SOUTHERN FIRST BANCSHARES INC
Form 10-Q
October 31, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission file number 000-27719

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Southern First Bancshares, Inc.

(Exact name of registrant as specified in its charter)

South Carolina	58-2459561
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Verdae Boulevard, Suite 100	
Greenville, S.C.	29606
(Address of principal executive offices)	(Zip Code)

864-679-9000
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address, and former fiscal year, if changed since last report)

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

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 preceding12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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 "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o(Do not check if a smaller reporting company)	Smaller Reporting Company	x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 4,832,014 shares of common stock, par value $0.01 per share, were issued and outstanding as of October 24, 2014.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
September 30, 2014 Form 10-Q

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PART I. CONSOLIDATED FINANCIAL INFORMATION
Item 1. CONSOLIDATED FINANCIAL STATEMENTS

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)	September 30, 2014 (Unaudited)	December 31, 2013 (Audited)
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 9,113	12,361
Interest-bearing deposits with banks	5,762	18,301
Federal funds sold	43,156	8,541
Total cash and cash equivalents	58,031	39,203
Investment securities:		
Investment securities available for sale	56,869	67,440
Other investments	6,522	6,116
Total investment securities	63,391	73,556
Mortgage loans held for sale	9,372	3,611
Loans	832,722	733,656
Less allowance for loan losses	(11,305)	(10,213)
Loans, net	821,417	723,443
Bank owned life insurance	21,881	21,383
Property and equipment, net	21,037	19,827
Deferred income taxes	5,211	4,938
Other assets	7,213	4,870
Total assets	$1,007,553	890,831
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$772,760	680,319
Federal Home Loan Bank advances and other borrowings	139,600	124,100
Junior subordinated debentures	13,403	13,403
Other liabilities	8,198	7,344
Total liabilities	933,961	825,166
Shareholders' equity:		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, 11,242 and 15,299 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	11,242	15,299
Common stock, par value $.01 per share, 10,000,000 shares authorized, 4,829,514 and 4,319,750 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	48	43
Nonvested restricted stock	(516)	(636)

Additional paid-in capital	50,166	43,585
Accumulated other comprehensive loss	(26)	(1,348)
Retained earnings	12,678	8,722
Total shareholders' equity	73,592	65,665
Total liabilities and shareholders' equity	$1,007,553	890,831

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
(dollars in thousands, except share data)	2014	2013	2014	2013
Interest income				
Loans	$ 9,829	8,639	27,956	25,371
Investment securities	400	447	1,378	1,336
Federal funds sold	24	14	54	47
Total interest income	10,253	9,100	29,388	26,754
Interest expense				
Deposits	718	673	2,094	2,203
Borrowings	1,044	1,064	3,088	3,180
Total interest expense	1,762	1,737	5,182	5,383
Net interest income	8,491	7,363	24,206	21,371
Provision for loan losses	1,325	775	3,275	2,650
Net interest income after provision for loan losses	7,166	6,588	20,931	18,721
Noninterest income				
Loan fee income	861	398	1,816	923
Service fees on deposit accounts	244	207	689	635
Income from bank owned life insurance	169	179	498	498
Gain on sale of investment securities	-	-	230	-
Other income	286	271	815	759
Total noninterest income	1,560	1,055	4,048	2,815
Noninterest expenses				
Compensation and benefits	3,459	3,134	10,384	9,104
Occupancy	777	755	2,235	2,206
Real estate owned activity	71	25	96	30
Data processing and related costs	625	611	1,841	1,781

Insurance	209	171	604	612
Marketing	193	171	591	576
Professional fees	207	246	724	609
Other	525	397	1,676	1,122
Total noninterest expenses	6,066	5,510	18,151	16,040
Income before income tax expense	2,660	2,133	6,828	5,496
Income tax expense	834	714	2,185	1,815
Net income	1,826	1,419	4,643	3,681
Preferred stock dividend	253	191	699	580
Redemption of preferred stock	-	-	-	20
Net income available to common shareholders	$1,573	1,228	3,944	3,121
Earnings per common share				
Basic	$0.33	$0.29	0.83	0.73
Diluted	$0.31	$0.27	0.79	0.71
Weighted average common shares outstanding				
Basic	4,829,514	4,271,652	4,775,791	4,267,693
Diluted	5,046,487	4,490,026	4,984,553	4,428,164

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
(dollars in thousands)	2014	2013	2014	2013
Net income	$ 1,826	1,419	4,643	3,681
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available for sale:				
Unrealized holding gain (loss) arising during the period, pretax	(25)	(251)	2,234	(2,982)
Tax (expense) benefit	8	84	(760)	1,015
Reclassification of realized gain	-	-	(230)	-
Tax expense	-	-	78	-
Other comprehensive income (loss)	(17)	(167)	1,322	(1,967)
Comprehensive income	$ 1,809	1,252	5,965	1,714

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2013
(Unaudited)

	Common stock		Preferred stock		Nonvested restricted	Additional paid-in	Accumulated other comprehensive	Retained	
(dollars in thousands, except share data)	Shares	Amount	Shares	Amount	stock	capital	income (loss)	earnings	Total
December 31, 2012	4,247,404	$ 43	16,299	$ 16,299	$ (160)	$ 42,396	$ 1,178	$ 4,369	$ 64,125
Net income	-	-	-	-	-	-	-	3,681	3,681
Preferred stock transactions:									
Redemption of preferred stock			(1,000)	(1,000)				20	(980)
Cash dividends on Series T preferred stock	-	-	-	-	-	-	-	(587)	(587)
Proceeds from exercise of stock options	23,527	-	-	-	-	152	-	-	152
Issuance of restricted stock	42,500	-	-	-	(552)	552	-	-	-
Cash in lieu of fractional shares	-	-	-	-	-	-	-	(7)	(7)
Amortization of deferred compensation on restricted stock	-	-	-	-	41	-	-	-	41
Compensation expense related to stock options, net of tax	-	-	-	-	-	318	-	-	318
Other comprehensive loss	-	-	-	-	-	-	(1,967)	-	(1,967)
September 30, 2013	4,313,431	$ 43	15,299	$ 15,299	$ (671)	$ 43,418	$ (789)	$ 7,476	$ 64,776
December 31, 2013	4,319,750	$ 43	15,299	$ 15,299	$ (636)	$ 43,585	$ (1,348)	$ 8,722	$ 65,665
Net income	-	-	-	-	-	-	-	4,643	4,643
Preferred stock transactions:									
Redemption of preferred stock	-	-	(4,057)	(4,057)	-	-	-	-	(4,057)
Cash dividends on Series T preferred stock	-	-	-	-	-	-	-	(687)	(687)
Issuance of common stock	475,000	5				5,945			5,950

Proceeds from exercise of stock options	32,764	-	-	-	-	287	-	-	287
Issuance of restricted stock	2,000	-	-	-	(27)	27	-	-	-
Amortization of deferred compensation on restricted stock	-	-	-	-	147	-	-	-	147
Compensation expense related to stock options, net of tax	-	-	-	-	-	322	-	-	322
Other comprehensive income	-	-	-	-	-	-	1,322	-	1,322
September 30, 2014	4,829,514	$ 48	11,242	$ 11,242	$ (516)	$ 50,166	$ (26)	$ 12,678	$ 73,592

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(dollars in thousands)	For the nine months ended September 30, 2014	2013
Operating activities		
Net income	$ 4,643	3,681
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	3,275	2,650
Depreciation and other amortization	901	897
Accretion and amortization of securities discounts and premium, net	291	538
Gain on sale of investment securities	(230)	-
(Gain) loss on sale and write-down of real estate owned	33	(15)
Compensation expense related to stock options and grants	469	359
Gain on sale of loans held for sale	(1,700)	(816)
Loans originated and held for sale	(71,733)	(49,871)
Proceeds from sale of loans held for sale	67,672	50,160
Increase in cash surrender value of bank owned life insurance	(498)	(498)
Increase in deferred tax asset	(954)	(44)
(Increase) decrease in other assets, net	8	(47)

Increase in other liabilities, net	854	123
Net cash provided by operating activities	3,031	7,117
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(103,836)	(64,795)
Purchase of property and equipment	(2,111)	(2,043)
Purchase of investment securities:		
Available for sale	(2,073)	(3,260)
Other	(900)	(2,025)
Payments and maturity of investment securities:		
Available for sale	3,609	7,592
Other	494	2,353
Purchase of bank owned life insurance	-	(2,000)
Proceeds from sale of investment securities	10,977	200
Proceeds from sale of real estate owned	203	1,468
Net cash used for investing activities	(93,637)	(62,510)
Financing activities		
Increase (decrease) in cash realized from:		
Increase in deposits, net	92,441	30,753
Decrease in short-term borrowings	-	(9,635)
Increase in other borrowings	15,500	30,000
Cash dividend on preferred stock	(687)	(587)
Redemption of preferred stock	(4,057)	(980)
Issuance of common stock	5,950	-
Cash in lieu of fractional shares	-	(7)
Proceeds from the exercise of stock options and warrants	287	152
Net cash provided by financing activities	109,434	49,696
Net increase in cash and cash equivalents	18,828	(5,697)
Cash and cash equivalents at beginning of the period	39,203	29,413
Cash and cash equivalents at end of the period	$ 58,031	23,716
Supplemental information		
Cash paid for		
Interest	$ 4,946	5,949
Income taxes	3,140	1,860
Schedule of non-cash transactions		
Real estate acquired in settlement of loans	2,587	1,313
Unrealized gain (loss) on securities, net of income taxes	1,474	(1,967)

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – Nature of Business and Basis of Presentation

Business Activity

Southern First Bancshares, Inc. (the "Company") is a South Carolina corporation that owns all of the capital stock of Southern First Bank (the "Bank") and all of the stock of Greenville First Statutory Trust I and II (collectively, the "Trusts"). The Trusts are special purpose non-consolidated entities organized for the sole purpose of issuing trust preferred securities. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions (the "S.C. Board"). The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on March 4, 2014. The consolidated financial statements include the accounts of the Company and the Bank. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, "Consolidation," the financial statements related to the Trusts have not been consolidated.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ 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, real estate acquired in the settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

Reclassifications

Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders' equity or net income.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management

performed an evaluation to determine whether there have been any subsequent events since the balance sheet date and determined that no subsequent events occurred requiring accrual or disclosure.

Recently Adopted Accounting Pronouncements

The following is a summary of recently adopted authoritative pronouncements that have impacted the accounting, reporting, and/or disclosure of financial information by the Company.

In April 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments went into effect for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The amendments did not have a material effect on the Company's financial statements.

The Comprehensive Income topic of the ASC was amended in September 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments were effective for the Company on a prospective basis for reporting periods beginning after December 15, 2013. These amendments did not have a material effect on the Company's financial statements.

NOTE 2 – Preferred and Common Stock

On February 27, 2009, as part of the Capital Purchase Program ("CPP"), the Company entered into a Securities Purchase Agreement with the U.S. Department of the Treasury (the "Treasury"), pursuant to which the Company sold 17,299 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series T (the "Series T Preferred Stock") and a warrant to purchase 399,970.34 shares of the Company's common stock (the "Warrant") for an aggregate purchase price of $17.3 million in cash. The Series T Preferred Stock qualifies as Tier 1 capital and is entitled to cumulative dividends at a rate of 5% per annum for the first five years, which increased to a rate of 9% per annum on May 15, 2014. The Warrant had a 10-year term and was immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to $6.487 per share of the common stock.

On June 28, 2012, the Treasury sold its Series T Preferred Stock through a public offering structured as a modified Dutch auction. The Company bid on a portion of the Series T Preferred Stock in the auction after receiving approval from its regulators to do so. The clearing price per share for the preferred shares was $904 (compared to a par value of $1,000 per share), and the Company was successful in repurchasing 1,000 shares of the 17,299 shares of Series T Preferred Stock outstanding through the auction process. The remaining 16,299 shares of Series T Preferred Stock held by the Treasury were sold to unrelated third-parties through the auction process. Included in the September 30, 2012 operating results are approximately $130,000 of costs incurred by the Company related to the offering. These costs are not tax-deductible. The net balance sheet impact was a reduction to shareholders’ equity of $904,000 which is comprised of a decrease in Series T Preferred Stock of $1.0 million and a $96,000 increase to retained earnings related to the discount on the shares repurchased.

In addition, on July 25, 2012, the Company completed its repurchase of the Warrant from the Treasury for a mutually agreed upon price of $1.1 million. The difference between the fair value of the Warrant, as originally recorded, and the $1.1 million repurchase price was $343,000 which resulted in a decrease to additional paid in capital. The Company also recorded the remaining accretion of $180,000 on the Series T Preferred Stock which brought the Series T Preferred Stock to its par value. Following the settlement of the Warrant on July 25, 2012, the Treasury has completely eliminated its equity stake in the Company through the Capital Purchase Program.

On January 3, 2013 and April 1, 2013, the Company redeemed a total of $1.0 million of its outstanding Series T Preferred Stock from three of its preferred shareholders.

On January 27, 2014, the Company issued a total of 475,000 shares of its common stock at $13.00 per share in a private placement offering. Immediately following the consummation of the Private Placement, the Company redeemed 4,057 shares of the Series T Preferred Stock from two of its preferred shareholders at a redemption price of $1,000 per share, or par, using the proceeds from the private placement. The redemption of the 4,057 shares of Series T Preferred Stock will reduce the Company’s annual preferred dividend expenses by approximately $200,000.

Since July of 2012, the Company has redeemed shares of its outstanding Series T Preferred Stock with a cumulative par value of $6,057,000, thus reducing the balance to shares with a par value of $11,242,000. The Company will continue to explore options and opportunities to repurchase the remaining Series T Preferred Stock outstanding.

NOTE 3 – Investment Securities

The amortized costs and fair value of investment securities are as follows:

	September 30, 2014		
	Amortized	Gross	Fair

(dollars in thousands)	Cost	Unrealized Gains	Losses	Value
Available for sale				
US government agencies	$ 8,761	7	416	8,352
SBA securities	5,532	-	323	5,209
State and political subdivisions	17,212	583	65	17,730
Mortgage-backed securities	25,403	319	144	25,578
Total investment securities available for sale	$56,908	909	948	56,869

	December 31, 2013			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
Available for sale				
US government agencies	$ 8,756	-	1,001	7,755
SBA securities	5,758	-	487	5,271
State and political subdivisions	23,622	331	583	23,370
Mortgage-backed securities	31,347	246	549	31,044
Total investment securities available for sale	$69,483	577	2,620	67,440

Contractual maturities and yields on our investment securities at September 30, 2014 and December 31, 2013 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2014									
	Less than one year		One to five years		Five to ten years		Over ten years		Total	
(dollars in thousands)	**Amount**	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
US government agencies	$-	-	984	2.12%	-	-	7,368	2.43%	8,352	2.40%
SBA securities	-	-	-	-	-	-	5,209	1.87%	5,209	1.87%
State and political subdivisions	1,234	0.61%	2,206	1.08%	7,997	3.30%	6,293	2.94%	17,730	2.69%
Mortgage-backed securities	-	-	-	-	2,276	1.74%	23,302	2.57%	25,578	2.50%
Total	$1,234	0.61%	3,190	1.40%	10,273	2.94%	42,172	2.51%	56,869	2.48%

	December 31, 2013									
	Less than one year		One to five years		Five to ten years		Over ten years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										

US government agencies	$-	-	-	-	956	2.13%	6,799	2.43%	7,755	2.40%
SBA securities	-	-	-	-	-	-	5,271	1.88%	5,271	1.88%
State and political subdivisions	1,507	0.51%	2,114	0.67%	7,398	3.22%	12,351	2.88%	23,370	2.63%
Mortgage-backed securities	-	-	-	-	2,072	1.77%	28,972	2.69%	31,044	2.62%
Total	$1,507	0.51%	2,114	0.67%	10,426	2.82%	53,393	2.61%	67,440	2.54%

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at September 30, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	September 30, 2014								
	Less than 12 months			12 months or longer			Total		
(dollars in thousands)	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
US government agencies	-	$ -	$ -	2	$ 7,368	$ 416	2	$ 7,368	$ 416
SBA securities	-	-	-	2	5,209	323	2	5,209	323
State and political subdivisions	-	-	-	7	3,481	65	7	3,481	65
Mortgage-backed securities	2	1,428	3	4	8,605	141	6	10,033	144
Total	2	$ 1,428	$ 3	15	$ 24,663	$ 945	17	$ 26,091	$ 948

	December 31, 2013								
	Less than 12 months			12 months or longer			Total		
	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
US government agencies	3	$ 7,755	$ 1,001	-	$ -	$ -	3	$ 7,755	$ 1,001
SBA securities	-	-	-	2	5,271	487	2	5,271	487
State and political subdivisions	22	8,482	364	9	3,705	219	31	12,187	583
Mortgage-backed securities	10	16,146	549	-	-	-	10	16,146	549
Total	35	$32,383	$ 1,914	11	$ 8,976	$ 706	46	$41,359	$ 2,620

At September 30, 2014, the Company had two individual investments with a fair market value of $1.4 million that were in an unrealized loss position for less than 12 months and 15 individual investments with a fair market value of $24.7 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities are not other-than-temporarily impaired. We also consider other factors such as the financial condition of the issuer including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, we have concluded that the securities are not impaired on an other-than-temporary basis.

During the second quarter of 2014, we developed a need for additional liquidity as we experienced increased loan demand and, as a result, sold $10.4 million of our mortgage-backed securities and state and municipal obligations and recorded a net gain on sale of investment securities of $230,000.

Other investments are comprised of the following and are recorded at cost which approximates fair value.

(dollars in thousands)	September 30, 2014	December 31, 2013
Federal Home Loan Bank stock	$ 6,020	5,614
Certificates of deposit with other banks	99	99
Investment in Trust Preferred securities	403	403
Total other investments	$ 6,522	6,116

The Company has evaluated the Federal Home Loan Bank (“FHLB”) stock for impairment and determined that the investment in the FHLB stock is not other than temporarily impaired as of September 30, 2014 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At September 30, 2014 $21.6 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $5.1 million of securities were pledged to secure client deposits. At December 31, 2013, $22.0 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $25.0 million of securities were pledged to secure client deposits.

NOTE 4 – Loans and Allowance for Loan Losses

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled $1.7 million and $1.3 million as of September 30, 2014 and December 31, 2013, respectively.

	September 30, 2014		December 31, 2013	
(dollars in thousands)	Amount	% of Total	Amount	% of Total
Commercial				
Owner occupied RE	$186,992	22.4%	$185,129	25.2%
Non-owner occupied RE	176,475	21.2%	166,016	22.6%
Construction	49,378	5.9%	30,906	4.2%
Business	141,214	17.0%	129,687	17.7%
Total commercial loans	554,059	66.5%	511,738	69.7%
Consumer				
Real estate	139,752	16.8%	110,590	15.1%
Home equity	91,733	11.0%	78,479	10.7%
Construction	34,126	4.1%	19,888	2.7%
Other	13,052	1.6%	12,961	1.8%
Total consumer loans	278,663	33.5%	221,918	30.3%
Total gross loans, net of deferred fees	832,722	100.0%	733,656	100.0%
Less—allowance for loan losses	(11,305)		(10,213)	
Total loans, net	$821,417		$723,443	

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following tables summarizes the loan maturity distribution by type and related interest rate characteristics based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below, because borrowers have the right to prepay obligations with or without prepayment penalties.

	September 30, 2014			
(dollars in thousands)	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 22,280	97,044	67,668	186,992
Non-owner occupied RE	48,859	100,480	27,136	176,475
Construction	14,073	19,691	15,614	49,378
Business	72,978	58,815	9,421	141,214
Total commercial loans	158,190	276,030	119,839	554,059

Consumer				
Real estate	22,150	39,853	77,749	139,752
Home equity	4,857	29,068	57,808	91,733
Construction	12,091	2,475	19,560	34,126
Other	6,076	5,580	1,396	13,052
Total consumer loans	45,174	76,976	156,513	278,663
Total gross loans, net of deferred fees	$203,364	353,006	276,352	832,722
Loans maturing after one year with:				
Fixed interest rates				$459,967
Floating interest rates				169,391

	December 31, 2013			
	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 26,959	93,377	64,793	185,129
Non-owner occupied RE	45,937	96,891	23,188	166,016
Construction	11,619	13,844	5,443	30,906
Business	63,720	58,780	7,187	129,687
Total commercial loans	148,235	262,892	100,611	511,738
Consumer				
Real estate	14,786	34,068	61,736	110,590
Home equity	4,988	26,319	47,172	78,479
Construction	11,749	1,709	6,430	19,888
Other	6,451	5,334	1,176	12,961
Total consumer	37,974	67,430	116,514	221,918
Total gross loan, net of deferred fees	$186,209	330,322	217,125	733,656
Loans maturing after one year with :				
Fixed interest rates				$380,476
Floating interest rates				166,971

Portfolio Segment Methodology

Commercial

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. We apply historic grade-specific loss factors to each class of loan. In the development of our statistically derived loan grade loss factors, we observe historical losses over 12 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a troubled debt restructuring (“TDR”), whether on accrual or nonaccrual status.

Consumer

For consumer loans, we determine the allowance on a collective basis utilizing historical losses over 12 quarters to represent our best estimate of inherent loss. We pool loans, generally by loan class with similar risk characteristics. The allowance also includes an amount for the estimated impairment on nonaccrual consumer loans and consumer loans modified in a TDR, whether on accrual or nonaccrual status.

Credit Quality Indicators

Commercial

We manage a consistent process for assessing commercial loan credit quality by monitoring our loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our risk categories include Pass, Special Mention, Substandard, and Doubtful, each of which is defined by banking regulatory agencies. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for credit losses.

We categorize our loans into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

- Pass—These loans range from minimal credit risk to average however still acceptable credit risk.
- Special mention—A special mention loan has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution’s credit position at some future date.
- Substandard—A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
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Doubtful—A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

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The tables below provide a breakdown of outstanding commercial loans by risk category.

				September 30, 2014	
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Pass	$178,685	164,247	46,073	131,413	520,418
Special mention	5,694	5,322	258	5,045	16,319
Substandard	2,613	6,906	3,047	4,756	17,322
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$186,992	176,475	49,378	141,214	554,059

				December 31, 2013	
	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Pass	$176,320	147,378	27,797	120,254	471,749
Special mention	5,563	7,987	-	3,629	17,179
Substandard	3,246	10,651	3,109	5,804	22,810
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$185,129	166,016	30,906	129,687	511,738

The following tables provide past due information for outstanding commercial loans and include loans on nonaccrual status as well as accruing TDRs.

				September 30, 2014	
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Current	$186,423	173,378	47,623	140,177	547,601
30-59 days past due	-	-	-	-	-

60-89 days past due	569	-	-	-	569
Greater than 90 Days	-	3,097	1,755	1,037	5,889
	$186,992	176,475	49,378	141,214	554,059

				December 31, 2013	
	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Current	$183,609	161,758	29,992	128,883	504,242
30-59 days past due	791	859	-	44	1,694
60-89 days past due	-	-	-	-	-
Greater than 90 Days	729	3,399	914	760	5,802
	$185,129	166,016	30,906	129,687	511,738

As of September 30, 2014 and December 31, 2013, loans 30 days or more past due represented 0.95% and 1.30% of our total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.78% and 1.02% of our total loan portfolio as of September 30, 2014 and December 31, 2013, respectively.

Consumer

We manage a consistent process for assessing consumer loan credit quality by monitoring our loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our categories include Pass, Special Mention, Substandard, and Doubtful, which are defined above. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for loan losses.

The tables below provide a breakdown of outstanding consumer loans by risk category.

				September 30, 2014	
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Pass	$134,734	87,492	34,126	12,773	269,125
Special mention	1,941	3,168	-	143	5,252
Substandard	3,077	1,073	-	136	4,286
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$139,752	91,733	34,126	13,052	278,663

	December 31, 2013				
	Real estate	Home equity	Construction	Other	Total
Pass	$106,693	75,304	19,888	12,641	214,526
Special mention	1,455	2,176	-	212	3,843
Substandard	2,442	999	-	108	3,549
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$110,590	78,479	19,888	12,961	221,918

The following tables provide past due information for outstanding consumer loans and include loans on nonaccrual status as well as accruing TDRs.

	September 30, 2014				
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Current	$138,666	91,415	34,126	13,017	277,224
30-59 days past due	12	130	-	-	142
60-89 days past due	-	-	-	33	33
Greater than 90 Days	1,074	188	-	2	1,264
	$139,752	91,733	34,126	13,052	278,663

	December 31, 2013				
	Real estate	Home equity	Construction	Other	Total
Current	$108,703	78,402	19,888	12,877	219,870
30-59 days past due	806	-	-	84	890
60-89 days past due	467	-	-	-	467
Greater than 90 Days	614	77	-	-	691
	$110,590	78,479	19,888	12,961	221,918

As of September 30, 2014 and December 31, 2013, consumer loans 30 days or more past due were 0.17% and 0.28%, respectively, of total loans.

Nonperforming assets

The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower’s financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

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Following is a summary of our nonperforming assets, including nonaccruing TDRs.

(dollars in thousands)	September 30, 2014	December 31, 2013
Commercial		
Owner occupied RE	$ 640	1,199
Non-owner occupied RE	2,877	373
Construction	855	914
Business	745	712
Consumer		
Real estate	488	76
Home equity	188	77
Construction	-	-
Other	3	3
Nonaccruing troubled debt restructurings	2,166	4,983
Total nonaccrual loans, including nonaccruing TDRs	7,962	8,337
Other real estate owned	3,549	1,198
Total nonperforming assets	$11,511	9,535
Nonperforming assets as a percentage of:		
Total assets	1.14%	1.07%
Gross loans	1.38%	1.30%
Total loans over 90 days past due	7,153	6,493
Loans over 90 days past due and still accruing	-	-
Accruing troubled debt restructurings	$ 7,216	8,045

Impaired Loans

The table below summarizes key information for impaired loans. Our impaired loans include loans on nonaccrual status and loans modified in a TDR, whether on accrual or nonaccrual status. These impaired loans may have estimated impairment which is included in the allowance for loan losses. Our commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

September 30, 2014
Recorded investment
Impaired loans

(dollars in thousands)	Unpaid Principal Balance	Impaired loans	with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 1,461	1,461	728	361
Non-owner occupied RE	6,267	5,029	3,132	911
Construction	4,497	1,755	1,755	264
Business	4,744	3,934	2,908	1,934
Total commercial	16,969	12,179	8,523	3,470
Consumer				
Real estate	2,356	2,334	2,012	837
Home equity	348	348	348	193
Construction	-	-	-	-
Other	317	317	106	106
Total consumer	3,021	2,999	2,466	1,136
Total	$19,990	15,178	10,989	4,606

	December 31, 2013			
		Recorded investment		
	Unpaid Principal Balance	Impaired loans	Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 1,935	1,935	1,666	333
Non-owner occupied RE	5,957	5,612	6,225	1,441
Construction	4,612	1,805	1,755	246
Business	5,494	4,684	2,807	1,813
Total commercial	17,998	14,115	12,453	3,833
Consumer				
Real estate	1,829	1,807	1,447	704
Home equity	239	239	239	188
Construction	-	-	-	-
Other	225	225	4	4
Total consumer	2,293	2,271	1,690	896
Total	$20,291	16,386	14,143	4,729

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

(dollars in thousands)	Three months ended September 30, 2014		Three months ended September 30, 2013	
	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial				
Owner occupied RE	$ 1,430	22	1,140	2
Non-owner occupied RE	6,582	31	5,487	61
Construction	1,752	-	2,118	19
Business	4,298	38	4,792	51
Total commercial	14,062	91	13,537	133
Consumer				
Real estate	2,334	16	1,078	9
Home equity	254	2	573	1
Construction	-	-	-	-
Other	327	4	225	2
Total consumer	2,915	22	1,876	12
Total	$ 16,977	113	15,413	145

(dollars in thousands)	**Nine months ended September 30, 2014**		Nine months ended September 30, 2013		Year ended December 31, 2013	
	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial						
Owner occupied RE	$ 1,680	25	1,416	4	1,519	47
Non-owner occupied RE	5,986	84	5,996	206	5,932	261
Construction	1,790	14	2,100	45	2,054	57
Business	4,511	105	4,480	150	4,521	189
Total commercial	13,967	228	13,992	405	14,026	554
Consumer						
Real estate	2,213	40	1,031	53	1,186	100
Home equity	227	8	671	6	610	8

Construction	-	-	-	-	-	-
Other	274	10	236	7	234	9
Total consumer	2,714	58	1,938	66	2,030	117
Total	$ 16,681	286	15,930	471	16,056	671

Allowance for Loan Losses

The allowance for loan loss is management's estimate of credit losses inherent in the loan portfolio. 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 collectability 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 revision as more information becomes available.

We have an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in our portfolio. While we attribute portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. Our process involves procedures to appropriately consider the unique risk characteristics of our commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. Our allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions.

The following table summarizes the activity related to our allowance for loan losses by commercial and consumer portfolio segments:

						Nine months ended September 30, 2014			
	Commercial				Consumer				
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Real Estate	Home equity	Construction	Other	Total
Balance, beginning of period	$ 1,880	2,633	397	3,329	1,091	644	99	140	10,213
Provision for loan losses	(138)	1,271	150	439	821	560	102	70	3,275
Loan charge-offs	-	(1,580)	-	(635)	-	(77)	-	(11)	(2,303)
Loan recoveries	-	1	-	114	-	5	-	-	120
Net loan charge-offs	-	(1,579)	-	(521)	-	(72)	-	(11)	(2,183)
Balance, end of period	$ 1,742	2,325	547	3,247	1,912	1,132	201	199	11,305

Net charge-offs to average loans (annualized)	0.37%
Allowance for loan losses to gross loans	1.36%
Allowance for loan losses to nonperforming loans	141.99%

						Nine months ended September 30, 2013			
	Commercial				Consumer				
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Real Estate	Home equity	Construction	Other	Total
Balance, beginning of period	$ 1,774	1,946	313	3,981	346	540	3	188	9,091
Provision for loan losses	475	548	546	530	254	226	87	(16)	2,650
Loan charge-offs	(386)	(247)	-	(1,295)	(22)	(38)	-	(46)	(2,034)
Loan recoveries	2	1	-	99	-	7	-	-	109
Net loan charge-offs	(384)	(246)	-	(1,196)	(22)	(31)	-	(46)	(1,925)
Balance, end of period	$ 1,865	2,248	859	3,315	578	735	90	126	9,816
Net charge-offs to average loans (annualized)									0.38%
Allowance for loan losses to gross loans									1.39%
Allowance for loan losses to nonperforming loans									115.54%

The following table disaggregates our allowance for loan losses and recorded investment in loans by impairment methodology.

					September 30, 2014	
	Allowance for loan losses			Recorded investment in loans		
(dollars in thousands)	Commercial	Consumer	Total	Commercial	Consumer	Total
Individually evaluated	$3,470	1,136	4,606	12,179	2,999	15,178
Collectively evaluated	4,391	2,308	6,699	541,880	275,664	817,544
Total	$7,861	3,444	11,305	554,059	278,663	832,722

					December 31, 2013	
	Allowance for loan losses			Recorded investment in loans		
	Commercial	Consumer	Total	Commercial	Consumer	Total
Individually evaluated	$3,833	896	4,729	14,111	2,271	16,382
Collectively evaluated	4,406	1,078	5,484	497,627	219,647	717,274

Total	$8,239	1,974	10,213	511,738	221,918	733,656

NOTE 5 – Troubled Debt Restructurings

The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing financial challenges in the current economic environment. At September 30, 2014, we had 37 loans totaling $9.4 million and at December 31, 2013 we had 34 loans totaling $13.0 million, which we considered as TDRs. To date, we have restored five commercial loans previously classified as TDRs to accrual status.

The following table summarizes the concession at the time of modification and the recorded investment in our TDRs before and after their modification during the nine months ended September 30, 2014 and 2013, respectively.

	For the nine months ended September 30, 2014						
(dollars in thousands)	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial							
Owner occupied RE	-	-	-	-	-	$ -	$ -
Non-owner occupied RE	-	-	-	2	2	275	285
Construction	-	-	-	-	-	-	-
Business	1	-	-	2	3	263	263
Consumer							
Real estate	-	-	1	-	1	116	116
Home equity	-	-	-	-	-	-	-
Construction	-	-	-	-	-	-	-
Other	2	-	-	-	2	126	126
Total loans	3	-	1	4	8	$ 780	$ 790

	For the nine months ended September 30, 2013						
	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment

Commercial							
Owner occupied RE	-	-	-	-	-	$ -	$ -
Non-owner occupied RE	-	-	-	-	-	-	-
Construction	-	-	-	-	-	-	-
Business	8	-	-	-	8	1,636	1,637
Consumer							
Real estate	-	-	-	-	-	-	-
Home equity	-	-	-	-	-	-	-
Construction	-	-	-	-	-	-	-
Other	1	-	-	-	1	4	4
Total loans	9	-	-	-	9	$ 1,640	$ 1,641

The following table summarizes loans modified as TDRs for which there was a payment default that occurred during the nine months ended September 30, 2014 and 2013 and within 12 months of the restructuring date.

	For the nine months ended September 30,			
	2014		2013	
(dollars in thousands)	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial				
Owner occupied RE	-	$ -	-	$ -
Non-owner occupied RE	-	-	-	-
Construction	-	-	-	-
Business	-	-	-	-
Consumer				
Real estate	-	-	1	579
Home equity	-	-	-	-
Construction	-	-	-	-
Other	-	-	-	-
Total loans	-	$ -	1	$ 579

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NOTE 6 – Fair Value Accounting

FASB ASC 820, "Fair Value Measurement and Disclosures," defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted market price in active markets
Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.
Level 2 – Significant other observable inputs
Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company's available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.
Level 3 – Significant unobservable inputs
Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as Federal Reserve Bank and FHLB stock, approximates fair value based on their redemption provisions.

Loans Held for Sale

Loans held for sale include mortgage loans and are carried at the lower of cost or market value. The fair values of mortgage loans held for sale are based on commitments on hand from investors within the secondary market for loans with similar characteristics. Carrying value approximates fair value.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, "Receivables." The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair

value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2014, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, "Fair Value Measurement and Disclosures," impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. The Company's current loan and appraisal policies require the Bank to obtain updated appraisals on an "as is" basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

Other Real Estate Owned ("OREO")

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the OREO as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013.

			September 30, 2014	
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Securities available for sale				
US government agencies	$ -	8,352	-	8,352
SBA securities	-	5,209	-	5,209
State and political subdivisions	-	17,730	-	17,730
Mortgage-backed securities	-	25,578	-	25,578
Total assets measured at fair value on a recurring basis	$ -	56,869	-	56,869

			December 31, 2013	
	Level 1	Level 2	Level 3	Total
Assets				
Securities available for sale				
US government agencies	$ -	7,755	-	7,755
SBA securities	-	5,271	-	5,271
State and political subdivisions	-	23,370	-	23,370
Mortgage-backed securities	-	31,044	-	31,044
Total assets measured at fair value on a recurring basis	$ -	67,440	-	67,440

The Company has no liabilities carried at fair value or measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company is predominantly an asset based lender with real estate serving as collateral on more than 80% of loans as of September 30, 2014. Loans which are deemed to be impaired are valued net of the allowance for loan losses, and other real estate owned is valued at the lower of cost or net realizable value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2014 and December 31, 2013.

			As of September 30, 2014	
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	$ -	9,601	971	10,572
Other real estate owned	-	3,282	267	3,549
Total assets measured at fair value on a nonrecurring basis	$ -	12,883	1,238	14,121

			As of December 31, 2013	
	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	$ -	10,495	1,158	11,653
Other real estate owned	-	1,085	113	1,198
Total assets measured at fair value on a nonrecurring basis	$ -	11,580	1,271	12,851

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis as of September 30, 2014 and December 31, 2013.

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

	Valuation Technique	Significant Unobservable Inputs
Impaired loans	Appraised Value/ Discounted Cash Flows	Discounts to appraisals or cash flows for estimated holding and/or selling costs
Other real estate owned	Appraised Value/ Comparable Sales	Discounts to appraisals for estimated holding or selling costs

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, and securities sold under agreement to repurchase.

Deposits – Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

FHLB Advances and Other Borrowings – Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

Junior subordinated debentures – Fair value for junior subordinated debentures are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

The estimated fair values of the Company’s financial instruments at September 30, 2014 and December 31, 2013 are as follows:

			September 30, 2014		
(dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$ 58,031	58,031	58,031	-	-
Other investments, at cost	6,522	6,522	-	-	6,522
Loans held for sale	9,372	9,372	-	9,372	-
Loans, net	821,417	823,913	-	10,572	813,341
Financial Liabilities:					
Deposits	772,760	731,529	-	731,529	-
FHLB and other borrowings	139,600	149,102	-	149,102	-
Junior subordinated debentures	13,403	5,234	-	5,234	-

			December 31, 2013		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$ 39,203	39,203	39,203	-	-
Other investments, at cost	6,116	6,116	-	-	6,116
Loans held for sale	3,611	3,611	-	3,611	-
Loans, net	723,443	732,328	-	10,676	721,652
Financial Liabilities:					
Deposits	680,319	643,399	-	643,399	-
FHLB and other borrowings	124,100	135,411	-	135,411	-
Junior subordinated debentures	13,403	5,145	-	5,145	-

NOTE 7 – Earnings Per Common Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and nine month periods ended September 30, 2014 and 2013. Dilutive common shares arise from the potentially dilutive effect of the Company’s stock options that were outstanding at September 30, 2014. The assumed conversion of stock options can create a difference between basic and dilutive net income per common share. At September 30, 2014 and 2013, 110,463 and 24,624 options, respectively, were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value.

(dollars in thousands, except share data)	Three months ended September 30, 2014	2013	Nine months ended September 30, 2014	2013
Numerator:				
Net income	$1,826	1,419	4,643	3,681
Less: Preferred stock dividend	253	191	699	580
Add: Redemption of preferred stock	-	-	-	20
Net income available to common shareholders	$1,573	1,228	3,944	3,121
Denominator:				
Weighted-average common shares outstanding – basic	4,829,514	4,271,652	4,775,791	4,267,693
Common stock equivalents	216,973	218,374	208,762	160,471
Weighted-average common shares outstanding – diluted	5,046,487	4,490,026	4,984,553	4,428,164
Earnings per common share:				
Basic	$0.33	0.29	0.83	0.73
Diluted	$0.31	0.27	0.79	0.71

Item 2. MANAGEMENT'S DISCUSSION AND Analysis of Financial Condition and Results of Operations.

The following discussion reviews our results of operations for the three and nine month periods ended September 30, 2014 as compared to the three and nine month periods ended September 30, 2013 and assesses our financial condition as of September 30, 2014 as compared to December 31, 2013. You should read the following discussion and analysis in conjunction with the accompanying consolidated financial statements and the related notes and the consolidated financial statements and the related notes for the year ended December 31, 2013 included in our Annual Report on Form 10-K for that period. Results for the three and nine month periods ended September 30, 2014 are not necessarily indicative of the results for the year ending December 31, 2014 or any future period.

CAUTIONARY WARNING REGARDING FORWARD-LOOKING STATEMENTS

This report, including information included or incorporated by reference in this report, contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may relate to our financial condition, results of operations, plans, objectives, or future performance. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words “may,” “would,” “could,” “should,” “will,” “expect,” “anticipate,” “predict,” “potential,” “believe,” “continue,” “assume,” “intend,” “plan,” and “estimate,” as well as similar expressions, are meant to iden such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described under Item 1A-Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2013, as well as the following:

- Restrictions or conditions imposed by our regulators on our operations;
- Increases in competitive pressure in the banking and financial services industries;
- Changes in access to funding or increased regulatory requirements with regard to funding;
- Changes in deposit flows;
- Credit losses as a result of declining real estate values, increasing interest rates, increasing unemployment, changes in payment behavior or other factors;
- Credit losses due to loan concentration;
- Changes in the amount of our loan portfolio collateralized by real estate and weaknesses in the real estate market;
- Our ability to attract and retain key personnel;

- Changes in the interest rate environment which could reduce anticipated or actual margins;
- Changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- Changes in economic conditions resulting in, among other things, a deterioration in credit quality;
- Changes occurring in business conditions and inflation;
- Increased cybersecurity risk, including potential business disruptions or financial losses;
- Changes in technology;
- The adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;
- Examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;
- Changes in monetary and tax policies;
- The rate of delinquencies and amounts of loans charged-off;
- The rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;
- Our ability to maintain appropriate levels of capital and to comply with our capital ratio requirements;
- Adverse changes in asset quality and resulting credit risk-related losses and expenses;
- Changes in accounting policies and practices; and

- Other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission (the "SEC").

If any of these risks or uncertainties materialize, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. We make these forward-looking statements as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements.

OVERVIEW

We are a bank holding company headquartered in Greenville, South Carolina, and were incorporated in March 1999 under the laws of South Carolina. We provide a wide range of banking services and products to our clients through our wholly-owned subsidiary, Southern First Bank, a South Carolina state bank.

The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public. We currently have nine offices located in Greenville, Lexington, Richland, and Charleston Counties of South Carolina. In August 2014, we opened our second full-service office in the Charleston, South Carolina market.

We operate our Bank using a simple and efficient style of banking that is focused on providing core banking products and services to our clients through a team of talented and experienced bankers. We refer to this model as "ClientFIRST," and it is structured to provide superior client service via "relationship teams," which provide each client with a specific banker contact and a consistent support team responsible for all of the client's banking needs. We believe this model results in a consistent and superior level of professional service that provides us with a distinct competitive advantage by enabling us to build and maintain long-term relationships with desirable clients, enhancing the quality and stability of our funding and lending operations and positioning us to take advantage of future growth opportunities in our existing markets. We also believe that this client focused culture has led to our successful expansion into new markets in the past and will enable us to be successful if we seek to expand into new markets in the future.

At September 30, 2014, we had total assets of $1.0 billion, a 13.1% increase from total assets of $890.8 million at December 31, 2013. The largest components of our total assets are net loans and securities which were $821.4

million and $63.4 million, respectively, at September 30, 2014. Comparatively, our net loans and securities totaled $723.4 million and $73.6 million, respectively, at December 31, 2013. Our liabilities and shareholders' equity at September 30, 2014 totaled $934.0 million and $73.6 million, respectively, compared to liabilities of $825.2 million and shareholders' equity of $65.7 million at December 31, 2013. The principal component of our liabilities is deposits which were $772.8 million and $680.3 million at September 30, 2014 and December 31, 2013, respectively.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our clients.

Our net income was $1.8 million and $1.4 million for the three months ended September 30, 2014 and 2013, respectively, an increase of $407,000, or 28.7%. After our dividend payment to our preferred shareholders, net income to common shareholders was $1.6 million, or diluted earnings per share ("EPS") of $0.31, for the third quarter of 2014 as compared to net income to common shareholders of $1.2 million, or diluted EPS of $0.27 for the same period in 2013. The increase in net income resulted primarily from increases in net interest income and noninterest income, partially offset by increases in the provision for loan losses and noninterest expense.

Our net income was $4.6 million and $3.7 million for the nine months ended September 30, 2014 and 2013, respectively, an increase of $962,000, or 26.1%. After our dividend payment to our preferred shareholders, net income to common shareholders was $3.9 million, or diluted EPS of $0.79, for the nine months ended September 30, 2014 as compared to net income to common shareholders of $3.1 million, or diluted EPS of $0.71, for the same period in 2013. The increase in net income resulted primarily from increases in net interest income and noninterest income, partially offset by increases in the provision for loan losses and noninterest expense.

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including the Bank. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

Effect of Economic Trends

Markets in the United States and elsewhere have experienced extreme volatility and disruption since the latter half of 2007. While the economy as a whole has steadily improved since 2009, the weaker economic conditions are expected to continue throughout the remainder of 2014. Financial institutions likely will continue to experience credit losses above historical levels and elevated levels of non-performing assets, charge-offs and foreclosures. In light of these conditions, financial institutions also face heightened levels of scrutiny from federal and state regulators. These factors negatively influenced, and likely will continue to negatively influence, earning asset yields at a time when the market for deposits is intensely competitive. As a result, financial institutions experienced, and may continue to experience, pressure on credit costs, loan yields, deposit and other borrowing costs, liquidity, and capital.

results of operations

Net Interest Income and Margin

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. For the three month period ended September 30, 2014 our net interest income was $8.5 million, a 15.3% increase over net interest income of $7.4 million for the same period in 2013. In comparison, our

average earning assets increased 17.0%, or $135.2 million, during the third quarter of 2014 compared to the third quarter of 2013, while our interest bearing liabilities increased by $91.3 million during the same period. The increase in average earning assets is primarily related to an increase in average loans and federal funds sold, partially offset by a decrease in investment securities, while the increase in average interest-bearing liabilities is primarily a result of an increase in interest bearing deposits.

We have included a number of tables to assist in our description of various measures of our financial performance. For example, the “Average Balances, Income and Expenses, Yields and Rates” table reflects the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during the three and nine month periods ended September 30, 2014 and 2013. A review of this table shows that our loans typically provide higher interest yields than do other types of interest-earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the “Rate/Volume Analysis” table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning accounts and interest-bearing accounts.

The following tables set forth information related to our average balance sheets, average yields on assets, and average costs of liabilities. We derived these yields by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the same periods, we had no securities purchased with agreements to resell. All investments owned have an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

Average Balances, Income and Expenses, Yields and Rates

	For the Three Months Ended September 30,					
	2014			2013		
(dollars in thousands)	Average Balance	Income/ Expense	Yield/ Rate(1)	Average Balance	Income/ Expense	Yield/ Rate(1)
Interest-earning assets						
Federal funds sold	$ 37,100	$ 24	0.26%	$ 21,745	$ 14	0.28%
Investment securities, taxable	45,762	284	2.46%	52,955	291	2.18%
Investment securities, nontaxable (2)	18,001	187	4.12%	23,474	252	4.25%
Loans, including loans held for sale	827,986	9,829	4.71%	695,524	8,639	4.93%
Total interest-earning assets	928,849	10,324	4.41%	793,698	9,196	4.60%
Noninterest-earning assets	51,080			48,188		
Total assets	$979,929			$841,886		
Interest-bearing liabilities						
NOW accounts	$145,124	59	0.16%	$148,076	82	0.22%
Savings & money market	210,155	174	0.33%	162,334	138	0.34%
Time deposits	271,865	485	0.71%	221,787	453	0.81%
Total interest-bearing deposits	627,144	718	0.45%	532,197	673	0.50%
FHLB advances and other borrowings	124,953	963	3.06%	132,617	982	3.03%
Junior subordinated debentures	13,403	81	2.40%	13,403	82	2.43%

Total interest-bearing liabilities	765,500	1,762	0.91%	674,217	1,737	1.02%
Noninterest-bearing liabilities	140,923			103,239		
Shareholders' equity	73,506	&nb				