

COLONY BANKCORP INC
Form 10-Q
November 05, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR QUARTER ENDED SEPTEMBER 30, 2012

COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

58-1492391
(I.R.S. EMPLOYER
IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750
ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000
REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED REPORTS REQUIRED TO BE FILED BY SECTIONS 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 DEFINITIONS OF "ACCELERATED FILER", "LARGE ACCELERATED FILER" AND "SMALLER REPORTING COMPANY" IN RULE 12b-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER
NON-ACCELERATED FILER

ACCELERATED FILER
SMALLER REPORTING
COMPANY

(DO NOT CHECK IF A SMALLER REPORTING COMPANY)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES NO

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

CLASS	OUTSTANDING AT NOVEMBER 5, 2012
COMMON STOCK, \$1 PAR VALUE	8,439,258

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Forward Looking Statement Disclosure

Certain statements contained in this Quarterly Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Company that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Colony Bankcorp, Inc. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- Loss and regional economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact.
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board.
 - Inflation, interest rate, market and monetary fluctuations.
 - Political instability.
 - Acts of war or terrorism.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by users.
 - Changes in consumer spending, borrowings and savings habits.
 - Technological changes.
 - Acquisitions and integration of acquired businesses.
 - The ability to increase market share and control expenses.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiary must comply.
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The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters.

- Changes in the Company's organization, compensation and benefit plans.
 - The costs and effects of litigation and of unexpected or adverse outcomes in such litigation.
 - Greater than expected costs or difficulties related to the integration of new lines of business.
 - The Company's success at managing the risks involved in the foregoing items.
- Restrictions or conditions imposed by our regulators on our operations, including the terms of our Memorandum of Understanding.

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Forward-looking statements speak only as of the date on which such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission (SEC).

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PART 1. FINANCIAL INFORMATION

ITEM 1

FINANCIAL STATEMENTS

THE FOLLOWING FINANCIAL STATEMENTS ARE PROVIDED FOR COLONY BANKCORP, INC. AND ITS WHOLLY-OWNED SUBSIDIARY BANK, COLONY BANK

- A. CONSOLIDATED BALANCE SHEETS – SEPTEMBER 30, 2012 (UNAUDITED) AND DECEMBER 31, 2011.
- B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 (UNAUDITED).
- C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 (UNAUDITED).
- D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 (UNAUDITED).

THE CONSOLIDATED FINANCIAL STATEMENTS FURNISHED HAVE NOT BEEN AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, BUT REFLECT, IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS (CONSISTING SOLELY OF NORMAL RECURRING ADJUSTMENTS) NECESSARY FOR A FAIR PRESENTATION OF THE RESULTS OF OPERATIONS FOR THE PERIODS PRESENTED.

THE RESULTS OF OPERATIONS FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2012 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2012 AND DECEMBER 31, 2011
(DOLLARS IN THOUSANDS)

	September 30, 2012 (Unaudited)	December 31, 2011 (Audited)
ASSETS		
Cash and Cash Equivalents		
Cash and Due from Banks	\$ 22,077	\$ 28,380
Federal Funds Sold	42,946	54,992
	65,023	83,372
Interest-Bearing Deposits	9,210	28,957
Investment Securities		
Available for Sale, at Fair Value	242,097	303,891
Held to Maturity, at Cost (Fair Value of \$46 and \$46, as of September 30, 2012 and December 31, 2011, Respectively)	45	46
	242,142	303,937
Federal Home Loan Bank Stock, at Cost	3,139	5,398
Loans	726,522	716,321
Allowance for Loan Losses	(14,389)	(15,650)
Unearned Interest and Fees	(162)	(57)
	711,971	700,614
Premises and Equipment	25,212	25,750
Other Real Estate	17,091	20,445
Other Intangible Assets	232	259
Other Assets	23,417	26,644
Total Assets	\$ 1,097,437	\$ 1,195,376
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-Bearing	\$ 101,852	\$ 94,269
Interest-Bearing	839,352	905,716
	941,204	999,985
Borrowed Money		
Subordinated Debentures	24,229	24,229
Other Borrowed Money	30,000	71,000
	54,229	95,229
Other Liabilities	5,635	3,549
Commitments and Contingencies		
Stockholders' Equity		
Preferred Stock, Stated Value \$1,000 a Share; Authorized 10,000,000 Shares, Issued 28,000 Shares	27,785	27,663

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Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 and 8,439,258 Shares as of September 30, 2012 and December 31, 2011, Respectively	8,439	8,439
Paid-In Capital	29,145	29,145
Retained Earnings	30,337	29,456
Accumulated Other Comprehensive Income, Net of Tax	663	1,910
	96,369	96,613
Total Liabilities and Stockholders' Equity	\$ 1,097,437	\$ 1,195,376

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	9/30/2012	9/30/2011	9/30/2012	9/30/2011
Interest Income				
Loans, Including Fees	\$10,538	\$10,920	\$31,391	\$33,623
Federal Funds Sold	16	19	72	91
Deposits with Other Banks	4	11	34	37
Investment Securities				
U.S. Government Agencies	1,116	1,703	4,125	5,397
State, County and Municipal	42	44	173	102
Corporate Obligations and Asset-Backed Securities	14	23	62	68
Dividends on Other Investments	18	12	55	36
	11,748	12,732	35,912	39,354
Interest Expense				
Deposits	2,110	3,124	6,833	10,228
Federal Funds Purchased	--	--	--	338
Borrowed Money	416	865	1,882	2,646
	2,526	3,989	8,715	13,212
Net Interest Income	9,222	8,743	27,197	26,142
Provision for Loan Losses	1,742	2,250	5,627	6,000
Net Interest Income After Provision for Loan Losses	7,480	6,493	21,570	20,142
Noninterest Income				
Service Charges on Deposits	917	835	2,527	2,391
Other Service Charges, Commissions and Fees	372	296	1,119	941
Mortgage Fee Income	103	57	296	161
Securities Gains	1,187	813	2,067	1,945
Other	324	422	1,082	1,760
	2,903	2,423	7,091	7,198
Noninterest Expenses				
Salaries and Employee Benefits	3,833	3,639	11,486	10,778
Occupancy and Equipment	1,000	1,040	2,901	3,084
Other	4,414	3,411	11,248	10,385
	9,247	8,090	25,635	24,247
Income Before Income Taxes	1,136	826	3,026	3,093
Income Taxes	364	268	953	940
Net Income	772	558	2,073	2,153
Preferred Stock Dividends	361	350	1,070	1,050

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Net Income Available to Common Stockholders	\$411	\$208	\$1,003	\$1,103
Net Income Per Share of Common Stock				
Basic	\$0.05	\$0.02	\$0.12	\$0.13
Diluted	\$0.05	\$0.02	\$0.12	\$0.13
Cash Dividends Declared Per Share of Common Stock	\$0.00	\$0.00	\$0.00	\$0.00
Weighted Average Basic Shares Outstanding	8,439,258	8,442,278	8,439,258	8,441,070
Weighted Average Diluted Shares Outstanding	8,439,258	8,442,278	8,439,258	8,441,070

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	09/30/12	09/30/11	09/30/12	09/30/11
Net Income	\$772	\$558	\$2,073	\$2,153
Other Comprehensive Income (Loss), Net of Tax				
Gains (Losses) on Securities Arising During the Year	(268)	2,663	117	5,128
Reclassification Adjustment	(783)	(537)	(1,364)	(1,284)
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effect	(1,051)	2,126	(1,247)	3,844
Comprehensive Income (Loss)	\$(279)	\$2,684	\$826	\$5,997

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$2,073	\$2,153
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	1,261	1,389
Provision for Loan Losses	5,627	6,000
Securities Gains	(2,067)	(1,945)
Amortization and Accretion	3,191	2,538
Loss on Sale of Other Real Estate and Repossessions	1,313	996
Provision for Losses on Other Real Estate	1,259	481
Increase in Cash Surrender Value of Life Insurance	(122)	(120)
Other Prepaids, Deferrals and Accruals, Net	4,877	1,995
Gain on Sale of Equipment	--	2
	17,412	13,489
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Investment Securities Available for Sale	(140,618)	(286,202)
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	37,685	31,268
Held for Maturity	7	6
Proceeds from Sale of Investment Securities		
Available for Sale	161,811	251,044
Decrease in Interest-Bearing Deposits in Other Banks	19,747	46,318
Net Loans to Customers	(22,853)	45,342
Purchase of Premises and Equipment	(723)	(267)
Proceeds from Sale of Other Real Estate and Repossessions	6,691	7,593
Federal Home Loan Bank Stock	2,259	490
Proceeds from Sale of Premises and Equipment	--	2
Transfer of Subsidiary	14	--
	64,020	95,594
CASH FLOWS FROM FINANCING ACTIVITIES		
Noninterest-Bearing Customer Deposits	7,583	(14,468)
Interest-Bearing Customer Deposits	(66,364)	(96,300)
Securities Sold Under Agreements to Repurchase	--	(20,000)
Dividends Paid On Preferred Stock	--	(1,050)
Principal Payments on Other Borrowed Money	(41,000)	(4,076)
	(99,781)	(135,894)
Net Decrease in Cash and Cash Equivalents	(18,349)	(26,811)
Cash and Cash Equivalents at Beginning of Period	83,372	54,149

Cash and Cash Equivalents at End of Period	\$65,023	\$27,338
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The accompanying notes are an integral part of these statements.

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Item 1 (Continued)

COLONY BANKCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Presentation

Colony Bankcorp, Inc. (the Company) is a bank holding company located in Fitzgerald, Georgia. The consolidated financial statements include the accounts of Colony Bankcorp, Inc. and its wholly-owned subsidiary, Colony Bank, Fitzgerald, Georgia. All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of Colony Bankcorp, Inc. conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

All dollars in notes to consolidated financial statements are rounded to the nearest thousand.

The consolidated financial statements in this report are unaudited, except for the December 31, 2011 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the nine months ended September 30, 2012, are not necessarily indicative of the results which may be expected for the entire year.

Nature of Operations

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. Colony Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Chester, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Pitts, Quitman, Rochelle, Savannah, Soperton, Sylvester, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans and the valuation of deferred tax assets.

Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2012. Such reclassifications had no effect on previously reported stockholders' equity or net income.

Concentrations of Credit Risk

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At September 30, 2012, approximately 85 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. The continued downturn of the housing and real estate market that began in 2007 has resulted in an increase of problem loans secured by real estate. These loans are centered primarily in the Company's larger MSA markets. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

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(1) Summary of Significant Accounting Policies (Continued)

Concentrations of Credit Risk (Continued)

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of Colony depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit rating is monitored by management to minimize credit risk.

Investment Securities

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities, which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

The Company evaluates each held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

Federal Home Loan Bank Stock

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

Loans

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectibility of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectibility of principal. Loans are returned to an accrual status when factors indicating doubtful collectibility on a timely basis no longer exist.

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Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Loans Modified in a Troubled Debt Restructuring (TDR)

Loans are considered to have been modified in a TDR when due to a borrower's financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available.

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (i) changes in the composition of the loan portfolio, (ii) the extent of loan concentrations within the portfolio, (iii) the effectiveness of the Company's lending policies, procedures and internal controls, (iv) the experience, ability and effectiveness of the Company's lending management and staff, and (v) national and local economics and business conditions.

Loans identified as losses by management, internal loan review and/or regulatory agencies are charged off.

In 2012, the Company refined its methodology used in estimating the amount of the Allowance for Loan and Lease Losses (ALLL). As discussed in Note 4 to the financial statements, the allowance for loan losses resulted in a reduction of \$3,422 due to a change in methodology in the current year. Refer to the financial statements for more

information on this topic.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

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Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Premises and Equipment

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows:

Description	Life in Years	Method
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5-10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

Intangible Assets

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Statement of Cash Flows

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks and federal funds sold. Cash flows from demand deposits, NOW accounts, savings accounts, loans and certificates of deposit are reported net.

Advertising Costs

The Company expenses the cost of advertising in the periods in which those costs are incurred.

Income Taxes

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been

used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

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Part I (Continued)
Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Income Taxes (Continued)

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statement of income.

Other Real Estate

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less the cost of disposal. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in foreclosed property expense.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners and are not reported in the consolidated statements of operations but as a separate component of the equity section of the consolidated balance sheets. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Accounting Standards Updates

ASU No. 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the

transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company's financial statements.

ASU No. 2011-04, "Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 became effective for the Company on January 1, 2012 and, aside from new disclosures, did not have a significant impact on the Company's financial statements.

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Part I (Continued)
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(1) Summary of Significant Accounting Policies (Continued)

Accounting Standards Updates (Continued)

ASU No. 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income.” ASU 2011-05 amends Topic 220, “Comprehensive Income,” to require that all non-owner changes in stockholders’ equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. ASU 2011-05 became effective for the Company on January 1, 2012; however, certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 “Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.”. The adoption of ASU 2011-05 did not have a significant impact on the Company’s financial statements.

ASU No. 2011-11, “Balance Sheet (Topic 210) – “Disclosures about Offsetting Assets and Liabilities.” ASU 2011-11 amends Topic 210, “Balance Sheet,” to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on the Company’s financial statements.

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Item 1 (Continued)

(2) Investment Securities

Investment securities as of September 30, 2012 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	\$ 235,730	\$ 1,573	\$ (493)	\$ 236,810
State, County & Municipal	3,995	43	(1)	4,037
Corporate Obligations	1,000	118	--	1,118
Asset-Backed Securities	367	--	(235)	132
	\$ 241,092	\$ 1,734	\$ (729)	\$ 242,097
Securities Held to Maturity:				
State, County and Municipal	\$ 45	\$ 1	\$ --	\$ 46

The amortized cost and fair value of investment securities as of September 30, 2012, by contractual maturity, are shown hereafter. Expected maturities will differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due Less Than One Year	\$ 125	\$ 127	\$ --	\$ --
Due After One Year Through Five Years	2,697	2,847	45	46
Due After Five Years Through Ten Years	1,965	1,973	--	--
Due After Ten Years	575	340	--	--
	5,362	5,287	45	46
Mortgage-Backed Securities	235,730	236,810	--	--
	\$ 241,092	\$ 242,097	\$ 45	\$ 46

Investment securities as of December 31, 2011 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	\$ 291,097	\$ 3,152	\$ (188)	\$ 294,061
State, County & Municipal	7,475	132	(23)	7,584

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Corporate Obligations	2,000	124	(10)	2,114
Asset-Backed Securities	426	--	(294)	132
	\$ 300,998	\$ 3,408	\$ (515)	\$ 303,891
Securities Held to Maturity:				
State, County and Municipal	\$ 46	\$ --	\$ --	\$ 46

Proceeds from the sale of investments available for sale during first nine months of 2012 totaled \$161,811 compared to \$251,044 for the first nine months of 2011. The sale of investments available for sale during 2012 resulted in gross realized gains of \$2,204 and losses of \$(137). This was offset by other than temporary impairment charges of \$(60). The sale of investments available for sale during the first nine months of 2011 resulted in gross realized gains of \$1,947 and losses of \$(2).

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Item 1 (Continued)

(2) Investment Securities (Continued)

Nonaccrual securities are securities for which principal and interest are doubtful of collection in accordance with original terms and for which accruals of interest have been discontinued due to payment delinquency. Fair value of securities on nonaccrual status totaled \$132 and \$132 as of September 30, 2012 and December 31, 2011, respectively.

Investment securities having a carry value approximating \$78,187 and \$136,838 as of September 30, 2012 and December 31, 2011, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at September 30, 2012 and December 31, 2011 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2012						
U.S. Government Agencies						
Mortgage-Backed	\$68,388	\$(464)	\$2,235	\$(29)	\$70,623	\$(493)
State, County and Municipal	208	(1)	--	--	208	(1)
Asset-Backed Securities	--	--	132	(235)	132	(235)
	\$68,596	\$(465)	\$2,367	\$(264)	\$70,963	\$(729)
December 31, 2011						
U.S. Government Agencies						
Mortgage-Backed	\$26,440	\$(188)	\$--	\$--	\$26,440	\$(188)
State, County and Municipal	1,224	(21)	73	(2)	1,297	(23)
Corporate Obligations	--	--	990	(10)	990	(10)
Asset-Backed Securities	--	--	132	(294)	132	(294)
	\$27,664	\$(209)	\$1,195	\$(306)	\$28,859	\$(515)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. 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 and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2012, the debt securities with unrealized losses have depreciated 1.02 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations, except for asset-backed securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were

purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary. However, the Company did own one asset-backed security at September 30, 2012 which has been in a continuous unrealized loss position for more than twelve months. This investment is comprised of one issuance of a trust preferred security, has a book value of \$367 and an unrealized loss of \$235. Management evaluates this investment on a quarterly basis utilizing a third-party valuation model. The results of this model revealed other-than-temporary impairment and as a result, \$60 was written off during the first quarter ended March 31, 2012. The Company does not intend to sell this investment, nor does the Company consider it likely that it will be required to sell the investment prior to recovery of the remaining fair value.

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Item 1 (Continued)

(3) Loans

The following table presents the composition of loans segregated by class of loans, as of September 30, 2012 and December 31, 2011.

	September 30, 2012	December 31, 2011
Commercial and Agricultural		
Commercial	\$ 54,281	\$ 48,986
Agricultural	12,594	8,422
Real Estate		
Commercial Construction	54,052	58,546
Residential Construction	6,038	3,530
Commercial	311,393	315,281
Residential	197,259	193,638
Farmland	49,478	48,225
Consumer and Other		
Consumer	29,585	30,449
Other	11,842	9,244
Total Loans	\$ 726,522	\$ 716,321

Commercial and industrial loans are extended to a diverse group of businesses within the Company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

Credit Quality Indicators. As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade assigned to commercial and consumer loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the Company's geographic markets.

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

- Grades 1 and 2 – Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the "pass" classification.

- Grades 3 and 4 – Loans assigned these “pass” risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.
- Grade 5 – This grade includes “special mention” loans on management’s watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.
- Grade 6 – This grade includes “substandard” loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.

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Item 1 (Continued)

(3) Loans (Continued)

- Grades 7 and 8 – These grades correspond to regulatory classification definitions of “doubtful” and “loss,” respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company’s problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

The following table presents the loan portfolio by credit quality indicator (risk grade) as of September 30, 2012 and December 31, 2011. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes.

September 30, 2012

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	\$48,210	\$ 1,740	\$ 4,331	\$54,281
Agricultural	12,456	83	55	12,594
Real Estate				
Commercial Construction	31,541	1,824	20,687	54,052
Residential Construction	5,934	104	--	6,038
Commercial	270,525	12,127	28,741	311,393
Residential	178,171	8,987	10,101	197,259
Farmland	45,820	927	2,731	49,478
Consumer and Other				
Consumer	28,594	342	649	29,585
Other	11,572	11	259	11,842
Total Loans	\$632,823	\$ 26,145	\$ 67,554	\$726,522

December 31, 2011

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	\$42,586	\$ 1,481	\$ 4,919	\$48,986
Agricultural	8,153	--	269	8,422
Real Estate				
Commercial Construction	28,746	2,814	26,986	58,546
Residential Construction	3,227	303	--	3,530
Commercial	272,062	14,790	28,429	315,281
Residential	175,100	8,343	10,195	193,638
Farmland	43,664	1,413	3,148	48,225

Consumer and Other				
Consumer	29,372	362	715	30,449
Other	9,029	99	116	9,244
Total Loans	\$611,939	\$ 29,605	\$ 74,777	\$716,321

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of \$50,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired.

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Item 1 (Continued)

(3) Loans (Continued)

In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. Nonaccrual loans totaled \$34,278 and \$38,822 as of September 30, 2012 and December 31, 2011, respectively, and total recorded investment in loans past due 90 days or more and still accruing interest approximated \$5 and \$15, respectively. During its review of impaired loans, the company determined the majority of its exposures on these loans were known losses. As a result, the exposures were charged off, reducing the specific allowances on impaired loans.

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of September 30, 2012 and December 31, 2011:

September 30, 2012

	Accruing Loans 90 Days			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days	or More	Total			
	Past Due	Past Due	Accruing Loans Past Due			
Commercial and Agricultural						
Commercial	\$1,529	\$--	\$ 1,529	\$297	\$ 52,455	\$54,281
Agricultural	--	--	--	109	12,485	12,594
Real Estate						
Commercial Construction	913	--	913	18,814	34,325	54,052
Residential Construction	--	--	--	--	6,038	6,038
Commercial	6,098	--	6,098	7,606	297,689	311,393
Residential	3,041	--	3,041	4,947	189,271	197,259
Farmland	687	--	687	2,297	46,494	49,478
Consumer and Other						
Consumer	433	5	438	208	28,939	29,585
Other	7	--	7	--	11,835	11,842
Total Loans	\$12,708	\$5	\$ 12,713	\$34,278	\$ 679,531	\$726,522

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Item 1 (Continued)

(3) Loans (Continued)

December 31, 2011

	30-89 Days Past Due	Accruing Loans 90 Days or More Past Due	Total Accruing Loans Past Due	Nonaccrual Loans	Current Loans	Total Loans
Commercial and Agricultural						
Commercial	\$645	\$--	\$ 645	\$2,103	\$ 46,238	\$48,986
Agricultural	--	--	--	86	8,336	8,422
Real Estate						
Commercial Construction	514	--	514	23,578	34,454	58,546
Residential Construction	33	--	33	--	3,497	3,530
Commercial	2,931	--	2,931	9,194	303,156	315,281
Residential	2,251	15	2,266	3,110	188,262	193,638
Farmland	376	--	376	487	47,362	48,225
Consumer and Other						
Consumer	410	--	410	221	29,818	30,449
Other	--	--	--	43	9,201	9,244
Total Loans	\$7,160	\$15	\$ 7,175	\$38,822	\$ 670,324	\$716,321

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Item 1 (Continued)

(3) Loans (Continued)

The following table details impaired loan data as of September 30, 2012:

September 30, 2012

	Unpaid Contractual Principal Balance	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
With No Related Allowance Recorded						
Commercial	\$85	\$34	\$--	\$1,056	\$4	\$2
Agricultural	109	109	--	64	8	18
Commercial Construction	10,527	8,205	--	10,121	(9)	1
Commercial Real Estate	35,399	30,152	--	30,141	670	667
Residential Real Estate	4,291	3,694	--	2,751	84	99
Farmland	2,340	2,297	--	2,297	31	44
Consumer	226	208	--	219	5	6
Other	--	--	--	27	--	--
	52,977	44,699	--	46,676	793	837
With An Allowance Recorded						
Commercial	1,677	1,677	514	759	69	64
Commercial Construction	12,331	10,610	1,786	11,506	1	4
Commercial Real Estate	4,789	4,059	864	4,282	115	116
Residential Real Estate	5,260	4,547	1,050	4,244	79	78
Farmland	--	--	--	87	--	--
Consumer	--	--	--	--	--	--
Other	--	--	--	--	--	--
	24,057	20,893	4,214	20,878	264	262
Total						
Commercial	1,762	1,711	514	1,815	73	66
Agricultural	109	109	--	64	8	18
Commercial Construction	22,858	18,815	1,786	21,627	(8)	5
Commercial Real Estate	40,188	34,211	864	34,423	785	783
Residential Real Estate	9,551	8,241	1,050	6,995	163	177
Farmland	2,340	2,297	--	2,384	31	44
Consumer	226	208	--	219	5	6
Other	--	--	--	27	--	--
	\$77,034	\$65,592	\$4,214	\$67,554	\$1,057	\$1,099

Table of ContentsPart I (Continued)
Item 1 (Continued)

(3) Loans (Continued)

The following table details impaired loan data as of December 31, 2011:

December 31, 2011

	Unpaid Contractual Principal Balance	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
With No Related Allowance Recorded						
Commercial	\$1,743	\$1,580	\$--	\$947	\$60	\$65
Agricultural	86	86	--	208	(4)	--
Commercial Construction	17,699	12,799	--	13,310	116	144
Commercial Real Estate	34,686	29,385	--	27,027	833	834
Residential Real Estate	2,601	1,934	--	3,176	88	80
Farmland	278	227	--	342	66	66
Consumer	229	216	--	184	11	12
Other	52	43	--	40	1	2
	57,374	46,270	--	45,234	1,171	1,203
With An Allowance Recorded						
Commercial	775	776	308	214	15	19
Commercial Construction	14,036	11,489	2,693	10,470	14	61
Commercial Real Estate	6,430	6,430	2,061	6,557	182	197
Residential Real Estate	4,772	4,042	675	3,859	97	97
Farmland	299	260	12	65	(18)	--
Consumer	5	5	2	4	1	1
Other	--	--	--	19	--	--
	26,317	23,002	5,751	21,188	291	375
Total						
Commercial	2,518	2,356	308	1,161	75	84
Agricultural	86	86	--	208	(4)	--
Commercial Construction	31,735	24,288	2,693	23,780	130	205
Commercial Real Estate	41,116	35,815	2,061	33,584	1,015	1,031
Residential Real Estate	7,373	5,976	675	7,035	185	177
Farmland	577	487	12	407	48	66
Consumer	234	221	2	188	12	13
Other	52	43	--	59	1	2
	\$83,691	\$69,272	\$5,751	\$66,422	\$1,462	\$1,578

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Item 1 (Continued)

(3) Loans (Continued)

The following table details impaired loan data as of September 30, 2011:

September 30, 2011

	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
With No Related Allowance Recorded					
Commercial	\$1,643	\$--	\$735	\$39	\$46
Agricultural	238	--	249	(29)	--
Commercial Construction	19,155	--	13,480	116	150
Commercial Real Estate	31,854	--	26,242	599	615
Residential Real Estate	3,737	--	3,590	30	46
Farmland	487	--	381	48	66
Consumer	159	--	174	5	6
Other	48	--	38	2	2
	57,321	--	44,889	810	931
With An Allowance Recorded					
Commercial	59	39	27	3	3
Commercial Construction	9,998	5,836	10,131	12	53
Commercial Real Estate	3,054	824	6,599	66	79
Residential Real Estate	5,345	523	3,798	197	181
Consumer	11	5	4	1	1
Other	--	--	26	--	--
	18,467	7,227	20,585	279	317
Total					
Commercial	1,702	39	762	42	49
Agricultural	238	--	249	(29)	--
Commercial Construction	29,153	5,836	23,611	128	203
Commercial Real Estate	34,908	824	32,841	665	694
Residential Real Estate	9,082	523	7,388	227	227
Farmland	487	--	381	48	66
Consumer	170	5	178	6	7
Other	48	--	64	2	2
	\$75,788	\$7,227	\$65,474	\$1,089	\$1,248

Troubled Debt Restructurings (TDRs) are troubled loans on which the original terms of the loan have been modified in favor of the borrower due to deterioration in the borrower's financial condition. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in

time. Not all loan modifications are TDRs. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether a loan is classified as a TDR include:

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(3) Loans (Continued)

- Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.
- Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.
- Principal reductions – These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon our normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged-off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged-off during modification there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

As discussed in Note 1, Summary of Significant Accounting Policies, once a loan is identified as a TDR, it is accounted for as an impaired loan. The Company had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of September 30, 2012. The following tables present the number of loan contracts restructured during the three and nine month periods ended September 30, 2012. It shows the pre- and post-modification recorded investment as well as the number of contracts and the recorded investment for those TDRs modified during the previous twelve months which subsequently defaulted during the period. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due.

Troubled Debt Restructurings	Three Months Ending September 30, 2012			Nine Months Ending September 30, 2012		
	# of			# of		
	Contracts	Pre-Modification	Post-Modification	Contracts	Pre-Modification	Post-Modification
Commercial RE	----	\$ ----	\$ ----	1	\$ 57	\$ 57
Residential RE	2	248	248	3	646	645
Total Loans	2	\$ 248	\$ 248	4	\$ 703	\$ 702

Troubled Debt Restructurings That Subsequently Defaulted	Three Months Ending September 30, 2012		Nine Months Ending September 30, 2012	
	# of	Recorded	# of	Recorded
	Contracts	Investment	Contracts	Investment
Commercial Construction	----	\$ ----	1	\$ 64
Residential RE	----	----	1	50

Total Loans	----	\$	----	2	\$	114
-------------	------	----	------	---	----	-----

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(4) Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses, segregated by class of loan, for the nine month period ended September 30, 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

September 30, 2012

	Beginning Balance	Charge-Offs	Recoveries	Provision	Ending Balance
Commercial and Agricultural					
Commercial	\$ 1,071	\$ (407)	\$ 105	\$ 153	\$ 922
Agricultural	297	(3)	--	--	294
Real Estate					
Commercial Construction	3,123	(1,929)	74	836	2,104
Residential Construction	138	--	--	--	138
Commercial	6,448	(4,273)	217	4,165	6,557
Residential	3,695	(632)	9	413	3,485
Farmland	365	(39)	5	--	331
Consumer and Other					
Consumer	205	(75)	63	60	253
Other	308	(11)	8	--	305
	\$ 15,650	\$ (7,369)	\$ 481	\$ 5,627	\$ 14,389

The following table details activity in the allowance for loan losses, segregated by class of loan, for the nine month period ended September 30, 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

September 30, 2011

	Beginning Balance	Charge-Offs	Recoveries	Provision	Ending Balance
Commercial and Agricultural					
Commercial	\$ 4,415	\$ (718)	\$ 124	\$ (1,591)	\$ 2,230
Agricultural	698	(455)	401	(257)	387
Real Estate					
Commercial Construction	4,126	(4,218)	548	4,217	4,673
Residential Construction	520	--	--	(159)	361

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Commercial	8,030	(12,175)	517	6,730	3,102
Residential	5,942	(1,291)	120	(910)	3,861
Farmland	944	(61)	1	(317)	567
Consumer and Other					
Consumer	3,074	(192)	123	(1,371)	1,634
Other	531	(100)	6	(342)	95
	\$ 28,280	\$ (19,210)	\$ 1,840	\$ 6,000	\$ 16,910

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Item 1 (Continued)

(4) Allowance for Loan Losses (Continued)

In 2012, the Company refined its methodology used in estimating the amount of the Allowance for Loan and Lease Losses (ALLL). Management has been proactive in identifying problem loans, assessing exposure, and providing sufficient reserves to cover the exposures. The ALLL was increased in anticipation of identified exposures resulting in confirmed losses. When losses were confirmed, they were promptly charged off. As a result, losses over the last three years have been very high. During this time, newer loans granted were made subject to higher underwriting standards and more conservative appraisals. Because of the prompt recognition of losses that drove the excessive charge-off history, management now believes the remaining losses incurred in the current portfolio, including newer loans made, will be less than unadjusted loss history factors will suggest. Considering the major losses taken, along with organizational and staffing changes, the validity of qualitative factors in determining adjustments of loss history needed to be reviewed. Recognizing the importance of credit administration and the role of personnel involved in granting, approving, administering, monitoring, and collecting loans, management concluded that greater weight should be placed on factors associated with those activities. Additionally, during the quarter ended September 30, 2012, management reviewed the appropriateness of continuing to use a one-year annual loss rate to determine losses incurred in the loan portfolio segments of loans collectively reviewed for impairment. Consideration was given to the trends in losses incurred over prior quarters and economic indicators impacting the company. Management concluded that the one-year charge-off history should be expanded to include quarters from the current year. Thus, the annualized loss rates used for the September 30, 2012 allowance for loan loss calculation was based on an expanded period that includes all 4 quarters of 2011 and the first 2 quarters of 2012. The effect of these changes on the ALLL resulted in a reduction in the ALLL estimate of \$3,422. Management believes the adjustments made will result in a better estimation of losses incurred in the portfolio.

The Company determines its individual reserves during its quarterly review of substandard loans. This process involves reviewing all loans with a risk grade of 6 or below and an outstanding balance of \$50,000 or more. At September 30, 2012 and 2011, impaired loans totaling \$944 and \$881 were below the \$50,000 review threshold and were not individually reviewed for impairment. Those loans were subject to the bank's general loan loss reserve methodology and are included in the "Collectively Evaluated for Impairment" column of the following tables. Since not all loans in the substandard category are considered impaired, this quarterly assessment often results in the identification of individual reserves which are placed against certain loans as part of management's allowance for loan loss calculation. The total of these loans and the related reserves are presented in the column titled "Substandard Loans Individually Reviewed for Impairment" in the following tables. The following tables present breakdowns of the allowance for loan losses, segregated by impairment methodology for September 30, 2012 and 2011:

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Item 1 (Continued)

(4) Allowance for Loan Losses (Continued)

September 30, 2012

	Nonaccrual/TDR Individually Evaluated for Impairment	Substandard Individually Evaluated for Impairment	Ending Allowance Balance		Total
			Total Individually Evaluated for Impairment	Collectively Evaluated for Impairment	
Commercial and Agricultural					
Commercial	\$ 514	\$ 214	\$ 728	\$ 194	\$ 922
Agricultural	--	--	--	294	294
Real Estate					
Commercial Construction	1,786	58	1,844	260	2,104
Residential Construction	--	--	--	138	138
Commercial	864	376	1,240	5,317	6,557
Residential	1,050	566	1,616	1,869	3,485
Farmland	--	--	--	331	331
Consumer and Other					
Consumer	--	--	--	253	253
Other	--	--	--	305	305
Total End of Period Allowance Balance	\$ 4,214	\$ 1,214	\$ 5,428	\$ 8,961	\$ 14,389

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Item 1 (Continued)

(4) Allowance for Loan Losses (Continued)

September 30, 2012

	Ending Loan Balance				
	Nonaccrual/TDR	Substandard	Total		
	Individually	Individually	Individually	Collectively	Total
	Evaluated for	Evaluated	Evaluated	Evaluated	
Impairment	for	for	for	Impairment	
	Impairment	Impairment	Impairment	Impairment	
Commercial and Agricultural					
Commercial	\$ 1,701	\$ 2,390	\$ 4,091	\$ 50,190	\$ 54,281
Agricultural	--	--	--	12,594	12,594
Real Estate					
Commercial Construction	18,743	1,793	20,536	33,516	54,052
Residential Construction	--	--	--	6,038	6,038
Commercial	34,165	6,069	40,234	271,159	311,393
Residential	7,751	2,900	10,651	186,608	197,259
Farmland	2,277	263	2,540	46,938	49,478
Consumer and Other					
Consumer	11	6	17	29,568	29,585
Other	--	18	18	11,824	11,842
Total End of Period Loan Balance	\$ 64,648	\$ 13,439	\$ 78,087	\$ 648,435	\$ 726,522

September 30, 2011

	Ending Allowance Balance				
	Nonaccrual/TDR	Substandard	Total		
	Individually	Individually	Individually	Collectively	Total
	Evaluated for	Evaluated	Evaluated	Evaluated	
Impairment	for	for	for	Impairment	
	Impairment	Impairment	Impairment	Impairment	
Commercial and Agricultural					
Commercial	\$ 39	\$ 647	\$ 686	\$ 1,544	\$ 2,230
Agricultural	7	--	7	380	387
Real Estate					
Commercial Construction	4,323	256	4,579	94	4,673
Residential Construction	--	--	--	361	361
Commercial	689	408	1,097	2,005	3,102
Residential	2,036	958	2,994	867	3,861
Farmland	--	11	11	556	567
Consumer and Other					
Consumer	5	63	68	1,566	1,634

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Other	--	--	--	95	95
Total End of Period Allowance Balance	\$ 7,099	\$ 2,343	\$ 9,442	\$ 7,468	\$ 16,910

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Item 1 (Continued)

(4) Allowance for Loan Losses (Continued)

September 30, 2011

	Ending Loan Balance				
	Nonaccrual/TDR	Substandard	Total		
	Individually	Individually	Individually	Collectively	
	Evaluated for	Evaluated	Evaluated	Evaluated	
Impairment	for	for	for		
	Impairment	Impairment	Impairment	Impairment	Total
Commercial and Agricultural					
Commercial	\$ 1,609	\$ 2,881	\$ 4,490	\$ 47,162	\$ 51,652
Agricultural	152	221	373	13,399	13,772
Real Estate					
Commercial Construction	29,064	1,650	30,714	32,390	63,104
Residential Construction	--	--	--	2,628	2,628
Commercial	34,888	4,533	39,421	280,701	320,122
Residential	8,692	4,970	13,662	181,771	195,433
Farmland	487	380	867	46,819	47,686
Consumer and Other					
Consumer	16	40	56	30,882	30,938
Other	--	31	31	15,633	15,664
Total End of Period Loan Balance	\$ 74,908	\$ 14,706	\$ 89,614	\$ 651,385	\$ 740,999

(5) Other Real Estate Owned

The aggregate carrying amount of Other Real Estate Owned (OREO) at September 30, 2012 and December 31, 2011 was \$17,091 and \$20,445, respectively. All of the Company's other real estate owned represents properties acquired through foreclosure or deed in lieu of foreclosure. The following table details the change in OREO for the nine months ended September 30, 2012 and the year ended December 31, 2011.

	Nine Months Ended September 30, 2012	Twelve Months Ended December 31, 2011
Balance, Beginning	\$ 20,445	\$ 20,208
Additions	5,756	12,556
Sales of OREO	(6,557)	(9,805)
Loss on Sale	(1,294)	(1,103)
Provision for Losses	(1,259)	(1,411)
Balance, Ending	\$ 17,091	\$ 20,445

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Part I (Continued)
Item 1 (Continued)

(6) Fair Value Measurements

Generally accepted accounting principles related to Fair Value Measurements, defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurements and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and represent the Company's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Assets

Securities – Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

Impaired loans – Impaired loans are those that are accounted for under ASC Sub-topic 310-40, Troubled Debt Restructurings by Creditors, in which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Other Real Estate – Other real estate owned assets are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate owned. Subsequently, other real estate owned assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. These assets are included as Level 3 fair values.

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Item 1 (Continued)

(6) Fair Value Measurements (Continued)

The following table presents the recorded amount of the Company's assets measured at fair value on a recurring and nonrecurring basis as of September 30, 2012 and December 31, 2011 aggregated by the level in the fair value hierarchy within which those measurements fall.

	September 30, 2012	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring				
Securities Available for Sale				
Mortgage-backed	\$ 236,810	\$ ---	\$ 236,810	\$ ---
State,County & Municipal	4,037	---	4,037	---
Corporate Obligations	1,118	---	1,118	---
Asset-Backed Securities	132	---	---	132
	\$ 242,097	\$ ---	\$ 241,965	\$ 132
Nonrecurring				
Impaired Loans	\$ 16,679	\$ ---	\$ ---	\$ 16,679
Other Real Estate	\$ 17,091	\$ ---	\$ ---	\$ 17,091
	December 31, 2011	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring				
Securities Available for Sale				
Mortgage-backed	\$ 294,061	\$ ---	\$ 294,061	\$ ---
State,County & Municipal	7,584	---	7,584	---
Corporate Obligations	2,114	---	1,124	990

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Asset-Backed Securities	132	---	---	132
	\$ 303,891	\$ ---	\$ 302,769	\$ 1,122
Nonrecurring				
Impaired Loans	\$ 17,251	\$ ---	\$ ---	\$ 17,251
Other Real Estate	\$ 20,445	\$ ---	\$ 6,170	\$ 14,275

Liabilities

The Company did not identify any liabilities that are required to be presented at fair value.

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Item 1 (Continued)

(6) Fair Value Measurements (Continued)

The following table presents quantitative information about the significant unobservable inputs used in the fair value measurements for assets in Level 3 of the fair value hierarchy measured on a recurring and non-recurring basis at September 30, 2012.

	September 30, 2012	Valuation Techniques	Unobservable Inputs	Range (Weighted Avg)
Recurring				
Securities Available for Sale				
Asset - Backed Securities	132	discounted cash flow	discount rate	2.73% - 3.22%
				(2.98%)
Nonrecurring				
Impaired Loans				
Commercial	1,163	sales comparison	adjustment for differences between the comparable sales	(45.00%) - 80.00%
				(17.50%)
Real Estate				
Commercial Construction	8,824	sales comparison	adjustment for differences between the comparable sales	0.00% - 186.90%
				(93.45%)
		income approach	discount rate	7.92%
Residential Real Estate	3,195	sales comparison	adjustment for differences between the comparable sales	(13.70%) - 24.20%
				(5.25%)
		income approach	capitalization rate	8.90%
Commercial Real Estate	3,497	sales comparison	adjustment for differences between the comparable sales	(40.00%) - 52.00%
				(6.00%)

		income approach	capitalization rate	11.00%
Other Real Estate Owned	17,091	sales comparison	adjustment for differences between the comparable sales	1.97% - 77.35% (29.93%)

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Item 1 (Continued)

(6) Fair Value Measurements (Continued)

The table below presents a reconciliation and statement of income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2012 and 2011.

Fair Value Measurement Using Significant Unobservable Inputs (Level 3)	2012	2011
	Available for Sale Securities (In Thousands)	Available for Sale Securities (In Thousands)
Balance, Beginning	\$ 1,122	\$ 1,017
Total Realized/Unrealized Gains (Losses) Included In		
Loss on OTTI Impairment	(60)	--
Other Comprehensive Income	70	104
Purchases, Sales, Issuances and Settlements		
Sales/Call	(1,000)	--
Balance, Ending	\$ 132	\$ 1,121

(7) Deposits

The aggregate amount of overdrawn deposit accounts reclassified as loan balances totaled \$246 and \$250 as of September 30, 2012 and December 31, 2011.

Components of interest-bearing deposits as of September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012	December 31, 2011
Interest-Bearing Demand	\$ 273,035	\$ 284,871
Savings	46,775	41,231
Time, \$100,000 and Over	224,013	247,589
Other Time	295,529	332,025
	\$ 839,352	\$ 905,716

At September 30, 2012 and December 31, 2011, the Company had brokered deposits of \$30,212 and \$28,158 respectively. Of the \$30,212 brokered deposits at September 30, 2012, \$30,212 represented Certificate of Deposits Account Registry Service (CDARS) reciprocal deposits in which customers placed core deposits into the CDARS program for FDIC insurance coverage and the Company received reciprocal brokered deposits in a like amount. Thus, brokered deposits less the reciprocal deposits totaled \$0 at September 30, 2012. The aggregate amount of short-term jumbo certificates of deposit, each with a minimum denomination of \$100,000 was approximately \$182,045 and \$190,877 as of September 30, 2012 and December 31, 2011, respectively.

As of September 30, 2012 and December 31, 2011, the scheduled maturities of certificates of deposits are as follows:

Maturity	September 30, 2012	December 31, 2011
----------	--------------------	-------------------

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One Year and Under	\$	420,728	\$	428,603
One to Three Years		82,107		137,619
Three Years and Over		16,707		13,392
	\$	519,542	\$	579,614

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Item 1 (Continued)

(8) Other Borrowed Money

Other borrowed money at September 30, 2012 and December 31, 2011 is summarized as follows:

	September 30, 2012	December 31, 2011
Federal Home Loan Bank Advances	\$ 30,000	\$ 71,000
	\$ 30,000	\$ 71,000

Advances from the Federal Home Loan Bank (FHLB) have maturities ranging from 2012 to 2019 and interest rates ranging from 3.17 percent to 4.75 percent. As collateral on the outstanding FHLB advances, the Company has provided a blanket lien on its portfolio of qualifying residential first mortgage loans and commercial loans. At September 30, 2012 the Company had remaining credit availability from the FHLB of approximately \$139,550. The Company may be required to pledge additional qualifying collateral in order to utilize the full amount of the remaining credit line.

The aggregate stated maturities of other borrowed money at September 30, 2012 are as follows:

Year	Amount
2012	\$ --
2013	--
2014	--
2015 and Thereafter	30,000
	\$ 30,000

The Company also has available federal funds lines of credit with various financial institutions totaling \$43,000, of which there were none outstanding at September 30, 2012.

In addition, the Company has the ability to borrow funds from the Federal Reserve Bank (FRB) of Atlanta utilizing the discount window. The discount window is an instrument of monetary policy that allows eligible institutions to borrow money from the FRB on a short-term basis to meet temporary liquidity shortages caused by internal or external disruptions. At September 30, 2012, the Company had borrowing capacity available under this arrangement, with no outstanding balances. The Company would be required to pledge certain available-for-sale investment securities as collateral under this agreement.

(9) Preferred Stock and Warrants

On January 9, 2009, the Company issued to the United States Department of the Treasury (Treasury), in exchange for aggregate consideration of \$28.0 million, (i) 28,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, (the Preferred Stock), and (ii) a warrant (the Warrant) to purchase up to 500,000 shares (the Warrant Common Stock) of the Company's common stock.

The Preferred Stock qualifies as Tier 1 capital and pays cumulative cash dividends quarterly at a rate of 5 percent per annum for the first five years, and 9 percent per annum thereafter. The Preferred Stock is non-voting, other than class voting rights on certain matters that could adversely affect the Preferred Stock. The Preferred Stock may be redeemed by the Company on or after February 15, 2012 at the liquidation preference of \$1,000 per share plus any accrued and unpaid dividends. Accrued and unpaid dividends on the Preferred Stock must be declared and set aside for the benefit

of the holders of the Preferred Stock before any dividend may be declared on our common stock.

On February 13, 2012, the Company announced the suspension of dividends on the Preferred Stock. At September 30, 2012, there were accumulated dividends in arrears of \$1.25 million, including related accrued interest. The Company may defer dividend payments for up to an aggregate of six dividend periods, whether consecutive or not, without default or penalty under the terms of the agreement. Failure to pay dividends for six periods would trigger board appointment rights for the holder of the Preferred Stock.

The Warrant may be exercised on or before January 9, 2019 at an exercise price of \$8.40 per share. The Treasury may not exercise voting power with respect to any shares of Warrant Common Stock until the Warrant has been exercised.

Upon receipt of the aggregate consideration from the Treasury on January 9, 2009, the Company allocated the \$28,000 proceeds on a pro rata basis to the Preferred Stock and the Warrant based on relative fair values. As a result, the Company allocated \$27,220 of the aggregate proceeds to the Preferred Stock, and \$780 thousand was allocated to the Warrant. The discount recorded on the Preferred Stock that resulted from allocating a portion of the proceeds to the Warrant is being accreted directly to retained earnings over a 5-year period applying a level yield.

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Item 1 (Continued)

(9) Preferred Stock and Warrants (Continued)

On June 19, 2012, the Treasury notified the Company via a letter that it is considering inclusion of the Company's Fixed Rate Cumulative Perpetual Preferred Stock issued to the Treasury under the TARP Capital Purchase Program as part of a series of pooled auctions of CPP investments. According to the letter, the Treasury will also offer the Company the opportunity to opt-out of the pooled auction if they decide, with regulatory approval, to make a bid to repurchase all of the remaining outstanding CPP securities or designate a single investor (or single group of investors) to make a bid to purchase these securities. Subsequently, as permitted, the Company was successful in opting out of the pooled auctions of CPP investments via a designated bidder submitting an acceptable bid. Subsequently, Treasury notified the Company that for transparency purposes it will conduct an individual auction of the Company's outstanding Fixed Rate Cumulative Perpetual Preferred Stock with the auction date yet to be determined. Should the Treasury not receive an acceptable bid in the individual auction, then the securities could be placed into a pooled sale process, for disposing of such securities.

(10) Subordinated Debentures (Trust Preferred Securities)

Description	Date	Amount	3 month Libor Rate	Added Points	Total Rate	Maturity	5 Year Call Option
Colony Bankcorp Statutory Trust III	6/17/2004	4,500	0.38875	2.68	3.06875	6/14/2034	6/17/2009
Colony Bankcorp Capital Trust I	4/13/2006	5,000	0.36025	1.50	1.86025	4/13/2036	4/13/2011
Colony Bankcorp Capital Trust II	3/12/2007	9,000	0.36025	1.65	2.01025	3/12/2037	3/12/2012
Colony Bankcorp Capital Trust III	9/14/2007	5,000	0.44710	1.40	1.84710	9/14/2037	9/14/2012

The Trust Preferred Securities are recorded as subordinated debentures on the consolidated balance sheets, but subject to certain limitations, qualify as Tier 1 Capital for regulatory capital purposes. The proceeds from the offering were used to fund the cash portion of the Quitman acquisition, payoff holding company debt, and inject capital into bank subsidiaries.

On February 13, 2012, the Company announced the suspension of the quarterly interest payments on the Trust Preferred Securities. Under the terms of the trust documents, the Company may defer payments of interest for up to 20 consecutive quarterly periods without default or penalty. The regularly scheduled interest payments will continue to be accrued for payment in the future and reported as an expense in the current period. At September 30, 2012, accrued but unpaid interest expense totaled \$419.

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Item 1 (Continued)

(11) Commitments and Contingencies

Credit-Related Financial Instruments. The Company is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At September 30, 2012 and December 31, 2011 the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	September 30, 2012	December 31, 2011
Loan Commitments	\$ 54,527	\$ 39,966
Letters of Credit	1,312	1,327

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby and performance letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Legal Contingencies. In the ordinary course of business, there are various legal proceedings pending against Colony and its subsidiary. The aggregate liabilities, if any, arising from such proceedings would not, in the opinion of management, have a material adverse effect on Colony's consolidated financial position.

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(12) Fair Value of Financial Instruments

Generally accepted accounting standards in the U.S. require disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of Colony Bankcorp, Inc. and Subsidiary's financial instruments are detailed hereafter. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination or issuance.

Cash and Short-Term Investments – For cash, due from banks, bank-owned deposits and federal funds sold, the carrying amount is a reasonable estimate of fair value and is classified as Level 1.

Investment Securities – Fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Federal Home Loan Bank Stock – The fair value of Federal Home Loan Bank stock approximates carrying value.

Loans – The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value.

Deposit Liabilities – The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date and is classified as Level 1. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities and is classified as Level 2.

Federal Funds Purchased – The carrying value of federal funds purchased approximates fair value.

Subordinated Debentures – Fair value approximates carrying value due to the variable interest rates of the subordinated debentures.

Securities Sold Under Agreements to Repurchase and Other Borrowed Money – The fair value of other borrowed money is calculated by discounting contractual cash flows using an estimated interest rate based on current rates available to the Company for debt of similar remaining maturities and collateral terms. Other borrowed money is classified as Level 2 due to their expected maturities.

Unrecognized Financial Instruments – Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fees associated with these instruments are not material.

Disclosures of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis, are required in the financial statements.

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Item 1 (Continued)

(12) Fair Value of Financial Instruments (Continued)

The carrying amount, estimated fair values, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2012 and December 31, 2011 are as follows:

	Carrying Value	Fair Value Measurements at September 30, 2012				Fair Value Measurements at December 31, 2011	
		Estimated Fair Value	Level 1	Level 2	Level 3	Carrying Value	Estimated Fair Value
Assets							
Cash and Short-Term Investments	\$ 74,233	\$ 74,233	\$ 74,233	\$ ---	\$ ---	\$ 112,329	\$ 112,329
Investment Securities Available for Sale	242,097	242,097	---	241,965	132	303,891	303,891
Investment Securities Held to Maturity	45	46	---	46	---	46	46
Federal Home Loan Bank Stock	3,139	3,139	3,139	---	---	5,398	5,398
Loans, Net	711,971	714,056	---	697,377	16,679	700,614	702,438
Liabilities							
Deposits	941,204	944,051	421,662	522,389	---	999,985	1,003,648
Subordinated Debentures	24,229	24,229	24,229	---	---	24,229	24,229
Other Borrowed Money	30,000	33,922	---	33,922	---	71,000	74,720

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

(13)

Regulatory Capital Matters

The amount of dividends payable to the parent company from the subsidiary bank is limited by various banking regulatory agencies. Upon approval by regulatory authorities, the Bank may pay cash dividends to the parent company in excess of regulatory limitations. Additionally, in the third quarter of 2009, the Company suspended the payment of dividends to common shareholders. At September 30, 2012, the Company is subject to certain regulatory restrictions that preclude the declaration of or payment of any dividends to its common stockholders, without prior approval from the Federal Reserve Bank.

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. The amounts and ratios as defined in regulations are presented hereafter. Management believes, as of September 30, 2012, the company meets all capital adequacy requirements to which it is subject under the regulatory framework for prompt corrective action. In the opinion of management, there are no conditions or events since prior notification of capital adequacy from the regulators that have changed the institution's category.

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(13) Regulatory Capital Matters (Continued)

The following table summarizes regulatory capital information as of September 30, 2012 and December 31, 2011 on a consolidated basis and for each significant subsidiary, as defined.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2012						
Total Capital to Risk-Weighted Assets						
Consolidated						