and Procedures** | 57 |
| **PART II – OTHER INFORMATION** | | 58 |
| **Item 1.** | **Legal Proceedings** | 58 |
| **Item 1A.** | **Risk Factors** | 58 |
| **Item 2.** | **Unregistered Sales of Equity Securities and Use of Proceeds** | 58 |
| **Item 3.** | **Defaults Upon Senior Securities** | 58 |
| **Item 4.** | **Mine Safety Disclosures** | 58 |
| **Item 5.** | **Other Information** | 58 |
| **Item 6.** | **Exhibits** | 58 |
| **SIGNATURES** | | 59 |
| **INDEX TO EXHIBITS** | | 60 |

**EX-31.1 RULE 13A-14(A) CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**
**EX-31.2 RULE 13A-14(A) CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**
**EX-32 SECTION 1350 CERTIFICATIONS**

**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**FIRST COMMUNITY CORPORATION**

**CONSOLIDATED BALANCE SHEETS**

| (Dollars in thousands, except par value) | June 30, 2015 (Unaudited) | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 9,611 | $ 12,480 |
| Interest-bearing bank balances | 15,585 | 9,454 |
| Federal funds sold and securities purchased under agreements to resell | 680 | 598 |
| Investment securities - held-to-maturity | 16,641 | 10,647 |
| Investment securities – available-for-sale | 252,322 | 270,164 |
| Other investments, at cost | 2,240 | 2,003 |
| Loans held for sale | 6,662 | 4,124 |
| Loans | 474,016 | 443,844 |
| Less, allowance for loan losses | 4,281 | 4,132 |
| Net loans | 469,735 | 439,712 |
| Property, furniture and equipment - net | 29,716 | 28,510 |
| Land held for sale | 1,100 | 1,200 |
| Bank owned life insurance | 14,848 | 14,642 |
| Other real estate owned | 2,523 | 2,943 |
| Intangible assets | 1,606 | 1,806 |
| Goodwill | 5,078 | 5,078 |
| Other assets | 8,059 | 9,002 |
| Total assets | $ 836,406 | $ 812,363 |
| LIABILITIES | | |
| Deposits: | | |
| Non-interest bearing demand | $ 147,046 | $ 133,004 |
| NOW and money market accounts | 294,113 | 287,982 |
| Savings | 57,369 | 53,583 |
| Time deposits less than $100,000 | 102,616 | 108,048 |
| Time deposits $100,000 and over | 82,888 | 86,966 |
| Total deposits | 684,032 | 669,583 |
| Securities sold under agreements to repurchase | 19,460 | 17,383 |
| Federal Home Loan Bank advances | 35,548 | 28,807 |
| Junior subordinated debt | 15,464 | 15,464 |
| Other liabilities | 5,491 | 6,598 |
| Total liabilities | 759,995 | 737,835 |
| SHAREHOLDERS' EQUITY | | |

| | | |
|---|---|---|
| Preferred stock, par value $1.00 per share, 10,000,000 shares authorized; none issued and outstanding | — | — |
| Common stock, par value $1.00 per share; 10,000,000 shares authorized; issued and outstanding 6,679,938 at June 30, 2015 6,664,391 at December 31, 2014 | 6,679 | 6,664 |
| Common stock warrants issued | 46 | 48 |
| Nonvested restricted stock | (555) | (673) |
| Additional paid in capital | 75,641 | 75,504 |
| Accumulated deficit | (6,352) | (8,286) |
| Accumulated other comprehensive income | 952 | 1,271 |
| Total shareholders' equity | 76,411 | 74,528 |
| Total liabilities and shareholders' equity | $ 836,406 | $ 812,363 |

See Notes to Consolidated Financial Statements

3

**FIRST COMMUNITY CORPORATION**

**CONSOLIDATED STATEMENTS OF INCOME**

| (Dollars in thousands) | Six Months Ended June 30, 2015 (Unaudited) | Six Months Ended June 30, 2014 (Unaudited) |
|---|---|---|
| Interest income: | | |
| Loans, including fees | $ 11,578 | $ 10,662 |
| Taxable securities | 1,911 | 1,949 |
| Nontaxable securities | 786 | 594 |
| Federal funds sold and securities purchased under resale agreements | 14 | 17 |
| Other | 43 | 30 |
| Total interest income | 14,332 | 13,252 |
| Interest expense: | | |
| Deposits | 861 | 857 |
| Federal funds sold and securities sold under agreement to repurchase | 15 | 19 |
| Other borrowed money | 804 | 933 |
| Total interest expense | 1,680 | 1,809 |
| Net interest income | 12,652 | 11,443 |
| Provision for loan losses | 797 | 550 |
| Net interest income after provision for loan losses | 11,855 | 10,893 |
| Non-interest income: | | |
| Deposit service charges | 693 | 745 |
| Mortgage banking income | 1,715 | 1,321 |
| Investment advisory fees and non-deposit commissions | 703 | 455 |
| Gain on sale of securities | 271 | 86 |
| Gain (loss) on sale of other assets | 7 | (12) |
| Loss on early extinguishment of debt | (103) | (67) |
| Other | 1,260 | 1,246 |
| Total non-interest income | 4,546 | 3,774 |
| Non-interest expense: | | |
| Salaries and employee benefits | 7,223 | 6,696 |
| Occupancy | 985 | 878 |
| Equipment | 796 | 714 |
| Marketing and public relations | 554 | 373 |
| FDIC assessments | 276 | 255 |
| Other real estate expense | 308 | 255 |
| Amortization of intangibles | 201 | 105 |
| Merger and acquisition expense | — | 435 |
| Other | 2,146 | 2,100 |
| Total non-interest expense | 12,489 | 11,811 |
| Net income before tax | 3,912 | 2,856 |
| Income taxes | 1,065 | 793 |
| Net income | $ 2,847 | $ 2,063 |
| Basic earnings per common share | $ 0.44 | $ 0.32 |

| | | |
|---|---|---|
| Diluted earnings per common share | $ 0.43 | $ 0.32 |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION**

**CONSOLIDATED STATEMENTS OF INCOME**

| (Dollars in thousands) | Three Months Ended June 30, 2015 (Unaudited) | Three Months Ended June 30, 2014 (Unaudited) |
|---|---|---|
| Interest income: | | |
| Loans, including fees | $ 5,704 | $ 5,582 |
| Taxable securities | 909 | 966 |
| Nontaxable securities | 406 | 277 |
| Federal funds sold and securities purchased under resale agreements | 8 | 7 |
| Other | 22 | 17 |
| Total interest income | 7,049 | 6,849 |
| Interest expense: | | |
| Deposits | 435 | 428 |
| Federal funds sold and securities sold under agreement to repurchase | 7 | 9 |
| Other borrowed money | 403 | 465 |
| Total interest expense | 845 | 902 |
| Net interest income | 6,204 | 5,947 |
| Provision for loan losses | 391 | 400 |
| Net interest income after provision for loan losses | 5,813 | 5,547 |
| Non-interest income: | | |
| Deposit service charges | 346 | 379 |
| Mortgage banking income | 980 | 702 |
| Investment advisory fees and non-deposit commissions | 407 | 198 |
| Gain on sale of securities | 167 | 78 |
| Gain (loss) on sale of other assets | 3 | (24) |
| Loss on early extinguishment of debt | — | (67) |
| Other | 662 | 633 |
| Total non-interest income | 2,565 | 1,899 |
| Non-interest expense: | | |
| Salaries and employee benefits | 3,658 | 3,272 |
| Occupancy | 500 | 465 |
| Equipment | 394 | 375 |
| Marketing and public relations | 328 | 212 |
| FDIC assessment | 138 | 131 |
| Other real estate expense | 154 | 117 |
| Amortization of intangibles | 98 | 63 |
| Merger and acquisition expense | — | 15 |
| Other | 1,119 | 1,135 |
| Total non-interest expense | 6,389 | 5,785 |
| Net income before tax | 1,989 | 1,661 |
| Income taxes | 546 | 460 |
| Net income | $ 1,443 | $ 1,201 |

| | | |
|---|---|---|
| Basic earnings per common share | $ 0.22 | $ 0.18 |
| Diluted earnings per common share | $ 0.22 | $ 0.18 |

See Notes to Consolidated Financial Statements

5

**FIRST COMMUNITY CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(Unaudited)**

| (Dollars in thousands) | Six months ended June 30, 2015 | 2014 |
|---|---|---|
| Net income | $2,847 | $2,063 |
| Other comprehensive income (loss): | | |
| Unrealized gain (loss) during the period on available-for-sale securities, net of tax of $32 and $1,533, respectively | (179) | 2,973 |
| Less: Reclassification adjustment for gain included in net income, net of tax benefit of $131 and $30, respectively | (140) | (56) |
| Other comprehensive income (loss) | (319) | 2,917 |
| Comprehensive income | $2,528 | $4,980 |

| (Dollars in thousands) | Three months ended June 30, 2015 | 2014 |
|---|---|---|
| Net income | $1,443 | $1,201 |
| Other comprehensive income (loss): | | |
| Unrealized gain (loss) during the period on available-for-sale securities, net of tax $567 and $659, respectively. | (1,101) | 1,278 |
| Less: Reclassification adjustment for gain included in net income, net of tax of $56 and $27 respectively. | (111) | (51) |
| Other comprehensive income (loss) | (1,212) | 1,227 |
| Comprehensive income | $231 | $2,428 |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION**

**Consolidated Statements of Changes in Shareholders' Equity**

**Six Months ended June 30, 2015 and June 30, 2014**

**(Unaudited)**

| (Dollars and shares in thousands) | 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, 2013 | 5,303 | $ 5,303 | $ 48 | $ 62,214 | $ (444) | $ (11,923) | $ (2,527) | $ 52,671 |
| Net income | | | | | | 2,063 | | 2,063 |
| Other comprehensive income net of tax of $1,503 | | | | | | | 2,917 | 2,917 |
| Issuance of restricted stock | 71 | 71 | | 697 | (768) | | | — |
| Amortization compensation restricted stock | | | | | 246 | | | 246 |
| Issuance of common stock | 1,274 | 1,274 | | 12,436 | | | | 13,710 |
| Dividends: Common ($0.12 per share) | | | | | | (703) | | (703) |
| Dividend reinvestment plan | 8 | 8 | | 80 | | | | 88 |
| Balance, June 30, 2014 | 6,656 | $ 6,656 | $ 48 | $ 75,427 | $ (966) | $ (10,563) | $ 390 | $ 70,992 |
| | | | | | | | | |
| Balance December 31, 2014 | 6,664 | $ 6,664 | $ 48 | $ 75,504 | $ (673) | $ (8,286) | $ 1,271 | $ 74,528 |
| Net income | | | | | | 2,847 | | 2,847 |
| Other comprehensive loss net of tax of $164 | | | | | | | (319) | (319) |
| Issuance of restricted stock | 13 | 13 | | 137 | (150) | | | — |
| Restricted shares surrendered | (8) | (8) | | (90) | | | | (98) |
| Amortization compensation restricted stock | | | | | 268 | | | 268 |
| Exercise of stock warrants | 2 | 2 | (2) | | | | | — |
| Dividends: Common ($0.14 per share) | | | | | | (913) | | (913) |
| Dividend reinvestment plan | 8 | 8 | | 90 | | | | 98 |
| Balance, June 30, 2015 | 6,679 | $ 6,679 | $ 46 | $ 75,641 | $ (555) | $ (6,352) | $ 952 | $ 76,411 |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Six months ended June 30, | |
|---|---|---|
| (Dollars in thousands) | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net income | $2,847 | $2,063 |
| Adjustments to reconcile net income to net cash provided in operating activities: | | |
| Depreciation | 613 | 532 |
| Premium amortization | 2,009 | 1,807 |
| Provision for loan losses | 797 | 550 |
| Writedowns of other real estate owned | 162 | 110 |
| Loss (gain) on sale of other real estate owned | (7) | 12 |
| Sale of loans held-for-sale | 51,243 | 40,993 |
| Originations of loans held-for-sale | (53,781) | (40,193) |
| Amortization of intangibles | 201 | 105 |
| Accretion on acquired loans | (607) | — |
| Gain on sale of securities | (271) | (86) |
| Writedown of land held for sale | 100 | — |
| Loss on early extinguishment of debt | 103 | 67 |
| Decrease in other assets | 1,098 | 1,189 |
| Decrease in other liabilities | (1,218) | (623) |
| Net cash provided from operating activities | 3,289 | 6,526 |
| Cash flows from investing activities: | | |
| Purchase of investment securities available-for-sale and other investments | (21,341) | (53,320) |
| Purchase of investment securities held-to –maturity | (6,065) | — |
| Maturity of investment securities available-for-sale | 19,127 | 18,960 |
| Proceeds from sale of securities available-for-sale | 17,061 | 36,385 |
| Proceeds from sale of other investments | 793 | 261 |
| Decrease (increase) in loans | (30,421) | 7,858 |
| Net cash disbursed in business combination | — | (11,353) |
| Proceeds from sale of other real estate owned | 388 | 790 |
| Purchase of property and equipment | (1,820) | (2,345) |
| Net cash used in investing activities | (22,278) | (2,764) |
| Cash flows from financing activities: | | |
| Increase in deposit accounts | 14,532 | 28,881 |
| Increase (decrease) in securities sold under agreements to repurchase | 2,077 | (2,260) |
| Advances from the Federal Home Loan Bank | 29,500 | 38,100 |
| Repayment of advances from Federal Home Loan Bank | (22,863) | (52,281) |
| Restricted shares surrendered | (98) | — |
| Dividends paid: Common Stock | (913) | (703) |
| Dividend reinvestment plan | 98 | 88 |
| Net cash provided from financing activities | 22,333 | 11,824 |
| Net increase in cash and cash equivalents | 3,344 | 15,586 |

| | | |
|---|---|---|
| Cash and cash equivalents at beginning of period | 22,532 | 14,166 |
| Cash and cash equivalents at end of period | $25,876 | $29,752 |
| Supplemental disclosure: | | |
| Cash paid during the period for: | | |
| Interest | $1,754 | $1,820 |
| Income taxes | $1,460 | $210 |
| Non-cash investing and financing activities: | | |
| Unrealized gain (loss) on securities | $(319) | $2,917 |
| Transfer of loans to foreclosed property | $122 | $841 |

See Notes to Consolidated Financial Statements

**Notes to Consolidated Financial Statements (Unaudited)**

***Note 1 - Basis of Presentation***

In the opinion of management, the accompanying unaudited consolidated balance sheets, and the consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and the cash flows of First Community Corporation (the "Company"), present fairly in all material respects the Company's financial position at June 30, 2015 and December 31, 2014, and the Company's results of operations and cash flows for the three and six months ended June 30, 2015 and 2014. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

In the opinion of management, all adjustments necessary to fairly present the consolidated financial position and consolidated results of operations have been made. All such adjustments are of a normal, recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements and notes thereto are presented in accordance with the instructions for Form 10-Q. The information included in the Company's 2014 Annual Report on Form 10-K should be referred to in connection with these unaudited interim financial statements.

***Note 2 – Earnings Per Common Share***

The following reconciles the numerator and denominator of the basic and diluted earnings per common share computation:

(In thousands except average market price)

| | Six months Ended June 30, | | Three months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Numerator (Net income) | $2,847 | $2,063 | $1,443 | $1,201 |
| Denominator | | | | |
| Weighted average common shares outstanding for: | | | | |
| Basic earnings per share | 6,534 | 6,654 | 6,539 | 6,413 |
| Dilutive securities: | | | | |
| Deferred compensation | 50 | 18 | 50 | 18 |
| Warrants/Restricted stock – Treasury stock method | 94 | 47 | 109 | 46 |
| Diluted earnings per share | 6,678 | 6,719 | 6,698 | 6,477 |
| The average market price used in calculating assumed number of shares | $12.12 | $10.88 | $12.12 | $10.86 |

At June 30, 2015, there were no outstanding options. At June 30, 2014, there were 70,903 outstanding options at an average exercise price of $20.83. None of these options had an exercise price below the average market price of $10.86 for the three-month period ended June 30, 2014 or $10.88 for the six-month period ended June 30, 2014, and, therefore, they were not deemed to be dilutive. In the fourth quarter of 2011, we issued $2.5 million in 8.75% subordinated notes maturing December 16, 2019. On November 15, 2012, the subordinated notes were redeemed in full at par. Warrants for 107,500 shares of common stock at $5.90 per share were issued in connection with the issuance of the subordinated debt. At June 30, 2015 there were 97,180 warrants outstanding. These warrants expire December 16, 2019 and are included in dilutive securities in the table above. The Company has issued a total of 157,000 restricted shares under the terms of its compensation plans and employment agreements. These shares cliff vest over a three-year period. The unrecognized compensation cost at June 30, 2015 for non-vested shares totaled $555 thousand.

***Note 3 – Investment Securities***

The amortized cost and estimated fair values of investment securities at June 30, 2015 and December 31, 2014 are summarized below:

**AVAILABLE-FOR-SALE:**

| (Dollars in thousands) | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
|---|---|---|---|---|
| June 30, 2015: | | | | |
| Government sponsored enterprises | $ 2,446 | $ 45 | $ 4 | $ 2,487 |
| Mortgage-backed securities | 140,048 | 1,028 | 582 | 140,494 |
| Small Business Administration pools | 60,523 | 427 | 378 | 60,572 |
| State and local government | 46,632 | 1,027 | 193 | 47,466 |
| Corporate and other securities | 1,349 | — | 46 | 1,303 |
| | $ 250,998 | $ 2,527 | $ 1,203 | $ 252,322 |
| December 31, 2014: | | | | |
| Government sponsored enterprises | $ 3,403 | $ 45 | $ 14 | $ 3,434 |
| Mortgage-backed securities | 159,861 | 1,211 | 719 | 160,353 |
| Small Business Administration pools | 58,643 | 385 | 483 | 58,545 |
| State and local government | 45,102 | 1,523 | 109 | 46,516 |
| Corporate and other securities | 1,349 | — | 33 | 1,316 |
| | $ 268,358 | $ 3,164 | $ 1,358 | $ 270,164 |

**HELD-TO-MATURITY:**

| (Dollars in thousands) | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
|---|---|---|---|---|
| June 30, 2015: | | | | |
| State and local government | $ 16,641 | $ 11 | $ 328 | $ 16,324 |
| | $ 16,641 | $ 11 | $ 328 | $ 16,324 |
| December 31, 2014: | | | | |
| State and local government | $ 10,647 | $ 6 | $ 68 | $ 10,585 |
| | $ 10,647 | $ 6 | $ 68 | $ 10,585 |

During the six months ended June 30, 2015 and June 30, 2014, the Company received proceeds of $17.1 million and $36.3 million, respectively, from the sale of investment securities available-for-sale. For the six months ended June 30, 2015, gross realized gains totaled $271 thousand and there were no gross realized losses. For the six months ended June 30, 2014, gross realized gains totaled $149 thousand and gross realized losses totaled $63 thousand. During the three months ended June 30, 2015 and June 30, 2014, the Company received proceeds of $10.1 million and $15.4

million, respectively, from the sale of investment securities available-for-sale. For the three months ended June 30, 2015, gross realized gains totaled $167 thousand and there were no gross realized losses. For the three months ended June 30, 2014, gross realized gains totaled $140 thousand and gross realized losses totaled $8 thousand.

At June 30, 2015, corporate and other securities available-for-sale included the following at fair value: mutual funds at $826.1 thousand, foreign debt of $60.2 thousand, and corporate preferred stock in the amount of $416.8 thousand. At December 31, 2014, corporate and other securities available-for-sale included the following at fair value: mutual funds at $839.2 thousand, foreign debt of $60.3 thousand, and corporate preferred stock in the amount of $416.8 thousand.

Other investments, at cost, include Federal Home Loan Bank (“FHLB”) stock in the amount of $2.2 million and $2.0 million at June 30, 2015 and December 31, 2014 respectively.

***Note 3 – Investment Securities – continued***

The following tables show gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous loss position, at June 30, 2015 and December 31, 2014.

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| June 30, 2015<br>(Dollars in thousands) | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Available-for-sale securities: | | | | | | |
| Government Sponsored Enterprises | $1,496 | $ 4 | $— | $ — | $1,496 | $ 4 |
| Government Sponsored Enterprise mortgage-backed securities | 29,836 | 226 | 19,106 | 354 | 48,942 | 580 |
| Small Business Administration pools | 13,723 | 126 | 22,276 | 252 | 35,999 | 378 |
| Non-agency mortgage-backed securities | 324 | 2 | — | — | 324 | 2 |
| State and local government | 12,122 | 88 | 3,284 | 105 | 15,406 | 193 |
| Corporate bonds and other | — | — | 826 | 46 | 826 | 46 |
| Total | $57,501 | $ 446 | $45,492 | $ 757 | $102,993 | $ 1,203 |

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| December 31, 2014<br>(Dollars in thousands) | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Available-for-sale securities: | | | | | | |
| Government Sponsored Enterprises | $— | $ — | $1,486 | $ 14 | $1,486 | $ 14 |
| Government Sponsored Enterprise mortgage-backed securities | 38,341 | 283 | 26,232 | 429 | 64,573 | 712 |
| Small Business Administration pools | 12,313 | 89 | 20,896 | 394 | 33,209 | 483 |
| Non-agency mortgage-backed securities | 576 | 6 | 18 | 1 | 594 | 7 |
| State and local government | — | — | 5,270 | 109 | 5,270 | 109 |
| Corporate bonds and other | — | — | 889 | 33 | 889 | 33 |
| Total | $51,230 | $ 378 | $54,791 | $ 980 | $106,021 | $ 1,358 |

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| June 30, 2015<br>(Dollars in thousands) | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Held-to-maturity securities: | | | | | | |
| State and local government | $12,307 | $ 328 | $ — | $ — | $12,307 | $ 328 |
| Total | $12,307 | $ 328 | $ — | $ — | $12,307 | $ 328 |

| Less than 12 months | 12 months or more | Total |
|---|---|---|

| December 31, 2014<br>(Dollars in thousands) | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
|---|---|---|---|---|---|---|
| Held-to-maturity securities: | | | | | | |
| State and local government | $8,655 | $ 68 | $ — | $ — | $8,655 | $ 68 |
| Total | $8,655 | $ 68 | $ — | $ — | $8,655 | $ 68 |

***Note 3 – Investment Securities - continued***

**Government Sponsored Enterprise, Mortgage-Backed Securities:** At June 30, 2015, the Company owned mortgage-backed securities ("MBSs"), including collateralized mortgage obligations ("CMOs"), with an amortized cost of $139.4 million and approximate fair value of $139.9 million issued by government sponsored enterprises ("GSEs"). At December 31, 2014, the Company owned MBSs, including CMOs with an amortized cost of $159.1 million and approximate fair value of $159.7 million issued by GSEs. As of June 30, 2015 and December 31, 2014, all of the MBSs issued by GSEs were classified as "Available for Sale." Unrealized losses on certain of these investments are not considered to be "other than temporary," and we have the intent and ability to hold these until they mature or recover the current book value. 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 the amortized cost of the Company's investment. Because the Company does not intend to sell these securities and it is more likely than not that the Company will not be required sell these securities before a recovery of its amortized cost, which may be maturity, the Company does not consider the investments to be other-than-temporarily ("OTTI") impaired at June 30, 2015.

**Non-agency Mortgage-Backed Securities:** The Company also held private label mortgage-backed securities ("PLMBSs"), including CMOs, at June 30, 2015 with an amortized cost of $625.1 thousand and approximate fair value of $628.0 thousand. The Company held PLMBSs, including CMOs, at December 31, 2014 with an amortized cost of $736.6 thousand and approximate fair value of $734.4 thousand. Management monitors each of these securities on a quarterly basis to identify any deterioration in the credit quality, collateral values and credit support underlying the investments. There were no PLMBSs rated below investment grade as of June 30, 2015.

**State and Local Governments and Other:** Management monitors these securities on a quarterly basis to identify any deterioration in the credit quality. Included in the monitoring is a review of the credit rating, a financial analysis and certain demographic data on the underlying issuer. The Company does not consider these securities to be OTTI at June 30, 2015.

The following sets forth the amortized cost and fair value of investment securities at June 30, 2015 by contractual maturity. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay the obligations with or without prepayment penalties. MBSs are based on average life at estimated prepayment speeds.

| (Dollars in thousands) | **Available-for-sale** | | **Held-to-maturity** | |
|---|---|---|---|---|
| | **Amortized Cost** | **Fair Value** | **Amortized Cost** | **Fair Value** |
| Due in one year or less | $8,296 | $8,399 | $— | $— |
| Due after one year through five years | 127,620 | 128,534 | 3,083 | 3,057 |
| Due after five years through ten years | 101,630 | 102,075 | 12,978 | 12,713 |
| Due after ten years | 13,452 | 13,314 | 580 | 554 |
| | $250,998 | $252,322 | $16,641 | $16,324 |

***Note 4 – Loans***

Loans summarized by category as of June 30, 2015, December 31, 2014 and June 30, 2014 are as follows:

| (Dollars in thousands) | June 30, **2015** | December 31, **2014** | June 30, **2014** |
|---|---|---|---|
| Commercial, financial and agricultural | $37,915 | $ 33,403 | $34,970 |
| Real estate: | | | |
| Construction | 30,392 | 27,545 | 23,736 |
| Mortgage-residential | 49,341 | 48,510 | 48,114 |
| Mortgage-commercial | 315,373 | 293,186 | 297,982 |
| Consumer: | | | |
| Home equity | 32,264 | 33,000 | 31,536 |
| Other | 8,731 | 8,200 | 8,332 |
| Total | $474,016 | $ 443,844 | $444,670 |

***Note 4 – Loans - continued***

The detailed activity in the allowance for loan losses and the recorded investment in loans receivable as of and for the six months ended June 30, 2015 and June 30, 2014 and for the year ended December 31, 2014 is as follows:

(Dollars in thousands)

| | Commercial | Real estate Construction | Real estate Mortgage Residential | Real estate Mortgage Commercial | Consumer Home equity | Consumer Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| June 30, 2015 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance December 31, 2014 | $ 67 | $ 45 | $ 179 | $ 1,572 | $ 134 | $ 44 | $ 2,091 | $ 4,132 |
| Charge-offs | (56) | — | (26) | (625) | — | (27) | — | (734) |
| Recoveries | 3 | — | 2 | 5 | 2 | 74 | — | 86 |
| Provisions | 207 | 79 | 24 | 822 | (17) | (31) | (287) | 797 |
| Ending balance June 30, 2015 | $ 221 | $ 124 | $ 179 | $ 1,774 | $ 119 | $ 60 | $ 1,804 | $ 4,281 |
| Ending balances: Individually evaluated for impairment | $ — | $ — | $ 3 | $ 1 | $ — | $ — | $ — | $ 4 |
| Collectively evaluated for impairment | 221 | 124 | 176 | 1,773 | 119 | 60 | 1,804 | 4,277 |
| Loans receivable: Ending balance-total | $ 37,915 | $ 30,392 | $ 49,341 | $ 315,373 | $ 32,264 | $ 8,731 | $ — | $ 474,016 |
| Ending balances: Individually evaluated for impairment | 13 | — | 997 | 5,924 | 89 | — | — | 7,023 |
| Collectively evaluated for impairment | $ 37,902 | $ 30,392 | $ 48,344 | $ 309,449 | $ 32,175 | $ 8,731 | $ — | $ 466,993 |

***Note 4 – Loans - continued***

(Dollars in thousands)

| | Commercial | Real estate Construction | Real estate Mortgage Residential | Real estate Mortgage Commercial | Consumer Home equity | Consumer Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| June 30, 2014 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance December 31, 2013 | $ 233 | $ 26 | $ 291 | $ 1,117 | $ 112 | $ 80 | $ 2,360 | $ 4,219 |
| Charge-offs | — | — | (35) | (689) | — | (20) | — | (744) |
| Recoveries | 24 | — | 9 | — | — | 8 | — | 41 |
| Provisions | (77) | 83 | (59) | 889 | 6 | (16) | (276) | 550 |
| Ending balance June 30, 2014 | $ 180 | $ 109 | $ 206 | $ 1,317 | $ 118 | $ 52 | $ 2,084 | $ 4,066 |
| Ending balances: Individually evaluated for impairment | $ — | $ — | $ 4 | $ 12 | $ — | $ — | $ — | $ 16 |
| Collectively evaluated for impairment | 180 | 109 | 202 | 1,305 | 118 | 52 | 2,084 | 4,050 |
| Loans receivable: | | | | | | | | |
| Ending balance-total | $ 34,970 | $ 23,736 | $ 48,114 | $ 297,982 | $ 31,536 | $ 8,332 | $ — | $ 444,670 |
| Ending balances: Individually evaluated for impairment | 62 | — | 1,136 | 6,930 | 73 | 6 | — | 8,207 |
| Collectively evaluated for impairment | $ 34,908 | $ 23,736 | $ 46,978 | $ 291,052 | $ 31,463 | $ 8,326 | $ — | $ 436,463 |

***Note 4 – Loans - continued***

(Dollars in thousands)

| | Commercial | Real estate Construction | Real estate Mortgage Residential | Real estate Mortgage Commercial | Consumer Home equity | Consumer Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| December 31, 2014 Allowance for loan losses: | | | | | | | | |
| Beginning balance | $ 233 | $ 26 | $ 291 | $ 1,117 | $ 112 | $ 80 | $ 2,360 | $ 4,219 |
| Charge-offs | (54) | — | (52) | (879) | (17) | (109) | — | (1,111) |
| Recoveries | 110 | — | 10 | — | 6 | 17 | — | 143 |
| Provisions | (222) | 19 | (70) | 1,334 | 33 | 56 | (269) | 881 |
| Ending balance | $ 67 | $ 45 | $ 179 | $ 1,572 | $ 134 | $ 44 | $ 2,091 | $ 4,132 |
| Ending balances: Individually evaluated for impairment | $ — | $ — | $ 4 | $ 57 | $ — | $ — | $ — | $ 61 |
| Collectively evaluated for impairment | 67 | 45 | 175 | 1,515 | 134 | 44 | 2,091 | 4,071 |
| Loans receivable: Ending balance-total | $ 33,403 | $ 27,545 | $ 48,510 | $ 293,186 | $ 33,000 | $ 8,200 | $ — | $ 443,844 |
| Ending balances: Individually evaluated for impairment | 55 | — | 1,078 | 7,334 | 92 | — | — | 8,559 |
| Collectively evaluated for impairment | $ 33,348 | $ 27,545 | $ 47,432 | $ 285,852 | $ 32,908 | $ 8,200 | $ — | $ 435,285 |

Loans outstanding to bank directors, executive officers and their related business interests totaled $8.4 million and $11.1 million at June 30, 2015 and June 30, 2014, respectively. Repayments on these loans during the six months ended June 30, 2015 were $1.2 million and loans made amounted to $1.7 million. During the six months ended June 30, 2014, repayments on these loans totaled $383 thousand and loans made totaled $1.4 million. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and generally do not involve more than the normal risk of collectability.

***Note 4 – Loans - continued***

The detailed activity in the allowance for loan losses as of and for the three months ended June 30, 2015 and the three months ended June 30, 2014 is as follows:

(Dollars in thousands)

| | Commercial | Real estate Construction | Real estate Mortgage Residential | Real estate Mortgage Commercial | Consumer Home equity | Consumer Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| 2015 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance March 31, 2015 | $ 210 | $ 134 | $ 243 | $ 1,580 | $ 121 | $ 58 | $ 1,906 | $4,252 |
| Charge-offs | — | — | (26) | (334) | — | (16) | — | (376) |
| Recoveries | 1 | — | 1 | 1 | 1 | 10 | — | 14 |
| Provisions | 10 | (10) | (39) | 527 | (3) | 8 | (102) | 391 |
| Ending balance June 30, 2015 | $ 221 | $ 124 | $ 179 | $ 1,774 | $ 119 | $ 60 | $ 1,804 | $4,281 |

(Dollars in thousands)

| | Commercial | Real estate Construction | Real estate Mortgage Residential | Real estate Mortgage Commercial | Consumer Home equity | Consumer Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| 2014 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning balance March 31, 2014 | $ 243 | $ 163 | $ 256 | $ 1,024 | $ 114 | $ 63 | $ 2,298 | $4,161 |
| Charge-offs | — | — | — | (502) | — | (12) | — | (514) |
| Recoveries | 7 | — | 8 | — | — | 4 | — | 19 |
| Provisions | (70) | (54) | (58) | 795 | 4 | (3) | (214) | 400 |
| Ending balance June 30, 2014 | $ 180 | $ 109 | $ 206 | $ 1,317 | $ 118 | $ 52 | $ 2,084 | $4,066 |

The following table presents at June 30, 2015 and December 31, 2014 loans individually evaluated and considered impaired under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310 "Accounting by Creditors for Impairment of a Loan." Impairment includes performing troubled debt restructurings

(“TDRs”).

| (Dollars in thousands) | June 30, **2015** | December 31, **2014** |
|---|---|---|
| Total loans considered impaired | $7,023 | $ 8,559 |
| Loans considered impaired for which there is a related allowance for loan loss: | | |
| Outstanding loan balance | 85 | 1,959 |
| Related allowance | 4 | 61 |
| Loans considered impaired and previously written down to fair value | 6,938 | 6,600 |
| Average impaired loans | 9,832 | 10,900 |

***Note 4 – Loans - continued***

The following tables are by loan category and present at June 30, 2015, December 31, 2014 and June 30, 2014 loans individually evaluated and considered impaired under FASB ASC 310 "Accounting by Creditors for Impairment of a Loan." Impairment includes performing TDRs.

| (Dollars in thousands) | | | | Six months ended | | Three months ended | |
|---|---|---|---|---|---|---|---|
| June 30, 2015 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no allowance recorded: | | | | | | | |
| Commercial | $ 13 | $ 13 | $ — | $ 15 | $ 1 | $ 14 | $ — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 946 | 1,201 | — | 1,207 | 14 | 1,204 | 8 |
| Mortgage-commercial | 5,890 | 8,327 | — | 8,428 | 165 | 8,073 | 79 |
| Consumer: | | | | | | | |
| Home Equity | 89 | 95 | — | 96 | 2 | 97 | 1 |
| Other | — | — | — | — | — | — | — |
| With an allowance recorded: | | | | | | | |
| Commercial | — | — | — | — | — | — | — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 51 | 51 | 3 | 52 | 2 | 51 | — |
| Mortgage-commercial | 34 | 34 | 1 | 34 | 1 | 346 | — |
| Consumer: | | | | | | | |
| Home Equity | — | — | — | — | — | — | — |
| Other | — | — | — | — | — | — | — |
| Total: | | | | | | | |
| Commercial | $ 13 | $ 13 | $ — | $ 15 | $ 1 | $ 14 | $ — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 997 | 1,252 | 3 | 1,259 | 16 | 1,255 | 8 |
| Mortgage-commercial | 5,924 | 8,361 | 1 | 8,462 | 166 | 8,419 | 79 |
| Consumer: | | | | | | | |
| Home Equity | 89 | 95 | — | 96 | 2 | 97 | 1 |
| Other | — | — | — | — | — | — | — |
| | $ 7,023 | $ 9,721 | $ 4 | $ 9,832 | $ 185 | $ 9,785 | $ 88 |

***Note 4 – Loans - continued***

| (Dollars in thousands) | | | | Six months ended | | Three months ended | |
|---|---|---|---|---|---|---|---|
| June 30, 2014 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no allowance recorded: | | | | | | | |
| Commercial | $ 62 | $ 68 | $ — | $ 134 | $ — | $ 133 | $ — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 1,082 | 1,187 | — | 1,307 | 4 | 1,303 | — |
| Mortgage-commercial | 6,688 | 8,083 | — | 9,188 | 23 | 8,910 | 6 |
| Consumer: | | | | | | | |
| Home Equity | 73 | 77 | — | 75 | — | 75 | — |
| Other | 6 | 6 | — | 8 | — | 8 | — |
| With an allowance recorded: | | | | | | | |
| Commercial | — | — | — | — | — | — | — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 54 | 54 | 4 | 55 | 2 | 55 | 1 |
| Mortgage-commercial | 242 | 242 | 12 | 246 | 6 | 246 | 3 |
| Consumer: | | | | | | | |
| Home Equity | — | — | — | — | — | — | — |
| Other | — | — | — | — | — | — | — |
| Total: | | | | | | | |
| Commercial | $ 62 | $ 68 | $ — | $ 134 | $ — | $ 133 | $ — |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | — | — |
| Mortgage-residential | 1,136 | 1,241 | 4 | 1,362 | 6 | 1,358 | 1 |
| Mortgage-commercial | 6,930 | 8,325 | 12 | 9,434 | 29 | 9,156 | 9 |
| Consumer: | | | | | | | |
| Home Equity | 73 | 77 | — | 75 | — | 75 | — |
| Other | 6 | 6 | — | 8 | — | 8 | — |
| | $ 8,207 | $ 9,717 | $ 16 | $ 11,013 | $ 35 | $ 10,730 | $ 10 |

***Note 4 – Loans - continued***

| (Dollars in thousands)<br>December 31, 2014 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no allowance recorded: | | | | | |
| Commercial | $ 55 | $112 | $ — | $ 132 | $ 3 |
| Real estate: | | | | | |
| Construction | — | — | — | — | — |
| Mortgage-residential | 1,025 | 1,167 | — | 1,071 | 8 |
| Mortgage-commercial | 5,428 | 6,469 | — | 7,634 | 64 |
| Consumer: | | | | | |
| Home Equity | 92 | 97 | — | 83 | — |
| Other | — | — | — | — | — |
| With an allowance recorded: | | | | | |
| Commercial | — | — | — | — | — |
| Real estate: | | | | | |
| Construction | — | — | — | — | — |
| Mortgage-residential | 53 | 53 | 4 | 54 | 3 |
| Mortgage-commercial | 1,906 | 2,134 | 57 | 1,926 | 85 |
| Consumer: | | | | | |
| Home Equity | — | — | — | — | — |
| Other | — | — | — | — | — |
| Total: | | | | | |
| Commercial | $ 55 | $112 | $ — | $ 132 | $ 3 |
| Real estate: | | | | | |
| Construction | — | — | — | — | — |
| Mortgage-residential | 1,078 | 1,220 | 4 | 1,125 | 11 |
| Mortgage-commercial | 7,334 | 8,603 | 57 | 9,560 | 149 |
| Consumer: | | | | | |
| Home Equity | 92 | 97 | — | 83 | — |
| Other | — | — | — | — | — |
| | $ 8,559 | $10,032 | $ 61 | $ 10,900 | $ 163 |

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the

loan or of the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered as pass rated loans. As of June 30, 2015 and December 31, 2014, and based on the most recent analysis performed, the risk category of loans by class of loans is shown in the table below. As of June 30, 2015 and December 31, 2014, no loans were classified as doubtful.

***Note 4 – Loans - continued***

| (Dollars in thousands)<br>June 30, 2015 | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| Commercial, financial & agricultural | $37,559 | $343 | $ 13 | $ — | $37,915 |
| Real estate: | | | | | |
| Construction | 29,671 | 721 | — | — | 30,392 |
| Mortgage – residential | 46,837 | 1,452 | 1,052 | — | 49,341 |
| Mortgage – commercial | 296,752 | 9,022 | 9,599 | — | 315,373 |
| Consumer: | | | | | |
| Home Equity | 31,777 | 266 | 221 | — | 32,264 |
| Other | 8,709 | 2 | 20 | — | 8,731 |
| Total | $451,305 | $11,806 | $ 10,905 | $ — | $474,016 |

| (Dollars in thousands)<br>December 31, 2014 | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| Commercial, financial & agricultural | $32,579 | $754 | $ 70 | $ — | $33,403 |
| Real estate: | | | | | |
| Construction | 26,824 | 721 | — | — | 27,545 |
| Mortgage – residential | 46,090 | 1,054 | 1,366 | — | 48,510 |
| Mortgage – commercial | 270,986 | 10,437 | 11,763 | — | 293,186 |
| Consumer: | | | | | |
| Home Equity | 32,008 | 751 | 241 | — | 33,000 |
| Other | 8,041 | 100 | 59 | — | 8,200 |
| Total | $416,528 | $13,817 | $ 13,499 | $ — | $443,844 |

At June 30, 2015 and December 31, 2014, non-accrual loans totaled $5.4 million and $6.6 million, respectively.

TDRs that are still accruing and included in impaired loans at June 30, 2015 and December 31, 2014 totaled $1.7 million and $2.2 million, respectively. TDRs in non-accrual status at June 30, 2015 and December 31, 2014 totaled $1.9 million and $2.6 million, respectively.

There were no loans greater than 90 days delinquent and still accruing interest as of June 30, 2015 and December 31, 2014.

***Note 4 – Loans - continued***

We account for acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality,* and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

Purchase credit impaired (“PCI”) loans acquired totaled $4.2 million at estimated fair value, and acquired performing loans totaling $102.3 million at estimated fair value were not credit impaired. The gross contractual amount receivable for PCI loans and acquired performing loans was approximately $5.7 million and $116.0 million, respectively, as of the acquisition date. For the acquired performing loans, the best estimate at acquisition date of contractual cash flows not expected to be collected is $825 thousand. Determining the fair value of PCI loans at acquisition required the Company to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of cash flows expected to be collected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the impact of estimated credit losses and is called the nonaccretable difference. In accordance with GAAP, there was no carry-over of previously established allowance for credit losses from the acquired company.

In conjunction with the acquisition of Savannah River (as defined below) on February 1, 2014, the acquired PCI loan portfolio was accounted for at fair value as follows:

| (Dollars in thousands) | February 1, 2014 |
| --- | --- |
| Contractual principal and interest at acquisition | $ 5,717 |
| Nonaccretable difference | (1,205) |
| Expected cash flows at acquisition | 4,512 |
| Accretable yield | (272) |
| Basis in PCI loans at acquisition – estimated fair value | $ 4,240 |

23

***Note 4 – Loans - continued***

A summary of changes in the accretable yield for PCI loans for the three and six months ended June 30, 2015 and June 30, 2014 follows (in thousands):

| | Three Months Ended June 30, 2015 | Six Months Ended June 30, 2015 |
|---|---|---|
| Accretable yield, beginning of period | $ 28 | $ 75 |
| Accretion | (34) | (471) |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | 141 | 531 |
| Accretable yield, end of period | $ 135 | $ 135 |

| | Three Months Ended June 30, 2014 | Six Months Ended June 30, 2014 |
|---|---|---|
| Accretable yield, beginning of period | $ 239 | $ 272 |
| Accretion | (50) | (83) |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | (25) | (25) |
| Accretable yield, end of period | $ 164 | $ 164 |

***Note 4 – Loans - continued***

The following tables are by loan category and present loans past due and on non-accrual status as of June 30, 2015 and December 31, 2014:

| (Dollars in thousands)<br>June 30, 2015 | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days and Accruing | Nonaccrual | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial | $34 | $— | $ — | $ 13 | $47 | $37,868 | $37,915 |
| Real estate: | | | | | | | |
| Construction | — | — | — | — | — | 30,392 | 30,392 |
| Mortgage-residential | 498 | 26 | — | 946 | 1,470 | 47,871 | 49,341 |
| Mortgage-commercial | 232 | 1,402 | — | 4,301 | 5,935 | 309,438 | 315,373 |
| Consumer: | | | | | | | |
| Home equity | 38 | 29 | — | 89 | 156 | 32,108 | 32,264 |
| Other | 37 | 14 | — | — | 51 | 8,680 | 8,731 |
| Total | $839 | $1,471 | $ — | $ 5,349 | $7,659 | $466,357 | $474,016 |

| (Dollars in thousands)<br>December 31, 2014 | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days and Accruing | Nonaccrual | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial | $— | $— | $ — | $ 55 | $147 | $33,256 | $33,403 |
| Real estate: | | | | | | | |
| Construction | — | 2 | — | — | 2 | 27,543 | 27,545 |
| Mortgage-residential | 131 | 5 | — | 1,025 | 1,161 | 47,349 | 48,510 |
| Mortgage-commercial | 1,443 | 4 | — | 5,413 | 6,860 | 286,326 | 293,186 |
| Consumer: | | | | | | | |
| Home equity | 19 | — | — | 92 | 111 | 32,899 | 33,000 |
| Other | 63 | 6 | — | — | 69 | 8,131 | 8,200 |
| Total | $1,748 | $ 17 | $ — | $ 6,585 | $8,350 | $435,494 | $443,844 |

***Note 4 – Loans - continued***

As a result of adopting the amendments in Accounting Standards Update ("ASU") 2011-02 (Receivables-Topic 310), the Company reassessed all restructurings that occurred on or after the beginning of the fiscal year of adoption (January 1, 2011) to determine whether they are considered TDRs under the amended guidance. The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company identified them as impaired under the guidance in ASC 310-10-35. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those loans newly identified as impaired.

There were no loans determined to be TDRs that were restructured during the three and six month periods ended June 30, 2015.

The following table, by loan category, presents loans determined to be TDRs during the three and six month periods ended June 30, 2014.

| Troubled Debt Restructurings (Dollars in thousands) | For the three and six months ended June 30, 2014 | | |
|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Nonaccrual | | | |
| Mortgage-Commercial | 1 | $ 1,751 | $ 1,751 |
| Mortgage-Residential | 1 | $ 180 | $ 180 |
| Total TDRs | 2 | $ 1,931 | $ 1,931 |

As shown in the table above, two loans were determined to be TDRs during the three and six months ended June 30, 2014. The interest rate was lowered on both of these loans.

During the three and six month periods ended June 30, 2015 and June 30, 2014 there were no loans determined to be TDRs in the previous twelve months that had payment defaults. Defaulted loans are those loans that are greater than 89 days past due.

In the determination of the allowance for loan losses, all TDRs are reviewed to ensure that one of the three proper valuation methods (fair market value of the collateral, present value of cash flows, or observable market price) is

adhered to. All non-accrual loans are written down to their corresponding collateral value. All troubled TDR accruing loans that have a loan balance that exceeds the present value of cash flows will have a specific allocation. All nonaccrual loans are considered impaired. Under ASC 310-10, a loan is impaired when it is probable that the Company will be unable to collect all amounts due including both principal and interest according to the contractual terms of the loan agreement.

***Note 5 – Recently Issued Accounting Pronouncements***

The following is a summary of recent authoritative pronouncements:

In January 2014, the FASB amended the Equity Method and Joint Ventures topic of the Accounting Standards Codification. The amendments provide criteria that must be met in order to apply a proportional amortization method to Low-Income Housing Tax Credit investments and provide guidance on the method used to amortize the investment, the impairment approach, and the eligibility criteria for entities that have other arrangements (e.g., loans) with the limited liability entity. The amendments were effective for the Company for new investments in qualified affordable housing projects for interim and annual periods beginning after December 15, 2014. The Company intends to continue using the effective yield method for existing investments in qualified affordable housing projects. These amendments did not have a material effect on the Company's financial statements.

In January 2014, the FASB amended Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned (OREO). In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments were effective for the Company for annual periods, and interim periods within those annual periods, beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. The Company applied the amendments prospectively. These amendments did not have a material effect on the Company's financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2017. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2014, the FASB issued guidance which clarifies that performance targets associated with stock compensation should be treated as a performance condition and should not be reflected in the grant date fair value of the stock award. The amendments will be effective for the Company for fiscal years that begin after December 15, 2015. The Company will apply the guidance to all stock awards granted or modified after the amendments are. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2014, the FASB issued guidance for determining whether embedded features need to be accounted for separately from their host shares. The new guidance requires companies to consider all terms and features, including the embedded feature(s) being evaluated for separate recognition, when determining whether a host contract is more akin to debt or equity; no single term or feature should be considered determinative regarding the nature of the host contract. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption, including adoption in an interim period, permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2015, the FASB issued guidance to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under the new guidance, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company will apply the guidance prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

***Note 5 – Recently Issued Accounting Pronouncements - continued***

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. Although the amendments are expected to result in the deconsolidation of many entities, the Company will need to reevaluate all its previous consolidation conclusions. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance that will require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This update affects disclosures related to debt issuance costs but does not affect existing recognition and measurement guidance for these items. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 with early adoption permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance which provides guidance to customers about whether a cloud computing arrangement includes a software license. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015-, with early adoption permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2015, the FASB issued guidance which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption 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.

***Note 6 – Fair Value of Financial Instruments***

The Company adopted FASB ASC Fair Value Measurement Topic 820, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 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. ASC 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 standard describes three levels of inputs that may be used to measure fair value:

| | |
|---|---|
| **Level l** | Quoted prices in active markets for identical assets or liabilities. |
| **Level 2** | Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. |
| **Level 3** | Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. |

FASB ASC 825-10-50 “Disclosure about Fair Value of Financial Instruments”, requires the Company to disclose estimated fair values for its financial instruments. Fair value estimates, methods, and assumptions are set forth below.

**Cash and Short Term Investments** - The carrying amount of these financial instruments (cash and due from banks, interest-bearing bank balances, federal funds sold and securities purchased under agreements to resell) approximates fair value. All mature within 90 days and do not present unanticipated credit concerns and are classified as Level 1.

**Investment Securities** - Measurement is on a recurring basis based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for prepayment assumptions, projected credit losses, and liquidity. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or by dealers or brokers in active over-the-counter markets. Level 2 securities include MBSs issued both by government sponsored enterprises and PLMBSs. Generally these fair values are priced from established pricing models. Level 3 securities include corporate debt obligations and asset–backed securities that are less liquid or for which there is an inactive market.

**Loans Held for Sale** - 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 and are classified as Level 2. The carrying amount of these loans approximates fair value.

**Loans -** The fair value of loans are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities and are classified as Level 2. As discount rates are based on current loan rates as well as management estimates, the fair values presented may not be indicative of the value negotiated in an actual sale. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such

fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs.

***Note 6 – Fair Value of Financial Instruments - continued***

**Other Real Estate Owned (OREO) -** OREO is carried at the lower of carrying value or fair value on a non-recurring basis. Fair value is based upon independent appraisals or management's estimation of the collateral and is considered a Level 3 measurement.

**Accrued Interest Receivable** - The fair value approximates the carrying value and is classified as Level 1.

**Interest Rate Swap -**The fair value approximates the carrying value and is classified as Level 3.

**Deposits -** The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities. Deposits are classified as Level 2.

**Federal Home Loan Bank Advances -** Fair value is estimated based on discounted cash flows using current market rates for borrowings with similar terms and are classified as Level 2.

**Short Term Borrowings -** The carrying value of short term borrowings (securities sold under agreements to repurchase and demand notes to the Treasury) approximates fair value. These are classified as Level 2.

**Junior Subordinated Debentures -** The fair values of junior subordinated debentures is estimated by using discounted cash flow analyses based on incremental borrowing rates for similar types of instruments. These are classified as Level 2.

**Accrued Interest Payable -**The fair value approximates the carrying value and is classified as Level 1.

**Commitments to Extend Credit** - The fair value of these commitments is immaterial because their underlying interest rates approximate market.

30

***Note 6 – Fair Value of Financial Instruments - continued***

The carrying amount and estimated fair value by classification level of the Company's financial instruments as of June 30, 2015 and December 31, 2014 are as follows:

| | **June 30, 2015** | | | | |
|---|---|---|---|---|---|
| | **Carrying** | **Fair Value** | | | |
| (Dollars in thousands) | **Amount** | **Total** | **Level 1** | **Level 2** | **Level 3** |
| Financial Assets: | | | | | |
| Cash and short term investments | $25,876 | $25,876 | $25,876 | $— | $— |
| Held-to-maturity securities | 16,641 | 16,324 | — | 16,324 | — |
| Available-for-sale securities | 252,322 | 252,322 | 826 | 251,079 | 417 |
| Other investments, at cost | 2,240 | 2,240 | — | — | 2,240 |
| Loans held for sale | 6,662 | 6,662 | — | 6,662 | — |
| Net loans receivable | 469,735 | 469,059 | — | 462,121 | 6,938 |
| Accrued interest | 2,729 | 2,729 | 2,729 | — | — |
| Financial liabilities: | | | | | |
| Non-interest bearing demand | $147,046 | $147,046 | $— | $147,046 | $— |
| NOW and money market accounts | 294,113 | 294,113 | — | 294,113 | — |
| Savings | 57,369 | 57,369 | — | 57,369 | — |
| Time deposits | 185,504 | 186,190 | — | 186,190 | — |
| Total deposits | 684,032 | 684,718 | — | 684,718 | — |
| Federal Home Loan Bank Advances | 35,548 | 37,181 | — | 37,181 | — |
| Short term borrowings | 19,460 | 19,460 | — | 19,460 | — |
| Junior subordinated debentures | 15,464 | 15,464 | — | 15,464 | — |
| Accrued interest payable | 652 | 652 | 652 | — | — |

| | **December 31, 2014** | | | | |
|---|---|---|---|---|---|
| | **Carrying** | **Fair Value** | | | |
| (Dollars in thousands) | **Amount** | **Total** | **Level 1** | **Level 2** | **Level 3** |
| Financial Assets: | | | | | |
| Cash and short term investments | $22,532 | $22,532 | $22,532 | $— | $— |
| Held-to-maturity securities | 10,647 | 10,585 | — | 10,585 | — |
| Available-for-sale securities | 270,164 | 270,164 | 839 | 268,908 | 417 |
| Other investments, at cost | 2,003 | 2,003 | — | — | 2,003 |
| Loans held for sale | 4,124 | 4,124 | — | 4,124 | — |
| Net loans receivable | 439,712 | 441,944 | — | 433,446 | 8,498 |
| Accrued interest | 2,712 | 2,712 | 2,712 | — | — |
| Financial liabilities: | | | | | |
| Non-interest bearing demand | $133,004 | $133,004 | $— | $133,004 | $— |
| NOW and money market accounts | 287,982 | 287,982 | — | 287,982 | — |

| | | | | | |
|---|---|---|---|---|---|
| Savings | 53,583 | 53,583 | — | 53,583 | — |
| Time deposits | 195,014 | 195,721 | — | 195,721 | — |
| Total deposits | 669,583 | 670,290 | — | 670,290 | — |
| Federal Home Loan Bank Advances | 28,807 | 30,745 | — | 30,745 | — |
| Short term borrowings | 17,383 | 17,383 | — | 17,383 | — |
| Junior subordinated debentures | 15,464 | 15,464 | — | 15,464 | — |
| Accrued interest payable | 725 | 725 | 725 | — | — |

***Note 6 – Fair Value of Financial Instruments - continued***

The following tables summarize quantitative disclosures about the fair value for each category of assets carried at fair value as of June 30, 2015 and December 31, 2014 that are measured on a recurring basis. There were no liabilities carried at fair value as of June 30, 2015 or December 31, 2014 that are measured on a recurring basis.

**(Dollars in thousands)**

| Description | June 30, 2015 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Available for sale securities | | | | |
| Government sponsored enterprises | $2,487 | $ | $2,487 | $ — |
| Mortgage-backed securities | 140,494 | — | 140,494 | — |
| Small Business Administration securities | 60,572 | — | 60,572 | — |
| State and local government | 47,466 | — | 47,466 | — |
| Corporate and other securities | 1,303 | 826 | 60 | 417 |
| Total | $252,322 | $ 826 | $251,079 | $ 417 |

**(Dollars in thousands)**

| Description | December 31, 2014 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Available for sale securities | | | | |
| Government sponsored enterprises | $3,434 | $ — | $3,434 | $ — |
| Mortgage-backed securities | 160,353 | — | 160,353 | — |
| Small Business Administration securities | 58,545 | — | 58,545 | — |
| State and local government | 46,516 | — | 46,516 | — |
| Corporate and other securities | 1,316 | 839 | 60 | 417 |

| | | | | |
|---|---|---|---|---|
| Total | $270,164 | $ 839 | $268,908 | $ 417 |

32

***Note 6 – Fair Value of Financial Instruments – continued***

The following table reconciles the changes in Level 3 financial instruments for the six months ended June 30, 2015 and June 30, 2014 that are measured on a recurring basis.

| | **June 30,** | |
|---|---|---|
| **(Dollars in thousands)** | **2015 Corporate Preferred Stock** | **2014 Corporate Preferred Stock** |
| Beginning Balance | $417 | $ 417 |
| Total gains or losses (realized/unrealized) Included in earnings | — | — |
| Included in other comprehensive income | — | — |
| Purchases, issuances, and settlements | — | — |
| Transfers in and/or out of Level 3 | — | — |
| Ending Balance | $417 | $ 417 |

The following table reconciles the changes in Level 3 financial instruments for the three months ended June 30, 2015 and June 30, 2014 that are measured on a recurring basis.

| | June 30, | |
|---|---|---|
| **(Dollars in thousands)** | **2015 Corporate Preferred Stock** | **2014 Corporate Preferred Stock** |
| Beginning Balance | $417 | $ 417 |
| Total gains or losses (realized/unrealized) Included in earnings | — | — |
| Included in other comprehensive income | — | — |
| Purchases, issuances, and settlements | — | — |
| Transfers in and/or out of Level 3 | — | — |
| Ending Balance | $417 | $ 417 |

***Note 6 – Fair Value of Financial Instruments – continued***

The following tables summarize quantitative disclosures about the fair value for each category of assets carried at fair value as of June 30, 2015 and December 31, 2014 that are measured on a non-recurring basis.

(Dollars in thousands)

| Description | June 30, 2015 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Impaired loans: | | | | |
| Commercial & Industrial | $13 | $ — | $ — | $ 13 |
| Real estate: | | | | |
| Mortgage-residential | 994 | — | — | 994 |
| Mortgage-commercial | 5,923 | — | — | 5,923 |
| Consumer: | | | | |
| Home equity | 89 | — | — | 89 |
| Other | — | — | — | — |
| Total impaired | 7,019 | — | — | 7,019 |
| Other real estate owned: | | | | |
| Construction | 276 | — | — | 276 |
| Mortgage-residential | 182 | — | — | 182 |
| Mortgage-commercial | 2,065 | — | — | 2,065 |
| Total other real estate owned | 2,523 | — | — | 2,523 |
| Total | $9,542 | $ — | $ — | $ 9,542 |

***Note 6 – Fair Value of Financial Instruments - continued***

(Dollars in thousands)

| **Description** | **December 31, 2014** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
|---|---|---|---|---|
| Impaired loans: | | | | |
| Commercial & Industrial | $ 55 | $ — | $ — | $ 55 |
| Real estate: | | | | |
| Mortgage-residential | 1,074 | — | — | 1,074 |
| Mortgage-commercial | 7,277 | — | — | 7,277 |
| Consumer: | | | | |
| Home equity | 92 | — | — | 92 |
| Other | — | — | — | — |
| Total impaired | 8,498 | — | — | 8,498 |
| Other real estate owned: | | | | |
| Construction | 424 | — | — | 424 |
| Mortgage-residential | 232 | — | — | 232 |
| Mortgage-commercial | 2,287 | — | — | 2,287 |
| Total other real estate owned | 2,943 | — | — | 2,943 |
| Total | $ 11,441 | $ — | $ — | $ 11,441 |

The Company has a large percentage of loans with real estate serving as collateral. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs. Third party appraisals are generally obtained when a loan is identified as being impaired or at the time it is transferred to OREO. This internal process consists of evaluating the underlying collateral to independently obtained comparable properties. With respect to less complex or smaller credits, an internal evaluation may be performed. Generally the independent and internal evaluations are updated annually. Factors considered in determining the fair value include geographic sales trends, the value of comparable surrounding properties as well as the condition of the property. The aggregate amount of impaired loans was $7.0 million and $8.5 million as of June 30, 2015 and December 31, 2014, respectively.

***Note 6 – Fair Value of Financial Instruments - continued***

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2015 and December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

| (Dollars in thousands) | Fair Value as of June 30, 2015 | Valuation Technique | Significant Observable Inputs | Significant Unobservable Inputs |
| --- | --- | --- | --- | --- |
| Preferred stock | $417 | Estimation based on comparable non-listed securities | Comparable transactions | n/a |
| OREO | $2,523 | Appraisal Value/Comparison Sales/Other estimates | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |
| Impaired loans | $7,019 | Appraisal Value | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |

| (Dollars in thousands) | Fair Value as of December 31, 2014 | Valuation Technique | Significant Observable Inputs | Significant Unobservable Inputs |
| --- | --- | --- | --- | --- |
| Preferred stock | $ 417 | Estimation based on comparable non-listed securities | Comparable transactions | n/a |
| OREO | $ 2,943 | Appraisal Value/Comparison Sales/Other estimates | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |
| Impaired loans | $ 8,498 | Appraisal Value | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |

***Note 7 – Mergers and Acquisitions – Savannah River Financial Corporation***

On February 1, 2014, the Company acquired all of the outstanding common stock of Savannah River Financial Corporation ("Savannah River"), of Augusta, Georgia, the bank holding company for Savannah River Banking Company ("SRBC"), in a cash and stock transaction. The total purchase price was approximately $33.5 million, consisting of $19.8 million in cash and 1,274,200 shares of our common stock valued at $13.7 million based on a provision in the merger agreement that 60% of the outstanding shares of Savannah River common stock be exchanged for cash and 40% of the outstanding shares of Savannah River common stock be exchanged for shares of the Company's common stock. The value of the Company's common stock issued was determined based on the closing price of the common stock of $10.76 on January 31, 2014 as reported by NASDAQ. Savannah River common shareholders received 1.0618 shares of the Company's common stock in exchange for each share of Savannah River common stock, or $11.00 per share, subject to the limitations discussed above. The Company issued 1,274,200 shares of its common stock in connection with the merger.

The Savannah River transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Fair values are subject to refinement for up to a year.

*Note 7 – Mergers and Acquisitions – Savannah River Financial Corporation - continued*

The following table presents the assets acquired and liabilities assumed as of February 1, 2014 as recorded by the Company on the acquisition date and initial fair value adjustments.

| (Dollars in thousands, except per share data) | As Recorded by Savannah River | Fair Value Adjustments | | As Recorded by the Company |
|---|---|---|---|---|
| Assets | | | | |
| Cash and cash equivalents | $ 8,451 | $— | | $ 8,451 |
| Investment securities | 23,014 | 126 | (a) | 23,140 |
| Loans | 109,532 | (3,016) | (b) | 106,516 |
| Premises and equipment | 7,695 | 473 | (c) | 8,168 |
| Intangible assets | — | 1,182 | (d) | 1,182 |
| Bank owned life insurance | 3,158 | — | | 3,158 |
| Other assets | 1,839 | (248) | (e) | 1,591 |
| Total assets | $ 153,689 | $(1,483) | | $ 152,206 |
| Liabilities | | | | |
| Deposits: | | | | |
| Noninterest-bearing | $ 11,045 | $— | | $ 11,045 |
| Interest-bearing | 102,891 | 211 | (f) | 103,102 |
| Total deposits | 113,936 | 211 | | 114,147 |
| FHLB advances | 8,684 | 22 | (g) | 8,706 |
| Other liabilities | 345 | — | | 345 |
| Total liabilities | 122,965 | 233 | | 123,198 |
| Net identifiable assets acquired over (under) liabilities assumed | 30,724 | (1,716) | | 29,008 |
| Goodwill | — | 4,507 | | 4,507 |
| Net assets acquired over liabilities assumed | $ 30,724 | $2,791 | | $ 33,515 |
| Consideration: | | | | |
| First Community Corporation common shares issued | 1,274,200 | | | |
| Purchase price per share of the Company's common stock | $ 10.76 | | | |
| | $ 13,710 | | | |
| Cash exchanged for stock and fractional shares | 19,805 | | | |
| Fair value of total consideration transferred | $ 33,515 | | | |

Explanation of fair value adjustments

(a)—Adjustment reflects marking the securities portfolio to fair value as of the acquisition date.

(b)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired loan portfolio. and excludes the allowance for loan losses recorded by Savannah River.

(c)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired premises and equipment.

(d)—Adjustment reflects the recording of the core deposit intangible on the acquired deposit accounts.

(e)—Adjustment reflects the deferred tax adjustment related to fair value adjustments at 34%.

(f)—Adjustment reflects the fair value adjustment on interest-bearing deposits.

(g)—Adjustment reflects the fair value adjustment on FHLB Advances which was equal to the prepayment fee paid to pay-off the FHLB Advances upon consummation of the merger.

***Note 7 – Mergers and Acquisitions – Savannah River Financial Corporation - continued***

The operating results of the Company for the period ended June 30, 2014 include the operating results of the acquired assets and assumed liabilities for the 59 days subsequent to the acquisition date of February 1, 2014. Merger-related charges of $435 thousand are recorded in the consolidated statement of income and include incremental costs related to closing the acquisition, including legal, accounting and auditing, investment banker, travel, printing, supplies and other costs.

The following table discloses the impact of the merger with Savannah River (excluding the impact of merger-related expenses) since the acquisition on February 1, 2014 through June 30, 2014. The table also presents certain pro forma information as if Savannah River had been acquired on January 1, 2014. The results combine the historical results of Savannah River in the Company's consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2014. The results for the three months ended June 30, 2014 and three and six month periods ended June 30, 2015 do not have any material merger related expenses and include the impact of the Savannah River acquisition for the entire period, and therefore, no pro-forma information is presented for such period.

| (Dollars in thousands) | Actual since Acquisition (February 1, 2014 through June 30, 2014) | Pro Forma Six Months Ended June 30, 2014 |
|---|---|---|
| Total revenues *(net interest income plus noninterest income)* | $ 12,981 | $ 15,736 |
| Net income | $ 1,996 | $ 2,517 |

On September 26, 2014, the Bank completed its acquisition of approximately $40 million in deposits and $8.7 million in loans from First South Bank ("First South"). This represented all of the deposits and a portion of the loans at First South's Columbia, South Carolina banking office located at 1333 Main Street. The Bank paid a premium of $714 thousand for the deposits and loans acquired. The deposits and loans from First South have been consolidated into the Bank's branch located at 1213 Lady Street, Columbia, South Carolina. The premium paid of $714 thousand plus fair value adjustments recorded on loans and deposits acquired resulted in a core deposit intangible of $365.9 thousand and other identifiable intangible assets in the amount of $538.6 thousand being recorded related to this transaction and is reflected on the consolidated balance sheet at December 31, 2014. The transaction is being accounted for as an asset acquisition and liability assumption. The core deposit intangible and other identifiable intangible are being amortized over seven years on an accelerated basis.

***Note 8 – Subsequent Events***

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

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.**

This report 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,” “projec “potential,” “continue,” “assume,” “believe,” “intend,” “plan,” “forecast,” “goal,” and “estimate,” as well as similar expression 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 our Annual Report on Form 10-K for the year ended December 31, 2014 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, changes in customer 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 recent acquisitions 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;
- 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 comply with the terms of the consent order between our bank subsidiary, First Community Bank (the "Bank"), and the FDIC within the timeframes specified;
- 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 detailed from time to time in our filings with the SEC.

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 our 2014 Annual Report on Form 10-K as filed with the SEC. 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.

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.

**Overview**

The following discussion describes our results of operations for the six months and three months ended June 30, 2015 as compared to the six months and three month periods ended June 30, 2014 and also analyzes our financial condition as of June 30, 2015 as compared to December 31, 2014. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, 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. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

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 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 non-interest income, as well as our non-interest expense, in the following discussion.

The following discussion and analysis 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 18, 2015, the Bank entered into the Stipulation and Consent to the Issuance of a Consent Order with the FDIC consenting to the issuance by the FDIC of a Consent Order (the “Consent Order”). The Consent Order requires the Bank to take certain actions with respect to the Bank Secrecy Act and anti-money laundering laws and regulations (collectively referred to as the “BSA”), including, among other things, enhancing its annual BSA risk assessment processes; revising certain internal controls related to BSA; and further developing and implementing certain BSA-related training programs. While the Bank recognizes that certain technical aspects of its BSA compliance activities were affected by a temporary period of significant turnover in the Bank’s BSA staff, the Bank believes that it has recognized and addressed all of the BSA compliance issues noted by the FDIC and that, as of the date of this report, it is in compliance with the requirements set forth in the Consent Order. Nevertheless, there can be no assurance that the FDIC will ultimately determine that the Bank has met all of the requirements of the Consent Order to its satisfaction. If the FDIC determines that the Bank has not made sufficient progress in complying with the Consent Order, the FDIC could seek to impose additional regulatory requirements, operational restrictions, enhanced supervision and/or civil money penalties. If any of these measures is imposed in the future, it could have a material adverse effect on our financial condition and results of operations and on our ability to raise additional capital on acceptable terms.

**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 footnotes to our unaudited consolidated financial statements as of June 30, 2015 and our notes included in the consolidated financial statements in our 2014 Annual Report on Form 10-K as filed with the SEC.

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.

Allowance for Loan Losses

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.

Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price over the sum of the estimated fair values of the tangible and identifiable intangible assets acquired less the estimated fair value of the liabilities assumed. Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Qualitative factors are assessed to first determine if it is more likely than not (more than 50%) that the carrying value of goodwill is less than fair value. These qualitative factors include but are not limited to overall deterioration in general economic conditions, industry and market conditions, and overall financial performance. If determined that it is more likely than not that there has been a deterioration in the fair value of the carrying value than the first of a two-step process would be performed. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

If required, the second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted. Management has determined that the Company has one reporting unit.

Core deposit intangibles consist of costs that resulted from the acquisition of deposits from Savannah River and First South. Core deposit intangibles represent the estimated value of long-term deposit relationships acquired in this transaction. These costs are amortized over the estimated useful lives of the deposit accounts acquired on a method that we believe reasonably approximates the anticipated benefit stream from the accounts. The estimated useful lives are periodically reviewed for reasonableness.

Income Taxes and Deferred Tax Assets and Liabilities

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 the Bank. At June 30, 2015 and December 31, 2014, we were in a net deferred tax asset position.

Other-Than-Temporary Impairment

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 3 to the Consolidated Financial Statements).

Business Combinations, Method of Accounting for Loans Acquired

We account for acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality.* and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

**Comparison of Results of Operations for Six Months Ended June 30, 2015 to the Six Months Ended June 30, 2014**

Net Income

Our net income for the six months ended June 30, 2015 was $2.8 million or $0.43 diluted earnings per common share, as compared to $2.1 million or $0.32 diluted earnings per common share for the six months ended June 30, 2014. Our acquisition of Savannah River was closed on February 1, 2014. Therefore, the results for the six months ended June 30, 2014 include the impact of this acquisition from February 1, 2014 through June 30, 2014. The increase in net

income between the two periods is primarily due to the increase in average earning assets resulting from the Savannah River acquisition reflected for the entire quarter in 2015, as well as organic growth between the two periods. In addition, during the first half of 2014, we incurred Savannah River merger related expenses of $435 thousand. There were no merger related expenses incurred in the first half of 2015. Net interest income increased $1.2 million for the six months ended June 30, 2015 as compared to the same period 2014. This increase is primarily the result of an increase in average earning assets of $60.4 million. Average earning assets increased by $60.4 million in the first half of 2015 as compared to the same period in 2014. Average earning assets were $756.0 million during the six months ended June 30, 2015 as compared to $695.5 million during the six months ended June 30, 2014. The net interest margin on a tax equivalent basis increased to 3.47% during the first half of 2015 as compared to 3.39% during the first quarter of 2015. The net interest margin was positively impacted in the first quarter of 2015 by two purchased impaired loan payoffs that were acquired in the Savannah River acquisition, and as a result, the credit mark established at the acquisition date was recovered. Non-interest income increased $772 thousand in the first six months of 2015 as compared to the first six months of 2014. This increase results from increases in mortgage banking income and Investment Advisory fees and non-deposit commissions of $394 thousand and $248 thousand, respectively, in the six months ended June 30, 2015 as compared to the same period in 2014. Non-interest expense in the six months ended June 30, 2015 increased $678 thousand as compared to the same period in 2014. This fluctuation is primarily a result of the impact of the Savannah River acquisition as well as normal salary adjustments between the two periods.

Net Interest Income

Please refer to the table at the end of this Item 2 for the yield and rate data for interest-bearing balance sheet components during the six-month periods ended June 30, 2015 and 2014, along with average balances and the related interest income and interest expense amounts.

Net interest income was $12.7 million for the six months ended June 30, 2015 as compared to $11.4 million for the six months ended June 30, 2014. The increase in average earning assets of $60.4 million contributed to the overall $1.2 million increase in net interest income in the six months ended June 30, 2015 as compared to the same period in 2014. Our net interest margin on a tax equivalent basis increased 8 basis points, from 3.39% at June 30, 2014 to 3.47% at June 30, 2015. As previously stated, the net interest margin was also positively impacted during the first six months of 2015 as a result of two pay-offs on purchased credit impaired loans. These two payoffs accounted for approximately 9 basis points in our taxable equivalent net-interest margin for the six months ended June 30, 2015. The yield on earning assets decreased by 2 basis points in the first half of 2015 as compared to the same period in 2014. Average loans comprised 61.1% of average earning assets in the first six months of 2015 as compared to 61.8% in the same period of 2014. The yield on our loan portfolio increased 5 basis points in the six month period ended June 30, 2015 to 5.05% as compared to 5.00% during the same period in 2014. This was partially offset by a decrease on the yield on securities of 9 basis points in comparing the same two periods. The decrease in the yield on securities was partially a result of an increase in prepayment rates in the MBS portfolio. As a result, the related amortization of the premiums on these securities is accelerated. The cost of interest-bearing liabilities during the first six months of 2015 was 0.56% as compared to 0.65% in the same period of 2014, reflecting a 9 basis point decrease. The continued focus and resulting shift in our deposit funding mix has continued to allow us to lower our overall cost of funds. Interest-bearing transaction accounts, money market accounts and savings deposits, which are typically our lower costing funds, represent 57.9% of our average interest bearing liabilities during the first six months of 2015 as compared to 55.5% in the same period of 2014.

Provision and Allowance for Loan Losses

At June 30, 2015 and December 31, 2014, the allowance for loan losses was $4.3 and $4.1 million, respectively. This represented 0.90% of total loans and 0.93% of loans at June 30, 2015 and December 31, 2014, respectively. No allowance for loan losses related to the Savannah River acquired loans was recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired were recorded at the acquisition date fair value, which was based on expected cash flows and included an estimation of expected future loan losses for the purchased credit-impaired loans, including principal and interest. There have been no material adjustments to our original assumptions since the acquisition date. At June 30, 2015 and December 31, 2014, the allowance for loan losses plus the fair value adjustment related to credit as a percentage of total loans (excluding loans held for sale) was 1.17% and 1.36%, respectively. Our provision for loan losses was $797 thousand for the six months ended June 30, 2015 as compared to $550 thousand for the six months ended June 30, 2014. This 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, the experience ability and depth of lending personnel, economic conditions (local and national) 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.

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 4 – Loans). The annualized weighted average loss ratios over the last 36 months for loans classified substandard, special mention and pass have been approximately 6.36%, 4.17% and 0.11%, 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. 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. As economic conditions show sustainable improvement, we believe the unallocated portion of the allowance should decrease as a percentage of the total allowance.

Our loan portfolio consists of a large percentage of real estate secured loans. Real estate values continue to be adversely impacted as a result of the economic downturn over the last several years. Impaired values of the underlying real estate collateral as well as lower historical residential and commercial real estate sales impacts our ability to sell collateral upon foreclosure. There is a risk that this trend will continue. 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. If real estate values continue to decline, it is also more likely that we would be required to increase our allowance for loan losses. If during a period of reduced real estate values we are required to liquidate the property collateralizing a loan to satisfy the debt or to increase the allowance for loan losses, it could materially reduce our profitability and adversely affect our financial condition.

Non-performing assets were $7.8 million (0.94% of total assets) at June 30, 2015 as compared to $8.7 million (1.04% of total assets) and $9.5 million (1.17% of total assets) at March 31, 2015 and December 31, 2014, respectively. While we believe these non-performing ratios are favorable in comparison to current industry results (both nationally and locally), we continue to be concerned about the impact of this economic environment on our customer base of local businesses and professionals. There were 41 loans, totaling $5.3 million, included in non-performing status (non-accrual loans and loans past due 90 days and still accruing) at June 30, 2015. The largest non-performing loan is a $1.1 million first mortgage on developed lots to be sold for residential use. The average balance of the remaining 40 loans is approximately $107.0 thousand and the majority of these loans are secured by first mortgage liens. At the time the loans are placed in non-accrual status, we typically obtain an updated appraisal and, if the loan balance exceeds fair value, write the balance down to the fair value. At June 30, 2015, we had no loans delinquent more than 90 days and still accruing interest. At June 30, 2015, we had loans totaling $2.3 million that were delinquent 30 days to 89 days which represented 0.49% of total loans.

Our management continuously monitors non-performing, classified and past due loans, to identify deterioration regarding the condition of these loans. We have identified one loan relationship in the amount of $1.1 million that is current as to principal and interest and not included in non-performing assets that could represent a potential problem loan. This balance is included as substandard loans in Note 4 of the financial statements.

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.

The following table summarizes the activity related to our allowance for loan losses for the periods indicated:

Allowance for Loan Losses

| (Dollars in thousands) | Six Months Ended June 30, 2015 | 2014 |
|---|---|---|
| Average loans (including loans held for sale) outstanding | $461,848 | $430,000 |
| Loans outstanding at period end | $474,016 | $444,670 |
| Non-performing assets: | | |
| Nonaccrual loans | $5,349 | $7,647 |
| Loans 90 days past due still accruing | — | 160 |
| Repossessed-other | — | — |
| Foreclosed real estate and other assets | 2,523 | 3,302 |
| Total non-performing assets | $7,872 | $11,109 |
| | | |
| Beginning balance of allowance | $4,132 | $4,219 |
| Loans charged-off: | | |
| Construction and development | — | — |
| 1-4 family residential mortgage | 26 | 35 |
| Non-residential real estate | 625 | 689 |
| Home equity | — | — |
| Commercial | 56 | 20 |
| Installment & credit card | 27 | — |
| Total loans charged-off | 734 | 744 |
| Recoveries: | | |
| 1-4 family residential mortgage | 2 | 9 |
| Non-residential real estate | 5 | — |
| Home equity | 2 | — |
| Commercial | 3 | 24 |
| Installment & credit card | 74 | 8 |
| Total recoveries | 86 | 41 |
| Net loan charge offs | 648 | 703 |
| Provision for loan losses | 797 | 550 |
| Balance at period end | $4,281 | $4,066 |
| | | |
| Net charge-offs to average loans | 0.14 % | 0.16 % |
| Allowance as percent of total loans | 0.90 % | 0.91 % |
| Non-performing assets as % of total assets | 0.94 % | 1.41 % |
| Allowance as % of non-performing loans | 80.03 % | 52.08 % |

The following allocation of the allowance to specific components is not necessarily indicative of future losses or future allocations. The entire allowance is available to absorb losses in the portfolio.

Composition of the Allowance for Loan Losses

| (Dollars in thousands) | June 30, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Amount | % of loans in Category | Amount | % of loans in Category |
| Commercial, Financial and Agricultural | $221 | 8.0 % | $67 | 7.5 % |
| Real Estate – Construction | 124 | 6.4 % | 45 | 6.2 % |
| Real Estate Mortgage: | | | | |
| Commercial | 1,774 | 66.6 % | 1,572 | 66.1 % |
| Residential | 179 | 10.4 % | 179 | 10.9 % |
| Consumer: | | | | |
| Home Equity | 119 | 6.8 % | 134 | 7.4 % |
| Other | 60 | 1.8 % | 44 | 1.9 % |
| Unallocated | 1,804 | N/A | 2,091 | N/A |
| Total | $4,281 | 100.0 % | $4,132 | 100.0 % |

Accrual of interest is discontinued on loans when management believes, 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.

Non-interest Income and Non-interest Expense

Non-interest income during the first half of 2015 was $4.5 million as compared to $3.8 million during the same period in 2014. Deposit service charges decreased by $52 thousand from $745 thousand in the first half of 2014, to $693 thousand in the same period of 2015. Over the last several years, we have continued to see a decline in deposit service charges as a result of lower levels of charges assessed for items presented against non-sufficient funds. Mortgage banking income increased $394 thousand during the first six months of 2015 compared to the same period in 2014. We continue to focus on this source of revenue. In 2011, the Bank expanded its residential mortgage business unit with the acquisition of the assets of Palmetto South Mortgage Corporation (“Palmetto South”), and in 2014, we consolidated the Palmetto South mortgage division into our legacy mortgage operation, First Community Mortgage, a division of the Bank. We hired several new mortgage originators and focused on increasing the level of purchase money activity. We believe these initiatives began to reflect the anticipated benefits in the second half of 2014 and continuing into 2015. Investment advisory fees and non-deposit commissions increased by $248 thousand in the first

half of 2015 as compared to the same period in 2014. Management continues to focus on increasing this recurring source of revenue by increasing total assets under management. During the first half of 2015, we sold investment securities for a net gain of $271 thousand as compared to a gain on the sale of investment securities of $86 thousand in the same period of 2014. These gains were partially offset by prepayment penalties on the early payoff of certain Federal Home Loan Bank Advances. In the first half of 2015 and 2014, we prepaid $2.7 million and $2.0 million in FHLB advances, respectively. The penalty on these prepayments of these advances amounted to $103 thousand and $67 thousand in 2015 and 2014, respectively.

Total non-interest expense increased by $678 thousand, or 5.7%, during the first six months of 2015 as compared to the same period in 2014. Salary and benefit expense increased $527 thousand from $6.7 million in the first half of 2014 to $7.2 million in the first half of 2015. Along with our normal salary adjustments, the increase is results from the addition of the Savannah River employees reflected for the entire first half of 2015 compared to only five months in the first half of 2014. At June 30, 2014, we had 188 full time equivalent employees as compared to 183 at June 30, 2015. Occupancy expense and equipment expense increased $107 thousand and $82 thousand, respectively, in the first half of 2015 as compared to the first half of 2014. Both increases are a result of the Savannah River merger reflected in the results for the entire first half of 2015, as well as, the additions of the Lady Street branch, in downtown Columbia in the third quarter of 2014 and our Blythewood branch in April 2015. Marketing and public relations expense was $373 thousand in the first half of 2014 as compared to $554 thousand in the first half of 2015. The timing of a media campaign in the first half of 2015 resulted in the increased marketing cost as compared to the same period of 2014. Amortization of intangibles increased from $105 thousand in the first half of 2014 to $201 thousand in the same period of 2015. The increase results from the core deposit and other intangible amortization recorded in connection with the deposit assumption and loan acquisition from First South Bank that closed in September 2014. During the first half of 2014, we incurred merger and acquisition related expenses of $435 thousand. Of this amount $420 thousand was related to the Savannah River acquisition and $15 thousand was related to the previously mentioned First South Bank transaction. There were no merger expenses for the first six months of 2015. Non-interest expense “Other” increased $46 thousand in the first six months of 2015 as compared to the same period of 2014. Included in other non-interest expense for the six months ended June 30, 2015 is a $100 thousand write down of excess property contiguous to our Augusta branch. This property was acquired by Savannah River at the time they initially purchased the lot that their main office was constructed on, as the seller did not want to subdivide the properties. The lot has been listed for sale since First Community acquired Savannah River. As of June 30, 2015, the property is under contract to sell and is expected to close in the fourth quarter of 2015. Under the terms of the contract, there should be no additional charges or cost incurred by First Community associated with the sale of this property.

The following is a summary of the components of other non-interest expense for the periods indicated:

| (In thousands) | Six months ended June 30, | |
|---|---|---|
| | 2015 | 2014 |
| Data processing | $284 | $284 |
| Supplies | 66 | 78 |
| Telephone | 183 | 180 |
| Courier | 44 | 42 |
| Correspondent services | 109 | 91 |
| Dues | 54 | 45 |
| Subscriptions | 68 | 81 |
| Loan closing costs/fees | 50 | 6 |
| Insurance | 137 | 138 |
| Loss on limited partnership interest | 86 | 93 |
| Postage | 95 | 88 |
| Legal and Professional fees | 286 | 364 |
| Director fees | 198 | 188 |
| Shareholder expense | 64 | 86 |

| | | |
|---|---|---|
| Other Miscellaneous | 422 | 336 |
| | $2,146 | $2,100 |

Income Tax Expense

Our effective tax rate was 27.2% and 27.8% in the first half of 2015 and 2014, respectively. As a result of our current level of tax exempt securities in our investment portfolio, our effective tax rate is expected to remain at 27.0% to 30.0% throughout the remainder of 2015.

**Comparison of Results of Operations for Three Months Ended June 30, 2015 to the Three Months Ended June 30, 2014:**

Net Income

Please refer to the table “Yields on Average Earning Assets and Rates on Average Interest-Bearing Liabilities” appearing at the end of this Item for the yield and rate data for interest-bearing balance sheet components during the three-month periods ended June 30, 2015 and 2014, along with average balances and the related interest income and interest expense amounts.

Our net income for the second quarter of 2015 was $1.4 million, or $0.22 diluted earnings per common share, as compared to $1.2 million, or $0.18 diluted earnings per common share, for the same period of 2014. Net interest income increased by $257 thousand for the three months ended June 30, 2015 to $6.2 million as compared to $5.9 million in the same period in 2014. Our taxable equivalent net interest margin in the second quarter of 2015 was 3.34% compared to 3.38% in the same period of 2014. The yield on average earning assets decreased to 3.69% in the second quarter of 2015 from 3.82% in the second quarter of 2014. The cost of interest bearing liabilities also decreased to 0.56% in the second quarter of 2015 as compared to 0.62% in the second quarter of 2014. The extended period of historically low interest rates continues to put pressure on the net interest margin. The decrease in our net interest margin has been offset by growth in the level of earning assets. Average earning assets were $766.0 million during the second quarter of 2015 as compared to $719.1 million during the second quarter of 2014. We continue to focus on growth in the loan portfolio as well as shifting our deposit funding mix to demand deposits, interest bearing transaction accounts and money market accounts. Average loans were $472.6 million in the second quarter of 2015 an increase of $28.5 million over the same period in 2014. Interest-bearing transaction accounts, money market accounts and savings deposits, which are typically our lower costing funds, represent 58.6% of our average interest bearing liabilities during the second quarter of 2015 as compared to 57.3% in the same period of 2014.

Provision for Loan Losses

The provision for loan losses for the three months ended June 30, 2015 was $391 thousand as compared to $400 thousand for the three months ended June 30, 2014. As previously discussed, the provision is made based on our assessment of general loan loss risk and asset quality, historical loss experience and various other qualitative factors.

Non-interest Income and Non-interest Expense

For the three months ended June 30, 2015, we had non-interest income of $2.6 million as compared to non-interest income of $1.9 million in the same period of 2014. Mortgage banking income increased by $278 thousand during the

second quarter of 2015, as compared to, the same period in 2014. As noted previously, we believe that our continued focus on this source of revenue resulted in the increase reflected in the second quarter of 2015 as compared to the same period in 2014. Investment advisory fees and non-deposit commissions increased $209 thousand in the second quarter of 2015 as compared to the same period in 2014. Management continues to focus on increasing this recurring source of revenue by increasing total assets under management. During the second quarter of 2014, we sold securities that resulted in a gain of $78 thousand. The proceeds from the sale were used to pay down $2.0 million in FHLB advances which resulted in a $67 thousand prepayment penalty. Gains on the sale of securities in the second quarter of 2015 amounted to $167 thousand. Total proceeds from the sales in the second quarter of 2015 amounted to approximately $10.1 million. These proceeds partially funded loan growth during the quarter.

Total non-interest expense increased $604 thousand in the second quarter of 2015, compared to the same period of 2014. Salaries and benefits increased $386 thousand in the second quarter of 2015 as compared to the same period in 2014. This increase is primarily a result of normal salary adjustments and increased commissions paid on the higher level of mortgage banking and investment advisory revenues. Marketing and public relations expense increased $116 thousand in the second quarter of 2015 as compared to the same period in 2014. As noted in the six month results, the timing of our media marketing campaign was designed to be concentrated more in the first half of the year for 2015. It is anticipated that marketing expenses will be lower in the second half of 2015. The increase in amortization expense of $35 thousand in the second quarter of 2015 as compared to the same period in 2014 is a result of intangibles acquired in the deposit assumption from First South that closed in September 2014.

**Financial Position**

Assets totaled $836.4 million at June 30, 2015 as compared to $812.4 million at December 31, 2014, an increase of $24.0 million. Loans (excluding loans held-for-sale) increased by approximately $30.2 million during the six months ended June 30, 2015. Loans at June 30, 2015 were $474.0 million as compared to $443.8 million at December 31, 2014. Total loan production was $55.9 million during the first half of 2015. At June 30, 2015 and December 31, 2014, loans (excluding loans held for sale) accounted for 61.6% and 59.9% of earning assets, respectively. The loan-to-deposit ratio at June 30, 2015 was 70.3% as compared to 66.9% at December 31, 2014. Investment securities decreased to $271.2 million at June 30, 2015 from $282.8 million at December 31, 2014. Deposits increased $14.4 million to $684.0 million at June 30, 2015 as compared to $669.6 million at December 31, 2014. Pure deposits (deposits less time deposits) represented 72.9% of total deposits as of June 30, 2015 as compared to 70.9% at December 31, 2014. We continue to focus on growing our pure deposits as a percentage of total deposits in order to better manage our overall cost of funds. One of our goals as a community bank has been, and continues to be, to grow our assets through quality loan growth by providing credit to small and mid-size businesses and individuals within the markets we serve. Loan production and portfolio growth rates continue to be impacted by the current 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.

The following table shows the composition of the loan portfolio by category at June 30, 2015 and December 31, 2014:

| (In thousands) | June 30, 2015 Amount | Percent | December 31, 2014 Amount | Percent |
|---|---|---|---|---|
| Commercial, financial & agricultural | $37,915 | 8.0 % | $33,403 | 7.5 % |
| Real estate: | | | | 6.2 % |
| Construction | 30,392 | 6.4 % | 27,545 | |
| Mortgage – residential | 49,341 | 10.4 % | 48,510 | 66.1 % |
| Mortgage – commercial | 315,373 | 66.6 % | 293,186 | 10.9 % |
| Consumer: | | | | |
| Home Equity | 32,264 | 6.8 % | 33,000 | 7.4 % |
| Other | 8,731 | 1.8 % | 8,200 | 1.9 % |
| Total gross loans | 474,016 | 100.0% | 443,844 | 100.0% |
| Allowance for loan losses | (4,281 ) | | (4,132 ) | |
| Total net loans | $469,735 | | $439,712 | |

In the context of this discussion, a real estate mortgage loan is defined as any loan, other than loans for construction purposes and advances on home equity lines of credit, secured by real estate, regardless of the purpose of the loan. Advances on home equity lines of credit are included in consumer loans. We follow the common practice of financial institutions in our market areas 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%.

**Market Risk Management**

The effective management of market risk is essential to achieving our strategic financial objectives. Our most significant 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 assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on 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 the ALCO is the measurement of 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. Simulation modeling is performed to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. We model the impact on net interest income for several different changes, to include a flattening, steepening and parallel shift in the yield curve. For each of these scenarios, we model the impact on net interest income in an increasing and decreasing rate environment of 100 and 200 basis points. Policies have been established in an effort to maintain the maximum anticipated negative impact of these modeled changes in net interest income at no more than 10% and 15% respectively, in a 100 and 200 basis point change in interest rates over a twelve month period. 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.

We are currently asset sensitive within one year. However, neither the “gap” analysis nor asset/liability simulation modeling is a precise indicator of our interest sensitivity position due to the many factors that affect net interest income, including changes in the volume and mix of earning assets and interest-bearing liabilities.

Based on the many factors and assumptions used in simulating the effect of changes in interest rates, the following table estimates the percentage change in net interest income at June 30, 2015 and December 31, 2014 over twelve months.

*Net Interest Income Sensitivity*

| **Change in short term interest rates** | **Hypothetical percentage change in net interest income** | | |
|---|---|---|---|
| | **June 30, 2015** | **March 31, 2015** | **December 31, 2014** |
| +200bp | +2.76 % | +4.92% | +3.53 % |
| +100bp | +1.22 % | +2.32% | +1.88 % |
| Flat | — | — | — |
| -100bp | -4.58 % | -5.14% | -5.04 % |
| -200bp | -11.43% | -9.83% | -11.81 % |

The significant decrease in net interest income in a down 200 basis point environment 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. At the current historically low interest rate levels, we believe that a downward shift of 200 basis points across the entire yield curve is unlikely.

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 June 30, 2015, March 31, 2015 and December 31 2014, the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be -0.16% ,+3.28% and +0.69%, respectively.

**Liquidity and Capital Resources**

We believe our liquidity remains adequate to meet operating and loan funding requirements. Interest-bearing bank balances, federal funds sold, and investment securities available-for-sale represent 32.1% of total assets at June 30, 2015. 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 and short-term liquidity needs successfully. These needs include the ability to respond to short-term demand for funds caused by the withdrawal of deposits, maturity of repurchase agreements, extensions of credit and the payment of operating expenses. Other sources of liquidity, in addition to deposit gathering activities, include maturing loans and investments, purchase of federal funds from other financial institutions and selling securities under agreements to repurchase. We monitor closely the level of large certificates of deposits in amounts of $100 thousand or more as they tend to be more sensitive to interest rate changes and, thus, less reliable sources of funding for liquidity purposes. At June 30, 2015, the amount of certificates of deposits of $100 thousand or more represented 12.1% of total deposits and the amount of certificates of deposits of $250 thousand or more represented 3.3% of deposits. The majority of these deposits are issued to local customers many of whom have other product relationships with the Bank.

Through the operations of our Bank, we have made contractual commitments to extend credit in the ordinary course of our business activities. These commitments are legally binding agreements to lend money to our customers at predetermined interest rates for a specified period of time. At June 30, 2015, we had issued commitments to extend credit of $75.7 million, including $30.9 million in unused home equity lines of credit, through various types of lending arrangements. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. We manage the credit risk on these commitments by subjecting them to normal underwriting and risk management processes.

Other than as described elsewhere in this report, we are not aware of any trends, events or uncertainties that we expect to result in a significant adverse effect on our liquidity position. However, no assurances can be given in this regard, as rapid growth, deterioration in loan quality, and poor earnings, or a combination of these factors, could change the liquidity position in a relatively short period of time.

The Company has generally maintained a high level of liquidity and adequate capital, which along with continued retained earnings, we believe will be sufficient to fund the operations of the Bank for at least the next 12 months. Shareholders' equity was 9.1% and 9.2% of total assets at June 30, 2015 and December 31, 2014, respectively. The Bank maintains federal funds purchased lines in the total amount of $20.0 million with two financial institutions, although these were not utilized in the first half of 2015. In addition, the Bank has a repo line in the amount of $10.0 million with another financial institution. Specific investment securities would be pledged if and when we were to utilize this line. The FHLB of Atlanta has approved a line of credit of up to 25% of the Bank's assets, which when utilized is 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 evaluate and monitor the total amount of purchased funds used to support the balance sheet and funding from noncore 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.

The Federal Reserve Board and bank regulatory agencies require bank holding companies and financial institutions to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. As disclosed in our 2014 Annual Report on Form 10-K as filed with the SEC, in July 2013, the federal bank regulatory agencies issued a final rule that has revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by the Basel Committee on Banking Supervision ("Basel III") and certain provisions of the Dodd-Frank Act. The final rule applies to, among other institutions, all depository institutions, and certain top-tier bank holding companies, which we refer to as "covered" banking organizations, including the Company and the Bank. Effective March 31, 2015, the Company and Bank were required to implement the new Basel III capital standards (subject to the phase in for certain parts of the new rules).

Under the Basel III rules, accumulated other comprehensive income ("AOCI") is presumptively included in Common Equity Tier 1 capital and can operate to reduce this category of capital. The final rule provided 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,

which election the Bank and the Company have made. As a result, the Company and the Bank will retain the pre-existing treatment for AOCI.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of Common Equity Tier 1 (CET1), but the buffer will apply to all three risk-based measurements (CET1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 Common Equity equal to 2.5% of risk-weighted assets.

At June 30, 2015, the Company and the Bank met or exceeded all of the required ratios on a fully phased in basis. These guidelines require an institution to maintain a certain level of Common Equity Tier 1 (CET1), Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common shareholders' equity, grandfathered trust preferred securities and excludes the unrealized gain or loss on securities available for sale, minus certain intangible assets. CET1 capital excludes the trust preferred securities. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor generally of 0% to 100% based on the risks believed to be inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the general reserve for loan losses, subject to certain limitations. We are also required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio.

At both the holding company and bank level, we are subject to various regulatory capital requirements administered by the federal banking agencies. To be considered "well capitalized," we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. Generally, to be considered adequately capitalized, the FDIC and Federal Reserve regulatory capital guidelines for Tier 1 capital, total capital and leverage capital ratios are 4.0%, 8.0% and 4.0%, respectively.

The Bank's risk-based capital ratios of leverage ratio, Tier 1, and total capital were 9.8%, 15.0%, and 15.8%, respectively, at June 30, 2015 as compared to 9.6%, 15.4%, and 16.2%, respectively, at December 31, 2014. The Bank's CET1 ratio at June 30, 2015 was 15.0%. Prior to March 31, 2015, the Bank was not required to maintain a CET1 ratio. The Company's risk-based capital ratios of leverage ratio, Tier 1, and total capital were 10.4%, 15.7%, and 16.6%, respectively at June 30, 2015 as compared to 10.0%, 16.1% and 16.9%, respectively at December 31, 2014. The Company's CET1 ratio at June 30, 2015 was 12.4%. Prior to March 31, 2015, the Company was not required to maintain a CET1 ratio. Our management anticipates that the Bank and the Company will remain a well-capitalized institution for at least the next 12 months.

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 Board. The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve Board'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 Board'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 a 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 South Carolina Board of Financial Institutions,

the Bank is generally permitted under South Carolina State banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Board of Financial Institutions. 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

**FIRST COMMUNITY CORPORATION**

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

| | Six months ended June 30, 2015 | | | Six months ended June 30, 2014 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest Earned/Paid | Yield/ Rate | Average Balance | Interest Earned/Paid | Yield/ Rate |
| Assets | | | | | | |
| Earning assets | | | | | | |
| Loans | $461,848 | $ 11,578 | 5.06% | $430,000 | $ 10,662 | 5.00% |
| Securities: | 276,529 | 2,697 | 1.97% | 248,394 | 2,543 | 2.06% |
| Federal funds sold and securities purchased under agreements to resell | 17,488 | 57 | 0.66% | 17,078 | 47 | 0.55% |
| Total earning assets | 755,865 | 14,332 | 3.82% | 695,472 | 13,252 | 3.84% |
| Cash and due from banks | 8,329 | | | 10,189 | | |
| Premises and equipment | 29,411 | | | 26,843 | | |
| Other assets | 32,630 | | | 31,671 | | |
| Allowance for loan losses | (4,290) | | | (4,127) | | |
| Total assets | $821,945 | | | $760,048 | | |
| Liabilities | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing transaction accounts | $135,278 | 78 | 0.12% | $129,981 | 84 | 0.13% |
| Money market accounts | 156,903 | 203 | 0.26% | 131,232 | 151 | 0.23% |
| Savings deposits | 55,977 | 32 | 0.12% | 50,393 | 29 | 0.12% |
| Time deposits | 190,722 | 548 | 0.58% | 174,553 | 593 | 0.69% |
| Other borrowings | 62,890 | 819 | 2.63% | 75,090 | 952 | 2.56% |
| Total interest-bearing liabilities | 601,770 | 1,680 | 0.56% | 561,249 | 1,809 | 0.65% |
| Demand deposits | 138,476 | | | 126,440 | | |
| Other liabilities | 5,558 | | | 5,512 | | |
| Shareholders' equity | 76,141 | | | 66,847 | | |
| Total liabilities and shareholders' equity | $821,945 | | | $760,048 | | |
| | | | | | | |
| Cost of funds, including demand deposits | | | 0.46% | | | 0.53% |
| Net interest spread | | | 3.26% | | | 3.19% |
| Net interest income/margin | | $ 12,652 | 3.38% | | $ 11,443 | 3.32% |
| Net interest income/margin FTE basis | $365 | $ 13,017 | 3.47% | $255 | $ 11,698 | 3.39% |

**FIRST COMMUNITY CORPORATION**

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

| | Three months ended June 30, 2015 | | | Three months ended June 30, 2014 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest Earned/Paid | Yield/ Rate | Average Balance | Interest Earned/Paid | Yield/ Rate |
| Assets | | | | | | |
| Earning assets | | | | | | |
| Loans | $472,591 | $ 5,704 | 4.84% | $444,060 | $ 5,582 | 5.04% |
| Securities: | 275,759 | 1,315 | 1.91% | 261,673 | 1,243 | 1.91% |
| Federal funds sold and securities purchased | 17,649 | 30 | 0.68% | 13,371 | 24 | 0.72% |
| Total earning assets | 765,999 | 7,049 | 3.69% | 719,104 | 6,849 | 3.82% |
| Cash and due from banks | 8,883 | | | 10,454 | | |
| Premises and equipment | 29,741 | | | 28,720 | | |
| Other assets | 32,002 | | | 32,810 | | |
| Allowance for loan losses | (4,341) | | | (4,022) | | |
| Total assets | $832,284 | | | $787,066 | | |
| Liabilities | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing transaction accounts | $137,534 | $ 39 | 0.11% | $135,875 | $ 46 | 0.14% |
| Money market accounts | 160,963 | 107 | 0.27% | 145,973 | 85 | 0.23% |
| Savings deposits | 56,808 | 16 | 0.11% | 50,593 | 15 | 0.12% |
| Time deposits | 188,162 | 273 | 0.58% | 174,712 | 282 | 0.65% |
| Other borrowings | 62,804 | 410 | 2.62% | 72,770 | 474 | 2.61% |
| Total interest-bearing liabilities | 606,271 | 845 | 0.56% | 579,923 | 902 | 0.62% |
| Demand deposits | 144,181 | | | 131,762 | | |
| Other liabilities | 4,923 | | | 5,346 | | |
| Shareholders' equity | 76,909 | | | 70,035 | | |
| Total liabilities and shareholders' equity | $832,284 | | | $787,066 | | |
| Cost of funds, including demand deposits | | | 0.45% | | | 0.51% |
| Net interest spread | | | 3.13% | | | 3.20% |
| Net interest income/margin | | $ 6,204 | 3.25% | | $ 5,947 | 3.32% |
| Net interest income/margin FTE basis | $183 | $ 6,387 | 3.34% | $119 | $ 6,066 | 3.38% |

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes in our quantitative and qualitative disclosures about market risk as of June 30, 2015 from that presented in our 2014 Annual Report on Form 10-K. See the "Market Risk Management" subsection in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, for quantitative and qualitative disclosures about market risk, which information is incorporated herein by reference.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There has been no change in the Company's internal control over financial reporting during the three months ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II -**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are a party to claims and lawsuits arising in the course of normal business activities. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, the Company believes would have a material adverse impact on the Company’s financial position, results of operations or cash flows.

**Item 1A. Risk Factors.**

Not Applicable.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Not Applicable.

**Item 3. Defaults Upon Senior Securities.**

Not Applicable.

**Item 4. Mine Safety Disclosures.**

Not Applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

| Exhibit | Description |
|---|---|
| 31.1 | Rule 13a-14(a) Certification of the Principal Executive Officer. |
| 31.2 | Rule 13a-14(a) Certification of the Principal Financial Officer. |
| 32 | Section 1350 Certifications |
| 101 | The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2015, formatted in eXtensible Business Reporting Language (XBRL); (i) Consolidated Balance Sheets at June 30, 2015 and December 31, 2014, (ii) Consolidated Statements of Income for the three and six months ended June 30, 2015 and 2014, (iii) Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and 2014 (iv) Consolidated Statements of Changes in Shareholders’ Equity for the six months ended June 30, 2015 and 2014, (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014, and (vi) Notes to Consolidated Financial Statements. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST COMMUNITY CORPORATION
(REGISTRANT)

Date: August 12, 2015 By: /s/ Michael C. Crapps
Michael C. Crapps
President and Chief Executive Officer

Date: August 12, 2015 By: /s/ Joseph G. Sawyer
Joseph G. Sawyer
Executive Vice President, Principal Financial Officer

INDEX TO EXHIBITS

| Exhibit Number | Description |
|---|---|
| 31.1 | Rule 13a-14(a) Certification of the Principal Executive Officer. |
| 31.2 | Rule 13a-14(a) Certification of the Principal Financial Officer. |
| 32 | Section 1350 Certifications. |
| 101 | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2015, formatted in eXtensible Business Reporting Language (XBRL); (i) Consolidated Balance Sheets at June 30, 2015 and December 31, 2014, (ii) Consolidated Statements of Income for the three and six months ended June 30, 2015 and 2014, (iii) Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and 2014 (iv) Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2015 and 2014, (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014, and (vi) Notes to Consolidated Financial Statements. |