

FIRST COMMUNITY CORP /SC/  
Form 10-Q  
November 10, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2016

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

**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

(I.R.S. Employer Identification No.)

or organization)

5455 Sunset Boulevard, Lexington, South Carolina 29072

(Address of principal executive offices) (Zip Code)

(803) 951-2265

(Registrant's telephone number, including area code)

Edgar Filing: FIRST COMMUNITY CORP /SC/ - Form 10-Q

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ 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 ☒

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: On November 10, 2016, 6,703,317 shares of the issuer’s common stock, par value \$1.00 per share, were issued and outstanding.

## TABLE OF CONTENTS

|   |             |
|---|-------------|
|   | <b>Page</b> |
| <b><u>PART I - FINANCIAL INFORMATION</u></b>  | <b>3</b>    |
| <b><u>Item 1.</u></b> <b><u>Financial Statements</u></b>  | <b>3</b>    |
| <u>Consolidated Balance Sheets</u>  | 4           |
| <u>Consolidated Statements of Income</u>  | 5           |
| <u>Consolidated Statements of Comprehensive Income</u>  | 6           |
| <u>Consolidated Statements of Changes in Shareholders' Equity</u>   | 7           |
| <u>Consolidated Statements of Cash Flows</u>  | 8           |
| <u>Notes to Consolidated Financial Statements</u>   | 9           |
| <b><u>Item 2.</u></b> <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> | <b>40</b>   |
| <b><u>Item 3.</u></b> <b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>                            | <b>57</b>   |
| <b><u>Item 4.</u></b> <b><u>Controls and Procedures</u></b>   | <b>57</b>   |
| <b><u>PART II – OTHER INFORMATION</u></b>   | <b>58</b>   |
| <b><u>Item 1.</u></b> <b><u>Legal Proceedings</u></b>   | <b>58</b>   |
| <b><u>Item 1A.</u></b> <b><u>Risk Factors</u></b>   | <b>58</b>   |
| <b><u>Item 2.</u></b> <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>                           | <b>58</b>   |
| <b><u>Item 3.</u></b> <b><u>Defaults Upon Senior Securities</u></b>   | <b>58</b>   |
| <b><u>Item 4.</u></b> <b><u>Mine Safety Disclosures</u></b>   | <b>58</b>   |
| <b><u>Item 5.</u></b> <b><u>Other Information</u></b>   | <b>58</b>   |
| <b><u>Item 6.</u></b> <b><u>Exhibits</u></b>  | <b>58</b>   |
| <b><u>SIGNATURES</u></b>  | <b>59</b>   |
| <b><u>INDEX TO EXHIBITS</u></b>   | <b>60</b>   |
| 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)  | September<br>30,<br>2016<br>(Unaudited) | December<br>31,<br>2015 |
|---|---|-------------------------|
| <b>ASSETS</b>   |   |                         |
| Cash and due from banks   | \$ 13,751                               | \$ 10,973               |
| Interest-bearing bank balances  | 24,345                                  | 11,375                  |
| Federal funds sold and securities purchased under agreements to resell  | 599                                     | 593                     |
| Investment securities - held to maturity  | 17,238                                  | 17,371                  |
| Investment securities - available for sale  | 269,255                                 | 264,687                 |
| Other investments, at cost  | 1,681                                   | 1,783                   |
| Loans held for sale   | 4,250                                   | 2,962                   |
| Loans   | 523,441                                 | 489,191                 |
| Less, allowance for loan losses   | 5,047                                   | 4,596                   |
| Net loans   | 518,394                                 | 484,595                 |
| Property, furniture and equipment - net   | 29,951                                  | 29,929                  |
| Land held for sale  | 1,055                                   | 1,080                   |
| Bank owned life insurance   | 20,755                                  | 20,301                  |
| Other real estate owned   | 1,198                                   | 2,458                   |
| Intangible assets   | 1,177                                   | 1,419                   |
| Goodwill  | 5,078                                   | 5,078                   |
| Other assets  | 6,525                                   | 8,130                   |
| Total assets  | \$ 915,252                              | \$ 862,734              |
| <b>LIABILITIES</b>  |   |                         |
| Deposits:   |   |                         |
| Non-interest bearing  | \$ 177,267                              | \$ 156,247              |
| Interest bearing  | 588,656                                 | 559,904                 |
| Total deposits  | 765,923                                 | 716,151                 |
| Securities sold under agreements to repurchase  | 22,232                                  | 21,033                  |
| Federal Home Loan Bank advances   | 21,022                                  | 24,788                  |
| Junior subordinated debt  | 14,964                                  | 14,964                  |
| Other liabilities   | 6,903                                   | 6,760                   |
| Total liabilities   | 831,044                                 | 783,696                 |
| <b>SHAREHOLDERS' EQUITY</b>   |   |                         |
| 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 6,703,317 at September 30, 2016 6,690,551 at December 31, 2015 | 6,703                                   | 6,690                   |
| Common stock warrants issued  | 46                                      | 46                      |

Edgar Filing: FIRST COMMUNITY CORP /SC/ - Form 10-Q

|  |            |   |            |   |
|--|------------|---|------------|---|
| Non-vested restricted stock                | (313       | ) | (297       | ) |
| Additional paid in capital                 | 75,921     |   | 75,761     |   |
| Accumulated deficit                        | (688       | ) | (3,992     | ) |
| Accumulated other comprehensive income     | 2,539      |   | 830        |   |
| Total shareholders' equity                 | 84,208     |   | 79,038     |   |
| Total liabilities and shareholders' equity | \$ 915,252 |   | \$ 862,734 |   |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

|  | Nine<br>Months Ended<br>September 30,<br>2016<br>(Unaudited) | Nine<br>Months Ended<br>September 30,<br>2015<br>(Unaudited) |
|--|--|--|
| (Dollars in thousands, except per share data)                        |  |  |
| Interest income:   |  |  |
| Loans, including fees  | \$ 17,582  | \$ 17,373  |
| Taxable securities   | 2,903  | 2,771  |
| Non taxable securities   | 1,428  | 1,216  |
| Federal funds sold and securities purchased under resale agreements  | 56   | 22   |
| Other  | 27   | 64   |
| Total interest income  | 21,996   | 21,446   |
| Interest expense:  |  |  |
| Deposits   | 1,358  | 1,304  |
| Federal funds sold and securities sold under agreement to repurchase | 32   | 26   |
| Other borrowed money   | 941  | 1,211  |
| Total interest expense   | 2,331  | 2,541  |
| Net interest income  | 19,665   | 18,905   |
| Provision for loan losses  | 536  | 990  |
| Net interest income after provision for loan losses                  | 19,129   | 17,915   |
| Non-interest income:   |  |  |
| Deposit service charges  | 1,064  | 1,083  |
| Mortgage banking income  | 2,515  | 2,679  |
| Investment advisory fees and non-deposit commissions                 | 871  | 993  |
| Gain on sale of securities   | 601  | 271  |
| Gain (loss) on sale of other assets                                  | (36)   | ) 24   |
| Loss on early extinguishment of debt                                 | (459)  | ) (103)  |
| Other  | 2,184  | 1,928  |
| Total non-interest income  | 6,740  | 6,875  |
| Non-interest expense:  |  |  |
| Salaries and employee benefits                                       | 11,472   | 10,818   |
| Occupancy  | 1,601  | 1,498  |
| Equipment  | 1,308  | 1,233  |
| Marketing and public relations                                       | 529  | 683  |
| FDIC assessments   | 336  | 389  |
| Other real estate expense  | 187  | 434  |
| Amortization of intangibles  | 243  | 299  |
| Other  | 3,582  | 3,202  |
| Total non-interest expense   | 19,258   | 18,556   |
| Net income before tax  | 6,611  | 6,234  |
| Income taxes   | 1,721  | 1,708  |
| Net income   | \$ 4,890   | \$ 4,526   |
| Basic earnings per common share                                      | \$ 0.74  | \$ 0.69  |
| Diluted earnings per common share                                    | \$ 0.72  | \$ 0.68  |
| See Notes to Consolidated Financial Statements                       |  |  |



**FIRST COMMUNITY CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

|  | Three<br>Months Ended<br>September 30,<br>2016<br>(Unaudited) | Three<br>Months Ended<br>September 30,<br>2015<br>(Unaudited) |
|--|---|---|
| (Dollars in thousands, except per share data)                        |   |   |
| Interest income:   |   |   |
| Loans, including fees  | \$ 5,977  | \$ 5,795  |
| Taxable securities   | 944   | 860   |
| Non taxable securities   | 445   | 430   |
| Federal funds sold and securities purchased under resale agreements  | 24  | 8   |
| Other  | 10  | 21  |
| Total interest income  | 7,400   | 7,114   |
| Interest expense:  |   |   |
| Deposits   | 465   | 443   |
| Federal funds sold and securities sold under agreement to repurchase | 12  | 11  |
| Other borrowed money   | 272   | 407   |
| Total interest expense   | 749   | 861   |
| Net interest income  | 6,651   | 6,253   |
| Provision for loan losses  | 179   | 193   |
| Net interest income after provision for loan losses                  | 6,472   | 6,060   |
| Non-interest income:   |   |   |
| Deposit service charges  | 377   | 390   |
| Mortgage banking income  | 937   | 964   |
| Investment advisory fees and non-deposit commissions                 | 283   | 290   |
| Gain on sale of securities   | 478   | —   |
| Gain on sale of other assets   | 45  | 17  |
| Loss on early extinguishment of debt                                 | (459)   | —   |
| Other  | 726   | 668   |
| Total non-interest income  | 2,387   | 2,329   |
| Non-interest expense:  |   |   |
| Salaries and employee benefits                                       | 3,888   | 3,595   |
| Occupancy  | 531   | 513   |
| Equipment  | 442   | 437   |
| Marketing and public relations                                       | 240   | 129   |
| FDIC assessment  | 60  | 113   |
| Other real estate expense  | 115   | 126   |
| Amortization of intangibles  | 80  | 98  |
| Other  | 1,227   | 1,056   |
| Total non-interest expense   | 6,583   | 6,067   |
| Net income before tax  | 2,276   | 2,322   |
| Income taxes   | 599   | 643   |
| Net income   | \$ 1,677  | \$ 1,679  |
| Basic earnings per common share                                      | \$ 0.26   | \$ 0.26   |
| Diluted earnings per common share                                    | \$ 0.25   | \$ 0.25   |



See Notes to Consolidated Financial Statements

**FIRST  
COMMUNITY  
CORPORATION**

**CONSOLIDATED  
STATEMENTS OF  
COMPREHENSIVE  
INCOME**

**(Unaudited)**

| <b>(Dollars in thousands)</b>   | Nine months ended September 30, |          |
|---|---------------------------------|----------|
|   | 2016                            | 2015     |
| Net income  | \$ 4,890                        | \$ 4,526 |
| Other comprehensive income:   |                                 |          |
| Unrealized gain during the period on available-for-sale securities, net of taxes of \$1,085 and \$275, respectively | 2,106                           | 532      |
| Less: Reclassification adjustment for gain included in net income, net of taxes of \$204 and \$92, respectively     | (397 )                          | (179 )   |
| Other comprehensive income  | 1,709                           | 353      |
| Comprehensive income  | \$ 6,599                        | \$ 4,879 |

| <b>(Dollars in thousands)</b>  | Three months ended September 30, |          |
|--|----------------------------------|----------|
|  | 2016                             | 2015     |
| Net income   | \$ 1,677                         | \$ 1,679 |
| Other comprehensive income:  |                                  |          |
| Unrealized gain (loss) during the period on available-for-sale securities, net of taxes of \$509 and \$357, respectively | (989 )                           | 672      |
| Less: Reclassification adjustment for gain included in net income, net of taxes of \$163 and \$0, respectively           | (315 )                           | —        |
| Other comprehensive income (loss)  | (1,304 )                         | 672      |
| Comprehensive income   | \$ 373                           | \$ 2,351 |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION****Consolidated Statements of Changes in Shareholders' Equity****Nine Months ended September 30, 2016 and September 30, 2015****(Unaudited)**

(Dollars and shares in thousands)

|  | Shares | Common   | Common   | Additional | Nonvested  | Accumulated | Other         |          |
|--|--------|----------|----------|------------|------------|-------------|---------------|----------|
|  | Issued | Stock    | Stock    | Paid-in    | Restricted | Deficit     | Comprehensive |          |
|  |        |          | Warrants | Capital    | Stock      |             | Income        | Total    |
|  |        |          |          |            |            |             | (Loss)        |          |
| Balance, December 31, 2014                     | 6,664  | \$ 6,664 | \$ 48    | \$ 75,504  | \$ (673 )  | \$ (8,286 ) | \$ 1,271      | \$74,528 |
| Net income                                     |        |          |          |            |            | 4,526       |               | 4,526    |
| Other comprehensive income net of tax of \$183 |        |          |          |            |            |             | 353           | 353      |
| Issuance of restricted stock                   | 13     | 13       |          | 137        | (150 )     |             |               | —        |
| Restricted shares surrendered                  | (8 )   | (8 )     |          | (90 )      |            |             |               | (98 )    |
| Amortization compensation restricted stock     |        |          |          |            | 397        |             |               | 397      |
| Exercise of stock warrants                     | 2      | 2        | (2 )     |            |            |             |               | —        |
| Dividends: Common (\$0.21 per share)           |        |          |          |            |            | (1,371 )    |               | (1,371 ) |
| Dividend reinvestment plan                     | 14     | 14       |          | 139        |            |             |               | 153      |
| Balance, September 30, 2015                    | 6,685  | \$ 6,685 | \$ 46    | \$ 75,690  | \$ (426 )  | \$ (5,131 ) | \$ 1,624      | \$78,488 |
| Balance, December 31, 2015                     | 6,690  | \$ 6,690 | \$ 46    | \$ 75,761  | \$ (297 )  | \$ (3,992 ) | \$ 830        | \$79,038 |
| Net income                                     |        |          |          |            |            | 4,890       |               | 4,890    |
| Other comprehensive income net of tax of \$881 |        |          |          |            |            |             | 1,709         | 1,709    |
| Issuance of restricted stock                   | 22     | 22       |          | 275        | (297 )     |             |               | —        |
| Restricted shares surrendered                  | (26 )  | (26 )    |          | (327 )     |            |             |               | (353 )   |
| Issuance of common stock                       | 1      | 1        |          | 13         |            |             |               | 14       |
| Amortization compensation restricted stock     |        |          |          |            | 281        |             |               | 281      |
| Dividends: Common (\$0.24 per share)           |        |          |          |            |            | (1,586 )    |               | (1,586 ) |
| Dividend reinvestment plan                     | 16     | 16       |          | 199        |            |             |               | 215      |
| Balance, September 30, 2016                    | 6,703  | \$ 6,703 | \$ 46    | \$ 75,921  | \$ (313 )  | \$ (688 )   | \$ 2,539      | \$84,208 |

See Notes to Consolidated Financial Statements

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

|   | Nine months<br>ended September<br>30, |          |
|---|---------------------------------------|----------|
| (Dollars in thousands)  | 2016                                  | 2015     |
| Cash flows from operating activities:   |                                       |          |
| Net income  | \$4,890                               | \$4,526  |
| Adjustments to reconcile net income to net cash provided from operating activities: |                                       |          |
| Depreciation  | 994                                   | 932      |
| Premium amortization  | 3,044                                 | 3,093    |
| Provision for loan losses   | 536                                   | 990      |
| Writedowns of other real estate owned   | 76                                    | 201      |
| Loss (gain) on sale of other real estate owned                                      | 36                                    | (24 )    |
| Sale of loans held-for-sale   | 69,880                                | 80,571   |
| Originations of loans held-for-sale   | (71,169)                              | (80,016) |
| Amortization of intangibles   | 243                                   | 299      |
| Accretion on acquired loans   | (804 )                                | (709 )   |
| Gain on sale of securities  | 601                                   | 271      |
| Writedown of land held for sale   | 25                                    | 120      |
| Loss on early extinguishment of debt  | 459                                   | 103      |
| Decrease in other assets  | 343                                   | 1,305    |
| Decrease in other liabilities   | 144                                   | (153 )   |
| Net cash provided from operating activities   | 8,096                                 | 10,967   |
| Cash flows from investing activities:   |                                       |          |
| Purchase of investment securities available-for-sale and other investments          | (64,059)                              | (33,441) |
| Purchase of investment securities held-to-maturity                                  | —                                     | (6,065 ) |
| Maturity of investment securities available-for-sale                                | 26,553                                | 28,470   |
| Proceeds from sale of securities available-for-sale                                 | 33,215                                | 17,061   |
| Proceeds from sale of other investments   | 486                                   | 1,133    |
| Increase in loans   | (34,052)                              | (40,336) |
| Proceeds from sale of other real estate owned                                       | 1,597                                 | 479      |
| Purchase of property and equipment  | (1,016 )                              | (2,502 ) |
| Net cash used in investing activities   | (37,275)                              | (35,201) |
| Cash flows from financing activities:   |                                       |          |
| Increase in deposit accounts  | 49,711                                | 34,871   |
| Increase in securities sold under agreements to repurchase                          | 1,199                                 | 2,525    |
| Advances from the Federal Home Loan Bank  | 70,593                                | 32,500   |
| Repayment of advances from Federal Home Loan Bank                                   | (74,860)                              | (33,867) |
| Restricted shares surrendered   | (353 )                                | (98 )    |
| Issuance of common stock  | 14                                    | —        |
| Dividends paid: Common Stock  | (1,586 )                              | (1,371 ) |
| Dividend reinvestment plan  | 215                                   | 153      |
| Net cash provided from financing activities   | 44,933                                | 34,713   |
| Net increase in cash and cash equivalents   | 15,754                                | 10,479   |
| Cash and cash equivalents at beginning of period                                    | 22,941                                | 22,532   |
| Cash and cash equivalents at end of period  | \$38,695                              | \$33,011 |
| Supplemental disclosure:  |                                       |          |

Cash paid during the period for:

|  |         |         |
|--|---------|---------|
| Interest                                     | \$2,395 | \$2,566 |
| Income taxes                                 | \$1,345 | \$2,220 |
| Non-cash investing and financing activities: |         |         |
| Unrealized gain on securities                | \$1,709 | \$353   |
| Transfer of loans to foreclosed property     | \$450   | \$193   |

See Notes to Consolidated Financial Statements

**FIRST COMMUNITY CORPORATION**

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

In the opinion of management, the accompanying unaudited consolidated balance sheets, and the consolidated statements of income, comprehensive income, 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 September 30, 2016 and December 31, 2015, and the Company's results of operations and cash flows for the three and nine months ended September 30, 2016 and 2015. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

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 2015 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)

|   | Nine months<br>Ended<br>September 30,<br>2016 |         | Three months<br>Ended<br>September 30,<br>2015 |         |
|---|---|---------|--|---------|
| Numerator (Net income)  | \$4,890                                       | \$4,526 | \$1,677  | \$1,679 |
| Denominator   |   |         |  |         |
| Weighted average common shares outstanding for:                       |   |         |  |         |
| Basic earnings per share  | 6,583   | 6,554   | 6,573  | 6,584   |
| Dilutive securities:  |   |         |  |         |
| Deferred compensation   | 39  | 38      | 42   | 38      |
| Warrants/Restricted stock – Treasury stock method                     | 152   | 141     | 147  | 147     |
| Diluted earnings per share  | 6,774   | 6,733   | 6,762  | 6,769   |
| The average market price used in calculating assumed number of shares | \$14.29                                       | \$14.00 | \$14.99  | \$14.00 |

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 notes. At September 30, 2016 there were 97,180 warrants outstanding. These warrants expire on December 16, 2019 and are included in dilutive securities in the table above.

The Company has issued a total of 138,000 restricted shares to its employees and non-employee directors under the terms of its compensation plans and employment agreements. The employee shares cliff vest over a three-year period, and the non-employee director shares vest one year after issuance. The unrecognized compensation cost at September 30, 2016 for non-vested shares amounts to \$313 thousand.

In 2006, the Company established a Non-Employee Director Deferred Compensation Plan, whereby a director may elect to defer all or any part of their annual retainer and monthly meeting fees payable with respect to service on the board of directors or a committee of the board. Units of common stock are credited to the director's account at the time compensation is earned and are included in dilutive securities in the table above. At September 30, 2016 there were 99,638 units issued under the Plan. The accrued liability at September 30, 2016 amounted to \$936.7 thousand and is included in "Other liabilities" on the balance sheet.





**Note 3—Investment Securities**

The amortized cost and estimated fair values of investment securities at September 30, 2016 and December 31, 2015 are summarized below:

**AVAILABLE-FOR-SALE:**

| (Dollars in thousands)              | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| September 30, 2016:                 |                   |                              |                               |               |
| US Treasury securities              | \$ 1,540          | \$ 23                        | \$ —                          | \$1,563       |
| Government sponsored enterprises    | 956               | 70                           | —                             | 1,026         |
| Mortgage-backed securities          | 153,070           | 1,588                        | 420                           | 154,238       |
| Small Business Administration pools | 53,197            | 424                          | 369                           | 53,252        |
| State and local government          | 54,881            | 2,628                        | 161                           | 57,348        |
| Corporate and other securities      | 1,882             | —                            | 54                            | 1,828         |
|                                     | \$ 265,526        | \$ 4,733                     | \$ 1,004                      | \$269,255     |
| December 31, 2015:                  |                   |                              |                               |               |
| US Treasury securities              | \$ 1,547          | \$ —                         | \$ 25                         | \$1,522       |
| Government sponsored enterprises    | 950               | 42                           | —                             | 992           |
| Mortgage-backed securities          | 146,935           | 498                          | 1,172                         | 146,261       |
| Small Business Administration pools | 57,474            | 355                          | 501                           | 57,328        |
| State and local government          | 55,294            | 2,037                        | 36                            | 57,295        |
| Corporate and other securities      | 1,349             | —                            | 60                            | 1,289         |
|                                     | \$ 263,549        | \$ 2,932                     | \$ 1,794                      | \$264,687     |

**HELD-TO-MATURITY:**

| (Dollars in thousands)     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|----------------------------|-------------------|------------------------------|-------------------------------|---------------|
| September 30, 2016:        |                   |                              |                               |               |
| State and local government | \$ 17,238         | \$ 627                       | \$ —                          | \$17,865      |
|                            | \$ 17,238         | \$ 627                       | \$ —                          | \$17,865      |
| December 31, 2015:         |                   |                              |                               |               |
| State and local government | \$ 17,371         | \$ 211                       | \$ 27                         | \$17,555      |
|                            | \$ 17,371         | \$ 211                       | \$ 27                         | \$17,555      |

During the nine months ended September 30, 2016 and 2015, the Company received proceeds of \$33.2 million and \$17.1 million, respectively, from the sale of investment securities available-for-sale. For the nine months ended September 30, 2016, gross realized gains totaled \$601 thousand and there were no gross realized losses. For the nine months ended September 30, 2015, gross realized gains totaled \$271 thousand and there were no gross realized losses. During the three months ended September 30, 2016, the Company received proceeds of \$19.1 million from the sale of investment securities available-for-sale, gross realized gains totaled \$478 thousand and there were no gross

realized losses. For the three months ended September 30, 2015, there were no sales of investment securities.

At September 30, 2016, corporate and other securities available-for-sale included the following at fair value: mutual funds at \$818.1 thousand, foreign debt of \$60.3 thousand, and corporate preferred stock in the amount of \$950.0 thousand. At December 31, 2015, 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 \$1.7 million and \$1.8 million at September 30, 2016 and December 31, 2015, respectively.

**Note 3—Investment Securities**

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 September 30, 2016 and December 31, 2015. There were no held-to-maturity securities with gross unrealized losses at September 30, 2016.

|   | Less than<br>12 months |                    | 12 months or more |                    | Total         |                    |
|---|------------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|   | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| September 30, 2016<br>(Dollars in thousands)                  |                        |                    |                   |                    |               |                    |
| Available-for-sale securities:                                |                        |                    |                   |                    |               |                    |
| Government Sponsored Enterprise<br>mortgage-backed securities | \$36,491               | \$ 185             | \$15,054          | \$ 230             | \$51,545      | \$ 415             |
| Small Business Administration pools                           | 6,377                  | 34                 | 23,978            | 335                | 30,355        | 369                |
| Non-agency mortgage-backed securities                         | 147                    | 2                  | 235               | 3                  | 382           | 5                  |
| State and local government                                    | 9,875                  | 161                | —                 | —                  | 9,875         | 161                |
| Corporate bonds and other                                     | —                      | —                  | 818               | 54                 | 818           | 54                 |
| Total   | \$52,890               | \$ 382             | \$40,085          | \$ 622             | \$92,975      | \$ 1,004           |

|   | Less than<br>12 months |                    | 12 months or more |                    | Total         |                    |
|---|------------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|   | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| December 31, 2015<br>(Dollars in thousands)                   |                        |                    |                   |                    |               |                    |
| Available-for-sale securities:                                |                        |                    |                   |                    |               |                    |
| US Treasury   | \$1,522                | \$ 25              | \$—               | \$ —               | \$1,522       | \$ 25              |
| Government Sponsored Enterprise<br>mortgage-backed securities | 69,112                 | 731                | 17,593            | 439                | 86,705        | 1,170              |
| Small Business Administration pools                           | 13,386                 | 153                | 25,709            | 348                | 39,095        | 501                |
| Non-agency mortgage-backed securities                         | —                      | —                  | 186               | 2                  | 186           | 2                  |
| State and local government                                    | 1,461                  | 8                  | 1,362             | 28                 | 2,823         | 36                 |
| Corporate bonds and other                                     | —                      | —                  | 812               | 60                 | 812           | 60                 |
| Total   | \$85,481               | \$ 917             | \$45,662          | \$ 877             | \$131,143     | \$ 1,794           |

|   | Less than<br>12 months |                    | 12 months or more |                    | Total         |                    |
|---|------------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|   | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| December 31, 2015<br>(Dollars in thousands) |                        |                    |                   |                    |               |                    |
| Held-to-maturity securities:                |                        |                    |                   |                    |               |                    |
| State and local government                  | \$3,473                | \$ 24              | \$444             | \$ 3               | \$3,917       | \$ 27              |
| Total                                       | \$3,473                | \$ 24              | \$444             | \$ 3               | \$3,917       | \$ 27              |

**Note 3—Investment Securities - continued**

**Government Sponsored Enterprise, Mortgage-Backed Securities:** The Company owned mortgage-backed securities (“MBSs”), including collateralized mortgage obligations (“CMOs”), issued by government sponsored enterprises (“GSEs”) with an amortized cost of \$152.6 million and \$146.9 million and approximate fair value of \$153.8 million and \$146.3 million at September 30, 2016 and December 31, 2015, respectively. As of September 30, 2016 and December 31, 2015, 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 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 impaired at September 30, 2016.

**Non-agency Mortgage-Backed Securities:** The Company held private label mortgage-backed securities (“PLMBSs”), including CMOs, at September 30, 2016 with an amortized cost of \$445.4 thousand and approximate fair value of \$441.3 thousand. The Company held PLMBSs, including CMOs, at December 31, 2015 with an amortized cost of \$554.8 thousand and approximate fair value of \$556.3 thousand.

**State and Local Governments and Other:** Management monitors these securities 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 other-than-temporarily impaired at September 30, 2016.

The following sets forth the amortized cost and fair value of investment securities at September 30, 2016 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                | \$7,707            | \$7,740    | \$—              | \$—        |
| Due after one year through five years  | 145,109            | 146,279    | 4,976            | 5,089      |
| Due after five years through ten years | 95,909             | 98,454     | 12,262           | 12,776     |
| Due after ten years                    | 16,801             | 16,782     | —                | —          |
|  | \$265,526          | \$269,255  | \$17,238         | \$17,865   |

***Note 4—Loans***

Loans summarized by category as of September 30, 2016, December 31, 2015, and September 30, 2015 are as follows:

| (Dollars in thousands)                 | September 30,<br>2016 | December 31,<br>2015 | September 30,<br>2015 |
|--|-----------------------|----------------------|-----------------------|
| Commercial, financial and agricultural | \$ 38,790             | \$ 37,809            | \$ 38,020             |
| Real estate:                           |                       |                      |                       |
| Construction                           | 41,228                | 35,829               | 33,127                |
| Mortgage-residential                   | 49,330                | 49,077               | 49,135                |
| Mortgage-commercial                    | 354,095               | 326,978              | 323,513               |
| Consumer:                              |                       |                      |                       |
| Home equity                            | 31,743                | 30,906               | 31,154                |
| Other                                  | 8,255                 | 8,592                | 8,982                 |
| Total                                  | \$ 523,441            | \$ 489,191           | \$ 483,931            |

14

**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 nine months ended September 30, 2016 and 2015 and for the year ended December 31, 2015 is as follows:

(Dollars in thousands)

|                                       | Real<br>estate | Real<br>estate | Real<br>estate | Real<br>estate | Consumer       | Consumer |             |            |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------|-------------|------------|
|                                       | Commercial     | Construction   | Residential    | Commercial     | Home<br>equity | Other    | Unallocated | Total      |
| September 30, 2016                    |                |                |                |                |                |          |             |            |
| Allowance for loan losses:            |                |                |                |                |                |          |             |            |
| Beginning balance                     | \$ 75          | \$ 51          | \$ 223         | \$ 2,036       | \$ 127         | \$ 37    | \$ 2,047    | \$ 4,596   |
| December 31, 2015                     |                |                |                |                |                |          |             |            |
| Charge-offs                           | —              | —              | (2 )           | (94 )          | (8 )           | (52 )    | —           | (156 )     |
| Recoveries                            | 4              | —              | 39             | 16             | 2              | 10       | —           | 71         |
| Provisions                            | 51             | 43             | 252            | 778            | 2              | 28       | (618 )      | 536        |
| Ending balance September 30, 2016     | \$ 130         | \$ 94          | \$ 512         | \$ 2,736       | \$ 123         | \$ 23    | \$ 1,429    | \$ 5,047   |
| Ending balances:                      |                |                |                |                |                |          |             |            |
| Individually evaluated for impairment | \$ —           | \$ —           | \$ 2           | \$ —           | \$ —           | \$ —     | \$ —        | \$ 2       |
| Collectively evaluated for impairment | 130            | 94             | 510            | 2,736          | 123            | 23       | 1,429       | 5,045      |
| September 30, 2016                    |                |                |                |                |                |          |             |            |
| Loans receivable:                     |                |                |                |                |                |          |             |            |
| Ending balance-total                  | \$ 38,790      | \$ 41,228      | \$ 49,330      | \$ 354,095     | \$ 31,743      | \$ 8,255 | \$ —        | \$ 523,441 |
| Ending balances:                      |                |                |                |                |                |          |             |            |
| Individually evaluated for impairment | —              | —              | 421            | 5,243          | 56             | —        | —           | 5,720      |
| Collectively evaluated for impairment | \$ 38,790      | \$ 41,228      | \$ 48,909      | \$ 348,852     | \$ 31,687      | \$ 8,255 | \$ —        | \$ 517,721 |

**Note 4—Loans-continued**

(Dollars in thousands)

|                                       | Real<br>estate<br>Commercial | Real<br>estate<br>Construction | Real<br>estate<br>Residential | Real<br>estate<br>Mortgage<br>Commercial | Real<br>estate<br>Mortgage<br>Home<br>equity | Consumer<br>Other | Consumer<br>Unallocated | Total      |
|---------------------------------------|------------------------------|--------------------------------|-------------------------------|--|--|-------------------|-------------------------|------------|
| September 30, 2015                    |                              |                                |                               |  |  |                   |                         |            |
| Allowance for loan losses:            |                              |                                |                               |  |  |                   |                         |            |
| Beginning balance                     | \$ 67                        | \$ 45                          | \$ 179                        | \$ 1,572                                 | \$ 134                                       | \$ 44             | \$ 2,091                | \$ 4,132   |
| December 31, 2014                     |                              |                                |                               |  |  |                   |                         |            |
| Charge-offs                           | (56 )                        | —                              | (39 )                         | (625 )                                   | —  | (44 )             | —                       | (764 )     |
| Recoveries                            | 5                            | —                              | 6                             | 16                                       | 3  | 80                | —                       | 110        |
| Provisions                            | 154                          | 130                            | 53                            | 861                                      | (17 )  | (25 )             | (166 )                  | 990        |
| Ending balance                        | \$ 170                       | \$ 175                         | \$ 199                        | \$ 1,824                                 | \$ 120                                       | \$ 55             | \$ 1,925                | \$ 4,468   |
| September 30, 2015                    |                              |                                |                               |  |  |                   |                         |            |
| Ending balances:                      |                              |                                |                               |  |  |                   |                         |            |
| Individually evaluated for impairment | \$ —                         | \$ —                           | \$ 3                          | \$ 1                                     | \$ —   | \$ —              | \$ —                    | \$ 4       |
| Collectively evaluated for impairment | 170                          | 175                            | 196                           | 1,823                                    | 120  | 55                | 1,925                   | 4,464      |
| September 30, 2015                    |                              |                                |                               |  |  |                   |                         |            |
| Loans receivable:                     |                              |                                |                               |  |  |                   |                         |            |
| Ending balance-total                  | \$ 38,020                    | \$ 33,127                      | \$ 49,135                     | \$ 323,513                               | \$ 31,154                                    | \$ 8,982          | \$ —                    | \$ 483,931 |
| Ending balances:                      |                              |                                |                               |  |  |                   |                         |            |
| Individually evaluated for impairment | 11                           | —                              | 923                           | 5,786                                    | —  | —                 | —                       | 6,720      |
| Collectively evaluated for impairment | \$ 38,009                    | \$ 33,127                      | \$ 48,212                     | \$ 317,727                               | \$ 31,154                                    | \$ 8,982          | \$ —                    | \$ 477,211 |

**Note 4—Loans-continued**

(Dollars in thousands)

|                                       | Real<br>estate<br>Commercial | Real<br>estate<br>Construction | Real<br>estate<br>Residential | Real<br>estate<br>Commercial | Consumer<br>Home<br>equity | Consumer<br>Other | Unallocated | Total      |
|---------------------------------------|------------------------------|--------------------------------|-------------------------------|------------------------------|----------------------------|-------------------|-------------|------------|
| December 31, 2015                     |                              |                                |                               |                              |                            |                   |             |            |
| Allowance for loan losses:            |                              |                                |                               |                              |                            |                   |             |            |
| Beginning balance                     | \$ 67                        | \$ 45                          | \$ 179                        | \$ 1,572                     | \$ 134                     | \$ 44             | \$ 2,091    | \$ 4,132   |
| December 31, 2014                     |                              |                                |                               |                              |                            |                   |             |            |
| Charge-offs                           | (69 )                        | —                              | (50 )                         | (626 )                       | —                          | (62 )             | —           | (807 )     |
| Recoveries                            | 6                            | —                              | 7                             | 33                           | 3                          | 84                | —           | 133        |
| Provisions                            | 71                           | 6                              | 87                            | 1,057                        | (10 )                      | (29 )             | (44 )       | 1,138      |
| Ending balance December 31, 2015      | \$ 75                        | \$ 51                          | \$ 223                        | \$ 2,036                     | \$ 127                     | \$ 37             | \$ 2,047    | \$ 4,596   |
| Ending balances:                      |                              |                                |                               |                              |                            |                   |             |            |
| Individually evaluated for impairment | \$ —                         | \$ —                           | \$ 3                          | \$ —                         | \$ —                       | \$ —              | \$ —        | \$ 3       |
| Collectively evaluated for impairment | 75                           | 51                             | 220                           | 2,036                        | 127                        | 37                | 2,047       | 4,593      |
| December 31, 2015                     |                              |                                |                               |                              |                            |                   |             |            |
| Loans receivable:                     |                              |                                |                               |                              |                            |                   |             |            |
| Ending balance-total                  | \$ 37,809                    | \$ 35,829                      | \$ 49,077                     | \$ 326,978                   | \$ 30,906                  | \$ 8,592          | \$ —        | \$ 489,191 |
| Ending balances:                      |                              |                                |                               |                              |                            |                   |             |            |
| Individually evaluated for impairment | 9                            | —                              | 848                           | 5,620                        | —                          | —                 | —           | 6,477      |
| Collectively evaluated for impairment | \$ 37,800                    | \$ 35,829                      | \$ 48,229                     | \$ 321,358                   | \$ 30,906                  | \$ 8,592          | \$ —        | \$ 482,714 |

Loans outstanding to bank directors, executive officers and their related business interests amounted to \$8.3 million and \$6.9 million at September 30, 2016 and September 30, 2015, respectively. Repayments on these loans during the nine months ended September 30, 2016 were \$716 thousand and loans made totaled \$139 thousand. Repayments on these loans during the nine months ended September 30, 2015 were \$1.3 million and loans made totaled \$4.1 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 September 30, 2016 and the three months ended September 30, 2015 is as follows:

(Dollars in thousands)

|                                   | Real estate |              | Real estate |            | Consumer    |       |             |         |
|-----------------------------------|-------------|--------------|-------------|------------|-------------|-------|-------------|---------|
|                                   | Commercial  | Construction | Residential | Commercial | Home equity | Other | Unallocated | Total   |
| 2016                              |             |              |             |            |             |       |             |         |
| Allowance for loan losses:        |             |              |             |            |             |       |             |         |
| Beginning balance June 30, 2016   | \$ 71       | \$ 59        | \$ 207      | \$ 2,349   | \$ 93       | \$ 23 | \$ 2,075    | \$4,877 |
| Charge-offs                       | —           | —            | (1 )        | (36 )      | —           | (19 ) | —           | (56 )   |
| Recoveries                        | 1           | —            | 34          | 8          | —           | 4     | —           | 47      |
| Provisions                        | 58          | 35           | 272         | 415        | 30          | 15    | (646 )      | 179     |
| Ending balance September 30, 2016 | \$ 130      | \$ 94        | \$ 512      | \$ 2,736   | \$ 123      | \$ 23 | \$ 1,429    | \$5,047 |

(Dollars in thousands)

|                                   | Real estate |              | Real estate |            | Consumer    |       |             |         |
|-----------------------------------|-------------|--------------|-------------|------------|-------------|-------|-------------|---------|
|                                   | Commercial  | Construction | Residential | Commercial | Home equity | Other | Unallocated | Total   |
| 2015                              |             |              |             |            |             |       |             |         |
| Allowance for loan losses:        |             |              |             |            |             |       |             |         |
| Beginning balance June 30, 2015   | \$ 221      | \$ 124       | \$ 179      | \$ 1,774   | \$ 119      | \$ 60 | \$ 1,804    | \$4,281 |
| Charge-offs                       | —           | —            | (13 )       | —          | —           | (17 ) | —           | (30 )   |
| Recoveries                        | 2           | —            | 4           | 11         | 1           | 6     | —           | 24      |
| Provisions                        | (53 )       | 51           | 29          | 39         | —           | 6     | 121         | 193     |
| Ending balance September 30, 2015 | \$ 170      | \$ 175       | \$ 199      | \$ 1,824   | \$ 120      | \$ 55 | \$ 1,925    | \$4,468 |

The following table presents at September 30, 2016 and December 31, 2015 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”).

Edgar Filing: FIRST COMMUNITY CORP /SC/ - Form 10-Q

| (Dollars in thousands)  | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
| Total loans considered impaired   | \$ 5,720              | \$ 6,477             |
| Loans considered impaired for which there is a related allowance for loan loss: |                       |                      |
| Outstanding loan balance  | 47                    | 49                   |
| Related allowance   | 2                     | 3                    |
| Loans considered impaired and previously written down to fair value             | 5,673                 | 6,428                |
| Average impaired loans  | 9,207                 | 9,518                |

18

**Note 4—Loans-continued**

The following tables are by loan category and present at September 30, 2016, December 31, 2015 and September 30, 2015 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)      |                     |                          |                   |  |                            |   |                            |
|-----------------------------|---------------------|--------------------------|-------------------|--|----------------------------|---|----------------------------|
| September 30, 2016          | Recorded Investment | Unpaid Principal Balance | Related Allowance | Nine months ended<br>Average Recorded Investment | Interest Income Recognized | Three months ended<br>Average Recorded Investment | Interest Income Recognized |
| With no allowance recorded: |                     |                          |                   |  |                            |   |                            |
| Commercial                  | \$ —                | \$ —                     | \$ —              | \$ —   | \$ —                       | \$ —  | \$ —                       |
| Real estate:                |                     |                          |                   |  |                            |   |                            |
| Construction                | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Mortgage-residential        | 374                 | 374                      | —                 | 419  | —                          | 411   | —                          |
| Mortgage-commercial         | 5,243               | 7,821                    | —                 | 8,683  | 88                         | 8,609   | 31                         |
| Consumer:                   |                     |                          |                   |  |                            |   |                            |
| Home Equity                 | 56                  | 56                       | —                 | 57   | —                          | 57  | —                          |
| Other                       | —                   | —                        | —                 | —  | —                          | —   | —                          |
| With an allowance recorded: |                     |                          |                   |  |                            |   |                            |
| Commercial                  | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Real estate:                |                     |                          |                   |  |                            |   |                            |
| Construction                | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Mortgage-residential        | 47                  | 47                       | 2                 | 48   | 2                          | 47  | 1                          |
| Mortgage-commercial         | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Consumer:                   |                     |                          |                   |  |                            |   |                            |
| Home Equity                 | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Other                       | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Total:                      |                     |                          |                   |  |                            |   |                            |
| Commercial                  | \$ —                | \$ —                     | \$ —              | \$ —   | \$ —                       | \$ —  | \$ —                       |
| Real estate:                |                     |                          |                   |  |                            |   |                            |
| Construction                | —                   | —                        | —                 | —  | —                          | —   | —                          |
| Mortgage-residential        | 421                 | 421                      | 2                 | 467  | 2                          | 458   | 1                          |
| Mortgage-commercial         | 5,243               | 7,821                    | —                 | 8,683  | 88                         | 8,609   | 31                         |
| Consumer:                   |                     |                          |                   |  |                            |   |                            |
| Home Equity                 | 56                  | 56                       | —                 | 57   | —                          | 57  | —                          |
| Other                       | —                   | —                        | —                 | —  | —                          | —   | —                          |
|                             | \$ 5,720            | \$ 8,298                 | \$ 2              | \$ 9,207   | \$ 90                      | \$ 9,124  | \$ 32                      |

**Note 4—Loans-continued**

(Dollars in thousands)

| September 30, 2015          | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Nine months ended<br>Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Three months ended<br>Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-----------------------------|------------------------|--------------------------------|----------------------|--|----------------------------------|---|----------------------------------|
| With no allowance recorded: |                        |                                |                      |  |                                  |   |                                  |
| Commercial                  | \$ 11                  | \$ 11                          | \$ —                 | \$ 14  | \$ —                             | \$ 13   | \$ —                             |
| Real estate:                |                        |                                |                      |  |                                  |   |                                  |
| Construction                | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Mortgage-residential        | 873                    | 952                            | —                    | 1,140  | 71                               | 1,133   | 1                                |
| Mortgage-commercial         | 5,753                  | 8,149                          | —                    | 8,388  | —                                | 8,293   | —                                |
| Consumer:                   |                        |                                |                      |  |                                  |   |                                  |
| Home Equity                 | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Other                       | —                      | —                              | —                    | —  | —                                | —   | —                                |
| With an allowance recorded: |                        |                                |                      |  |                                  |   |                                  |
| Commercial                  | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Real estate:                |                        |                                |                      |  |                                  |   |                                  |
| Construction                | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Mortgage-residential        | 50                     | 50                             | 3                    | 51   | 2                                | 50  | —                                |
| Mortgage-commercial         | 33                     | 33                             | 1                    | 34   | 2                                | 34  | —                                |
| Consumer:                   |                        |                                |                      |  |                                  |   |                                  |
| Home Equity                 | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Other                       | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Total:                      |                        |                                |                      |  |                                  |   |                                  |
| Commercial                  | \$ 11                  | \$ 11                          | \$ —                 | \$ 14  | \$ —                             | \$ 13   | \$ —                             |
| Real estate:                |                        |                                |                      |  |                                  |   |                                  |
| Construction                | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Mortgage-residential        | 923                    | 1,002                          | 3                    | 1,191  | 73                               | 1,183   | 1                                |
| Mortgage-commercial         | 5,786                  | 8,182                          | 1                    | 8,422  | 2                                | 8,327   | —                                |
| Consumer:                   |                        |                                |                      |  |                                  |   |                                  |
| Home Equity                 | —                      | —                              | —                    | —  | —                                | —   | —                                |
| Other                       | —                      | —                              | —                    | —  | —                                | —   | —                                |
|                             | \$ 6,720               | \$ 9,195                       | \$ 4                 | \$ 9,627   | \$ 75                            | \$ 9,523  | \$ 1                             |

**Note 4—Loans-continued**

(Dollars in thousands)

December 31, 2015

|                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-----------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no allowance recorded: |                        |                                |                      |                                   |                                  |
| Commercial                  | \$ 9                   | \$ 9                           | \$ —                 | \$ 13                             | \$ —                             |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 799                    | 874                            | —                    | 1,082                             | 1                                |
| Mortgage-commercial         | 5,620                  | 7,548                          | —                    | 8,372                             | 60                               |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
| With an allowance recorded: |                        |                                |                      |                                   |                                  |
| Commercial                  | —                      | —                              | —                    | —                                 | —                                |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 49                     | 49                             | 3                    | 51                                | 3                                |
| Mortgage-commercial         | —                      | —                              | —                    | —                                 | —                                |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
| Total:                      |                        |                                |                      |                                   |                                  |
| Commercial                  | 9                      | 9                              | —                    | 13                                | —                                |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 848                    | 923                            | 3                    | 1,133                             | 4                                |
| Mortgage-commercial         | 5,620                  | 7,548                          | —                    | 8,372                             | 60                               |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
|                             | \$ 6,477               | \$ 8,480                       | \$ 3                 | \$ 9,518                          | \$ 64                            |

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 September 30, 2016 and December 31, 2015, 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 September 30, 2016 and December 31, 2015, no loans were classified as doubtful.

**Note 4—Loans-continued**

(Dollars in thousands)

September 30, 2016

|                                      | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|--------------------------------------|-----------|--------------------|-------------|----------|-----------|
| Commercial, financial & agricultural | \$38,563  | \$ 227             | \$ —        | \$ —     | \$38,790  |
| Real estate:                         |           |                    |             |          |           |
| Construction                         | 41,077    | 151                | —           | —        | 41,228    |
| Mortgage – residential               | 47,804    | 597                | 929         | —        | 49,330    |
| Mortgage – commercial                | 343,073   | 3,966              | 7,056       | —        | 354,095   |
| Consumer:                            |           |                    |             |          |           |
| Home Equity                          | 31,374    | 169                | 200         | —        | 31,743    |
| Other                                | 8,255     | —                  | —           | —        | 8,255     |
| Total                                | \$510,146 | \$ 5,110           | \$ 8,185    | \$ —     | \$523,441 |

(Dollars in thousands)

December 31, 2015

|                                      | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|--------------------------------------|-----------|--------------------|-------------|----------|-----------|
| Commercial, financial & agricultural | \$37,501  | \$ 299             | \$ 9        | \$ —     | \$37,809  |
| Real estate:                         |           |                    |             |          |           |
| Construction                         | 35,374    | 455                | —           | —        | 35,829    |
| Mortgage – residential               | 46,580    | 1,378              | 1,119       | —        | 49,077    |
| Mortgage – commercial                | 310,367   | 7,555              | 9,056       | —        | 326,978   |
| Consumer:                            |           |                    |             |          |           |
| Home Equity                          | 30,587    | 180                | 139         | —        | 30,906    |
| Other                                | 8,587     | 1                  | 4           | —        | 8,592     |
| Total                                | \$468,996 | \$ 9,868           | \$ 10,327   | \$ —     | \$489,191 |

At September 30, 2016 and December 31, 2015, non-accrual loans totaled \$3.9 million and \$4.8 million, respectively.

TDRs that are still accruing and included in impaired loans at September 30, 2016 and December 31, 2015 amounted to \$1.8 million and \$1.6 million, respectively. TDRs in non-accrual status at September 30, 2016 and December 31, 2015 amounted to \$1.3 million and \$1.8 million, respectively.

Loans greater than 90 days delinquent and still accruing interest were \$98.7 thousand as of September 30, 2016. There were no loans greater than 90 days delinquent and still accruing interest as of December 31, 2015.

**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 Financial Corporation of Augusta, Georgia, the bank holding company for Savannah River Banking Company (“Savannah River”), on February 1, 2014, the acquired PCI loan portfolio was accounted for at fair value as follows:

|  |                     |
|--|---------------------|
| (Dollars in thousands)                                   | February 1,<br>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            |





*Note 4—Loans-continued*

A summary of changes in the accretable yield for PCI loans for the three and nine months ended September 30, 2016 and 2015 follows (in thousands):

|  | Three Months<br>Ended<br>September 30,<br>2016 |      | Nine Months<br>Ended<br>September 30,<br>2016 |       |
|--|--|------|---|-------|
| Accretable yield,<br>beginning of period   | \$   | 53   | \$  | 92    |
| Accretion  |  | (17) |   | (150) |
| Reclassification of<br>nonaccretable<br>difference due to<br>improvement in<br>expected cash flows |  | 18   |   | 112   |
| Accretable yield, end<br>of period   | \$   | 54   | \$  | 54    |
|  | Three Months<br>Ended<br>September 30,<br>2015 |      | Nine Months<br>Ended<br>September 30,<br>2015 |       |
| Accretable yield,<br>beginning of period   | \$   | 135  | \$  | 75    |
| Accretion  |  | (42) |   | (513) |
| Reclassification of<br>nonaccretable<br>difference due to<br>improvement in<br>expected cash flows |  | —    |   | 531   |
| Accretable yield, end<br>of period   | \$   | 93   | \$  | 93    |

**Note 4—Loans-continued**

The following tables are by loan category and present loans past due and on non-accrual status as of September 30, 2016 and December 31, 2015:

| (Dollars in thousands)<br>September 30, 2016 | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days and<br>Accruing | Nonaccrual | Total<br>Past<br>Due | Current    | Total<br>Loans |
|--|------------------------------|------------------------------|--|------------|----------------------|------------|----------------|
| Commercial                                   | \$—                          | \$ 20                        | \$ —                                       | \$ —       | \$ 20                | \$ 38,770  | \$ 38,790      |
| Real estate:                                 |                              |                              |  |            |                      |            |                |
| Construction                                 | 457                          | —                            | —  | —          | 457                  | 40,771     | 41,228         |
| Mortgage-residential                         | 595                          | 211                          | 99   | 374        | 1,279                | 48,051     | 49,330         |
| Mortgage-commercial                          | 457                          | 471                          | —  | 3,475      | 4,403                | 349,692    | 354,095        |
| Consumer:                                    |                              |                              |  |            |                      |            |                |
| Home equity                                  | 292                          | 144                          | —  | 56         | 492                  | 31,251     | 31,743         |
| Other  | 34                           | 5                            | —  | —          | 39                   | 8,216      | 8,255          |
| Total  | \$1,835                      | \$ 851                       | \$ 99                                      | \$ 3,905   | \$ 6,690             | \$ 516,751 | \$ 523,441     |

| (Dollars in thousands)<br>December 31, 2015 | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days and<br>Accruing | Nonaccrual | Total<br>Past<br>Due | Current    | Total<br>Loans |
|---|------------------------------|------------------------------|--|------------|----------------------|------------|----------------|
| Commercial                                  | \$ 5                         | \$ —                         | \$ —                                       | \$ 9       | \$ 14                | \$ 37,795  | \$ 37,809      |
| Real estate:                                |                              |                              |  |            |                      |            |                |
| Construction                                | —                            | —                            | —  | —          | —                    | 35,829     | 35,829         |
| Mortgage-residential                        | 126                          | 195                          | —  | 799        | 1,120                | 47,957     | 49,077         |
| Mortgage-commercial                         | 1,180                        | 290                          | —  | 4,031      | 5,501                | 321,477    | 326,978        |
| Consumer:                                   |                              |                              |  |            |                      |            |                |
| Home equity                                 | 135                          | —                            | —  | —          | 135                  | 30,771     | 30,906         |
| Other                                       | 4                            | 4                            | —  | —          | 8                    | 8,584      | 8,592          |
| Total                                       | \$1,450                      | \$ 489                       | \$ —                                       | \$ 4,839   | \$ 6,778             | \$ 482,413 | \$ 489,191     |

**Note 4—Loans-continued**

The Company reviews TDRs in accordance with applicable regulatory and accounting guidance.

There were no loans determined to be TDRs that were restructured during the three and nine month periods ended September 30, 2015 or the three month period ended September 30, 2016.

The following table, by loan category, presents one loan determined to be a TDR during the nine month period ended September 30, 2016. The loan was modified to extend the term of the loan due to financial hardship of the borrower. The loan was subsequently paid off in June 2016.

| Troubled Debt Restructurings For the nine months ended September 30, 2016<br>(Dollars in thousands) |                           |   |  |
|---|---------------------------|---|--|
|   | Number<br>of<br>Contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| Accrual   |                           |   |  |
| Mortgage-Commercial   | 1                         | \$ 413  | \$ 413   |
| Total Accrual   | 1                         | \$ 413  | \$ 413   |
| Total TDRs  | 1                         | \$ 413  | \$ 413   |

During the three and nine month periods ended September 30, 2016 and 2015, 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***

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 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 does not expect these amendments to have a material effect on its financial statements.

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 became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance which changes the presentation of debt issuance costs. The amendments became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. 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 a practical expedient that permits the Company to measure defined benefit plan assets and obligations using the month-end that is closest to the Company's fiscal year-end. The amendments became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. 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 became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. 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 became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral, the guidance in ASU 2014-09 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 August 2015, the FASB issued amendments to the Interest topic of the Accounting Standards Codification to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. The amendments were effective upon issuance. The Company does not expect these amendments to have a material effect on its financial statements.

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

In September 2015, the FASB amended the Business Combinations topic of the Accounting Standards Codification to simplify the accounting for adjustments made to provisional amounts recognized in a business combination by eliminating the requirement to retrospectively account for those adjustments. The amendments became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. All entities are required to apply the amendments prospectively to adjustments to provisional amounts that occur after the effective date. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2015, the FASB amended the Income Taxes topic of the Accounting Standards Codification to simplify the presentation of deferred income taxes by requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments will be effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company will apply the guidance prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In March 2016, the FASB amended the Liabilities topic of the Accounting Standards Codification to address the current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability. The amendments will be effective for financial statements issued for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance using a modified retrospective transition method by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective to each period presented. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended the Derivatives and Hedging topic of the Accounting Standards Codification to clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria continue to be met. The amendments will be effective for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company will apply the guidance prospectively to each period presented. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended the Investments—Equity Method and Joint Ventures topic of the Accounting Standards Codification to eliminate the requirement to retroactively adopt the equity method of accounting. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company will apply the guidance prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. The Company does not expect these amendments to have a material effect on its financial statements.



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

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them to apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Company for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify guidance related to identifying performance obligations and accounting for licenses of intellectual property. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify guidance related to collectability, noncash consideration, presentation of sales tax, and transition. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In August 2016, the FASB amended the Statement of Cash Flows topic of the Accounting Standards Codification to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments will be effective for the Company for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. 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.

29

***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:

Quoted prices in active markets for identical assets or liabilities.

**Level 1**

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

**Level 2** data for substantially the full term of the assets or liabilities.

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.

**Level 3**

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.

**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.

**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 September 30, 2016 and December 31, 2015 are as follows:

| (Dollars in thousands)          | September 30, 2016 |           |          |           |         |
|---------------------------------|--------------------|-----------|----------|-----------|---------|
|                                 | <b>Fair Value</b>  |           |          |           |         |
|                                 | Carrying Amount    | Total     | Level 1  | Level 2   | Level 3 |
| <b>Financial Assets:</b>        |                    |           |          |           |         |
| Cash and short term investments | \$38,695           | \$38,695  | \$38,695 | \$—       | \$—     |
| Held-to-maturity securities     | 17,238             | 17,865    | —        | 17,865    | —       |
| Available-for-sale securities   | 269,255            | 269,255   | 818      | 267,487   | 950     |
| Other investments, at cost      | 1,681              | 1,681     | —        | —         | 1,681   |
| Loans held for sale             | 4,250              | 4,250     | —        | 4,250     | —       |
| Net loans receivable            | 518,394            | 517,927   | —        | 512,209   | 5,718   |
| Accrued interest                | 2,784              | 2,784     | 2,784    | —         | —       |
| <b>Financial liabilities:</b>   |                    |           |          |           |         |
| Non-interest bearing demand     | \$177,267          | \$177,267 | \$—      | \$177,267 | \$—     |
| NOW and money market accounts   | 325,800            | 325,800   | —        | 325,800   | —       |
| Savings                         | 76,516             | 76,516    | —        | 76,516    | —       |
| Time deposits                   | 186,340            | 186,541   | —        | 186,541   | —       |
| Total deposits                  | 765,923            | 766,124   | —        | 766,124   | —       |
| Federal Home Loan Bank Advances | 21,022             | 21,823    | —        | 21,823    | —       |
| Short term borrowings           | 22,232             | 22,232    | —        | 22,232    | —       |
| Junior subordinated debentures  | 14,964             | 14,982    | —        | 14,982    | —       |
| Accrued interest payable        | 588                | 588       | 588      | —         | —       |

| (Dollars in thousands)               | December 31, 2015 |           |          |           |         |
|--------------------------------------|-------------------|-----------|----------|-----------|---------|
|                                      | <b>Fair Value</b> |           |          |           |         |
|                                      | Carrying Amount   | Total     | Level 1  | Level 2   | Level 3 |
| <b>Financial Assets:</b>             |                   |           |          |           |         |
| Cash and short term investments      | \$22,941          | \$22,941  | \$22,941 | \$—       | \$—     |
| Held-to-maturity securities          | 17,371            | 17,555    | —        | 17,555    | —       |
| Available-for-sale securities        | 264,687           | 264,687   | 812      | 263,458   | 417     |
| Other investments, at cost           | 1,783             | 1,783     | —        | —         | 1,783   |
| Loans held for sale                  | 2,962             | 2,962     | —        | 2,962     | —       |
| Net loans receivable                 | 484,595           | 484,669   | —        | 478,195   | 6,474   |
| Accrued interest                     | 2,877             | 2,877     | 2,877    | —         | —       |
| <b>Financial liabilities:</b>        |                   |           |          |           |         |
| Non-interest bearing demand deposits | \$156,247         | \$156,247 | \$—      | \$156,247 | \$—     |
| NOW and money market accounts        | 318,308           | 318,308   | —        | 318,308   | —       |
| Savings                              | 60,699            | 60,699    | —        | 60,699    | —       |
| Time deposits                        | 180,897           | 181,325   | —        | 181,325   | —       |

Edgar Filing: FIRST COMMUNITY CORP /SC/ - Form 10-Q

|                                 |         |         |     |         |   |
|---------------------------------|---------|---------|-----|---------|---|
| Total deposits                  | 716,151 | 716,579 | —   | 716,579 | — |
| Federal Home Loan Bank Advances | 24,788  | 25,841  | —   | 25,841  | — |
| Short term borrowings           | 21,033  | 21,033  | —   | 21,033  | — |
| Junior subordinated debentures  | 14,964  | 14,954  | —   | 14,954  | — |
| Accrued interest payable        | 652     | 652     | 652 | —       | — |

32

**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 September 30, 2016 and December 31, 2015 that are measured on a recurring basis. There were no liabilities carried at fair value as of September 30, 2016 or December 31, 2015 that are measured on a recurring basis.

**(Dollars in thousands)**

| Description                              | September 30,<br>2016 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|-----------------------|--|---|--|
| Available for sale securities            |                       |  |   |  |
| US Treasury                              | \$ 1,563              | \$ —   | \$ 1,563  | \$ —   |
| Government sponsored enterprises         | 1,026                 | —  | 1,026   | —  |
| Mortgage-backed securities               | 154,238               | —  | 154,238   | —  |
| Small Business Administration securities | 53,252                | —  | 53,252  | —  |
| State and local government               | 57,348                | —  | 57,348  | —  |
| Corporate and other securities           | 1,828                 | 818  | 60  | 950  |
| Total                                    | \$ 269,255            | \$ 818   | \$ 267,487  | \$ 950   |

**(Dollars in thousands)**

| Description                              | December 31,<br>2015 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|----------------------|--|---|--|
| Available for sale securities            |                      |  |   |  |
| US Treasury Securities                   | \$ 1,522             | \$ —   | \$ 1,522  | \$ —   |
| Government sponsored enterprises         | 992                  | —  | 992   | —  |
| Mortgage-backed securities               | 146,261              | —  | 146,261   | —  |
| Small Business Administration securities | 57,328               | —  | 57,328  | —  |
| State and local government               | 57,295               | —  | 57,295  | —  |
| Corporate and other securities           | 1,289                | 812  | 60  | 417  |
| Total                                    | \$ 264,687           | \$ 812   | \$ 263,458  | \$ 417   |



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

The following table reconciles the changes in Level 3 financial instruments for the nine months ended September 30, 2016 and 2015 that are measured on a recurring basis.

| (Dollars in thousands)   | September 30,             |                           |
|--|---------------------------|---------------------------|
|  | 2016                      | 2015                      |
|  | Corporate Preferred Stock | 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                            | 950                       | —                         |
| Maturities, sales, payoffs                                       | (417)                     | —                         |
| Transfers in and/or out of Level 3                               | —                         | —                         |
| Ending Balance   | \$950                     | \$ 417                    |

The following table reconciles the changes in Level 3 financial instruments for the three months ended September 30, 2016 and September 30, 2015 that are measured on a recurring basis.

| (Dollars in thousands)   | September 30,             |                           |
|--|---------------------------|---------------------------|
|  | 2016                      | 2015                      |
|  | Corporate Preferred Stock | Corporate Preferred Stock |
| Beginning Balance  | \$950                     | \$ 417                    |
| Total gains or losses (realized/unrealized) Included in earnings | —                         | —                         |
| Included in other comprehensive income                           | —                         | —                         |
| Purchases, issuances, and settlements                            | —                         | —                         |
| Maturities, sales, payoffs                                       | —                         | —                         |
| Transfers in and/or out of Level 3                               | —                         | —                         |
| Ending Balance   | \$950                     | \$ 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 September 30, 2016 and December 31, 2015 that are measured on a non-recurring basis.

(Dollars in thousands)

| Description                   | September 30,<br>2016 | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|-----------------------|--|---|--|
| Impaired loans:               |                       |  |   |  |
| Commercial & Industrial       | \$ —                  | \$ —   | \$ —  | \$ —   |
| Real estate:                  |                       |  |   |  |
| Mortgage-residential          | 419                   | —  | —   | 419  |
| Mortgage-commercial           | 5,243                 | —  | —   | 5,243  |
| Consumer:                     |                       |  |   |  |
| Home equity                   | 56                    | —  | —   | 56   |
| Other                         | —                     | —  | —   | —  |
| Total impaired                | 5,718                 | —  | —   | 5,718  |
| Other real estate owned:      |                       |  |   |  |
| Construction                  | —                     | —  | —   | —  |
| Mortgage-residential          | 337                   | —  | —   | 337  |
| Mortgage-commercial           | 861                   | —  | —   | 861  |
| Total other real estate owned | 1,198                 | —  | —   | 1,198  |
| Total                         | \$ 6,916              | \$ —   | \$ —  | \$ 6,916   |

35

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

(Dollars in thousands)

| Description                   | December 31,<br>2015 | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|----------------------|---|---|--|
| Impaired loans:               |                      |   |   |  |
| Commercial                    | \$ 9                 | \$ —  | \$ —  | \$ 9   |
| Real estate:                  |                      |   |   |  |
| Mortgage-residential          | 845                  | —   | —   | 845  |
| Mortgage-commercial           | 5,620                | —   | —   | 5,620  |
| Consumer:                     |                      |   |   |  |
| Home equity                   | —                    | —   | —   | —  |
| Other                         | —                    | —   | —   | —  |
| Total impaired                | 6,474                | —   | —   | 6,474  |
| Other real estate owned:      |                      |   |   |  |
| Construction                  | 276                  | —   | —   | 276  |
| Mortgage-residential          | 191                  | —   | —   | 191  |
| Mortgage-commercial           | 1,991                | —   | —   | 1,991  |
| Total other real estate owned | 2,458                | —   | —   | 2,458  |
| Total                         | \$ 8,932             | \$ —  | \$ —  | \$ 8,932   |

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. The independent and internal evaluations are generally 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 \$5.7 million and \$6.5 million as of September 30, 2016 and December 31, 2015, 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 September 30, 2016 and December 31, 2015, the significant unobservable inputs used in the fair value measurements were as follows:

| (Dollars in thousands) | Fair Value as of September 30, 2016 | Valuation Technique                                  | Significant Observable Inputs                    | Significant Unobservable Inputs  |
|------------------------|-------------------------------------|--|--|--|
| Preferred stock        | \$ 950                              | Estimation based on comparable non-listed securities | Comparable transactions                          | n/a  |
| OREO                   | \$ 1,198                            | 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         | \$ 5,718                            | 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, 2015  | Valuation Technique                                  | Significant Observable Inputs                    | Significant Unobservable Inputs  |
| Preferred stock        | \$ 417                              | Estimation based on comparable non-listed securities | Comparable transactions                          | n/a  |
| OREO                   | \$ 2,458                            | 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         | \$ 6,474                            | Appraisal Value                                      | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |

**Note 7 — Deposits**

The Company's total deposits are comprised of the following at the dates indicated:

| (Dollars in thousands)               | September 30, 2016 | December 31, 2015 |
|--------------------------------------|--------------------|-------------------|
| Non-interest bearing demand deposits | \$ 177,267         | \$ 156,247        |
| NOW and money market accounts        | 325,800            | 318,308           |
| Savings                              | 76,516             | 60,699            |

|                |            |            |
|----------------|------------|------------|
| Time deposits  | 186,340    | 180,897    |
| Total deposits | \$ 765,923 | \$ 716,151 |

As of September 30, 2016 and December 31, 2015, the Company had time deposits greater than \$250,000 of \$37.4 million and \$21.2 million, respectively.

37

**Note 8 – Reportable Segments**

The Company's reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning by management. The Company has four reportable segments:

**Commercial and retail banking:** The Company's primary business is to provide deposit and lending products and services to its commercial and retail customers.

**Mortgage banking:** This segment provides mortgage origination services for loans that will be sold to investors in the secondary market.

**Investment advisory and non-deposit:** This segment provides investment advisory services and non-deposit products.

**Corporate:** This segment includes the parent company financial information, including interest on parent company debt and dividend income received from First Community Bank (the "Bank").

The following tables present selected financial information for the Company's reportable business segments for the three and nine months ended September 30, 2016 and 2015:

| Nine months ended September 30,<br>2016 | Commercial |          | Investment  |           |              |              |
|---|------------|----------|-------------|-----------|--------------|--------------|
| (Dollars in thousands)                  | and Retail | Mortgage | advisory    |           |              |              |
|   | Banking    | Banking  | non-deposit | Corporate | Eliminations | Consolidated |
| Dividend and Interest Income            | \$ 21,732  | \$ 142   | \$ —        | \$ 2,072  | \$ (1,950 )  | \$ 21,996    |
| Interest expense                        | 1,968      | —        | —           | 363       | —            | 2,331        |
| Net interest income                     | \$ 19,764  | \$ 142   | \$ —        | \$ 1,709  | \$ —         | \$ 19,665    |
| Provision for loan losses               | 536        | —        | —           | —         | —            | 536          |
| Noninterest income                      | 3,353      | 2,516    | 871         | —         | —            | 6,740        |
| Noninterest expense                     | 16,227     | 1,828    | 766         | 437       | —            | 19,258       |
| Net income before taxes                 | \$ 6,354   | \$ 830   | \$ 105      | \$ 1,272  | \$ —         | \$ 6,611     |
| Income tax (provision) benefit          | (1,910 )   | —        | —           | 189       | —            | (1,721 )     |
| Net income                              | \$ 4,444   | \$ 830   | \$ 105      | \$ 1,461  | \$ —         | \$ 4,890     |

| Three months ended September 30,<br>2016 | Commercial |          | Investment  |           |              |              |
|--|------------|----------|-------------|-----------|--------------|--------------|
| (Dollars in thousands)                   | and Retail | Mortgage | advisory    |           |              |              |
|  | Banking    | Banking  | non-deposit | Corporate | Eliminations | Consolidated |
| Dividend and Interest Income             | \$ 7,336   | \$ 60    | \$ —        | \$ 658    | \$ (654 )    | \$ 7,400     |
| Interest expense                         | 625        | —        | —           | 124       | —            | 749          |
| Net interest income                      | \$ 6,711   | \$ 60    | \$ —        | \$ 534    | \$ —         | \$ 6,651     |
| Provision for loan losses                | 179        | —        | —           | —         | —            | 179          |
| Noninterest income                       | 1,166      | 937      | 284         | —         | —            | 2,387        |
| Noninterest expense                      | 5,506      | 672      | 249         | 156       | —            | 6,583        |

Edgar Filing: FIRST COMMUNITY CORP /SC/ - Form 10-Q

|                                |          |        |       |        |      |          |
|--------------------------------|----------|--------|-------|--------|------|----------|
| Net income before taxes        | \$ 2,192 | \$ 325 | \$ 35 | \$ 378 | \$ — | \$ 2,276 |
| Income tax (provision) benefit | (677 )   | —      | —     | 78     | —    | (599 )   |
| Net income                     | \$ 1,515 | \$ 325 | \$ 35 | \$ 456 | \$ — | \$ 1,677 |
| 38                             |          |        |       |        |      |          |

**Note 8 – Reportable Segments – continued**

Nine months ended September 30, 2015

|                                | Commercial |          | Investment   |           |              |              |
|--------------------------------|------------|----------|--------------|-----------|--------------|--------------|
| (Dollars in thousands)         | and Retail | Mortgage | advisory and |           |              |              |
|                                | Banking    | Banking  | non-deposit  | Corporate | Eliminations | Consolidated |
| Dividend and Interest Income   | \$ 21,244  | \$ 158   | \$ —         | \$ 1,677  | \$ (1,633 )  | \$ 21,446    |
| Interest expense               | 2,208      | —        | —            | 333       |              | 2,541        |
| Net interest income            | \$ 19,036  | \$ 158   | \$ —         | \$ 1,344  | \$ —         | \$ 18,905    |
| Provision for loan losses      | 990        | —        | —            | —         | —            | 990          |
| Noninterest income             | 3,203      | 2,679    | 993          | —         | —            | 6,875        |
| Noninterest expense            | 15,197     | 2,003    | 730          | 626       | —            | 18,556       |
| Net income before taxes        | \$ 6,052   | \$ 834   | \$ 263       | \$ 718    | \$ —         | \$ 6,234     |
| Income tax (provision) benefit | (1,975 )   | —        | —            | 267       | —            | (1,708 )     |
| Net income                     | \$ 4,077   | \$ 834   | \$ 263       | \$ 985    | \$ —         | \$ 4,526     |

Three months ended September 30, 2015

|                                | Commercial |          | Investment   |           |              |              |
|--------------------------------|------------|----------|--------------|-----------|--------------|--------------|
| (Dollars in thousands)         | and Retail | Mortgage | advisory and |           |              |              |
|                                | Banking    | Banking  | non-deposit  | Corporate | Eliminations | Consolidated |
| Dividend and Interest Income   | \$ 7,046   | \$ 50    | \$ —         | \$ 550    | \$ (532 )    | \$ 7,114     |
| Interest expense               | 748        | —        | —            | 113       |              | 861          |
| Net interest income            | \$ 6,298   | \$ 50    | \$ —         | \$ 437    | \$ —         | \$ 6,253     |
| Provision for loan losses      | 193        | —        | —            | —         | —            | 193          |
| Noninterest income             | 1,076      | 963      | 290          | —         | —            | 2,329        |
| Noninterest expense            | 4,973      | 686      | 225          | 183       | —            | 6,067        |
| Net income before taxes        | \$ 2,208   | \$ 327   | \$ 65        | \$ 254    | \$ —         | \$ 2,322     |
| Income tax (provision) benefit | (727 )     | —        | —            | 84        | —            | (643 )       |
| Net income                     | \$ 1,481   | \$ 327   | \$ 65        | \$ 338    | \$ —         | \$ 1,679     |

|                                       | Commercial |          | Investment   |           |              |              |
|---------------------------------------|------------|----------|--------------|-----------|--------------|--------------|
| (Dollars in thousands)                | and Retail | Mortgage | advisory and |           |              |              |
|                                       | Banking    | Banking  | non-deposit  | Corporate | Eliminations | Consolidated |
| Total Assets as of September 30, 2016 | \$ 907,006 | \$ 6,167 | \$ 35        | \$ 96,765 | \$ (94,721 ) | \$ 915,252   |
| Total Assets as of December 31, 2015  | \$ 855,888 | \$ 4,355 | \$ 34        | \$ 93,296 | \$ (90,839 ) | \$ 862,734   |

**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," "project," "potential," "continue," "assume," "believe," "intend," "plan," "forecast," "goal," and "estimate," as well as similar expressions are intended 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, 2015 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;
- examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;
- reduced earnings due to higher other-than-temporary impairment charges resulting from additional decline in the value of our securities portfolio, specifically as a result of increasing default rates, and loss severities on the underlying real estate collateral;
- increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- general economic conditions resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in access to funding or increased regulatory requirements with regard to funding;
  - increased cybersecurity risk, including potential business disruptions or financial losses;
- changes in deposit flows;
- changes in technology;
- our current and future products, services, applications and functionality and plans to promote them;
- changes in monetary and tax policies;
- changes in accounting standards, policies, estimates, and practices;

- our assumptions and estimates used in applying critical accounting policies, which may prove unreliable, inaccurate or not predictive of actual results;
- the rate of delinquencies and amounts of loans charged-off;
- the rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;
- our ability to maintain appropriate levels of capital, including levels of capital required under the capital rules implementing Basel III;
- our ability to attract and retain key personnel;
- our ability to retain our existing clients, including our deposit relationships;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- loss of consumer confidence and economic disruptions resulting from terrorist activities;
- disruptions due to flooding, severe weather or other natural disasters; 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 2015 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 nine months and three months ended September 30, 2016 as compared to the nine month and three month periods ended September 30, 2015 and also analyzes our financial condition as of September 30, 2016 as compared to December 31, 2015. 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.

### **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 September 30, 2016 and our notes included in the consolidated financial statements in our 2015 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 four reporting units (See Note 8 to the Consolidated Financial Statements).

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 September 30, 2016 and December 31, 2015, 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 Nine Months Ended September 30, 2016 to the Nine Months Ended September 30, 2015**

#### Net Income

Our net income for the nine months ended September 30, 2016 was \$4.9 million or \$0.72 diluted earnings per common share, as compared to \$4.5 million or \$0.68 diluted earnings per common share for the nine months ended September 30, 2015. Net interest income increased \$760 thousand for the nine months ended September 30, 2016 as compared to the same period in 2015. This increase resulted from an increase in average earning assets, which increased by \$51.1 million in the nine months ended September 30, 2016 as compared to the same period in 2015. Average earning assets were \$759.3 million during the nine months ended September 30, 2015 as compared to \$810.4

million during the nine months ended September 30, 2016. The net interest margin decreased to 3.24% during the first nine months of 2016 as compared to 3.33% during the first nine months of 2015. Non-interest income decreased by \$135 thousand in the first nine months of 2016 compared to the first nine months of 2015. This was primarily attributable to a decrease in mortgage banking income and investment advisory fees and non-deposit commissions of \$164 thousand and \$122 thousand, respectively, in the nine months ended September 30, 2016 as compared to the same period in 2015. Non-interest expense in the nine months ended September 30, 2016 increased \$702 thousand as compared to the same period in 2015, primarily as a result of an increase in salary and benefit expense of \$654 thousand from \$10.8 million in the first nine months of 2015 to \$11.5 million in the first nine months of 2016.

#### 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 nine-month periods ended September 30, 2016 and 2015, along with average balances and the related interest income and interest expense amounts.



Net interest income was \$19.7 million for the nine months ended September 30, 2016 as compared to \$18.9 million for the nine months ended September 30, 2015. The \$760 thousand increase in net interest income was attributable to an increase in average earning assets of \$51.7 million partially offset by a decrease of 9 basis points in the net interest margin between the two periods. Our net interest margin decreased 9 basis points from 3.33% for the nine months ended September 30, 2015 to 3.24% for the same period in 2016. The net interest margin was positively impacted during the first nine months of 2016 as a result of two pay-offs on purchased credit impaired loans. These two payoffs accounted for approximately 5 basis points in our net-interest margin for the nine months ended September 30, 2015. During the first nine months of 2016, the net interest margin was positively impacted by an investment that had been purchased at a discount and was called at par during the second quarter of 2016. The \$82 thousand remaining discount recognized in interest income accounted for approximately 2 basis points of the net interest margin for the nine months ended September 30, 2016. The yield on earning assets decreased by 15 basis points in the first nine months of 2016 as compared to the same period in 2015. Average loans comprised 62.6% of average earning assets in the first nine months of 2016 as compared to 61.7% in the same period of 2015. The yield on our loan portfolio decreased 33 basis points in the nine month-period ended September 30, 2016 to 4.63% as compared to 4.96% during the same period in 2015. As previously noted, the yield on loans was positively impacted by recognizing the discount on two purchased impaired loans that paid off in the nine months ended September 30, 2015. The yield on our investment portfolio increased from 1.94% for the nine months ended September 30, 2015 to 2.04% for the same period in 2016. The previously mentioned \$82 thousand discount recognized on a called bond accounted for approximately 4 basis points of the investment yield increase between the two periods. The cost of interest-bearing liabilities during the first nine months of 2016 was 0.50% as compared to 0.56% in the same period of 2015, reflecting a 6 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 61.5% of our average interest bearing liabilities during the first nine months of 2016 as compared to 58.1% in the same period of 2015.

#### Provision and Allowance for Loan Losses

At September 30, 2016 and December 31, 2015, the allowance for loan losses was \$5.0 million and \$4.6 million, respectively. This represented 0.96% of total loans and 0.94% of total loans at September 30, 2016 and December 31, 2015, respectively. No allowance for loan losses related to the Savannah River acquired loans was recorded on the acquisition date, February 1, 2014, 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 September 30, 2016 and December 31, 2015, 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 1.03% and 1.15%, respectively. Our provision for loan losses was \$536 thousand for the nine months ended September 30, 2016 as compared to \$990 thousand for the nine months ended September 30, 2015. 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 5.70%, 3.11% and 0.04%, 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. Impaired values of the underlying real estate collateral as well as a slowdown in both residential and commercial real estate sales could impact our ability to sell collateral upon foreclosure. 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 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 \$5.2 million (0.57% of total assets) at September 30, 2016 as compared to \$5.9 million (0.66% of total assets), \$7.5 million (0.86% of total assets) and \$7.3 million (0.85% of total assets) at June 30, 2016, March 31, 2016 and December 31, 2015, respectively. While we believe our amount of non-performing assets compares favorably 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 40 loans, totaling \$4.0 million, included in non-performing status (non-accrual loans and loans past due 90 days and still accruing) at September 30, 2016. The largest non-performing loan is a \$964 thousand first mortgage on developed lots to be sold for residential use. The average balance of the remaining 38 loans is approximately \$105.0 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 September 30, 2016, we had one loan delinquent more than 90 days in the amount of \$99 thousand and still accruing interest. At September 30, 2016, we had loans totaling \$2.7 million that were delinquent 30 days to 89 days which represented 0.52% 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.

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

Allowance for Loan Losses

| (Dollars in thousands)                                    | Nine months Ended<br>September 30, |   |           |   |
|---|------------------------------------|---|-----------|---|
|   | 2016                               |   | 2015      |   |
| Average loans outstanding (including loans held for sale) | \$507,326                          |   | \$468,704 |   |
| Loans outstanding at period end                           | \$523,441                          |   | \$483,931 |   |
| Non-performing assets:                                    |                                    |   |           |   |
| Nonaccrual loans  | \$3,905                            |   | \$5,067   |   |
| Loans 90 days past due still accruing                     | 99                                 |   | 2         |   |
| Foreclosed real estate                                    | 1,198                              |   | 2,450     |   |
| Total non-performing assets                               | \$5,202                            |   | \$7,519   |   |
| Beginning balance of allowance                            | \$4,596                            |   | \$4,132   |   |
| Loans charged-off:  |                                    |   |           |   |
| 1-4 family residential mortgage                           | 2                                  |   | 39        |   |
| Non-residential real estate                               | 94                                 |   | 625       |   |
| Home equity   | 8                                  |   | —         |   |
| Commercial  | —                                  |   | 56        |   |
| Installment & credit card                                 | 52                                 |   | 44        |   |
| Total loans charged-off                                   | 156                                |   | 764       |   |
| Recoveries:   |                                    |   |           |   |
| 1-4 family residential mortgage                           | 39                                 |   | 6         |   |
| Non-residential real estate                               | 16                                 |   | 16        |   |
| Home equity   | 2                                  |   | 3         |   |
| Commercial  | 4                                  |   | 5         |   |
| Installment & credit card                                 | 10                                 |   | 80        |   |
| Total recoveries  | 71                                 |   | 110       |   |
| Net loan charge offs                                      | 85                                 |   | 654       |   |
| Provision for loan losses                                 | 536                                |   | 990       |   |
| Balance at period end                                     | \$5,047                            |   | \$4,468   |   |
| Net charge -offs to average loans                         | 0.02                               | % | 0.14      | % |
| Allowance as percent of total loans                       | 0.96                               | % | 0.92      | % |
| Non-performing assets as % of total assets                | 0.57                               | % | 0.88      | % |
| Allowance as % of non-performing assets                   | 97.02                              | % | 59.42     | % |

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)                 | September 30, 2016 |                        | December 31, 2015 |                        |   |
|--|--------------------|------------------------|-------------------|------------------------|---|
|  | Amount             | % of loans in Category | Amount            | % of loans in Category |   |
| Commercial, Financial and Agricultural | \$ 130             | 7.4                    | % \$ 75           | 7.7                    | % |
| Real Estate – Construction             | 94                 | 7.9                    | % 51              | 7.3                    | % |
| Real Estate Mortgage:                  |                    |                        |                   |                        |   |
| Commercial                             | 2,736              | 67.6                   | % 2,036           | 66.9                   | % |
| Residential                            | 512                | 9.4                    | % 223             | 10.0                   | % |
| Consumer:                              |                    |                        |                   |                        |   |
| Home Equity                            | 123                | 6.1                    | % 127             | 6.3                    | % |
| Other                                  | 23                 | 1.6                    | % 37              | 1.8                    | % |
| Unallocated                            | 1,429              | N/A                    | 2,047             | N/A                    |   |
| Total                                  | \$5,047            | 100.0                  | % \$4,596         | 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 nine months of 2016 was \$6.7 million as compared to \$6.9 million during the same period in 2015. Mortgage banking income decreased \$164 thousand during the first nine months of 2016 compared to the same period in 2015, resulting primarily from the resignation of one mortgage loan producer in the first quarter of 2016. Investment advisory fees and non-deposit commissions decreased by \$122 thousand in the first nine months of 2016 as compared to the same period in 2015. During the first nine months of 2015, we had one transaction that is non-recurring that accounted for substantially all of the difference between the two periods. Management continues to focus on increasing this recurring source of revenue by increasing total assets under management. We had assets under management of \$195.1 million and \$168.6 million at September 30, 2016 and September 30, 2015, respectively. During the first nine months of 2016, we sold investment securities for a net gain of \$601 thousand as compared to a gain on the sale of investment securities of \$271 thousand in the same period of 2015. These gains in 2016 were partially offset by prepayment penalties in the amount of \$459 thousand and \$103 thousand for the nine months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016, we paid down advances of \$11.4 million as compared to \$2.7 million in the same period of 2015. Non-interest income other increased by \$256 thousand in the first nine months of 2016 as compared to the same period in 2015. This increase resulted from increased ATM/debit card income of \$103 thousand in first nine months of 2016 as compared to the same period in 2015. In addition, income recognized on bank owned life insurance increased by \$149 thousand in the 2016 period as compared to the 2015 period. At the end of 2015 the Bank purchased additional bank

owned life insurance which accounts for the increased income.

Total non-interest expense increased by \$702 thousand, or 3.8%, during the first nine months of 2016 as compared to the same period in 2015. Salary and benefit expense increased \$654 thousand from \$10.8 million in the first nine months of 2015 to \$11.5 million in the first nine months of 2016. This increase is primarily a result of the normal salary adjustments, the additional staff including the new Greenville loan production office staff in the first quarter of 2016, as well as increased medical benefit premiums. At September 30, 2015, we had 184 full time equivalent employees as compared to 201 at September 30, 2016. Occupancy expense increased \$103 thousand in the first nine months of 2016 as compared to the first nine months of 2015. The increase in occupancy expense primarily relates to repair costs associated with the fourth quarter 2015 flooding and rain that were not previously identified and determined not to be covered by insurance in the approximate amount of \$50 thousand as well as occupancy cost of \$23 thousand associated with opening the Greenville loan production office. Marketing and public relations expense decreased from \$683 thousand in the first nine months of 2015 to \$529 thousand in the first nine months of 2016. The timing of our media campaigns impact the recognition of marketing expense and, in 2015, more of these costs were incurred in the first half of the year. It is expected that we will have higher media costs in the fourth quarter of 2016. Other real estate expense decreased \$247 thousand in the first nine months of 2016 as compared to the same period in 2015. This reflects the overall decrease in the level of our repossessed real estate assets between the two periods. Non-interest expense "Other" increased by \$380 thousand in the first nine months of 2016 as compared to the same period in 2015. This increase is primarily a result of increased ATM/debit card activity charges of \$183 thousand during the first nine months of 2016 as compared to the same period in 2015. We incurred \$64 thousand in costs associated with the mass reissue of our debit cards to implement the new EMV (chip) card in the first nine months of 2016. We have also had significantly higher levels of attempted fraud activity on our card base in the first nine months of 2016 as compared to the same period in 2015. There is a direct cost assessed by our processor for each card that is compromised or had attempted fraud activity. The higher level of fraud cases in the first nine months of 2016 accounted for approximately \$43 thousand in debit card losses. We believe the "chip" card technology will ultimately reduce the level of fraud activity and losses on debit cards. Also included in the increase of "Other" non-interest expense were costs of approximately \$23 thousand related to converting our current bill pay system to another vendor. This conversion was completed in the second quarter of 2016.

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

| (Dollars in thousands)               | Nine months ended  |       |
|--------------------------------------|--------------------|-------|
|                                      | September 30, 2016 | 2015  |
| Data processing                      | \$628              | \$445 |
| Supplies                             | 101                | 108   |
| Telephone                            | 261                | 271   |
| Correspondent services               | 187                | 157   |
| Subscriptions and publications       | 108                | 93    |
| Loss on limited partnership interest | 123                | 136   |
| Insurance                            | 207                | 204   |
| Postage                              | 137                | 140   |
| Legal and Professional fees          | 536                | 437   |
| Director fees                        | 294                | 283   |
| Loan closing costs/filing fees       | 163                | 85    |
| Shareholder expenses                 | 113                | 94    |
| Other Miscellaneous                  | 724                | 749   |

\$3,582 \$3,202

Income Tax Expense

Our effective tax rate was 26.0% and 27.5% in the first nine months of 2016 and 2015, 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 26.0% to 27.0% throughout the remainder of 2016.



**Comparison of Results of Operations for Three Months Ended September 30, 2016 to the Three Months Ended September 30, 2015:**

Net Income

Our net income for the three months ended September 30, 2016 and 2015 was substantially unchanged at \$1.7 million, or \$0.25 diluted earnings per common share, for each of these periods. Net interest income increased \$398 thousand for the three months ended September 30, 2016 as compared to the same period in 2015. This increase was offset by increased non-interest expense of \$516 thousand for the three months ended September 30, 2016 as compared to the same period of 2015.

Net Interest 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 September 30, 2016 and 2015, along with average balances and the related interest income and interest expense amounts.

Net interest income increased by \$398 thousand for the three months ended September 30, 2016 to \$6.7 million as compared to \$6.2 million in the same period in 2015. Our net interest margin in the third quarter of 2016 was 3.19% compared to 3.22% in the same period of 2015. The yield on average earning assets decreased 12 basis points to 3.55% in the third quarter of 2016 from 3.67% in the third quarter of 2015. The extended period of historically low interest rates continues to put pressure on our net interest margin. We believe we can continue to offset some of this margin pressure by continuing to remix our balance sheet asset mix out of investments into the loan portfolio. Average earning assets were \$829.8 million during the third quarter of 2016 as compared to \$769.5 million during the third quarter of 2015. Average loans were \$520.1 million (62.7% of earning assets) in the third quarter of 2016 and \$482.2 million (62.7% of earning assets) in the third quarter of 2015. The cost of interest bearing liabilities decreased to 0.47% in the third quarter of 2016 as compared to 0.57% in the third quarter of 2015. Interest-bearing transaction accounts, money market accounts and savings deposits, which are typically our lower costing funds, represent 61.9% of our average interest bearing liabilities during the third quarter of 2016 as compared to 58.6% in the same period of 2015. Due to the continued historically low interest rate environment, the cost of these funds has remained very stable over the last several years. The current low cost of these funds do not provide significant ability to offset further interest rate declines or a flattening of the yield curve.

Provision for Loan Losses

The provision for loan losses for the three months ended September 30, 2016 was \$179 thousand as compared to \$193 thousand for the three months ended September 30, 2015. 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 September 30, 2016, we had non-interest income of \$2.4 million as compared to non-interest income of \$2.3 million in the same period of 2015. Mortgage banking income decreased slightly by \$27 thousand during the third quarter of 2016, as compared to the same period in 2015. Gains on the sale of securities in the third quarter of 2016 amounted to \$478 thousand. As noted above, the sales were offset by prepayment penalties of \$459 thousand resulting from the pay down of approximately \$11.4 million in Federal Home Loan Bank Advances. There were no gains on sale of securities or prepayment penalties during the third quarter of 2015. Non-interest income other increased by \$58 thousand in the third quarter of 2016 as compared to the same period in 2015. As mentioned above, this increase resulted primarily from increased income recognized on bank owned life insurance.

Total non-interest expense increased \$516 thousand in the third quarter of 2016, compared to the same period of 2015. Salaries and benefits increased \$293 thousand in the third quarter of 2016 as compared to the same period in 2015. This increase is primarily a result of normal salary adjustments and additional staff to include the four employees that were added as a result of the expansion of the loan production office in Greenville, South Carolina. Marketing and public relations expense increased \$111 thousand in the third quarter of 2016 as compared to the same period in 2015. As noted in the nine month results, the timing of our media marketing campaign was designed to be concentrated more in the first half of the year for 2015 and later in the year during 2016. FDIC assessments decreased by \$53 thousand in the third quarter of 2016 as compared to the same period in 2015. Beginning on July 1, 2016, the FDIC adjusted the assessment formula and the new assessment should reduce our assessment by approximately 45% as compared to the last several years. Non-interest expense "Other" increased \$171 thousand in the third quarter of 2016 as compared to the same period of 2015.

## Financial Position

Assets totaled \$915.3 million at September 30, 2016 as compared to \$862.7 million at December 31, 2015, an increase of \$52.6 million. Loans increased by approximately \$34.2 million during the nine months ended September 30, 2016. Loans (excluding loans held for sale) at September 30, 2016 were \$523.4 million as compared to \$489.2 million at December 31, 2015. Total loan production was \$114.2 million during the first nine months of 2016. At September 30, 2016 and December 31, 2015, loans (excluding loans held for sale) accounted for 62.3% and 62.1% of earning assets, respectively. The loan-to-deposit ratio at September 30, 2016 was 68.9% as compared to 68.7% at December 31, 2015. Investment securities increased to \$288.2 million at September 30, 2016 from \$283.8 million at December 31, 2015. Deposits increased \$49.7 million at September 30, 2016 as compared to December 31, 2015. Pure deposits (deposits less time deposits) represented 75.7% of total deposits as of September 30, 2016 as compared to 74.7% at December 31, 2015. 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. Deposits were \$765.9 million at September 30, 2016 as compared to \$716.2 million at December 31, 2015. FHLB advances decreased \$3.8 million from December 31, 2015 to September 30, 2016. This decrease represents pay downs of \$11.4 million in term advances during the nine months ended September 30, 2016 and the addition of \$8.0 million in overnight advances as of the end of the quarter.

The following table shows the composition of the loan portfolio by category at September 30, 2016 and December 31, 2015:

| (In thousands)                       | September 30,<br>2016 |         |   | December 31,<br>2015 |         |   |
|--------------------------------------|-----------------------|---------|---|----------------------|---------|---|
|                                      | Amount                | Percent |   | Amount               | Percent |   |
| Commercial, financial & agricultural | \$38,790              | 7.4     | % | \$37,809             | 7.7     | % |
| Real estate:                         |                       |         |   |                      |         |   |
| Construction                         | 41,228                | 7.9     | % | 35,829               | 7.3     | % |
| Mortgage – residential               | 49,330                | 9.4     | % | 49,077               | 10.0    | % |
| Mortgage – commercial                | 354,095               | 67.6    | % | 326,978              | 66.9    | % |
| Consumer:                            |                       |         |   |                      |         |   |
| Home Equity                          | 31,743                | 6.1     | % | 30,906               | 6.3     | % |
| Other                                | 8,255                 | 1.6     | % | 8,592                | 1.8     | % |
| Total gross loans                    | 523,441               | 100.0   | % | 489,191              | 100.0   | % |
| Allowance for loan losses            | (5,047 )              |         |   | (4,596 )             |         |   |
| Total net loans                      | \$518,394             |         |   | \$484,595            |         |   |

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.

#### *Net Interest Income Sensitivity*

| Change in short term interest rates | Hypothetical percentage change in net interest income |               |                |                   |
|-------------------------------------|---|---------------|----------------|-------------------|
|                                     | September 30, 2016                                    | June 30, 2016 | March 31, 2016 | December 31, 2015 |
| +200bp                              | +2.12 %   | +2.13 %       | +1.68 %        | +1.61 %           |
| +100bp                              | +1.26 %   | +1.26 %       | +1.18 %        | +0.89 %           |
| Flat                                | —   | —             | —              | —                 |
| -100bp                              | -2.84 %   | -3.66 %       | -4.08 %        | -3.55 %           |
| -200bp                              | -4.57 %   | -4.60 %       | -6.27 %        | -9.19 %           |

The 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 September 30, 2016, June 30, 2016, March 31, 2016 and December 31 2015, the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be +4.06%, +5.73% ,+3.49% and -0.07%, 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 September 30, 2016. 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 September 30, 2016, the amount of certificates of deposits of \$100 thousand or more represented 12.3% of total deposits and the amount of certificates of deposits of \$250 thousand or more represented 4.9% 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 September 30, 2016, we had issued commitments to extend credit of \$81.0 million, including \$31.0 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 9.2% of total assets at both September 30, 2016 and December 31, 2015. 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 2016. 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.

Regulatory capital rules released by the federal bank regulatory agencies in July 2013 to implement capital standards, referred to as Basel III and developed by an international body known as the Basel Committee on Banking Supervision, impose higher minimum capital requirements for certain bank holding companies and for banks. The rules apply to all national and state banks and savings associations regardless of size and bank holding companies and savings and loan holding companies with \$500 million or more in total consolidated assets. However, in May 2015, amendments to the Federal Reserve Board's small bank holding company policy statement (the "SBHC Policy") became effective which increased the asset threshold to qualify to utilize the provisions of the SBHC Policy from \$500 million to \$1.0 billion. Bank holding companies which are subject to the SBHC Policy are not subject to compliance with the regulatory capital requirements until they exceed \$1.0 billion in assets. As a consequence, as of September 30, 2016, the Company was not required to comply with the requirements set forth below until such time that its consolidated total assets exceed \$1.0 billion or the Federal Reserve Board determines that the Company is no longer deemed to be a small bank holding company. However, if the Company had been subject to the requirements, it is management's belief that it would have been in compliance with such requirements. More stringent requirements are imposed on "advanced approaches" banking organizations which are organizations with \$250 billion or more in total consolidated assets, with \$10 billion or more in total foreign exposures, or that have opted in to the Basel II capital regime. The new regulatory capital rules became effective on January 1, 2015 (subject to a phase-in period for certain provisions), and all of the requirements in the rules will be fully phased in by January 1, 2019.





The final rule includes certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements apply to the Bank and, absent the Company being subject to the SBHC Policy, would apply to the Company:

- a new Common Equity Tier 1 risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from former requirements); and
- a leverage ratio of 4% (also unchanged from the former requirement).

Under the rules, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as noncumulative perpetual preferred stock. The rules permit bank holding companies with less than \$15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rules have disqualified from Tier 1 capital treatment. Cumulative perpetual preferred stock, formerly includable in Tier 1 capital, is now included only in Tier 2 capital. Accumulated other comprehensive income (“AOCI”) is presumptively included in Common Equity Tier 1 capital and often would operate to reduce this category of capital. The rules 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. We elected to opt out from the inclusion of AOCI in Common Equity Tier 1 capital.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a “capital conservation buffer” on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets. As of January 1, 2016, we are required to hold a capital conservation buffer of 0.625%, increasing by that amount each successive year until 2019.

In general, the rules have had the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, certain loans past due 90 days or more or in nonaccrual status, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

The Bank’s risk-based capital ratios of leverage ratio, Tier 1, and total capital were 9.7%, 14.4%, and 15.3%, respectively, at September 30, 2016 as compared to 9.7%, 14.7%, and 15.5%, respectively, at December 31, 2015. The Bank’s CET1 ratio at September 30, 2016 was 14.4% and 14.7% at December 31, 2015. The Company’s risk-based capital ratios of leverage ratio, Tier 1, and total capital were 10.2%, 15.1%, and 15.9%, respectively at September 30,

2016 as compared to 10.2%, 15.4% and 16.2%, respectively at December 31, 2015. The Company's CET1 ratio at September 30, 2016 and December 31, 2015 was 12.7% and 12.9%, respectively. 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**

|   | Nine months ended September<br>30, 2016 |                         |                | Nine months ended September<br>30, 2015 |                         |                |
|---|---|-------------------------|----------------|---|-------------------------|----------------|
|   | Average<br>Balance                      | Interest<br>Earned/Paid | Yield/<br>Rate | Average<br>Balance                      | Interest<br>Earned/Paid | Yield/<br>Rate |
| <b>Assets</b>   |   |                         |                |   |                         |                |
| Earning assets  |   |                         |                |   |                         |                |
| Loans   | \$507,326                               | \$ 17,582               | 4.63 %         | \$468,704                               | \$ 17,373               | 4.96 %         |
| Securities:   | 284,241                                 | 4,331                   | 2.04 %         | 274,306                                 | 3,987                   | 1.94 %         |
| Federal funds sold and securities purchased<br>under agreements to resell | 18,813                                  | 83                      | 0.59 %         | 16,242                                  | 86                      | 0.71 %         |
| Total earning assets  | 810,380                                 | 21,996                  | 3.63 %         | 759,252                                 | 21,446                  | 3.78 %         |
| Cash and due from banks   | 10,735                                  |                         |                | 10,802                                  |                         |                |
| Premises and equipment  | 30,136                                  |                         |                | 29,569                                  |                         |                |
| Other assets  | 35,854                                  |                         |                | 32,611                                  |                         |                |
| Allowance for loan losses   | (4,787 )                                |                         |                | (4,314 )                                |                         |                |
| Total assets  | \$882,318                               |                         |                | \$827,920                               |                         |                |
| <b>Liabilities</b>  |   |                         |                |   |                         |                |
| Interest-bearing liabilities  |   |                         |                |   |                         |                |
| Interest-bearing transaction accounts                                     | \$151,989                               | 132                     | 0.12 %         | \$135,877                               | 118                     | 0.12 %         |
| Money market accounts   | 165,240                                 | 323                     | 0.26 %         | 157,180                                 | 315                     | 0.27 %         |
| Savings deposits  | 67,050                                  | 59                      | 0.12 %         | 57,115                                  | 50                      | 0.12 %         |
| Time deposits   | 179,454                                 | 844                     | 0.63 %         | 188,438                                 | 821                     | 0.58 %         |
| Other borrowings  | 61,201                                  | 973                     | 2.12 %         | 63,881                                  | 1,237                   | 2.59 %         |
| Total interest-bearing liabilities  | 624,934                                 | 2,331                   | 0.50 %         | 602,491                                 | 2,541                   | 0.56 %         |
| Demand deposits   | 168,520                                 |                         |                | 143,220                                 |                         |                |
| Other liabilities   | 6,505                                   |                         |                | 5,490                                   |                         |                |
| Shareholders' equity  | 82,359                                  |                         |                | 76,719                                  |                         |                |
| Total liabilities and shareholders' equity                                | \$882,318                               |                         |                | \$827,920                               |                         |                |
| Cost of funds, including demand deposits                                  |   |                         | 0.39 %         |   |                         | 0.46 %         |
| Net interest spread   |   |                         | 3.13 %         |   |                         | 3.22 %         |
| Net interest income/margin  |   | \$ 19,665               | 3.24 %         |   | \$ 18,905               | 3.33 %         |
| Net interest income/margin FTE basis                                      | \$648                                   | \$ 20,313               | 3.35 %         | \$560                                   | \$ 19,465               | 3.43 %         |

55

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

|   | Three months ended September<br>30, 2016 |                         |                | Three months ended September<br>30, 2015 |                         |                |
|---|--|-------------------------|----------------|--|-------------------------|----------------|
|   | Average<br>Balance                       | Interest<br>Earned/Paid | Yield/<br>Rate | Average<br>Balance                       | Interest<br>Earned/Paid | Yield/<br>Rate |
| <b>Assets</b>                               |  |                         |                |  |                         |                |
| Earning assets                              |  |                         |                |  |                         |                |
| Loans                                       | \$520,130                                | \$ 5,977                | 4.57 %         | \$482,198                                | \$ 5,795                | 4.77 %         |
| Securities:                                 | 286,330                                  | 1,389                   | 1.93 %         | 269,931                                  | 1,290                   | 1.90 %         |
| Federal funds sold and securities purchased | 23,301                                   | 34                      | 0.58 %         | 17,415                                   | 29                      | 0.66 %         |
| Total earning assets                        | 829,761                                  | 7,400                   | 3.55 %         | 769,544                                  | 7,114                   | 3.67 %         |
| Cash and due from banks                     | 10,927                                   |                         |                | 9,895                                    |                         |                |
| Premises and equipment                      | 30,088                                   |                         |                | 29,879                                   |                         |                |
| Other assets                                | 35,062                                   |                         |                | 32,604                                   |                         |                |
| Allowance for loan losses                   | (4,945 )                                 |                         |                | (4,360 )                                 |                         |                |
| Total assets                                | \$900,893                                |                         |                | \$837,562                                |                         |                |
| <b>Liabilities</b>                          |  |                         |                |  |                         |                |
| Interest-bearing liabilities                |  |                         |                |  |                         |                |
| Interest-bearing transaction accounts       | \$151,778                                | \$ 43                   | 0.11 %         | \$137,055                                | \$ 40                   | 0.12 %         |
| Money market accounts                       | 165,290                                  | 105                     | 0.25 %         | 157,726                                  | 112                     | 0.28 %         |
| Savings deposits                            | 74,986                                   | 23                      | 0.12 %         | 59,355                                   | 18                      | 0.12 %         |
| Time deposits                               | 182,716                                  | 294                     | 0.64 %         | 183,943                                  | 273                     | 0.59 %         |
| Other borrowings                            | 58,254                                   | 284                     | 1.94 %         | 65,830                                   | 418                     | 2.52 %         |
| Total interest-bearing liabilities          | 633,024                                  | 749                     | 0.47 %         | 603,909                                  | 861                     | 0.57 %         |
| Demand deposits                             | 176,734                                  |                         |                | 150,412                                  |                         |                |
| Other liabilities                           | 6,686                                    |                         |                | 5,857                                    |                         |                |
| Shareholders' equity                        | 84,449                                   |                         |                | 77,384                                   |                         |                |
| Total liabilities and shareholders' equity  | \$900,893                                |                         |                | \$837,562                                |                         |                |
| Cost of funds, including demand deposits    |  |                         | 0.37 %         |  |                         | 0.45 %         |
| Net interest spread                         |  |                         | 3.08 %         |  |                         | 3.10 %         |
| Net interest income/margin                  |  | \$ 6,651                | 3.19 %         |  | \$ 6,253                | 3.22 %         |
| Net interest income/margin FTE basis        | \$216                                    | \$ 6,867                | 3.29 %         | \$195                                    | \$ 6,448                | 3.32 %         |

### **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 September 30, 2016 from that presented in our 2015 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 September 30, 2016 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.

32Section 1350 Certifications.

101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in eXtensible Business Reporting Language (XBRL); (i) Consolidated Balance Sheets at September 30, 2016 and December 31, 2015, (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2016 and 2015, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015 (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2016 and 2015, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015, 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: November 10, 2016 By: /s/ Michael C. Crapps  
Michael C. Crapps  
President and Chief Executive Officer

Date: November 10, 2016 By: /s/ Joseph G. Sawyer  
Joseph G. Sawyer  
Executive Vice President, Principal Financial Officer



## INDEX TO EXHIBITS

| <u>Exhibit<br/>Number</u> | <u>Description</u> |
|---------------------------|--------------------|
|---------------------------|--------------------|

|      |  |
|------|--|
| 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 September 30, 2016, formatted in eXtensible Business Reporting Language (XBRL); (i) Consolidated Balance Sheets at September 30, 2016 and December 31, 2015, (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2016 and 2015, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015 (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2016 and 2015, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015, and (vi) Notes to Consolidated Financial Statements.

60