COMMUNITY FINANCIAL CORP /MD/
Form 10-Q
May 06, 2016

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 March 31, 2016

OR

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

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission File Number 0-18279

The Community Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1652138

(State of other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

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

(301) 645-5601

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes x No ¨

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

Yes x No ¨

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

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

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

Yes ¨ No x

As of April 28, 2016, the registrant had 4,652,633 shares of common stock outstanding.

THE COMMUNITY FINANCIAL CORPORATION

FORM 10-Q

INDEX

PART 1 - FINANCIAL INFORMATION
ITEM 1 – FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	March 31, 2016 (Unaudited)	December 31, 2015
Assets		
Cash and due from banks	$ 9,501	$ 9,059
Federal funds sold	175	225
Interest-bearing deposits with banks	482	1,855
Securities available for sale (AFS), at fair value	36,636	35,116
Securities held to maturity (HTM), at amortized cost	114,455	109,420
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock - at cost	6,541	6,931
Loans receivable - net of allowance for loan losses of $8,591 and $8,540	935,499	909,200
Premises and equipment, net	22,450	20,156
Premises and equipment held for sale	-	2,000
Other real estate owned (OREO)	11,038	9,449
Accrued interest receivable	3,382	3,218
Investment in bank owned life insurance	28,032	27,836
Other assets	8,722	8,867
Total Assets	$ 1,176,913	$ 1,143,332
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	$ 137,312	$ 142,771
Interest-bearing deposits	813,287	764,128
Total deposits	950,599	906,899
Short-term borrowings	30,500	36,000
Long-term debt	50,602	55,617
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000
Subordinated notes - 6.25%	23,000	23,000
Accrued expenses and other liabilities	9,270	10,033
Total Liabilities	1,075,971	1,043,549
Stockholders' Equity		
Common stock - par value $.01; authorized - 15,000,000 shares;		
Common stock - par value $.01; authorized - 15,000,000 shares; issued 4,652,292 and 4,645,429 shares, respectively	47	46
Additional paid in capital	46,907	46,809
Retained earnings	54,316	53,495

Accumulated other comprehensive loss	(12)	(251)
Unearned ESOP shares	(316)	(316)
Total Stockholders' Equity	100,942	99,783
Total Liabilities and Stockholders' Equity	$ 1,176,913	$ 1,143,332

See notes to Consolidated Financial Statements

1

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(dollars in thousands, except per share amounts)	Three Months Ended March 31, 2016	2015
Interest and Dividend Income		
Loans, including fees	$10,545	$10,177
Taxable interest and dividends on investment securities	763	547
Interest on deposits with banks	4	4
Total Interest and Dividend Income	11,312	10,728
Interest Expense		
Deposits	1,095	988
Short-term borrowings	38	9
Long-term debt	786	668
Total Interest Expense	1,919	1,665
Net Interest Income	9,393	9,063
Provision for loan losses	427	178
Net Interest Income After Provision For Loan Losses	8,966	8,885
Noninterest Income		
Loan appraisal, credit, and miscellaneous charges	61	58
Gain on sale of asset	-	18
Net gains on sale of OREO	5	-
Net losses on sale of investment securities	-	(1)
Income from bank owned life insurance	196	205
Service charges	588	585
Gain on sale of loans held for sale	-	97
Total Noninterest Income	850	962
Noninterest Expense		
Salary and employee benefits	4,152	4,145
Occupancy expense	589	630
Advertising	63	103
Data processing expense	554	518
Professional fees	425	295
Depreciation of premises and equipment	196	201
Telephone communications	44	46
Office supplies	43	39
FDIC Insurance	243	198
OREO valuation allowance and expenses	301	219
Other	630	549
Total Noninterest Expense	7,240	6,943

Income before income taxes	2,576	2,904
Income tax expense	968	1,083
Net Income	$1,608	$1,821
Preferred stock dividends	-	23
Net Income Available to Common Stockholders	$1,608	$1,798
Earnings Per Common Share		
Basic	$0.35	$0.38
Diluted	$0.35	$0.38
Cash dividends paid per common share	$0.10	$0.10

See notes to Consolidated Financial Statements

2

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(dollars in thousands)	Three Months Ended March 31, 2016	2015
Net Income	$1,608	$1,821
Net unrealized holding gains arising during period, net of tax expense of $155 and $181, respectively	239	278
Comprehensive Income	$1,847	$2,099

See notes to Consolidated Financial Statements

3

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(dollars in thousands)	Three Months Ended March 31, 2016	2015
Cash Flows from Operating Activities		
Net income	$1,608	$1,821
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	427	178
Depreciation and amortization	354	349
Loans originated for resale	-	(4,215)
Proceeds from sale of loans originated for sale	-	4,021
Gain on sale of loans held for sale	-	(97)
Net gains on the sale of OREO	(5)	-
Losses on sales of HTM investment securities	-	1
Gain on sale of asset	-	(18)
Net amortization of premium/discount on investment securities	128	127
Increase in OREO valuation allowance	255	125
Increase in cash surrender of bank owned life insurance	(196)	(205)
Decrease (increase) in deferred income tax benefit	82	(118)
Increase in accrued interest receivable	(164)	(79)
Stock based compensation	80	54
Decrease in deferred loan fees	(100)	(30)
(Decrease) increase in accrued expenses and other liabilities	(763)	1,463
(Increase) decrease in other assets	(84)	575
Net Cash Provided by Operating Activities	1,622	3,952
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(2,512)	(22)
Proceeds from redemption or principal payments of AFS investment securities	1,361	1,937
Purchase of HTM investment securities	(9,962)	-
Proceeds from maturities or principal payments of HTM investment securities	4,824	3,706
Net decrease (increase) of FHLB and FRB stock	391	(499)
Loans originated or acquired	(79,948)	(74,011)
Principal collected on loans	50,806	52,988
Purchase of premises and equipment	(2,648)	(1,040)
Proceeds from sale of OREO	676	452
Proceeds from sale of HTM investment securities	-	66
Proceeds from disposal of asset	2,000	21
Net Cash Used in Investing Activities	(35,012)	(16,402)

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(continued)

(dollars in thousands)	Three Months Ended March 31, 2016	2015
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	$43,700	$(14,893)
Payments of long-term debt	(5,015)	(4,013)
Net (decrease) increase in short term borrowings	(5,500)	19,000
Proceeds from subordinated notes	-	23,000
Redemption of Small Business Lending Fund Preferred Stock	-	(20,000)
Dividends paid	(453)	(534)
Net change in unearned ESOP shares	-	(28)
Repurchase of common stock	(323)	(16)
Net Cash Provided by Financing Activities	32,409	2,516
Decrease in Cash and Cash Equivalents	$(981)	$(9,934)
Cash and Cash Equivalents - January 1	11,139	21,373
Cash and Cash Equivalents - March 31	$10,158	$11,439
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for		
Interest	$2,244	$1,479
Income taxes	$300	$50
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	$464	$216
Transfer from loans to OREO	$2,515	$1,556

See notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 – BASIS OF PRESENTATION

The consolidated financial statements of The Community Financial Corporation (the "Company") and its wholly owned subsidiary, Community Bank of the Chesapeake (the "Bank"), and the Bank's wholly owned subsidiary, Community Mortgage Corporation of Tri-County, included herein are unaudited.

The consolidated financial statements reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company's financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2015 have been derived from audited financial statements. There have been no significant changes to the Company's accounting policies as disclosed in the 2015 Annual Report. The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2016 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's 2015 Annual Report.

NOTE 2 – NATURE OF BUSINESS

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

The Bank conducts business through its main office in Waldorf, Maryland, and eleven branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Fredericksburg, Virginia. The Company maintains five loan production offices ("LPOs") in Annapolis, La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches. The Company's second branch in Fredericksburg opened in April 2016.

The Company sold its King George, Virginia branch building and equipment to a credit union. The Company's 2015 third quarter operating results reflect the financial impact of the transaction. The Company recorded an impairment of $426,000 during the third quarter of 2015. The transaction closed on January 28, 2016.

NOTE 3 – INCOME TAXES

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

NOTE 4 - ACCUMULATED OTHER COMPREHENSIVE GAIN (LOSS)

The following tables present the components of comprehensive gain (loss) for the ended March 31, 2016 and 2015. The Company's comprehensive gain (loss) was solely related to securities for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
(dollars in thousands)	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Net unrealized holding gains arising during period	$394	$ 155	$239	$459	$ 181	$278
Reclassification adjustments	-	-	-	-	-	-
Other comprehensive gain	$394	$ 155	$239	$459	$ 181	$278

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended March 31, 2016 and 2015.

(dollars in thousands)	Three Months Ended March 31, 2016 Net Unrealized Gains And Losses	Three Months Ended March 31, 2015 Net Unrealized Gains And Losses
Beginning of period	$ (251)	$ (378)
Other comprehensive gain, net of tax	239	278
End of period	$ (12)	$ (100)

NOTE 5 - EARNINGS PER SHARE ("EPS")

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. At March 31, 2016 and 2015, there were 21,111 and 87,436 options, respectively, which were excluded from the calculation as their effect would be anti-dilutive, because the exercise price of the options were greater than the average market price of the common shares. The Company has not granted any stock options since 2007 and all options outstanding at March 31, 2016 were anti-dilutive. Unvested restricted stock is excluded from the calculation of basic earnings per share. At March 31, 2016 there were 43,539 unvested shares of restricted stock. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Three Months Ended March 31,	
(dollars in thousands)	2016	2015
Net Income	$1,608	$1,821
Less: dividends paid and accrued on preferred stock	-	(23)
Net income available to common shareholders	$1,608	$1,798
Average number of common shares outstanding	4,594,683	4,694,460
Dilutive effect of common stock equivalents	29,920	-
Average number of shares used to calculate diluted EPS	4,624,603	4,694,460

7

NOTE 6 - STOCK-BASED COMPENSATION

The Company has stock-based incentive arrangements to attract and retain key personnel. In May 2015, the 2015 Equity Compensation Plan (the "Plan") was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service-based awards is recognized over the vesting period. Performance-based awards are recognized based on a vesting schedule and the probability of achieving goals specified at the time of the grant. The 2015 Plan replaced the 2005 Equity Compensation Plan.

Stock-based compensation expense totaled $80,000 and $54,000 for the three months ended March 31, 2016 and 2015, respectively. Stock-based compensation expense consisted of the vesting of grants of restricted stock.

All outstanding options are fully vested and the Company has not granted any stock options since 2007. The fair value of the Company's outstanding employee stock options is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

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

The following tables below summarize outstanding and exercisable options at March 31, 2016 and December 31, 2015.

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2016	21,211	$ 27.70	$ -	
Forfeited	(100)	27.70		
Outstanding at March 31, 2016	21,111	$ 27.70	$ -	1.0
Exercisable at March 31, 2016	21,111	$ 27.70	$ -	1.0

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2015	87,436	$ 23.60	$ -	
Expired	(66,225)	22.29		
Outstanding at December 31, 2015	21,211	$ 27.70	$ -	1.0
Exercisable at December 31, 2015	21,211	$ 27.70	$ -	1.0

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

Shares Outstanding March 31, 2016	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
21,111	1 year	$ 27.70

The aggregate intrinsic value of outstanding stock options and exercisable stock options was $0 at March 31, 2016 and December 31, 2015, respectively because all options outstanding were anti-dilutive.

8

The Company granted restricted stock and stock units in accordance with the Plan. The vesting period for outstanding granted restricted stock is between three and five years. As of March 31, 2016, unrecognized stock compensation expense was $1.3 million. The following tables summarize the unvested restricted stock awards outstanding at March 31, 2016 and December 31, 2015, respectively.

	Restricted Stock	
	Number of Shares	**Weighted Average Grant Date Fair Value**
Nonvested at January 1, 2016	37,048	$ 19.83
Granted	22,403	20.75
Vested	(15,912)	20.09
Nonvested at March 31, 2016	43,539	$ 20.21

	Restricted Stock	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2015	29,472	$ 20.83
Granted	28,040	18.63
Vested	(20,464)	19.62
Nonvested at December 31, 2015	37,048	$ 19.83

NOTE 7 - GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES (“TRUPs”)

On June 15, 2005, Tri-County Capital Trust II (“Capital Trust II”), a Delaware business trust formed, funded and wholly owned by the Company, issued $5.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I ("Capital Trust I"), a Delaware business trust formed, funded and wholly owned by the Company, issued $7.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company's $217,000 capital contribution for Capital Trust I's common securities, to purchase $7.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

NOTE 8 – SUBORDINATED NOTES

On February 6, 2015 the Company issued $23.0 million of unsecured 6.25% fixed to floating rate subordinated notes due February 15, 2025 ("subordinated notes"). On February 13, 2015, the Company used proceeds of the offering to redeem all $20 million of the Company's outstanding preferred stock issued under the Small Business Lending Fund ("SBLF") program. The subordinated notes qualify as Tier 2 regulatory capital and replaced SBLF Tier 1 capital. The subordinated notes are not listed on any securities exchange or included in any automated dealer quotation system and there is no market for the notes. The notes are unsecured obligations and are subordinated in right of payment to all existing and future senior debt, whether secured or unsecured. The notes are not guaranteed obligations of any of the Company's subsidiaries.

9

Interest will accrue at a fixed per annum rate of 6.25% from and including the issue date to but excluding February 15, 2020. From and including February 15, 2020 to but excluding the maturity date interest will accrue at a floating rate equal to the three-month LIBOR plus 479 basis points. Interest is payable on the notes on February 15 and August 15 of each year, commencing August 15, 2015, through February 15, 2020, and thereafter February 15, May 15, August 15 and November 15 of each year through the maturity date or earlier redemption date.

The subordinated notes may be redeemed in whole or in part on February 15, 2020 or on any scheduled interest payment date thereafter and upon the occurrence of certain special events. The redemption price is equal to 100% of the principal amount of the subordinated notes to be redeemed plus accrued and unpaid interest to the date of redemption. Any partial redemption will be made pro rata among all holders of the subordinated notes. The subordinated notes are not subject to repayment at the option of the holders. The subordinated notes may be redeemed at any time, if (1) a change or prospective change in law occurs that could prevent the Company from deducting interest payable on the notes for U.S. federal income tax purposes, (2) a subsequent event occurs that precludes the notes from being recognized as Tier 2 Capital for regulatory capital purposes, or (3) the Company is required to register as an investment company under the Investment Company Act of 1940, as amended.

NOTE 9 - OTHER REAL ESTATE OWNED ("OREO")

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

	Three Months Ended March 31,		**Year Ended December 31,**
(dollars in thousands)	2016	2015	2015
Balance at beginning of year	$9,449	$5,883	$ 5,883
Additions of underlying property	2,515	1,556	5,436
Disposals of underlying property	(671)	(453)	(1,206)
Valuation allowance	(255)	(125)	(664)
Balance at end of period	$11,038	$6,861	$ 9,449

During the three months ended March 31, 2016, additions of $2.5 million consisted of $400,000 for a residential property and $2.1 million for a deed in lieu of foreclosure on an improved commercial office building with multiple tenants. The commercial office building was taken into OREO at the carrying value of the loan and is presently under contract in the feasibility study period. During the three months ended March 31, 2015, additions of $1.6 million consisted of $784,000 for five residential properties, $378,000 for three residential lots and $400,000 for a commercial building. The Company disposed of one residential property and two commercial properties for proceeds of $676,000 and a gain of $5,000 for the three months ended March 31, 2016. The Company disposed of one residential property and two finished residential lots at no gain for the three months ended March 31, 2015.

Additions to the valuation allowances of $255,000 and $125,000 were taken to adjust properties to current appraised values for the three months ended March 31, 2016 and 2015, respectively. OREO carrying amounts reflect management’s estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs. Expenses applicable to OREO assets include the following.

	Three Months Ended March 31,	
(dollars in thousands)	2016	2015
Valuation allowance	$255	$125
Operating expenses	46	94
	$301	$219

10

NOTE 10 – SECURITIES

	March 31, 2016			
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential Mortgage Backed Securities ("MBS")	$21	$ 4	$ -	$25
Residential Collateralized Mortgage Obligations ("CMOs")	32,286	127	311	32,102
Corporate equity securities	37	2	-	39
Bond mutual funds	4,312	158	-	4,470
Total securities available for sale	$36,656	$ 291	$ 311	$36,636
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs				
Residential MBS	$37,944	$ 753	$ 27	$38,670
Residential CMOs	70,663	575	192	71,046
Asset-backed securities issued by Others:				
Residential CMOs	1,028	-	100	928
Total debt securities held to maturity	109,635	1,328	319	110,644
Callable GSE Agency Bonds	$3,005	$ -	$ 11	$2,994
U.S. SBA Debentures	1,016	-	5	1,011
U.S. government obligations	799	-	-	799
Total securities held to maturity	$114,455	$ 1,328	$ 335	$115,448

	December 31, 2015			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$22	$ 4	$ -	$26
Residential CMOs	31,182	39	557	30,664
Corporate equity securities	37	2	-	39
Bond mutual funds	4,289	98	-	4,387
Total securities available for sale	$35,530	$ 143	$ 557	$35,116
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs				

Residential MBS	$34,085	$ 552	$ 242	$34,395
Residential CMOs	73,492	278	599	73,171
Asset-backed securities issued by Others:				
Residential CMOs	1,093	-	100	993
Total debt securities held to maturity	108,670	830	941	108,559
U.S. government obligations	750	-	-	750
Total securities held to maturity	$109,420	$ 830	$ 941	$109,309

At March 31, 2016, certain asset-backed securities with an amortized cost of $22.3 million were pledged to secure certain deposits. At March 31, 2016, asset-backed securities with an amortized cost of $1.9 million were pledged as collateral for advances from the Federal Home Loan Bank ("FHLB") of Atlanta.

11

At March 31, 2016, 99% of the asset-backed securities and agency bond portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS securities issued by GSEs had an average life of 3.77 years and average duration of 3.54 years and are guaranteed by their issuer as to credit risk. HTM securities issued by GSEs or U.S. government agencies had an average life of 4.17 years and average duration of 3.83 years and are guaranteed by their issuer as to credit risk.

At December 31, 2015, certain asset-backed securities with an amortized cost of $21.4 million were pledged to secure certain deposits. At December 31, 2015, asset-backed securities with an amortized cost of $1.9 million were pledged as collateral for advances from the Federal Home Loan Bank ("FHLB") of Atlanta.

At December 31, 2015, 99% of the asset-backed securities and agency bond portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS securities issued by GSEs had an average life of 4.39 years and average duration of 4.04 years and are guaranteed by their issuer as to credit risk. HTM securities issued by GSEs or U.S. government agencies had an average life of 5.07 years and average duration of 4.58 years and are guaranteed by their issuer as to credit risk.

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

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

No charges related to other-than-temporary impairment were made during for the three months ended March 31, 2016 and the year ended December 31, 2015.

During the three months ended March 31, 2016, no securities were sold. During the three months ended March 31, 2015, the Company sold one HTM security with a carrying value of $68,000 and recognized a loss of $1,000. The sale of HTM securities were permitted under ASC 320 "Investments - Debt and Equity Securities." ASC 320 permits the sale of HTM securities for certain changes in circumstances. The Company will dispose of HTM securities using the safe harbor rule that allows for the sale of HTM securities that have principal payments paid down to less than 15% of original purchased par. ASC 320 10-25-15 indicates that a sale of a debt security after a substantial portion of the principal has been collected is equivalent to holding the security to maturity. In addition, the Company will dispose of HTM securities under ASC 320-10-25-6 due to a significant deterioration in the issues' creditworthiness and the increase in regulatory risk weights mandated for risk-based capital purposes.

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at March 31, 2016 were as follows:

March 31, 2016	Less Than 12 Months		More Than 12 Months		Total	
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$5,386	$ 50	$13,902	$ 261	$19,288	$ 311

At March 31, 2016, the AFS investment portfolio had an estimated fair value of $36.6 million, of which $19.3 million of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses were CMOs issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $311,000 of the portfolio amortized cost of $32.3 million. AFS asset-backed securities issued by GSEs with unrealized losses had an average life of 3.95 years and an average duration of 3.66 years. We believe that the securities will either recover in market value or be paid off as agreed.

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at December 31, 2015 were as follows:

December 31, 2015	Less Than 12 Months		More Than 12 Months		Total	
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$4,658	$ 28	$17,344	$ 529	$22,002	$ 557

At December 31, 2015, the AFS investment portfolio had an estimated fair value of $35.1 million, of which $22.0 million of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses were CMOs issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $557,000 of the portfolio amortized cost of $31.2 million. AFS asset-backed securities issued by GSEs with unrealized losses had an average life of 4.45 years and an average duration of 4.04 years. We believe that the securities will either recover in market value or be paid off as agreed.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at March 31, 2016 were as follows:

March 31, 2016	Less Than 12 Months		More Than 12 Months		Total	
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	16,677	45	13,807	174	30,484	219
Callable GSE Agency Bonds	2,994	11	-	-	2,994	11
U.S. SBA Debentures	1,011	5	-	-	1,011	5
Asset-backed securities issued by other	-	-	928	100	928	100
	$20,682	$ 61	$14,735	$ 274	$35,417	$ 335

At March 31, 2016, the HTM investment portfolio had an estimated fair value of $115.5 million, of which $35.4 million of the securities had some unrealized losses from their amortized cost. Of these securities, $34.5 million were asset-backed securities or bonds issued by GSEs and debentures issued by U.S. government agencies. The remaining $928,000 were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. Total unrealized losses on the asset-backed securities or bonds issued by GSEs and debentures issued by U.S. government agencies were $235,000 of the portfolio amortized cost of $113.4 million. The securities with unrealized losses had an average life of 3.60 years and an average duration of 3.35 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $100,000 of the portfolio amortized cost of $1.0 million. HTM asset-backed securities issued by others with unrealized losses have an average life of 3.54 years and an average duration of 2.80 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2015 were as follows:

December 31, 2015	Less Than 12 Months		More Than 12 Months		Total	
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$36,337	$ 346	$16,431	$ 495	$52,768	$ 841
Asset-backed securities issued by other	-	-	992	100	992	100
	$36,337	$ 346	$17,423	$ 595	$53,760	$ 941

At December 31, 2015, the HTM investment portfolio had an estimated fair value of $109.3 million, of which $53.8 million of the securities had some unrealized losses from their amortized cost. Of these securities, $52.8 million were asset-backed securities issued by GSEs and the remaining $992,000 were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $841,000 of the portfolio amortized cost of $107.6 million. HTM asset-backed securities issued by GSEs with unrealized losses had an average life of 5.42 years and an average duration of 4.78 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $100,000 of the portfolio amortized cost of $1.1 million. HTM asset-backed securities issued by others with unrealized losses have an average life of 4.04 years and an average duration of 3.29 years.

Credit Quality of Asset-Backed Securities and Agency Bonds

The tables below present the Standard & Poor’s (“S&P”) or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and others or bonds issued by U.S. government agencies at March 31, 2016 and December 31, 2015 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed securities and GSE agency bonds with S&P AA+ ratings were treated as AAA based on regulatory guidance.

March 31, 2016		December 31, 2015	
Credit Rating	Amount	Credit Rating	Amount
(dollars in thousands)			
AAA	$145,554	AAA	$138,267
BBB	-	BBB	-
BB	487	BB	518
B+	541	B+	-
CCC+	-	CCC+	575
Total	$146,582	Total	$139,360

14

NOTE 11 – LOANS

Loans consist of the following:

(dollars in thousands)	March 31, 2016	December 31, 2015
Commercial real estate	$643,977	$ 613,479
Residential first mortgages	155,532	149,967
Construction and land development	38,687	36,189
Home equity and second mortgages	21,019	21,716
Commercial loans	54,220	67,246
Consumer loans	330	366
Commercial equipment	31,379	29,931
	945,144	918,894
Less:		
Deferred loan fees	1,054	1,154
Allowance for loan losses	8,591	8,540
	9,645	9,694
	$935,499	$ 909,200

At March 31, 2016 and December 31, 2015, the Bank's allowance for loan losses totaled $8.6 million and $8.5 million, respectively or 0.91% and 0.93%, respectively, of loan balances. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

Risk Characteristics of Portfolio Segments

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

Commercial Real Estate ("CRE")

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were 6.8% and 5.3% of the CRE portfolio at March 31, 20016 and December 31, 2015, respectively. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

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

Residential First Mortgages

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

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank’s adjustable rate residential first mortgage portfolio was $35.1 million or 3.7% of total gross loans of $945.1 million at March 31, 2016 compared to $33.6 million or 3.7% of gross loans of $918.9 million at December 31, 2015.

Construction and Land Development

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

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

Home Equity and Second Mortgage Loans

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

Commercial Loans

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

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

Consumer Loans

Consumer loans consist of loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower’s continuing financial stability.

Commercial Equipment Loans

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

Non-accrual and Past Due Loans

Non-accrual loans as of March 31, 2016 and December 31, 2015 were as follows:

(dollars in thousands)	March 31, 2016 90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$3,454	11	$ -	-	$ 3,454	11
Residential first mortgages	936	4	-	-	936	4
Construction and land development	3,482	3	-	-	3,482	3
Home equity and second mortgages	20	1	-	-	20	1
Commercial loans	1,165	5	689	2	1,854	7
Commercial equipment	646	4	-	-	646	4
	$9,703	28	$ 689	2	$ 10,392	30

(dollars in thousands)	December 31, 2015 90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$3,480	11	$ -	-	$ 3,480	11
Residential first mortgages	1,948	7	-	-	1,948	7
Construction and land development	3,555	3	-	-	3,555	3
Home equity and second mortgages	48	3	-	-	48	3
Commercial loans	1,361	8	693	2	2,054	10
Commercial equipment	348	4	-	-	348	4
	$10,740	36	$ 693	2	$ 11,433	38

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) decreased $1.0 million from $11.4 million or 1.24% of total loans at December 31, 2015 to $10.4 million or 1.10% of total loans at March 31, 2016. Non-accrual only loans are loans classified as non-accrual due to customer operating results or payment history. In accordance with the Company's policy, interest income is recognized on a cash basis for these loans.

The Company had 30 non-accrual loans at March 31, 2016 compared to 38 non-accrual loans at December 31, 2015. Non-accrual loans at March 31, 2016 included $7.6 million, or 75% of non-accrual loans, attributed to 17 loans representing six customer relationships classified as substandard. Non-accrual loans at December 31, 2015 included $8.1 million, or 71% of non-accrual loans, attributed to 19 loans representing six customer relationships classified as substandard. Of these loans at March 31, 2016 and December 31, 2015, $3.5 million and $3.8 million, respectively, represented a residential development project. During the second quarter of 2014, the Company deferred the collection of principal and interest on this project. The project is currently being built out with the support of private equity funds which have been used for vertical construction that has significantly improved the collateral value and the viability of the project. The Company's loans remain as troubled debt restructures ("TDRs") and non-accrual. In addition, at March 31, 2016 and December 31, 2015, the Company had three TDR loans totaling $1.6 million and $1.7 million, respectively, classified as non-accrual. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $9.7 million and $10.5 million at March 31, 2016 and December 31, 2015, respectively. Interest due but not recognized on these balances at March 31, 2016 and December 31, 2015 was $905,000 and $953,000, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $698,000 and $902,000 at March 31, 2016 and December 31, 2015, respectively. Interest due but not recognized on these balances at March 31, 2016 and December 31, 2015 was $76,000 and $34,000, respectively.

An analysis of past due loans as of March 31, 2016 and December 31, 2015 was as follows:

	March 31, 2016					
(dollars in thousands)	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$640,272	$251	$-	$3,454	$3,705	$ 643,977
Residential first mortgages	154,023	573	-	936	1,509	155,532
Construction and land dev.	35,205	-	-	3,482	3,482	38,687
Home equity and second mtg.	20,954	-	45	20	65	21,019
Commercial loans	53,055	-	-	1,165	1,165	54,220
Consumer loans	330	-	-	-	-	330
Commercial equipment	30,619	48	66	646	760	31,379
Total	$934,458	$872	$111	$9,703	$10,686	$ 945,144

	December 31, 2015					
(dollars in thousands)	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$609,999	$-	$-	$3,480	$3,480	$ 613,479
Residential first mortgages	147,720	-	299	1,948	2,247	149,967
Construction and land dev.	32,634	-	-	3,555	3,555	36,189
Home equity and second mtg.	21,603	65	-	48	113	21,716
Commercial loans	65,747	-	138	1,361	1,499	67,246
Consumer loans	365	-	1	-	1	366
Commercial equipment	29,138	152	293	348	793	29,931
Total	$907,206	$217	$731	$10,740	$11,688	$ 918,894

There were no loans greater than 90 days still accruing interest at March 31, 2016 and at December 31, 2015.

Impaired Loans and Troubled Debt Restructures ("TDRs")

Impaired loans, including TDRs, at March 31, 2016 and 2015 and at December 31, 2015 were as follows:

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Quarter Average Recorded Investment	Quarter Interest Income Recognized

Commercial real estate	$ 27,003	$ 24,165	$ 2,411	$ 26,576	$ 613	$ 26,712	$ 233
Residential first mortgages	3,353	2,681	671	3,352	65	3,382	34
Construction and land dev.	4,284	3,780	431	4,211	398	4,210	4
Home equity and second mtg.	130	130	-	130	-	128	1
Commercial loans	4,857	4,179	192	4,371	74	4,376	33
Commercial equipment	848	687	138	825	138	845	