COMMUNITY FINANCIAL CORP /MD/
Form 10-Q
November 07, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission File Number 0-18279

The Community Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1652138
(State of other jurisdiction of	(I.R.S. Employer

incorporation or organization) Identification No.)

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

(301) 645-5601

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No¨

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

Large Accelerated Filer ¨	Accelerated Filer ¨
Non-accelerated Filer ¨	Smaller Reporting Company x

(Do not check if a smaller reporting company)

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

Yes ¨ No x

As of October 30, 2013, the registrant had 4,647,324 shares of common stock outstanding.

THE COMMUNITY FINANCIAL CORPORATION

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PART I FINANCIAL STATEMENTS

ITEM I. FINANCIAL STATEMENTS

THE COMMUNITY FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS SEPTEMBER 30, 2013 AND DECEMBER 31, 2012

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and due from banks	$ 23,269,755	$ 10,696,653
Federal funds sold	-	190,000
Interest-bearing deposits with banks	3,626,750	409,002
Securities available for sale (AFS), at fair value	50,869,490	47,205,663
Securities held to maturity (HTM), at amortized cost	91,349,615	112,619,434
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock - at cost	5,593,100	5,476,050
Loans receivable - net of allowance for loan losses of $8,079,277 and $8,246,957	759,880,727	747,640,752
Premises and equipment, net	19,272,212	19,782,236
Other real estate owned (OREO)	7,058,504	6,891,353
Accrued interest receivable	2,850,066	2,904,325
Investment in bank owned life insurance	19,195,355	18,730,580
Other assets	9,938,081	9,093,164
Total Assets	$ 992,903,655	$ 981,639,212
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	$ 107,856,339	$ 102,319,581
Interest-bearing deposits	709,391,120	717,910,707
Total deposits	817,247,459	820,230,288
Short-term borrowings	2,640,000	1,000,000
Long-term debt	70,488,848	60,527,208
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000,000	12,000,000
Accrued expenses and other liabilities	8,379,012	8,834,455
Total Liabilities	910,755,319	902,591,951
Stockholders' Equity		
Preferred Stock, Senior Non-Cumulative Perpetual, Series C - par value $1,000; authorized 20,000; issued 20,000	20,000,000	20,000,000
	30,484	30,524

Common stock - par value $.01; authorized - 15,000,000 shares; issued 3,048,439 and 3,052,416 shares, respectively		
Additional paid in capital	18,275,729	17,873,560
Retained earnings	45,626,970	41,986,633
Accumulated other comprehensive gain (loss)	(910,940)	139,184
Unearned ESOP shares	(873,907)	(982,640)
Total Stockholders' Equity	82,148,336	79,047,261
Total Liabilities and Stockholders' Equity	$ 992,903,655	$ 981,639,212

See notes to Consolidated Financial Statements

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THE COMMUNITY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest and Dividend Income				
Loans, including fees	$ 9,340,139	$ 9,113,063	$ 27,703,885	$ 27,624,323
Taxable interest and dividends on investment securities	631,652	768,611	1,852,692	2,465,529
Interest on deposits with banks	3,268	4,982	8,552	7,730
Total Interest and Dividend Income	9,975,059	9,886,656	29,565,129	30,097,582
Interest Expense				
Deposits	1,335,916	2,001,535	4,332,351	6,630,820
Short-term borrowings	4,237	298	12,930	12,483
Long-term debt	532,833	537,216	1,569,247	1,684,772
Total Interest Expense	1,872,986	2,539,049	5,914,528	8,328,075
Net Interest Income	8,102,073	7,347,607	23,650,601	21,769,507
Provision for loan losses	285,610	746,075	640,210	1,523,580
Net Interest Income After Provision For Loan Losses	7,816,463	6,601,532	23,010,391	20,245,927
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	55,620	280,456	374,769	663,897
Gain on sale of asset	-	-	11,000	-
Net gain (losses) on sale of OREO	215,345	-	215,345	(96,917)
Income from bank owned life insurance	156,348	157,177	464,775	476,294
Service charges	661,134	528,420	1,764,314	1,530,323
Gain on sale of loans held for sale	30,769	336,384	546,819	471,725
Total Noninterest Income	1,119,216	1,302,437	3,377,022	3,045,322
Noninterest Expense				
Salary and employee benefits	3,737,000	3,492,524	10,883,606	9,982,603
Occupancy expense	504,627	487,233	1,556,877	1,389,024
Advertising	118,421	86,020	391,152	345,111
Data processing expense	237,054	329,005	967,368	1,118,598
Professional fees	293,028	177,818	754,719	746,322
Depreciation of furniture, fixtures, and equipment	191,320	188,870	580,842	486,159
Telephone communications	45,787	45,563	148,516	137,649

Office supplies	41,689	52,751	151,157	186,741
FDIC Insurance	284,591	201,607	858,860	1,092,809
Valuation allowance on OREO	170,560	31,050	500,536	657,226
Other	621,650	508,343	1,701,338	1,719,647
Total Noninterest Expense	6,245,727	5,600,784	18,494,971	17,861,889
Income before income taxes	2,689,952	2,303,185	7,892,442	5,429,360
Income tax expense	987,111	830,244	2,885,761	1,910,014
Net Income	$ 1,702,841	$ 1,472,941	$ 5,006,681	$ 3,519,346
Preferred stock dividends	50,000	50,000	150,000	150,000
Net Income Available to Common Shareholders	$ 1,652,841	$ 1,422,941	$ 4,856,681	$ 3,369,346
Net Income	$ 1,702,841	$ 1,472,941	$ 5,006,681	$ 3,519,346
Net unrealized holding gains (losses) arising during period, net of tax	(231,346)	68,791	(1,050,124)	76,542
Comprehensive Income	$ 1,471,495	$ 1,541,732	$ 3,956,557	$ 3,595,888
Earnings Per Common Share				
Basic	$ 0.55	$ 0.47	$ 1.61	$ 1.11
Diluted	$ 0.55	$ 0.47	$ 1.60	$ 1.10
Cash dividends paid per common share	$ 0.10	$ -	$ 0.30	$ 0.40

See notes to Consolidated Financial Statements

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THE COMMUNITY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

	Nine Months Ended September 30, 2013	2012
Cash Flows from Operating Activities		
Net income	$5,006,681	$3,519,346
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	640,210	1,523,580
Depreciation and amortization	965,380	845,804
Loans originated for resale	(20,903,681)	(9,987,050)
Proceeds from sale of loans originated for sale	21,326,491	10,383,776
Gain on sale of loans held for sale	(546,819)	(471,725)
Net (gains) losses on the sale of OREO	(215,345)	96,917
Gain on sale of asset	(11,000)	-
Net amortization of premium/discount on investment securities	440,932	308,509
Increase in OREO valuation allowance	500,536	657,226
Increase in cash surrender of bank owned life insurance	(464,775)	(476,293)
Deferred income tax benefit	(128,314)	(773,527)
Decrease (Increase) in accrued interest receivable	54,259	(39,413)
Stock based compensation	249,129	263,088
Decrease in deferred loan fees	215,478	104,942
(Decrease) Increase in accounts payable, accrued expenses and other liabilities	(455,443)	441,789
(Increase) Decrease in other assets	(165,764)	2,411,207
Net Cash Provided by Operating Activities	6,507,955	8,808,176
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(13,486,742)	(10,101,789)
Proceeds from redemption or principal payments of AFS investment securities	8,091,820	15,465,959
Purchase of HTM investment securities	(11,682,813)	(11,249,535)
Proceeds from maturities or principal payments of HTM investment securities	32,651,698	39,413,413
Net (increase) decrease of FHLB and FRB stock	(117,050)	155,250
Loans originated or acquired	(182,200,307)	(173,628,906)
Principal collected on loans	168,063,366	147,989,755
Purchase of premises and equipment	(455,356)	(4,253,518)
Proceeds from sale of OREO	712,945	344,512
Proceeds from disposal of asset	11,000	-
Net Cash Provided by Investing Activities	1,588,561	4,135,141

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THE COMMUNITY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012 (continued)

	Nine Months Ended September 30, 2013	2012
Cash Flows from Financing Activities		
Net decrease in deposits	$(2,982,829)	$(4,265,600)
Proceeds from long-term borrowings	10,000,000	-
Payments of long-term borrowings	(38,360)	(36,854)
Net increase in short term borrowings	1,640,000	-
Exercise of stock options	125,222	67,391
Dividends Paid	(1,063,992)	(1,371,571)
Net change in unearned ESOP shares	126,812	(1,942)
Redemption of common stock	(302,519)	(257,935)
Net Cash Provided by (Used in) Financing Activities	7,504,334	(5,866,511)
Increase in Cash and Cash Equivalents	$15,600,850	$7,076,806
Cash and Cash Equivalents - January 1	11,295,655	19,118,189
Cash and Cash Equivalents - September 30	$26,896,505	$26,194,995
Supplemental Disclosures of Cash Flow Information		
Cash paid during the nine months for:		
Interest	$5,856,848	$8,340,170
Income taxes	$3,164,596	$1,470,590
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	$249,129	$263,088
Transfer from loans to OREO	$1,390,286	$2,165,376

See notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

1. BASIS OF PRESENTATION

General - The consolidated financial statements of The Community Financial Corporation (formerly Tri-County Financial Corporation) (the “Company”) and its wholly owned subsidiary, Community Bank of the Chesapeake (formerly Community Bank of Tri-County) (the “Bank”), and the Bank’s wholly owned subsidiary, Community Mortgage Corporation of Tri-County, included herein are unaudited. The Bank conducts business through its main office in Waldorf, Maryland, and ten branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Dahlgren, Virginia. Effective October 18, 2013, the Company changed its name from Tri-County Financial Corporation and the Bank changed its name from Community Bank of Tri-County. The new names reflect the Bank's recent expansion into the Northern Neck of Virginia. The name of the holding company changed to better align the parent company name with that of the Bank.

The consolidated financial statements reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company’s financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2012 have been derived from audited financial statements. There have been no significant changes to the Company’s accounting policies as disclosed in the 2012 Annual Report. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2013 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s 2012 Annual Report.

In October 2013, the Company completed a stock offering and issued 1,591,300 shares of common stock at a price of $18.75 per share resulting in net proceeds of $27.4 million after commissions and related offering expenses. The additional capital raise was completed in the fourth quarter 2013 and is not reflected in the financial statements as of September 30, 2013.

2. NATURE OF BUSINESS

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

3. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

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

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

There were no transfers between levels of the fair value hierarchy and the Company had no Level 3 fair value assets or liabilities for the three and nine months ended September 30, 2013 and the year ended December 31, 2012, respectively.

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

Securities Available for Sale

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

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At September 30, 2013 and December 31, 2012, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned ("OREO")

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of September 30, 2013 and December 31, 2012 measured at fair value on a recurring basis.

	September 30, 2013			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
Collateralized Mortgage Obligations ("CMOs")	$46,471,000	$ -	$46,471,000	$ -
Mortgage Backed Securities ("MBS")	198,713	-	198,713	-
Corporate equity securities	38,698	-	38,698	-
Bond mutual funds	4,161,079	-	4,161,079	-
Total available for sale securities	$50,869,490	$ -	$50,869,490	$ -

	December 31, 2012			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	$42,655,799	$ -	$42,655,799	$ -
MBS	231,386	-	231,386	-
Corporate equity securities	37,332	-	37,332	-
Bond mutual funds	4,281,146	-	4,281,146	-
Total available for sale securities	$47,205,663	$ -	$47,205,663	$ -

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of September 30, 2013 and December 31, 2012 are included in the tables below.

	September 30, 2013					
Description of Asset	Fair Value	Level 1		Level 2	Level 3	
Loans with impairment						
Commercial real estate	$3,411,781	$	-	$3,411,781	$	-
Residential first mortgage	530,170		-	530,170		-
Commercial loans	429,000		-	429,000		-
Total loans with impairment	$4,370,951	$	-	$4,370,951	$	-
Other real estate owned	$7,058,504	$	-	$7,058,504	$	-

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	December 31, 2012			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$2,028,534	$ -	$2,028,534	$ -
Residential first mortgage	602,290	-	602,290	-
Commercial loans	94,355	-	94,355	-
Total loans with impairment	$2,725,179	$ -	$2,725,179	$ -
Other real estate owned	$6,891,353	$ -	$6,891,353	$ -

Loans with impairment have unpaid principal balances of $5,415,721 and $4,272,836 at September 30, 2013 and December 31, 2012, respectively, and include impaired loans with a specific allowance.

4. INCOME TAXES

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

5. EARNINGS PER COMMON SHARE (EPS)

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. As of September 30, 2013 and 2012, there were 101,549 and 187,367 shares, respectively, excluded from the diluted net income per share computation because the exercise price of the stock options were greater than the market price, and thus were anti-dilutive. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net Income	$1,702,841	$1,472,941	$5,006,681	$3,519,346
Less: dividends paid and accrued on preferred stock	(50,000)	(50,000)	(150,000)	(150,000)
Net income available to common shareholders	$1,652,841	$1,422,941	$4,856,681	$3,369,346
Average number of common shares outstanding	2,997,401	3,044,556	3,016,793	3,042,645

Effect of dilutive options	24,981	8,693	25,295	13,026
Average number of shares used to calculate diluted EPS	3,022,382	3,053,249	3,042,088	3,055,671

6. STOCK-BASED COMPENSATION

The Company has stock option and incentive arrangements to attract and retain key personnel. In May 2005, the 2005 Equity Compensation Plan (the "Plan") was approved by the shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service based awards is recognized over the vesting period. Performance based awards are recognized based on a vesting, if applicable, and the probability of achieving the goals.

Stock-based compensation expense totaled $159,089 and $91,826 for the nine months ended September 30, 2013 and 2012, respectively, which consisted of grants of restricted stock and restricted stock units. Stock-based compensation for the nine months ended September 30, 2013 and 2012 included director compensation of $3,320 and $18,128, respectively, for stock granted in lieu of cash compensation for board fees. All outstanding options are fully vested and the Company has not granted any stock options since 2007.

The fair value of the Company's outstanding employee stock options is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

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

The following tables below summarize outstanding and exercisable options at September 30, 2013 and December 31, 2012.

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2013	236,059	$ 18.49	$ 164,304	
Granted at fair value	-	-		
Exercised	(16,009)	13.63	73,518	
Expired	-			
Forfeited	(2)	13.05		
Outstanding at September 30, 2013	220,048	$ 18.84	$ 478,620	0.8
Exercisable at September 30, 2013	220,048	$ 18.84	$ 478,620	0.8

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2012	264,156	$ 17.90	$ 175,911	
Granted at fair value	-	-		
Exercised	(24,780)	12.25	88,607	

Expired	-			
Forfeited	(3,317)	18.25		
Outstanding at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0
Exercisable at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0

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

Shares Outstanding September 30, 2013	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
39,668	1 years	$ 12.97
78,831	2 years	15.89
80,138	3 years	22.29
21,411	4 years	27.70
220,048		$ 18.84

The aggregate intrinsic value of outstanding stock options and exercisable stock options was $478,620 and $164,304 at September 30, 2013 and December 31, 2012, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was $18.95 and $15.98 per share at September 30, 2013 and December 31, 2012, respectively, and the exercise price multiplied by the number of options outstanding.

The Company has outstanding restricted stock and stock units granted in accordance with the Plan. The following tables summarize the unvested restricted stock awards and units outstanding at September 30, 2013 and December 31, 2012, respectively.

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at December 31, 2012	23,569	$ 15.64	5,211	$ 15.98
Granted	13,656	18.00	2,105	16.87
Vested	(16,678)	16.35	(3,106)	15.98
Nonvested at September 30, 2013	20,547	$ 16.63	4,210	$ 18.95

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at January 1, 2012	8,113	$ 16.47	6,845	$ 15.00
Granted	23,281	15.21	2,105	15.98
Vested	(7,825)	15.20	(3,739)	14.80
Nonvested at December 31, 2012	23,569	$ 15.64	5,211	$ 15.98

7. GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES ("TRUPs")

On June 15, 2005, Tri-County Capital Trust II ("Capital Trust II"), a Delaware business trust formed, funded and wholly owned by the Company, issued $5,000,000 of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5,155,000 of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital

Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I (“Capital Trust I”), a Delaware business trust formed, funded and wholly owned by the Company, issued $7,000,000 of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company’s $217,000 capital contribution for Capital Trust I’s common securities, to purchase $7,217,000 of the Company’s junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as “Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures.” Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

8. PREFERRED STOCK

Small Business Lending Fund Preferred Stock

On September 22, 2011, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the Treasury (the "Secretary"), pursuant to which the Company issued 20,000 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred Stock"), having a liquidation amount per share equal to $1,000, for a total purchase price of $20,000,000. The Purchase Agreement was entered into, and the Series C Preferred Stock was issued, as authorized by the Small Business Lending Fund program.

The Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly. The dividend rate can fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" (as defined in the Purchase Agreement) by the Bank. Based upon the increase in the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at one percent (1%). For the second through ninth calendar quarters, the dividend rate may be adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank's level of QSBL. If the level of the Bank's qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than 10%, then the dividend rate payable on the Series C Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%). In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, if the Company had not increased its QSBL from the baseline as of the quarter ending September 30, 2013, the Company would have been required to pay to the Secretary, on each share of Series C Preferred Stock, but only out of assets legally available, a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock. At September 30, 2013, the Company had increased its QSBL from the baseline so that the dividend rate should remain at 1% through four and one half years from issuance.

The Series C Preferred Stock is non-voting, except in limited circumstances. If the Company misses five dividend payments, whether or not consecutive, the holder of the Series C Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Company's Board of Directors. The Series C Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of our federal banking regulator. The Company is permitted to repay its SBLF funding in increments of 25% or $5.0 million, subject to the approval of its federal banking regulator.

The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Company has agreed to register the Series C Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series C Preferred Stock is not subject to any contractual restrictions on transfer.

9. OTHER REAL ESTATE OWNED ("OREO")

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

	Nine Months Ended September 30,		Year Ended December 31,
	2013	2012	2012
Balance at beginning of year	$ 6,891,353	$ 5,028,513	$ 5,028,513
Additions of underlying property	1,390,286	2,165,375	4,020,494
Disposals of underlying property	(722,599)	(441,429)	(1,483,449)
Valuation allowance	(500,536)	(657,226)	(674,205)
Balance at end of period	$ 7,058,504	$ 6,095,233	$ 6,891,353

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During the nine months ended September 30, 2013, the Bank recognized $215,345 in gains on the sale of OREO which consisted of the sale of four properties for net proceeds of $712,944 and net losses of $9,655 and the recognition of $225,000 of previously deferred gain from the sale of an OREO property that the Bank financed during 2011 that did not initially qualify for full accrual sales treatment under ASC Topic 360-20-40 “Property Plant and Equipment – Derecognition. During the nine months ended September 30, 2012, the Bank disposed of three OREO properties resulting in proceeds of $344,512 and recognized net losses of $96,917.

Expenses applicable to OREO assets include the following.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Valuation allowance	$ 170,560	$ 31,050	$ 500,536	$ 657,226
Operating expenses	41,080	54,529	105,168	85,374
	$ 211,640	$ 85,579	$ 605,704	$ 742,600

Operating expenses for the nine months ended September 30, 2012 included $7,600 in deposits refunded on sold foreclosed real estate.

10. SECURITIES

	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$181,968	$ 16,745	$ -	$198,713
Residential CMOs	47,721,616	75,448	1,326,064	46,471,000
Corporate equity securities	37,310	1,572	184	38,698
Bond mutual funds	4,078,129	82,950	-	4,161,079
Total securities available for sale	$52,019,023	$ 176,715	$ 1,326,248	$50,869,490
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$23,722,148	$ 684,723	$ 186,163	$24,220,708
Residential CMOs	63,583,106	385,242	864,471	63,103,877
Asset-backed securities issued by Others:				
Residential CMOs	3,294,474	100,907	418,975	2,976,406
Total debt securities held to maturity	90,599,728	1,170,872	1,469,609	90,300,991
U.S. government obligations	749,887	75	-	749,962
Total securities held to maturity	$91,349,615	$ 1,170,947	$ 1,469,609	$91,050,953

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$198,400	$ 32,986	$ -	$231,386
Residential CMOs	42,507,542	266,775	118,518	42,655,799
Corporate equity securities	37,310	306	284	37,332
Bond mutual funds	4,012,609	268,537	-	4,281,146
Total securities available for sale	$46,755,861	$ 568,604	$ 118,802	$47,205,663
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$31,239,176	$ 1,237,277	$ -	$32,476,453
Residential CMOs	76,191,199	715,620	97,998	76,808,821
Asset-backed securities issued by Others:				-
Residential CMOs	4,439,118	197,028	484,343	4,151,803
Total debt securities held to maturity	111,869,493	2,149,925	582,341	113,437,077
U.S. government obligations	749,941	-	-	749,941
Total securities held to maturity	$112,619,434	$ 2,149,925	$ 582,341	$114,187,018

At September 30, 2013, certain asset-backed securities with an aggregate carrying value of $36.7 million were pledged to secure certain deposits. At September 30, 2013, asset-backed securities with an aggregate carrying value of $2.9 million were pledged as collateral for advances from the Federal Home Loan Bank of Atlanta.

At September 30, 2013, 98% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs had an average life of 5.12 years and an average duration of 4.68 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 5.54 years and an average duration of 5.14 years and are guaranteed by their issuer as to credit risk.

At December 31, 2012, 97% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs had an average life of 3.43 years and average duration of 3.26 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 3.43 years and average duration of 3.24 years and are guaranteed by their issuer as to credit risk.

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

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

No charges related to other-than-temporary impairment were made during the three and nine months ended September 30, 2013 and for the year ended December 31, 2012. During the year ended December 31, 2009, the Company recorded a charge of $148,000 related to other-than-temporary impairment on a single HTM CMO issue. At September 30, 2013, the CMO issue had a par value of $889,000, a market fair value of $611,000 and a carrying value of $511,000.

During the fourth quarter of the year ended December 31, 2012, the Company recognized net losses on the sale of securities of $3,736. The Company sold one AFS security with a carrying value of $1,469,911 and three HTM securities with aggregate carrying values of $3,796,011, recognizing a gain of $153,417 and losses of $157,153, respectively. The sale of HTM securities was permitted under ASC 320 "Investments - Debt and Equity Securities." ASC 320-10-25-6 permits the sale of HTM securities for certain changes in circumstances. The Company sold the HTM positions due to a significant deterioration in the issues' creditworthiness and the increase in regulatory risk weights mandated for risk-based capital purposes. There were no sales of AFS and HTM securities during the three and nine months ended September 30, 2013 and 2012, respectively.

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at September 30, 2013 are as follows:

September 30, 2013	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$33,460,034	$1,098,769	$5,623,802	$227,295	$39,083,836	$1,326,064
Corporate equity securities	126	184	-	-	126	184
	$33,460,160	$1,098,953	$5,623,802	$227,295	$39,083,962	$1,326,248

At September 30, 2013, the AFS investment portfolio had an estimated fair value of $50,869,490, of which $39,083,962 or 77% of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses are predominantly mortgage-backed securities issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $1,326,064 or 2.77% of the portfolio amortized cost of $47,903,584. AFS asset-backed securities issued by GSEs with unrealized losses have an average life of 5.22 years and an average duration of 4.74 years. We believe that the securities will either recover in market value or be paid off as agreed.

At December 31, 2012, the AFS investment portfolio had a fair value of $47,205,663 with unrealized losses from their amortized cost of $118,802. Asset-backed securities and corporate securities with unrealized losses had a fair value of $11,956,182 and all unrealized losses were for less than twelve months.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at September 30, 2013 are as follows:

September 30, 2013	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$41,773,548	$1,029,248	$3,300,948	$21,386	$45,074,496	$1,050,634
Asset-backed securities issued by other	-	-	2,258,562	418,975	2,258,562	418,975
	$41,773,548	$1,029,248	$5,559,510	$440,362	$47,333,058	$1,469,609

At September 30, 2013, the HTM investment portfolio had an estimated fair value of $91,050,953, of which $47,333,058 or 52%, of the securities had some unrealized losses from their amortized cost. Of these securities, $45,074,496 or 95%, are mortgage-backed securities issued by GSEs and the remaining $2,258,562 or 5%, were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $1,050,634 or 1.20% of the portfolio amortized cost of $87,305,254. HTM asset-backed securities issued by GSEs with unrealized losses have an average life of 6.02 years and an average duration of 5.56 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $418,975, or 12.72% of the portfolio amortized cost of $3,294,474. HTM asset-backed securities issued by others with unrealized losses have an average life of 4.24 years and an average duration of 3.27 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2012 are as follows:

December 31, 2012	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$14,253,558	$ 89,638	$6,132,036	$ 8,360	$20,385,594	$ 97,998
Asset-backed securities issued by other	-	-	3,057,666	484,343	3,057,666	484,343
	$14,253,558	$ 89,638	$9,189,702	$ 492,703	$23,443,260	$ 582,341

At December 31, 2012, the HTM investment portfolio had an estimated fair value of $114,187,018, of which $23,443,260, or 21% of the securities, had some unrealized losses from their amortized cost. Of these securities, $20,385,594, or 87%, are mortgage-backed securities issued by GSEs and the remaining $3,057,666, or 13%, were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $97,998 or 0.09% of the portfolio amortized cost of $107,430,375. HTM asset-backed securities issued by GSEs with unrealized losses have an average life of 1.85 years and an average duration of 1.72 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $484,343, or 10.91% of the portfolio amortized cost of $4,439,118. HTM asset-backed securities issued by others with unrealized losses have an average life of 3.17 years and an average duration of 2.40 years.

Credit Quality of Asset-Backed Securities

The tables below present the Standard & Poor’s or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and others at September 30, 2013 and December 31, 2012 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed security downgrades by Standard and Poor’s were treated as AAA based on regulatory guidance.

September 30, 2013		December 31. 2012	
Credit Rating	Amount	Credit Rating	Amount
AAA	$133,974,968	AAA	$150,317,560
A+	-	A+	-
A	-	A	110,780
BBB	635,920	BBB	978,043
BBB-	106,045	BBB-	322,329
BB+	-	BB+	-
BB	836,679	BB	1,069,517
BB-	-	BB-	68,604
B+	66,873	B+	1,008,126
CCC+	874,410	CCC+	-
CCC	774,547	CCC	881,719
Total	$137,269,442	Total	$154,756,678

11. LOANS

Loans consist of the following:

	September 30, 2013	December 31, 2012
Commercial real estate	$ 445,662,038	$ 419,667,312
Residential first mortgages	161,861,710	177,663,354
Construction and land development	31,113,145	31,818,782
Home equity and second mortgages	21,711,980	21,982,375
Commercial loans	86,504,220	88,157,606
Consumer loans	901,800	995,206
Commercial equipment	21,085,197	16,267,684
	768,840,090	756,552,319
Less:		
Deferred loan fees	880,086	664,610
Allowance for loan loss	8,079,277	8,246,957
	8,959,363	8,911,567
	$ 759,880,727	$ 747,640,752

At September 30, 2013, the Bank’s allowance for loan losses totaled $8,079,277, or 1.05% of loan balances, as compared to $8,246,957, or 1.09% of loan balances, at December 31, 2012. Management’s determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management’s judgment, warrant recognition in providing an adequate allowance.

At December 31, 2012, gross loans included $1,454,757 from the sales of OREO property that the Bank financed during 2011 that did not qualify for full accrual sales treatment under ASC Topic 360-20-40 “Property Plant and Equipment – Derecognition”. The deferred gain balance was $225,000 at December 31, 2012. The Bank recognized the deferred gain of $225,000 during the three months ended September 30, 2013 as the transaction qualified for full accrual sales treatment under ASC Topic 360-20-40.

Risk Characteristics of Portfolio Segments

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

Commercial Real Estate (“CRE”)

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were below 5% of the CRE portfolio at September 30, 2013 and December 31, 2012. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank's capital. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

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

Residential First Mortgages

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

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also unquantifiable credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower.

Construction and Land Development

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

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

Home Equity and Second Mortgage Loans

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

Commercial Loans

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

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

Consumer Loans

The Bank has developed a number of programs to serve the needs of its customers with primary emphasis upon loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

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

Non-accrual and Past Due Loans

Non-accrual loans as of September 30, 2013 and December 31, 2012 were as follows:

	September 30, 2013					
	90 or Greater Days Delinquent	Number of Loans	Non-accrual Performing Loans	Number of Loans	Total Dollars	Total Number of Loans
Commercial real estate	$2,947,607	9	$3,728,175	2	$6,675,782	11
Residential first mortgages	2,155,122	7	565,802	3	2,720,924	10
Commercial loans	5,670,331	10	-	-	5,670,331	10
Consumer loans	-	-	31,935	1	31,935	1
Commercial equipment	316,662	5	-	-	316,662	5
	$11,089,722	31	$4,325,912	6	$15,415,634	37

	December 31, 2012					
	90 or Greater Days Delinquent	Number of Loans	Non-accrual Performing Loans	Number of Loans	Total Dollars	Total Number of Loans
Commercial real estate	$1,527,844	7	$3,802,947	2	$5,330,791	9
Residential first mortgages	3,169,404	10	569,693	3	3,739,097	13
Home equity and second mortgages	71,296	2	-	-	71,296	2
Commercial loans	3,732,090	11	-	-	3,732,090	11
Consumer loans	-	-	51,748	1	51,748	1
Commercial equipment	216,383	4	-	-	216,383	4
	$8,717,017	34	$4,424,388	6	$13,141,405	40

The Bank categorized six performing loans totaling $4,325,912 and $4,424,388 as non-accrual loans at September 30, 2013 and December 31, 2012, respectively. These six loans represent one well-secured commercial relationship with no specific reserves in the allowance due to the Bank's superior credit position with underlying collateral, which consists primarily of commercial real estate. As of September 30, 2013, the Bank had received all scheduled interest and principal payments on this relationship. It is management’s belief that there is no current risk of loss to the Bank for this relationship. These loans were classified as non-accrual loans due to the customer’s operating results. In accordance with the Company’s policy, interest income is recognized on a cash-basis for these loans.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $12,932,327 and $11,371,542 at September 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at September 30, 2013 and December 31, 2012 was $432,916 and $443,856, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $2,483,307 and $1,769,863 at September 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at September 30, 2013 and December 31, 2012 was $180,751 and $182,106, respectively.

An analysis of past due loans as of September 30, 2013 and December 31, 2012 was as follows:

September 30, 2013	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$440,735,812	$-	$1,978,619	$2,947,607	$4,926,226	$445,662,038
Residential first mortgages	159,568,816	-	137,772	2,155,122	2,292,894	161,861,710
Construction and land dev.	30,786,474	326,671	-	-	326,671	31,113,145
Home equity and second mortgages	21,388,847	199,217	123,916	-	323,133	21,711,980
Commercial loans	80,633,889	200,000	-	5,670,331	5,870,331	86,504,220
Consumer loans	898,574	3,226	-	-	3,226	901,800
Commercial equipment	20,730,853	37,682	-	316,662	354,344	21,085,197
Total	$754,743,265	$766,796	$2,240,307	$11,089,722	$14,096,825	$768,840,090
December 31, 2012						
Commercial real estate	$416,721,658	$-	$1,417,810	$1,527,844	$2,945,654	$419,667,312
Residential first mortgages	173,593,886	97,307	802,757	3,169,404	4,069,468	177,663,354
Construction and land dev.	31,818,782	-	-	-	-	31,818,782
Home equity and second mortgages	21,499,018	350,715	61,346	71,296	483,357	21,982,375
Commercial loans	84,384,426	-	41,090	3,732,090	3,773,180	88,157,606
Consumer loans	983,094	9,363	2,749	-	12,112	995,206
Commercial equipment	15,659,007	371,921	20,373	216,383	608,677	16,267,684
Total	$744,659,871	$829,306	$2,346,125	$8,717,017	$11,892,448	$756,552,319

There were no accruing loans 90 days or greater past due at September 30, 2013 and December 31, 2012, respectively.

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the three and nine months ended September 30, 2013 and September 30, 2012, respectively, and the year ended December 31, 2012 and loan receivable balances at September 30, 2013 and September 30, 2012, respectively, and at December 31, 2012. An allocation of the allowance to one category of loans does not prevent the Company's ability to utilize the allowance to absorb losses in a different category. The loan receivables are disaggregated on the basis of the Company's impairment methodology.

	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Three Months Ended September 30, 2013								
Allowance for loan losses:								
Balance at July 1,	$3,358,001	$1,960,882	$600,525	$364,281	$1,519,332	$13,972	$216,560	$8,033,55
Charge-offs	(140,048)	(80,110)	(50)	(155)	(28,576)	(1,012)	(31)	(249,982
Recoveries	-	154	-	-	168	28	9,746	10,096
Provisions	311,035	(177,787)	(131,581)	(45,812)	272,009	1,539	56,207	285,610
Balance at September 30,	$3,528,988	$1,703,139	$468,894	$318,314	$1,762,933	$14,527	$282,482	$8,079,27
At and For the Nine Months Ended September 30, 2013								
Allowance for loan losses:								
Balance at January 1,	$4,089,834	$1,083,228	$533,430	$279,819	$1,949,024	$19,341	$292,281	$8,246,95
Charge-offs	(140,048)	(139,048)	(36,012)	(111,038)	(434,149)	(10,003)	(22,008)	(892,306
Recoveries	-	11,054	-	-	12,059	2,010	59,293	84,416
Provisions	(420,798)	747,905	(28,524)	149,533	235,999	3,179	(47,084)	640,210
Balance at September 30,	$3,528,988	$1,703,139	$468,894	$318,314	$1,762,933	$14,527	$282,482	$8,079,27

Ending balance: individually evaluated for impairment	$559,333	$170,741	$-	$-	$291,821	$-	$22,875	$1,044,77
Ending balance: collectively evaluated for impairment	$2,969,655	$1,532,398	$468,894	$318,314	$1,471,112	$14,527	$259,607	$7,034,50
Loan receivables: Ending balance	$445,662,038	$161,861,710	$31,113,145	$21,711,980	$86,504,220	$901,800	$21,085,197	$768,840,
Ending balance: individually evaluated for impairment	$19,856,516	$3,882,548	$5,349,737	$58,000	$11,054,771	$31,935	$316,662	$40,550,1
Ending balance: collectively evaluated for impairment	$425,805,522	$157,979,162	$25,763,408	$21,653,980	$75,449,449	$869,865	$20,768,535	$728,289,

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	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Year Ended December 31, 2012								
Allowance for loan losses:								
Balance at January 1,	$2,525,199	$539,205	$354,385	$143,543	$3,850,294	$19,119	$223,296	$7,655,04
Charge-offs	(486,431)	(10,987)	(140,835)	(210,753)	(1,003,824)	(4,994)	(168,802)	(2,026,6
Recoveries	-	37,524	-	-	51,350	987	-	89,861
Provisions	2,051,066	517,486	319,880	347,029	(948,796)	4,229	237,787	2,528,68
Balance at December 31,	$4,089,834	$1,083,228	$533,430	$279,819	$1,949,024	$19,341	$292,281	$8,246,95
Ending balance: individually evaluated for impairment	$785,878	$403,475	$-	$-	$353,883	$-	$4,421	$1,547,65
Ending balance: collectively evaluated for impairment	$3,303,956	$679,753	$533,430	$279,819	$1,595,141	$19,341	$287,860	$6,699,30
Loan receivables:								
Ending balance	$419,667,312	$177,663,354	$31,818,782	$21,982,375	$88,157,606	$995,206	$16,267,684	$756,552
Ending balance: individually evaluated for impairment	$21,618,890	$3,367,827	$4,877,868	$291,000	$8,778,681	$51,748	$4,421	$38,990,4
Ending balance: collectively evaluated for impairment	$398,048,422	$174,295,527	$26,940,914	$21,691,375	$79,378,925	$943,458	$16,263,263	$717,561

	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Three Months Ended September 30, 2012								
Allowance for loan losses:								
Balance at July 1,	$3,478,458	$901,505	$596,854	$212,791	$1,968,491	$18,316	$287,722	$7,464,
Charge-offs	(50,034)	(10,991)	(5,995)	(46,989)	(413)	-	(90)	(114,5
Recoveries	-	429	-	-	23	-	-	452
Provisions	683,311	(3,991)	40,378	18,402	(14,062)	1,505	20,532	746,07
Balance at September 30,	$4,111,735	$886,952	$631,237	$184,204	$1,954,039	$19,821	$308,164	$8,096,
At and For the Nine Months Ended September 30, 2012								
Allowance for loan losses:								
Balance at January 1,	$2,525,199	$539,205	$354,385	$143,543	$3,850,294	$19,119	$223,296	$7,655,
Charge-offs	(171,867)	(10,991)	(5,995)	(88,931)	(693,461)	(999)	(149,884)	(1,122
Recoveries	-	37,676	-	-	1,983	-	-	39,659
Provisions	1,758,403	321,062	282,847	129,592	(1,204,777)	1,701	234,752	1,523,
Balance at September 30,	$4,111,735	$886,952	$631,237	$184,204	$1,954,039	$19,821	$308,164	$8,096,
Ending balance: individually evaluated for impairment	$1,122,590	$247,541	$134,500	$21,855	$499,654	$-	$4,715	$2,030,
Ending balance: collectively evaluated for	$2,989,145	$639,411	$496,737	$162,349	$1,454,385	$19,821	$303,449	$6,065,

impairment								
Loan receivables:								
Ending balance	$406,261,770	$176,825,516	$31,639,206	$21,940,441	$86,057,488	$1,047,046	$17,246,112	$741,01
Ending balance: individually evaluated for impairment	$23,039,920	$4,011,851	$5,217,025	$293,855	$12,972,808	$60,925	$4,715	$45,601
Ending balance: collectively evaluated for impairment	$383,221,850	$172,813,665	$26,422,181					