MAULDIN & JENKINS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
and Stockholders of
Coastal Banking Company

We have audited the accompanying consolidated financial statements of **Coastal Banking Company and Subsidiaries**, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Coastal Banking Company as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mauldin & Jenkins, LLC

Albany, Georgia
March 14, 2016

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31,	
	2015	2014
Assets		
Cash and due from banks	$ 3,058,112	$ 2,726,911
Interest-bearing deposits in banks	1,772,456	1,363,282
Federal funds sold	82,642	87,967
Securities available for sale, at fair value	20,524,668	24,836,625
Restricted equity securities, at cost	6,781,900	5,392,500
Loans held for sale, at fair value	35,725,005	24,491,859
Loans, net of unearned income	285,932,549	272,756,670
Less allowance for loan losses	5,254,407	4,828,899
Loans, net	280,678,142	267,927,771
Premises and equipment, net	7,174,034	7,237,183
Cash surrender value of life insurance	2,521,887	2,402,713
SBA loan servicing rights	1,544,682	1,658,706
Other real estate owned	6,115,715	7,322,404
Loan sales receivable	92,456,618	70,651,624
Other assets	6,231,111	5,831,811
Total assets	$ 464,666,972	$ 421,931,356
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing	$ 42,156,742	$ 34,929,754
Interest-bearing	241,682,642	250,733,682
Total deposits	283,839,384	285,663,436
Other borrowings	120,500,000	83,500,000
Senior note payable	9,916,667	—
Junior subordinated debentures	7,217,000	7,217,000
Other liabilities	9,935,021	7,687,318
Total liabilities	431,408,072	384,067,754
Commitments and contingencies (Note 15)		
Shareholders' Equity:		
Preferred stock, par value $.01; 10,000,000 shares authorized; no shares issued and outstanding at December 31, 2015; 9,950 shares issued and outstanding at December 31, 2014	—	9,950,000
Common stock, par value $.01; 10,000,000 shares authorized; 2,684,478 shares issued and outstanding at December 31, 2015; 2,654,225 shares issued and outstanding at December 31, 2014	26,845	26,542
Additional paid-in capital	41,764,823	41,400,835
Accumulated deficit	(8,825,989)	(13,877,647)
Accumulated other comprehensive income	293,221	363,872
Total shareholders' equity	33,258,900	37,863,602
Total liabilities and shareholders' equity	$ 464,666,972	$ 421,931,356

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Income

	For the years ended December 31,	
	2015	2014
Interest income:		
Interest and fees on loans	$ 18,362,518	$ 16,662,385
Interest on taxable securities	675,536	842,033
Interest on nontaxable securities	113,770	220,231
Interest on deposits in other banks	8,361	6,885
Interest on federal funds sold	188	151
Total interest income	19,160,373	17,731,685
Interest expense:		
Interest on deposits	1,603,573	1,778,001
Interest on senior note payable and junior subordinated debentures	255,623	170,499
Interest on other borrowings	649,144	579,228
Total interest expense	2,508,340	2,527,728
Net interest income	16,652,033	15,203,957
Provision for loan losses	393,863	1,218,300
Net interest income after provision for loan losses	16,258,170	13,985,657
Noninterest income:		
Service charges on deposit accounts	209,486	249,207
Other service charges, commissions and fees	453,294	427,774
SBA loan income	1,414,020	3,290,535
Mortgage banking income	56,877,511	31,550,305
Gain on sale of securities available for sale	—	215,953
Income from investment in life insurance contracts	84,594	81,536
Other income	23,166	497,347
Total other income	59,062,071	36,312,657
Noninterest expenses:		
Salaries and employee benefits	50,961,553	33,353,671
Occupancy and equipment expense	3,663,962	2,945,956
Advertising fees	493,755	352,686
Audit fees	552,606	365,634
Data processing fees	1,568,600	1,554,539
Director fees	301,550	249,650
FDIC insurance expense	327,462	342,993
Legal and other professional fees	1,655,330	858,694
Mortgage loan expense	3,205,972	2,512,284
OCC examination fees	103,812	118,555
Other real estate owned expenses	741,311	1,227,028
Other operating	2,145,479	1,651,705
Total other expenses	65,721,392	45,533,395
Income before income taxes	9,598,849	4,764,919
Income tax expense	3,763,628	1,647,360
Net income	$ 5,835,221	$ 3,117,559
Preferred stock dividends	783,563	838,860
Net earnings available to common shareholders	$ 5,051,658	$ 2,278,699
Basic earnings per share available to common shareholders	$ 1.89	$ .86
Diluted earnings per share available to common shareholders	$ 1.85	$ .86

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

	For the years ended December 31,	
	2015	2014
Net income	$ 5,835,221	$ 3,117,559
Other comprehensive income (loss), net of tax (benefit):		
Net unrealized holding gains (losses) from securities available for sale arising during period, net of taxes (benefit) of $(36,396) and $321,960	(70,651)	624,981
Reclassification adjustment for gains of securities included in net income, net of tax of $0 and $73,424	—	(142,529)
Total other comprehensive income (loss)	(70,651)	482,452
Comprehensive income	$ 5,764,570	$ 3,600,011

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2015 and 2014

	Preferred Stock		Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Capital	Deficit	Income (Loss)	Total
Balance, December 31, 2013	9,950	$ 9,950,000	2,618,275	$ 26,183	$ 41,207,631	$ (16,156,346)	$ (118,580)	$ 34,908,888
Net income	—	—	—	—	—	3,117,559	—	3,117,559
Proceeds from exercise of stock options	—	—	20,122	201	70,513	—	—	70,714
Proceeds from employee stock purchase program	—	—	15,828	158	113,179	—	—	113,337
Preferred stock dividend	—	—	—	—	—	(838,860)	—	(838,860)
Stock-based compensation expense	—	—	—	—	9,512	—	—	9,512
Other comprehensive income	—	—	—	—	—	—	482,452	482,452
Balance, December 31, 2014	9,950	$ 9,950,000	2,654,225	$ 26,542	$ 41,400,835	$ (13,877,647)	$ 363,872	$ 37,863,602
Net income	—	—	—	—	—	5,835,221	—	5,835,221
Proceeds from exercise of stock options	—	—	200	2	678	—	—	680
Proceeds from employee stock purchase program	—	—	30,053	301	312,176	—	—	312,477
Preferred stock dividend	—	—	—	—	—	(783,563)	—	(783,563)
Preferred stock redemption	(9,950)	(9,950,000)	—	—	—	—	—	(9,950,000)
Stock-based compensation expense	—	—	—	—	51,134	—	—	51,134
Other comprehensive loss	—	—	—	—	—	—	(70,651)	(70,651)
Balance, December 31, 2015	—	$ —	2,684,478	$ 26,845	$ 41,764,823	$ (8,825,989)	$ 293,221	$ 33,258,900

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the years ended December 31,	
	2015	2014
Cash flows from operating activities:		
Net income	$ 5,835,221	$ 3,117,559
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion	694,247	792,579
Loss on sales of fixed assets	1,476	—
Stock-based compensation expense	51,134	9,512
Provision for loan losses	393,863	1,218,300
Gain on sales of securities available for sale	—	(215,953)
Net increase in loan sales receivable	(21,804,994)	(46,029,639)
Write downs of other real estate owned	607,334	350,036
(Gain) loss on sales of other real estate owned	(15,877)	477,344
Increase in cash value of life insurance	(119,174)	(116,123)
Originations of mortgage loans held for sale	(2,754,460,532)	(1,649,554,419)
Proceeds from sales of mortgage loans held for sale	2,800,104,897	1,688,896,573
Net (increase) decrease in interest receivable	14,827	(7,277)
Net increase in interest payable	25,145	4,718
SBA loan income	(1,414,020)	(3,290,535)
Mortgage banking income	(56,877,511)	(31,550,305)
Net other operating activities	3,372,870	6,127,863
Net cash used in operating activities	(23,591,094)	(29,769,767)
Cash flows from investing activities:		
Net increase in interest-bearing deposits in banks	(409,174)	(576,799)
Net (increase) decrease in federal funds sold	5,325	(27,611)
Proceeds from maturities of securities available for sale	3,881,768	4,089,472
Proceeds from sale of securities available for sale	—	10,404,149
Net change in restricted equity securities	(1,389,400)	(1,888,450)
Net increase in loans	(13,715,376)	(30,410,719)
Purchase of premises and equipment	(309,431)	(110,897)
Proceeds from sales of other real estate owned	1,186,374	4,929,510
Net cash used in investing activities	(10,749,914)	(13,591,345)
Cash flows from financing activities:		
Net decrease in deposits	(1,824,052)	(6,327,321)
Proceeds from other borrowings	663,850,000	576,100,000
Repayment of other borrowings	(626,850,000)	(528,950,000)
Dividends paid on preferred stock	(783,563)	(838,860)
Proceeds from senior note payable	10,000,000	—
Repayment of senior note payable	(83,333)	—
Redemption of preferred stock	(9,950,000)	—
Proceeds from employee stock purchase plan	312,477	113,337
Proceeds from exercise of stock options	680	70,714
Net cash provided by financing activities	34,672,209	40,167,870
Net increase (decrease) in cash and due from banks	331,201	(3,193,242)
Cash and due from banks at beginning of year	2,726,911	5,920,153
Cash and due from banks at end of year	$ 3,058,112	$ 2,726,911
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 2,483,195	$ 2,523,010
Cash paid during the year for income taxes	$ 3,828,635	$ 14,188
Noncash transactions:		
Principal balances of loans transferred to other real estate owned	$ 871,142	$ 1,534,574
Sales of other real estate owned through internally financed loans	$ 300,000	$ 2,437,000

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Basis of Presentation and Nature of Operations

Coastal Banking Company, Inc. (the "Company") is organized under the laws of the State of South Carolina for the purpose of operating as a bank holding company for CBC National Bank (the "Bank"). The Bank commenced business on May 10, 2000 as Lowcountry National Bank. The Company acquired First National Bank of Nassau County, which began its operations in 1999, through its merger with First Capital Bank Holding Corporation on October 1, 2005. On August 10, 2008, Lowcountry National Bank and First National Bank of Nassau County merged into one charter. Immediately after the merger, the name of the surviving bank was changed to CBC National Bank and the main office relocated to 1891 South 14th Street, Fernandina Beach, Nassau County, Florida. The Bank provides full commercial and consumer banking services to customers throughout Beaufort County, South Carolina and Nassau County, Florida, and is subject to regulation by the Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation (the "FDIC"). The Company is subject to regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board").

The Bank also has a residential mortgage banking division headquartered in Atlanta, Georgia. The mortgage banking division operates thirteen retail residential loan production offices located in nine states within Arizona, Florida, Georgia, Illinois, Indiana, Maryland, Michigan, North Carolina and Ohio. The Company also has an investment in Coastal Banking Company Statutory Trust I ("Trust I") and Coastal Banking Company Statutory Trust II ("Trust II"). Both trusts are special purpose subsidiaries organized for the sole purpose of issuing trust preferred securities.

The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry.

Accounting 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, the valuation of other real estate owned and deferred taxes, other-than-temporary impairments of securities, and the fair value of financial instruments.

The Company has evaluated all transactions, events, and circumstances for consideration or disclosure through March 14, 2016, the date these financial statements were available to be issued, and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Company's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Cash, Due from Banks and Cash Flows

For purposes of reporting cash flows, cash and due from banks includes cash on hand, cash items in process of collection and amounts due from banks. Cash flows from loans, loans sales receivable, federal funds sold, deposits, interest-bearing deposits in banks and restricted equity securities are reported net.

On July 21, 2010 the Dodd-Frank Act was signed into law. There are a number of provisions that are likely to significantly impact the ways in which banks and bank holding companies, including us and CBC National Bank, do business. For example, the Dodd-Frank Act permanently increases the standard amount of deposit insurance per customer to $250,000. At times our deposit accounts at other institutions exceed this coverage limit as daily transaction amounts clearing through correspondent accounts can be sizable and vary widely. We had one deposit account that exceeded the coverage limit with a balance of $2,042,000 and $1,614,000 at December 31, 2015 and 2014, respectively.

The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve requirements was approximately $762,000 at December 31, 2015 and $565,000 at December 31, 2014.

Securities

The Company classifies its securities as available for sale or held to maturity. Held to maturity securities are those securities for which the Company has the ability and intent to hold until maturity. All securities not included in held to maturity are classified as available for sale.

Available for sale securities are recorded at fair value. Held to maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on securities available for sale, net of the related tax effect, are excluded from earnings and are reported as a separate component of shareholders' equity until realized.

In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

A decline in the market value of securities below cost that is deemed other than temporary is charged to earnings and establishes a new cost basis for the security.

Premiums and discounts are amortized or accreted over the life of the related securities as adjustments to the yield. Realized gains and losses for securities classified as available for sale and held to maturity are recorded on trade date, are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

The Company evaluates investment securities for other-than-temporary impairment using relevant accounting guidance specifying that (a) if the Company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss has occurred in the security. If management does not intend to sell the security and it is more likely than not that they will not have to sell the security before recovery of the cost basis, management will recognize the credit component of another-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Restricted Equity Securities

The Company is required to maintain an investment in capital stock of the Federal Home Loan Bank of Atlanta ("FHLB") and the Federal Reserve Bank of Atlanta ("FRB"). The stock is generally pledged as collateral against any borrowings from these institutions. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks. At December 31, 2015 the balance of FHLB stock was $5,501,000 and the balance of FRB stock was $1,281,000. At December 31, 2014 the balance of FHLB stock was $4,095,000 and the balance of FRB stock was $1,297,000.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at fair value under the fair value option accounting guidance for financial instruments. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income. All residential loans are sold servicing released so there is no servicing income recognized on those loans. Interest income is generally recognized on those loans held for sale until the loan sale is fully completed and the loan is transferred. Interest income on loans held for sale is reflected along with portfolio loans in interest and fees on loans in the consolidated statement of income. At December 31, 2015 unpaid principal balances for loans held for sale totaled $39,597,000 and the fair market value of those loans was $35,725,000. At December 31, 2014 the unpaid principal balance for loans held for sale totaled $30,334,000 with a fair market value of $24,492,000.

The Company also originates SBA loans, which in some cases are sold on the secondary market. Once the decision is made to sell, adjustments to reflect fair value and realized gains and losses upon ultimate sale of the loans are classified as noninterest income in the consolidated statements of income.

Loan Sales Receivable

In accordance with trade date accounting guidance, the sale of residential mortgage loans is recognized at the time that all conditions precedent to the sale have been met and all material risks and rewards of loan ownership have passed from the Company to the investor purchasing the loans. This typically occurs when the physical loan documents are delivered to the investor. Upon delivery of loan documents, the Company records the gain or loss on sale of the loans and recognizes the receivable from the investor for the proceeds of sale.

Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding, net of deferred loan origination fees and costs and the allowance for loan losses. Interest on loans is calculated by using the interest rates and terms as stipulated in the loan notes and based upon the principal amount outstanding. Loan origination and commitment fees and direct loan origination costs are deferred and amortized over the contractual or expected economic life of the related loan or commitments as an adjustment of the related loan yields.

A loan is considered impaired when, based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or at the fair value of the collateral of the loan if the loan is collateral dependent.

To the extent that the recovery of loan balances has become collateral dependent, we obtain appraisals not less than annually, and then we reduce these appraised values for estimated selling and holding costs to determine the liquidated value. Any shortfall between the liquidated value and the loan balance is charged against the allowance for loan losses in the month the related appraisal was received. In the ordinary course of managing and monitoring non-performing loans, information may come to our attention that indicates the collateral value has declined further from the value established in the most recent appraisal. Such other information may include prices on recent comparable property sales or internet based property valuation estimates. In cases where this other information is deemed reliable, and the impact of a further reduction in collateral value would result in a further loss to the Company, we will record an increase to the allowance to reflect the additional estimated collateral shortfall.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Loans and Allowance for Loan Losses (Continued)

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance represents an amount, which, in management's judgment, will be adequate to absorb probable losses on existing loans that may become uncollectible.

Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, historical losses, high loan concentrations, trends in past dues and non accrual loans, loan risk ratings, economic conditions, market conditions and other internal and external factors that influence each portfolio segment and review of specific impaired loans. The combination of these results are compared monthly to the recorded allowance for loan losses for reasonableness and material differences are adjusted by increasing or decreasing the provision for loan losses. Management uses an external loan review program to challenge and corroborate the internal loan grading system and provide additional analysis in determining the adequacy of the allowance and the future provisions for estimated loan losses.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on judgments different than those of management.

Troubled Debt Restructurings

The Company designates loan modifications as troubled debt restructurings ("TDRs") when for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. In circumstances where the TDR involves charging off a portion of the loan balance, the Company typically classifies these restructurings as nonaccrual.

In connection with restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which among other things may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, a debt to income analysis, and an evaluation of secondary sources of payment from the borrower and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables.

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation must include consideration of the borrower's sustained historical repayment for a reasonable period, generally a minimum of six months, prior to the date on which the loan is returned to accrual status.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Non-performing Assets

Loans are placed in a non accrual status when, in the opinion of management, the collection of additional interest is questionable. Thereafter, no interest is taken into income unless received in cash or until such time as the borrower demonstrates the ability to pay principal and interest.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Costs incurred for maintenance and repairs that do not extend the useful life of the asset are expensed as incurred.

Depreciation expense totaled $371,000 and $428,000 for the years ended December 31, 2015 and December 31, 2014, respectively, and is computed using the straight-line method over the following estimated useful lives:

Building and improvements	10 - 40 years
Furniture and equipment	3 - 10 years

Intangible Assets

Intangible assets consist of Loan Servicing Rights (LSR) on the portion of Small Business Administration (SBA) loans participated to other institutions and serviced by the Company.

LSRs are carried at original fair value, as determined by an independent evaluation, less accumulated amortization. Amortization is recorded over the expected life of the loan. The LSR asset is evaluated for impairment at the end of each quarter, by obtaining a revised fair value from an independent third party. The related balance of SBA loans participated and serviced for others was $85,830,000 at December 31, 2015, and $82,474,000 at December 31, 2014.

Other real estate owned

Other real estate owned acquired through or in lieu of loan foreclosure are held for sale and are initially recorded at fair value less estimated selling costs. Any write-down to fair value at the time of transfer to other real estate owned is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated costs to sell. Costs of improvements are capitalized, to the extent that these costs don't increase the total carrying amount above the improved fair value less estimated selling costs. Costs relating to holding other real estate owned and subsequent adjustments to the value are expensed. The carrying amount of other real estate owned at December 31, 2015 and 2014 was $6,116,000 and $7,322,000 respectively.

Derivatives

Derivatives are recognized as assets and liabilities on the consolidated balance sheet and measured at fair value. For exchange-traded contracts, fair value is based on quotable market prices. For nonexchange traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

Cash flows resulting from the derivative financial instruments that are accounted for as hedges of assets and liabilities are classified in the cash flow statement in the same category as the cash flows of the items being hedged.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Derivatives (Continued)

Derivative Loan Commitments: Mortgage loan commitments that relate to the origination of a mortgage that will be held for sale upon funding are considered derivative instruments under the derivatives and hedging accounting guidance (FASB ASC 815, *Derivatives and Hedging*). Loan commitments that are derivatives are recognized at fair value on the consolidated balance sheet in other assets and other liabilities with changes in their fair values recorded in noninterest income.

Forward Loan Sale Commitments: The Company carefully evaluates all loan sales agreements to determine whether they meet the definition of a derivative under the derivatives and hedging accounting guidance (FASB ASC 815) as facts and circumstances may differ significantly. If agreements qualify, to protect against the price risk inherent in derivative loan commitments, the Company uses both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Mandatory delivery contracts which include both bulk sales and assignment of trade structures are accounted for as derivative instruments. Accordingly, forward loan sale commitments are recognized at fair value on the consolidated balance sheet in other assets and liabilities with changes in their fair values recorded in other noninterest income.

The Company estimates the fair value of its forward loan sales commitments using a methodology similar to that used for derivative loan commitments.

Income Taxes

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Stock Compensation Plans

Stock compensation accounting guidance (FASB ASC 718, *Compensation - Stock Compensation)* requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. Compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards and stock grants.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Earnings Per Share

The Company is required to report earnings per common share with and without the dilutive effects of potential common stock issuances from instruments such as options, convertible securities and warrants on the face of the statements of operations. Basic earnings per common share are based on the weighted average number of common shares outstanding during the period, which was 2,667,940 shares in 2015 and 2,638,539 shares in 2014, while the effects of potential common shares outstanding during the period are included in diluted earnings per share. Additionally, the Company must reconcile the amounts used in the computation of both "basic earnings per share" and "diluted earnings per share". At December 31, 2015, potential common shares of 11,619 were not included in the calculation of diluted earnings per share because the exercise of such shares would be anti-dilutive. There were 29,369 anti-dilutive potential common shares at December 31, 2014. Earnings per common share amounts are as follows:

	For the years ended December 31,	
	2015	2014
Net income	$ 5,835,221	$ 3,117,559
Preferred stock dividends	(783,563)	(838,860)
Net income available to common shareholders	$ 5,051,658	$ 2,278,699
Weighted average common shares	2,667,940	2,638,539
Effect of dilutive securities	60,336	26,026
Diluted average common shares	2,728,276	2,664,565
Earnings per common share	$ 1.89	$ .86
Diluted earnings per common share	$ 1.85	$ .86

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 18. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Advertising Costs

Advertising costs are expensed as incurred.

Note 1. Summary of Significant Accounting Policies (Continued)

Risks and Uncertainties

In the normal course of its business, the Company encounters two significant types of risk: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrowers' inability or unwillingness to make contractually required payments, or that a counterparty to a financial contract or commitment fails to perform in accordance with the contract or commitment terms. Market risk reflects changes in the value of collateral underlying loans receivable, the valuation of real estate held by the Company, and the valuation of loans held for sale and mortgage-backed securities available for sale.

The Company is subject to the regulations of various government agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances, and operating restrictions, resulting from the regulators' judgments based on information available to them at the time of their examination.

Concentrations of Credit Risk

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily through our full-service offices in Beaufort County, South Carolina and in and around Duval and Nassau Counties in Florida. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral period, loans with initial interest-only payments, etc.), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable-rate loans and fixed-rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon-payment loans). These loans are underwritten and monitored to manage the associated risks.

The Company's investment portfolio consists principally of obligations of the United States, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in this investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Reclassification of Certain Items

Certain items in the consolidated financial statements as of and for the year ended December 31, 2014 have been reclassified, with no effect on net income, to be consistent with the classifications adopted for the year ended December 31, 2015.

Notes to Consolidated Financial Statements

Note 2. Investment Securities

Investment securities are as follows:

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
State and municipal securities	$ 3,135,595	$ 318,519	$ (101)	$ 3,454,013
Mortgage-backed securities - residential	16,944,799	231,847	(105,991)	17,070,655
	$ 20,080,394	$ 550,366	$ (106,092)	$ 20,524,668

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
State and municipal securities	$ 3,165,203	$ 294,072	$ —	$ 3,459,275
Mortgage-backed securities - residential	21,120,101	301,808	(44,559)	21,377,350
	$ 24,285,304	$ 595,880	$ (44,559)	$ 24,836,625

The following table shows gross unrealized losses and fair value of securities, aggregated by category and length of time that securities have been in a continuous unrealized loss position, at December 31, 2015.

Investment securities available for sale:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
State and municipal securities	$ 50,827	$ (101)	$ —	$ —	$ 50,827	$ (101)
Mortgage-backed securities - residential	5,961,080	(91,702)	607,552	(14,288)	6,568,632	(105,991)
Total	$ 6,011,907	$ (91,803)	$ 607,552	$ (14,288)	$ 6,619,459	$ (106,092)

State and municipal securities. The unrealized loss on one investment in state and municipal securities was caused by interest rate increases. The contractual terms of the investment does not permit the issuer to settle the security at a price less than the amortized cost basis of the investment. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investment to be other-than-temporarily impaired at December 31, 2015.

Mortgage-backed securities - residential: The unrealized losses on the Company's investment in nine mortgage-backed residential securities were caused by interest rate increases. The Company purchased those investments at a discount relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2015.

Note 2. Investment Securities (Continued)

The following table shows gross unrealized losses and fair value of securities, aggregated by category and length of time that the securities have been in a continuous unrealized loss position, at December 31, 2014.

Investment securities available for sale:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities - residential	$ 1,564,716	$ (2,612)	$ 3,610,801	$ (41,947)	$ 5,175,517	$ (44,559)
Total	$ 1,564,716	$ (2,612)	$ 3,610,801	$ (41,947)	$ 5,175,517	$ (44,559)

Mortgage-backed securities – residential: The unrealized losses on the Company's investment in five mortgage-backed residential securities were caused by interest rate increases. The Company purchased those investments at a discount relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2014.

The amortized cost and estimated fair value of investment securities at December 31, 2015 and 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2015		December 31, 2014	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Due in one year or less	$ —	$ —	$ —	$ —
Due from one year to five years	—	—	—	—
Due from five to ten years	3,135,595	3,454,013	3,165,203	3,459,275
Due after ten years	—	—	—	—
Mortgage-backed securities – residential	16,944,799	17,070,655	21,120,101	21,377,350
	$ 20,080,394	$ 20,524,668	$ 24,285,304	$ 24,836,625

Securities were pledged to secure public deposits and Federal Home Loan Bank borrowings with an approximate amortized cost and fair value of $12,851,000 and $13,227,000, respectively, as of December 31, 2015 and $10,247,000 and $10,596,000, respectively, as of December 31, 2014. Pledged securities may not be sold without first pledging replacement securities and obtaining consent of the party to whom the securities are pledged.

Gains and losses on sales of securities available for sale consist of the following:

	For the years ended December 31,	
	2015	2014
Gross gains on sales of securities	$ —	$ 247,560
Gross losses on sales of securities	—	(31,607)
Net realized gains on sales of securities available for sale	$ —	$ 215,953

Notes to Consolidated Financial Statements

Note 3. Loans and Allowance for Loan Losses

The composition of loans is summarized as follows:

	December 31,	
	2015	2014
Commercial and financial	$ 18,795,061	$ 13,267,236
Agricultural	17,500	3,747
Real estate – construction, commercial	20,635,761	24,420,805
Real estate – construction, residential	12,901,736	9,356,855
Real estate – mortgage, commercial	106,651,258	97,704,811
Real estate – mortgage, residential	121,878,211	126,418,534
Real estate – mortgage, farmland	3,845,325	263,847
Consumer installment loans	1,207,697	1,320,835
Gross loans, net of unearned income	285,932,549	272,756,670
Less: Allowance for loan losses	5,254,407	4,828,899
Net loans	$ 280,678,142	$ 267,927,771

The Company grants loans and extensions of credit to individuals and a variety of businesses and corporations located in its general trade areas of Beaufort County, South Carolina, and Nassau County, Florida. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by improved and unimproved real estate and is dependent upon the real estate market.

A loan is considered impaired, in accordance with the impairment accounting guidance (FASB ASC 310-10-35-16), when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Additionally, recent FASB guidance requires that by definition, all loans classified as troubled debt restructurings must also be classified as impaired. In cases where management believes a restructured loan will return all amounts due under the restructured loan terms, and those terms do not include the loss of any portion of the original principal balance, restructured loans are not internally classified, monitored or managed as impaired loans. Accordingly, GAAP reporting requirements result in a higher level of loans classified as impaired than are considered as impaired by management. Impaired loans as defined by GAAP are summarized as follows:

	December 31, 2015				
(In thousands)	Recorded Investment	Unpaid Principal Balance	Recorded Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate - construction	$ 139	$ 500	$ —	$ 191	$ —
Real estate - mortgage	411	411	—	417	35
With an allowance recorded:					
Real estate - construction	747	747	572	748	4
Real estate - mortgage	4,997	5,035	891	6,247	211
Total impaired loans:					
Real estate - construction	$ 886	$ 1,247	$ 572	$ 939	$ 4
Real estate - mortgage	$ 5,408	$ 5,446	$ 891	$ 6,664	$ 246

As of December 31, 2015, there are six restructured loans with a recorded investment of $2,610,000 included in the impaired loans table above, as required by GAAP, that management has not internally classified as impaired. These loans are performing in accordance with their restructured terms such that we expect to recover all loan principal and interest, however, these loans meet the GAAP definition of a TDR.

Note 3. Loans and Allowance for Loan Losses (Continued)

	December 31, 2014				
(In thousands)	Recorded Investment	Unpaid Principal Balance	Recorded Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial, financial & agricultural	$ —	$ —	$ —	$ —	$ —
Real estate - construction	39	383	—	39	—
Real estate - mortgage	5,351	5,623	—	5,676	224
With an allowance recorded:					
Commercial, financial & agricultural	91	91	53	280	11
Real estate - construction	—	—	—	—	—
Real estate - mortgage	3,453	3,541	704	4,401	134
Total impaired loans:					
Commercial, financial & agricultural	$ 91	$ 91	$ 53	$ 280	$ 11
Real estate - construction	$ 39	$ 383	$ —	$ 39	$ —
Real estate - mortgage	$ 8,804	$ 9,164	$ 704	$ 10,077	358

As of December 31, 2014, there are six restructured loans with a recorded investment of $3,554,000 included in the impaired loans table above, as required by GAAP, that management has not internally classified as impaired. These loans are performing in accordance with their restructured terms such that we expect to recover all loan principal and interest, however, these loans meet the GAAP definition of a TDR.

Loans exhibiting one or more of the following attributes are placed on a nonaccrual status:

a.) Principal and/or interest is 90 days or more delinquent, unless the obligation is (i) well secured by collateral with a realizable value sufficient to discharge the debt including accrued interest in full, and (ii) in the process of collection, which is reasonably expected to result in repayment of the debt or in its restoration to a current status.

b.) A borrower's financial condition has deteriorated to such an extent, or some condition exists, that makes collection of interest and/or principal in full unlikely in management's opinion.

c.) Foreclosure or legal action has been initiated as a result of default by the borrower on the terms of the debt.

The following is a summary of current, past due and nonaccrual loans:

	December 31, 2015						
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due & Accruing	Nonaccrual	Total Past Due & Nonaccrual	Current Loans	Total Loans
Commercial and financial	$ —	$ —	$ —	$ —	$ —	$ 18,795	$ 18,795
Agricultural	—	—	—	—	—	18	18
Real estate – construction, commercial	—	—	—	887	887	19,749	20,636
Real estate – construction, residential	—	—	—	—	—	12,902	12,902
Real estate – mortgage, commercial	—	—	—	1,026	1,026	105,625	106,651
Real estate – mortgage, residential	114	—	—	565	679	121,199	121,878
Real estate – mortgage, farmland	—	—	—	—	—	3,845	3,845
Consumer installment loans	9	—	—	—	9	1,199	1,208
	$ 123	$ —	$ —	$ 2,478	$ 2,601	$ 283,332	$ 285,933

Note 3. Loans and Allowance for Loan Losses (Continued)

(In thousands)	December 31, 2014						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due & Accruing	Nonaccrual	Total Past Due & Nonaccrual	Current Loans	Total Loans
Commercial and financial	$ 7	$ —	$ —	$ 91	$ 98	$ 13,169	$ 13,267
Agricultural	—	—	—	—	—	4	4
Real estate – construction, commercial	451	—	—	210	661	23,760	24,421
Real estate – construction, residential	54	—	—	—	54	9,303	9,357
Real estate – mortgage, commercial	—	—	—	2,555	2,555	95,150	97,705
Real estate – mortgage, residential	294	—	—	1,474	1,768	124,650	126,418
Real estate – mortgage, farmland	—	—	—	—	—	264	264
Consumer installment loans	—	—	—	—	—	1,321	1,321
	$ 806	$ —	$ —	$ 4,330	$ 5,136	$ 267,621	$ 272,757

Management evaluates all loan relationships periodically in order to assess the financial strength of the borrower and the value of any underlying collateral. Based on the results of these evaluations, management will assign internal loan classifications to designate the relative strength of the credit. The internal grades used are Pass, Special Mention, and Substandard. Within the Pass classification, there are sub grades that range from High to Acceptable, all of which indicate that the loan is expected to continue to perform in accordance with its terms. Loans with potential weaknesses that deserve management's close attention are classified as Special Mention. If the potential weakness in a Special Mention loan was to go uncorrected, it could result in deteriorating prospects for continued loan performance at some future date; however, the loan is not currently adversely classified. The Substandard classification is assigned to loans that are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. These loans have a well-defined weakness that jeopardizes the payment of the debt or the liquidation of the collateral securing the debt, and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as Special Mention or Substandard are subject to increased monitoring by management. This typically includes frequent contact with the borrower to actively manage the borrowing relationship as needed to rehabilitate or mitigate the weakness, or potential weakness, identified. At December 31, 2015, the Company had $8,835,000 in loans that were internally classified as Special Mention or Substandard, of which $6,357,000, or 72%, were either current or less than 30 days past due. At December 31, 2014, the Company had $9,741,000 in loans that were internally classified as Special Mention or Substandard, of which $5,650,000, or 58%, were either current or less than 30 days past due.

A summary of loan credit quality is presented below:

(In thousands)	December 31, 2015			
	Pass	Special Mention	Substandard	Total
Commercial and financial	$ 18,022	$ 767	$ 6	$ 18,795
Agricultural	18	—	—	18
Real estate – construction, commercial	19,749	—	887	20,636
Real estate – construction, residential	12,902	—	—	12,902
Real estate – mortgage, commercial	101,274	1,936	3,441	106,651
Real estate – mortgage, residential	120,081	360	1,437	121,878
Real estate – mortgage, farmland	3,845	—	—	3,845
Consumer installment loans	1,207	—	1	1,208
	$ 277,098	$ 3,063	$ 5,772	$ 285,933

Note 3. Loans and Allowance for Loan Losses (Continued)

(In thousands)	December 31, 2014			
	Pass	Special Mention	Substandard	Total
Commercial and financial	$ 12,056	$ 1,100	$ 111	$ 13,267
Agricultural	4	—	—	4
Real estate – construction, commercial	23,759	452	210	24,421
Real estate – construction, residential	9,357	—	—	9,357
Real estate – mortgage, commercial	92,949	2,128	2,628	97,705
Real estate – mortgage, residential	123,308	1,579	1,531	126,418
Real estate – mortgage, farmland	264	—	—	264
Consumer installment loans	1,319	—	2	1,321
	$ 263,016	$ 5,259	$ 4,482	$ 272,757

Risk Elements in the Loan Portfolio

The following is a summary of risk elements in the loan portfolio:

	Loans with Interest Only Payments			
(In thousands)	December 31, 2015		December 31, 2014	
Commercial and financial	$ 3,047	7%	$ 3,247	8%
Agricultural	18	—%	4	—%
Real estate – construction, commercial	7,018	17%	9,070	21%
Real estate – construction, residential	7,461	18%	4,857	11%
Real estate – mortgage, commercial	6,255	15%	5,442	13%
Real estate – mortgage, residential	18,131	43%	19,719	47%
Consumer installment loans	33	—%	81	—%
	$ 41,963		$ 42,420	

As shown above, the Company has a moderate concentration of interest only loans in the portfolio, and such loans are generally regarded as carrying a higher risk profile than fully amortizing loans. It is important to note that none of the interest only loans in the portfolio allow negative amortization, nor does the Company have any loans with capitalized interest reserves.

Management also monitors and evaluates several other loan portfolio characteristics at a total portfolio level rather than by major loan category. These characteristics include:

Junior Liens – Loans secured by liens in subordinate positions tend to have a higher risk profile than loans secured by liens in the first or senior position. At December 31, 2015, the Company held approximately $19,243,000 of loans secured by junior liens, which represents approximately 6.7% of the total gross portfolio of loans. At December 31, 2014, the Company held approximately $17,681,000 of loans secured by junior liens, which represented approximately 6.5% of the gross loan portfolio.

High Loan to Value Ratios – Typically the Company will not originate a new loan with a loan to value (LTV) ratio in excess of 100%. However, declines in collateral values can result in the case of an existing loan renewal with an LTV ratio in excess of 100% based on the current appraised value of the collateral. In such cases the borrower may be asked to pledge additional collateral or to renew the loan for a lesser amount. If the borrower lacks the ability to pay down the loan or provide additional collateral, but has the ability to continue to service the debt, the loan will be renewed with an LTV ratio in excess of 100%. At December 31, 2015, the loan portfolio included 50 loans with an aggregate balance of approximately $12,972,000, or 4.5% of the gross loan portfolio, with LTV ratios in excess of 100%. At December 31, 2014 the loan portfolio included 59 loans with an aggregate balance of approximately $20,053,000, or 7.4% of the gross loan portfolio, with LTV ratios in excess of 100%.

Note 3. Loans and Allowance for Loan Losses (Continued)

Restructured Loans – The following table provides a summary of all loans that are currently designated as restructured.

	December 31, 2015			December 31, 2014		
Troubled debt restructurings	**Number of loans**	**Recorded Investment**	**Unpaid Principal Balance**	**Number of loans**	**Recorded Investment**	**Unpaid Principal Balance**
Real estate – mortgage	9	$ 3,741,945	$ 3,866,771	12	$ 6,659,886	$ 7,018,289
Total troubled debt restructurings	9	$ 3,741,945	$ 3,866,771	12	$ 6,659,886	$ 7,018,289

The following tables provide the payment status and impact on the allowance for loan losses as of December 31, 2015 and December 31, 2014 of all loans that were restructured in the twelve month periods ending on those respective dates.

	Troubled-Debt Restructurings		
	Number of loans	**Recorded Investment**	**Impact on the Allowance for Loan Losses**
December 31, 2015:			
Restructured loans less than 30 days past due			
Real estate – mortgage	1	$ 140,079	$ —
Total restructured loans less than 30 days past due	1	$ 140,079	$ —
Restructured loans 30 days or more past due			
Total restructured loans 30 days or more past due	—	$ —	$ —
Restructured loans on nonaccrual			
Total restructured loans on nonaccrual	—	$ —	$ —

	Troubled-Debt Restructurings		
	Number of loans	**Recorded Investment**	**Impact on the Allowance for Loan Losses**
December 31, 2014:			
Restructured loans less than 30 days past due			
Real estate – mortgage	1	$ 730,932	$ —
Total restructured loans less than 30 days past due	1	$ 730,932	$ —
Restructured loans 30 days or more past due			
Total restructured loans 30 days or more past due	—	$ —	$ —
Restructured loans on nonaccrual			
Total restructured loans on nonaccrual	—	$ —	$ —

Loans modified in a troubled-debt restructuring (the "TDR") are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance for loan losses may be increased, adjustments may be made in the allocation of the allowance for loan losses, or partial charge-offs may be taken to further write-down the carrying value of the loan. During the years ending December 31, 2015 and December 31, 2014 there were no such defaults of TDR loans. The Company has no commitments to lend additional funds to any of the related debtors whose terms have been modified in a TDR.

Note 3. Loans and Allowance for Loan Losses (Continued)

Management has established an allowance for loan losses through a provision for loan losses charged to expense on the statement of earnings. Additions to the allowance for loan losses are made periodically to maintain the allowance at an appropriate level based on management's analysis of the potential risk in the loan portfolio. The allowance for loan losses represents an amount, which is believed to be adequate to absorb probable losses on existing loans that may become uncollectible. Management's judgment as to the adequacy of the allowance for loan losses is based upon a number of assumptions about future events, which are believed to be reasonable, but which may or may not prove to be accurate. To the extent that the recovery of loan balances has become collateral dependent, the Company obtains appraisals not less than annually, and then reduces these appraised values by the amount estimated for selling and holding costs to determine the liquidated value. Any shortfall between the liquidated value and the loan balance is charged against the allowance for loan losses in the month the related appraisal was received. Losses will undoubtedly vary from management estimates, and there is a possibility that charge-offs can reduce this allowance. Management's determination of the allowance for loan losses is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of the overall loan portfolio, economic conditions that may affect the borrower's ability to repay, commercial and residential real estate market trends, the amount and quality of collateral securing the loans, the Company's historical loan loss experience, and a review of specific problem loans. Management also considers subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons.

An analysis of the activity in the allowance for loan losses is presented below:

	For the years ended December 31,	
	2015	2014
Balance, beginning of year	$ 4,828,899	$ 4,273,099
Provision for loan losses	393,863	1,218,300
Loans charged off	(200,760)	(1,059,602)
Recoveries of loans previously charged off	232,405	397,102
Balance, end of year	$ 5,254,407	$ 4,828,899

The following tables provide additional information concerning changes to the allowance for loan losses within major loan categories:

	For the year ended December 31, 2015					
(In thousands)	Commercial, Financial & Agricultural	Real Estate - Construction	Real Estate - Mortgage	Consumer	Unallocated	Total
Allowance balance, beginning of year	$ 655	$ 488	$ 2,913	$ 46	$ 727	$ 4,829
Loans charged off	(71)	(30)	(99)	(1)	—	(201)
Recoveries	53	1	126	52	—	232
Provision for loan losses	356	291	(1,165)	(80)	992	394
Allowance balance, end of period	$ 993	$ 750	$ 1,775	$ 17	$ 1,719	$ 5,254
Allowance for loans individually evaluated for impairment	$ 390	$ 209	$ 518	$ —	$ —	$ 1,117
Allowance for loans collectively evaluated for impairment	603	541	1,257	17	1,719	4,137
Total allowance for loan losses	$ 993	$ 750	$ 1,775	$ 17	$ 1,719	$ 5,254
Loans individually evaluated for impairment	$ 511	$ 396	$ 2,565	$ —	$ —	$ 3,472
Loans collectively evaluated for impairment	18,284	33,142	229,809	1,226	—	282,461
Total loans	$ 18,795	$ 33,538	$ 232,374	$ 1,226	$ —	$ 285,933

Note 3. Loans and Allowance for Loan Losses (Continued)

	For the year ended December 31, 2014					
(In thousands)	Commercial, Financial & Agricultural	Real Estate - Construction	Real Estate - Mortgage	Consumer	Unallocated	Total
Allowance balance, beginning of year	$ 593	$ 698	$ 2,344	$ 35	$ 603	$ 4,273
Loans charged off	(177)	(1)	(746)	(135)	—	(1,059)
Recoveries	119	25	235	18	—	397
Provision for loan losses	120	(234)	1,080	128	124	1,218
Allowance balance, end of period	$ 655	$ 488	$ 2,913	$ 46	$ 727	$ 4,829
Allowance for loans individually evaluated for impairment	$ 53	$ —	$ 704	$ —	$ —	$ 757
Allowance for loans collectively evaluated for impairment	602	488	2,209	46	727	4,072
Total allowance for loan losses	$ 655	$ 488	$ 2,913	$ 46	$ 727	$ 4,829
Loans individually evaluated for impairment	$ 91	$ 39	$ 8,804	$ —	$ —	$ 8,934
Loans collectively evaluated for impairment	13,180	33,739	215,583	1,321	—	263,823
Total loans	$ 13,271	$ 33,778	$ 224,387	$ 1,321	$ —	$ 272,757

In the ordinary course of business, the Company has granted loans to certain directors, executive officers and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. Changes in related-party loans are summarized as follows:

	For the years ended December 31,	
	2015	2014
Balance, beginning of year	$ 3,047,472	$ 2,832,449
Advances	517,270	801,848
Repayments	(138,650)	(586,825)
Balance, end of year	$ 3,426,092	$ 3,047,472

Note 4. Premises and Equipment

Premises and equipment are summarized as follows:

	December 31,	
	2015	2014
Land	$ 3,631,015	$ 3,631,015
Building	4,712,599	4,694,276
Furniture and equipment	3,622,354	3,423,654
	11,965,968	11,748,945
Less accumulated depreciation	(4,791,934)	(4,511,762)
	$ 7,174,034	$ 7,237,183

Depreciation expense totaled approximately $371,000 for the year ended December 31, 2015 and $428,000 for the year ended December 31, 2014.

The Company also has operating leases for rental space for each of the retail residential mortgage loan production offices. Each of these leases is cancelable at any time, or transferable upon disassociation with the Company.

Note 4. Premises and Equipment (Continued)

At December 31, 2015, future minimum lease payments under the non-cancelable operating leases with initial or remaining terms of one year or more are as follows:

2016	$ 324,324
2017	12,440
2018	—
	$ 336,764

Total rental expense amounted to approximately $1,180,000 and $1,044,000 for the years ended December 31, 2015 and 2014, respectively, under both cancelable and non-cancelable operating leases.

Note 5. Other Real Estate Owned

A summary of other real estate owned is presented as follows:

	Years ended December 31,	
	2015	2014
Balance, beginning of year	$ 7,322,404	$ 11,544,720
Additions	871,142	1,534,574
Disposals	(1,486,374)	(4,929,510)
Net gain (loss) on sales of real estate	15,877	(477,344)
Valuation write-downs	(607,334)	(350,036)
Balance, end of year	$ 6,115,715	$ 7,322,404

Expenses related to other real estate owned include the following:

	Years ended December 31,	
	2015	2014
Net (gain) loss on sales of real estate	$ (15,877)	$ 477,344
Valuation write-downs	607,334	350,036
Operating expenses	149,854	399,648
Total expenses related to other real estate owned	$ 741,311	$ 1,227,028

Residential real estate properties included in other real estate owned totaled approximately $595,000 and $722,000 at December 31, 2015 and 2014, respectively.

The Company's special asset group is charged with the administration and liquidation of other real estate owned. Our approach has been to manage each property individually in such a way as to maximize our net proceeds upon sale. Management continues to evaluate other methods to liquidate these properties more quickly, but such methods typically result in a much lower recovery relative to the original loan amount. Management attempts to balance the desire to aggressively drive down the level of non-performing assets with the objective to maximize recovery levels from liquidation of these assets.

Notes to Consolidated Financial Statements

Note 6. SBA Loan Servicing Rights

Following is a summary of information related to SBA loan servicing rights:

	December 31,	
	2015	2014
Loan servicing rights		
Balance at beginning of period	$ 1,658,706	$ 1,432,976
Additions	219,695	532,450
Amortization	(333,719)	(306,720)
Net carrying amount	$ 1,544,682	$ 1,658,706

Loan Servicing Rights (LSR) are initially booked at an estimated original fair value during the current quarter. At quarter end the estimated original fair value is determined by an independent evaluation at loan level detail, less accumulated amortization with any resulting adjustment to SBA loan income. Amortization is recorded over the expected life of the loan as a component of SBA loan income. Under the amortization method, loan servicing rights are amortized in proportion to, and over the period of, estimated servicing income. In the event a loan pays off prior to the expected life, the full remaining balance of the related LSR is charged off. The LSR asset is evaluated for impairment at the end of each quarter, by obtaining a current fair value from an independent third party. For the period ended December 31, 2015, the carrying value of the SBA LSRs was approximately $1,545,000 and the fair value of the SBA LSRs was $1,938,000. As of December 31, 2014, the carrying value of the SBA LSRs was approximately $1,659,000 and the fair value of the SBA LSRs was $1,970,000. As a result of the quarterly independent valuation process, no valuation allowance was required at either period end. The related balance of SBA loans participated and serviced for others was $85,830,000 at December 31, 2015 and $82,474,000 at December 31, 2014.

The fair value of loan servicing rights typically rises as market interest rates increase and declines as market interest rates decrease; however, the extent to which this occurs depends in part on (1) the magnitude of changes in market interest rates, and (2) the differential between the then current market interest rates for mortgage loans and the mortgage interest rates included in the loan-servicing portfolio. Since sales of mortgage servicing rights tend to occur in private transactions and the precise terms and conditions of the sales are typically not readily available, there is a limited market to refer to in determining the fair value of loan servicing rights. As such, like other participants in the SBA loan servicing business, we determine value of loan servicing rights by estimating the present value of the future income stream attained from all of the servicing related cash flows. The value is the sum on the present value of these future income streams, which is impacted by assumptions on prepayment speeds, age and type of the underlying mortgage, and the rate at which these cash flows are discounted. The present value of the portfolio's expected stream of future cash flows is determined through a loan level analysis utilizing assumptions that would be used by other market participants. The valuation incorporates a five step process. Three income elements that include servicing value, remittance value, and additional income are determined as a present value of the respective estimated cash flows from each loan. Finally, the servicing cost, also expressed as a dollar amount per loan, is valued. The net servicing value for each loan is then determined by subtracting the servicing cost from the three income values.

Note 7. Deposits

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2015 and 2014 was approximately $12,271,000 and $10,585,000, respectively. The Company held $14,793,000 and $13,840,000 in brokered deposits included in time deposits as of December 31, 2015 and 2014, respectively.

The scheduled maturities of time deposits at December 31, 2015 are as follows:

2016	$ 85,465,467
2017	22,906,121
2018	4,095,732
2019	747,182
2020	4,399,058
	$ 117,613,560

Note 7. Deposits (Continued)

At December 31, 2015 and 2014, overdraft demand deposits reclassified to loans totaled $30,274 and $118,131, respectively.

Note 8. Employee Benefit Plans

The Company sponsors the Coastal Banking Company, Inc. 401(k) Profit Sharing Plan & Trust (the "Plan") for the benefit of all eligible employees. All full-time and part-time employees are eligible to participate in the Plan provided they have met the eligibility requirements. Contributions may begin after 30 days of employment. Part-time employees must work a minimum of 1,000 hours per year to be eligible. The Plan allows a participant to defer a portion of his or her compensation and provides that the Company will match a portion of the deferred compensation. Company matched contributions are vested over a five year period. The Company contributes to the Plan annually. Contributions made to the Plan in 2015 and 2014 totaled $611,860 and $460,652, respectively.

On February 27, 2013 the Board of Directors approved the adoption of the Coastal Banking Company Employee Stock Purchase Plan (the "Stock Purchase Plan") effective April 1, 2013, and set aside 250,000 shares of common stock for issuance under the Stock Purchase Plan. The Stock Purchase Plan allows eligible full-time employees to direct an after-tax deduction from their pay to be accumulated and disbursed once per quarter to purchase newly issued common stock in the Company at a 5% discount to fair market value on the final day of each calendar quarter. Total shares purchased through the Stock Purchase Plan were 30,053 shares for the year ended December 31, 2015 and 15,828 shares for the year ending December 31, 2014. The 5% discount to fair market value is considered compensation cost to the Company and it totaled $15,233 for the year ended December 31, 2015, and $6,005 for the year ended December 31, 2014. At December 31, 2015, there were 191,251 shares left available for issuance under this Plan.

Note 9. Deferred Compensation Plans

The Company adopted a deferred compensation arrangement in 2004 that provides a defined benefit payable to executive officers upon retirement or reaching a specific age. This benefit is held in trust and, therefore, the Company does not carry a liability related to the plan. The Company made annual contributions to the plan of approximately $58,000 and $92,000 in 2015 and 2014, respectively. There is no remaining liability to the trust at December 31, 2015.

The Company adopted a deferred compensation arrangement in 2009 that provides a defined benefit payable monthly for 15 years to executive officers upon reaching the age of 68. The Company funds this benefit from its investment in life insurance policies on participating executive officers. Accrued benefits under this plan are included in other liabilities, and were $289,614 and $246,172 at December 31, 2015 and 2014, respectively.

Note 10. Other Borrowings

Other borrowings consist of the following FHLB advances.

		FHLB Advances Outstanding December 31, 2015		
Type advance	Balance	Interest rate	Maturity date	Convertible date
Fixed rate	$ 10,000,000	0.39%	January 15, 2016	
Fixed rate	15,000,000	0.40%	January 21, 2016	
Fixed rate	10,000,000	0.38%	January 29, 2016	
Fixed rate	5,000,000	1.95%	August 9, 2016	
Fixed rate	2,500,000	0.94%	July 28, 2017	
Fixed rate	2,000,000	2.84%	August 9, 2017	
Convertible fixed rate advance	2,000,000	3.69%	September 7, 2017	March 7, 2016
Fixed rate	2,500,000	1.32%	July 30, 2018	
Fixed rate	3,000,000	2.94%	August 9, 2018	
Fixed rate	2,500,000	1.70%	July 24, 2019	
Fixed rate	2,500,000	1.98%	July 24, 2020	
Variable rate overnight advance	63,500,000	0.49%		
Total	$ 120,500,000	0.76%		

Note 10. Other Borrowings (Continued)

Type advance	Balance	FHLB Advances Outstanding December 31, 2014 Interest rate	Maturity date	Convertible date
Fixed rate	$ 10,000,000	0.18%	January 5, 2015	
Fixed rate	5,000,000	0.23%	January 26, 2015	
Fixed rate	10,000,000	0.20%	January 28, 2015	
Fixed rate	5,000,000	0.20%	January 28, 2015	
Fixed rate	10,000,000	0.19%	January 28, 2015	
Fixed rate	5,000,000	2.09%	August 10, 2015	
Fixed rate	5,000,000	1.95%	August 9, 2016	
Fixed rate	2,000,000	2.84%	August 9, 2017	
Convertible fixed rate advance	2,000,000	3.69%	September 7, 2017	March 7, 2015
Fixed rate	3,000,000	2.94%	August 9, 2018	
Variable rate overnight advance	26,500,000	0.36%		
Total	$ 83,500,000	0.71%		

The Company maintains relationships with correspondent banks that can provide funds on short notice, if needed. Presently, the Company has arrangements with five commercial banks for short term unsecured advances of overnight borrowings of up to $37,000,000, in addition to up to $9,945,000 available for day light overdraft. The Company also has reverse repurchase accommodations with a term of up to one month for a maximum advance of $25,000,000 limited by the amount of eligible securities pledged, which was $5,682,000 at December 31, 2015. The reverse repurchase agreements are committed borrowing facilities granted by other commercial banks and are secured by securities in the Company's investment portfolio.

At December 31, 2015 the Company has pledged approximately $163,326,000 of its portfolio loans and loans available for sale to the FHLB and can borrow up to $131,563,000 on such collateral. The Company has also pledged $49,090,000 of its portfolio loans to the Federal Reserve Bank of Atlanta at December 31, 2015 and can borrow up to $26,580,000 on such collateral at the Discount Window. At December 31, 2014, the Company pledged $104,651,000 of its portfolio loans to FHLB and could borrow up to $92,789,000 on such collateral. The Company had also pledged $43,711,000 of its portfolio loans to the Federal Reserve Bank of Atlanta at December 31, 2014 and could borrow up to $25,286,000 on such collateral at the Discount Window.

Note 11. Income Taxes

The components of income tax expense is as follows:

	For the years ended December 31, 2015	2014
Currently payable	$ 4,362,084	$ 1,059,025
Deferred tax benefit	(598,456)	588,335
Income tax expense	$ 3,763,628	$ 1,647,360

The Company's income tax expense differs from the amounts computed by applying the federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

Note 11. Income Taxes (Continued)

	For the years ended December 31,	
	2015	2014
Tax at federal income tax rate	$ 3,263,609	$ 1,620,072
Increase (decrease) resulting from:		
Tax exempt interest	(38,682)	(69,543)
Other	538,701	96,831
Income tax expense	$ 3,763,628	$ 1,647,360

Net deferred tax assets are included in other assets. The components of deferred income taxes are as follows:

	December 31,	
	2015	2014
Deferred income tax assets:		
Loan loss reserves	$ 643,490	509,577
Other real estate owned	494,280	284,972
Other	967,726	628,316
Total deferred tax assets	2,105,496	1,422,865
Deferred income tax liabilities:		
Deferred loan costs	593,909	527,586
Depreciation and amortization	151,481	119,026
Intangible assets	7,836	22,439
Unrealized gain on securities available for sale	151,053	187,449
Total deferred tax liabilities	904,279	856,500
Net deferred tax asset	$ 1,201,217	$ 566,365

The federal income tax returns of the Company for 2014, 2013, and 2012 are subject to examination by the IRS, generally for three years after they were filed.

Note 12. Senior Note Payable

	For the years ended December 31,	
	2015	2014
Note payable to NexBank SSB with variable interest rate at 3-month LIBOR plus 4% subject to a 5% floor, with principal and interest due monthly through maturity at November 2020.	$ 9,916,667	$ -
	$ 9,916,667	$ -

As of December 31, 2015, the Company and its subsidiary were in compliance with the covenants in this agreement.

The senior note payable is secured by 100% of the common stock of CBC National Bank.

The contractual maturities of the senior note payable are as follows:

2016	$ 1,000,000
2017	1,000,000
2018	1,000,000
2019	1,000,000
2020	5,916,667
	$ 9,916,667

Note 13. Junior Subordinated Debentures

In May 2004, Coastal Banking Company Statutory Trust I (the "Trust I") (a non-consolidated subsidiary) issued $3,000,000 of floating rate trust preferred securities with a maturity of July 23, 2034. The Company received from the Trust I the $3,000,000 proceeds from the issuance of securities and the $93,000 initial proceeds from the capital investment in the Trust I, and accordingly has shown the funds due to the Trust I as $3,093,000 junior subordinated debentures.

All of the common securities of the Trust I are owned by the Company. The proceeds from the issuance of the trust preferred securities were used by the Trust I to purchase $3,093,000 of junior subordinated debentures of the Company, which carry a floating rate equal to the 3-month LIBOR plus 2.75%. At December 31, 2015, this rate was 3.35%. The proceeds received by the Company from the sale of the junior subordinated debentures were used to strengthen the capital position of the Bank and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole assets of the Trust I.

The trust preferred securities accrue and pay distributions quarterly, equal to 3-month LIBOR plus 2.75% per annum of the stated liquidation value of $1,000 per capital security. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by the Trust I; and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust I.

The trust preferred securities must be redeemed upon maturity of the debentures on July 23, 2034, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust I in whole or in part, on or after July 23, 2009. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

In June 2006, Coastal Banking Company Statutory Trust II (the "Trust II") (a non-consolidated subsidiary) issued $4,000,000 of fixed to floating rate trust preferred securities with a maturity of September 30, 2036. The Company received from the Trust II the $4,000,000 proceeds from the issuance of securities and the $124,000 initial proceeds from the capital investment in the Trust II, and accordingly has shown the funds due to the Trust II as $4,124,000 junior subordinated debentures.

All of the common securities of the Trust II are owned by the Company. The proceeds from the issuance of the trust preferred securities were used by the Trust II to purchase $4,124,000 of junior subordinated debentures of the Company, which carried a fixed rate of 7.18% until September 30, 2011 and a floating rate equal to the 3-month LIBOR plus 1.60%, adjusted quarterly thereafter. At December 31, 2015, this rate was 2.20%. The proceeds received by the Company from the sale of the junior subordinated debentures were used to strengthen the capital position of the Bank and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole assets of the Trust II.

The trust preferred securities accrue and pay distributions quarterly, equal to 3-month LIBOR plus 1.60% per annum of the stated liquidation value of $1,000 per capital security. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by the Trust II; and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust II.

The trust preferred securities must be redeemed upon maturity of the debentures on September 30, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust II in whole or in part, on or after September 30, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

Note 14. Stock Based Compensation

The Company issued no stock option grants in 2015 or 2014. As of December 31, 2015, there were 267,458 shares available for grant as non-qualified stock options under legacy stock option plans. As a result of the expiration of the Company's incentive stock plan in 2010, there are no incentive stock options available for grant.

On May 26, 2010, the Company granted non-qualified stock options to all full-time employees for a total of 126,000 options. The options vest over a five-year period beginning on May 26, 2010. The cost to the Company from this grant was $177,370 and was expensed between May 26, 2010 and May 26, 2015.

Information pertaining to options outstanding at December 31, 2015 is as follows:

Options Outstanding			Options Fully Vested and Exercisable		Options Expected to Vest	
Option Shares Outstanding	Average Remaining Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Number Expected To Vest	Weighted Average Exercise Price
500	6.2	$ 3.00	300	$ 3.00	200	$ 3.00
58,120	4.4	3.40	58,120	3.40	—	3.40
60,000	7.2	7.40	24,000	7.40	36,000	7.40
9,975	.8	7.50	9,975	7.50	—	7.50
11,619	1.5	19.05	11,619	19.05	—	19.05
140,214	5.1	$ 6.70	104,014	$ 6.46	36,200	$ 7.37

A summary status of the Company's stock options as of December 31, 2015 and changes during the year is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding, beginning of year	161,964	$ 6.65	5.7	$ 424,269
Granted during the year	—	—	—	—
Exercised during the year	(200)	3.40	—	—
Forfeited or expired during the year	(21,550)	5.86	—	—
Outstanding, end of year	140,214	6.70	5.1	825,220
Options exercisable at year end	104,014	6.46	4.4	657,820

The total intrinsic value of options exercised during the year ended December 31, 2015 was $668. The total intrinsic value of options exercised during the year ended December 31, 2014 was $80,216.

It is the Company's policy to issue new shares for stock option exercises and restricted stock rather than issue treasury shares. The Company recognizes stock-based compensation expense on a straight-line basis over the options' related vesting term. As of December 31, 2015, there was $101,851 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under the 2000 Plan. That cost is expected to be recognized over a weighted-average period of 2.2 years.

Note 15. Commitments and Contingent Liabilities

Loan Commitments

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments consist of commitments to extend credit, standby letters of credit and loans sold with representations and warranties. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. Our exposure to credit loss in the event of non-performance by the other party to the instrument is represented by the contractual notional amount of the instrument.

Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit policies in making commitments to extend credit as we do for on-balance sheet instruments. Collateral held for commitments to extend credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

Loans on one-to-four family residential mortgages originated by us are sold to various other financial institutions with representations and warranties that are usual and customary for the industry. In addition to these representations and warranties, our loan sale contracts define a condition in which the borrower fails to make any one of the first four loan payments within 30 days of the due date as an Early Payment Default ("EPD"). In the event of an EPD occurrence, we are required to return the premium paid by the investor for the loan as well as pay certain administrative fees. In the event of a breach of any of the representations and warranties related to a loan sold, we could be liable for damages to the investor up to and including a "make whole" demand that involves, at the investor's option, either reimbursing the investor for actual losses incurred on the loan or repurchasing the loan in full. Our maximum exposure to credit loss in the event of a loan repurchase related to a make whole claim would be the unpaid principal balance of the loan to be repurchased along with any premium paid by the investor when the loan was purchased and other minor collection cost reimbursements.

From the September 2007 inception of the mortgage banking division through December 31, 2015, we have sold over 34,000 residential mortgage loans into the secondary market with a principal balance of just over $79.4 billion. From this population of sold loans, the Company has received notification from purchasers of a total of thirty-nine EPD claims or an average of one EPD claim per 1,065 loans sold. Below are the EPD claims experience by year of sale-vintage:

Year of Sale	# Loans Sold	EPDs	Claims Rate	$ Loans Sold
2015	7,741	3	0.04%	$ 1,904,602,055
2014	4,892	2	0.04%	1,151,537,418
2013	5,607	3	0.05%	1,301,421,133
2012	8,104	7	0.09%	1,803,108,311
2011 & prior	15,189	24	0.16%	3,245,925,703
Total	41,533	39	0.09%	$ 9,406,594,620

Note 15. Commitments and Contingent Liabilities (Continued)

Loan Commitments (Continued)

Beyond the initial payment to the purchasers of $203,000 upon receipt of the EPD claims, the maximum remaining exposure under investor claims of a representation and warranty breach would be the difference between the total loan amount and the liquidated value of the underlying collateral. In the case of our thirty-nine EPD claims received since the inception of mortgage banking operations, the aggregate loan balance was $7,384,000 and consisted of 39 single family residences. Original loan-to-value ratios ranged from 65% to 98%, and loans with a loan-to-value ratio over 80% have a mortgage insurance policy in place. If repurchase was required in the future, management believes that the potential amount of loss would not be material and that sufficient reserves exist to fully absorb any loss. Management does not anticipate any material credit risk related to potential EPD claims on loans that have been previously sold and are no longer on the Company's balance sheet. Because the risk of an EPD claim only exists during the first four payments after a loan is originated, the Company reports the total of the most recent four months mortgage banking lending volume as off-balance sheet credit risk from EPD claims. As of December 31, 2015, the total off-balance sheet credit risk from EPD claims was $509,068,000.

As discussed above, the representations and warranties in loan sale agreements require that the Company repurchase loans or indemnify the investors for losses or costs on loans sold under certain limited conditions. Some of these conditions include underwriting errors or omissions, fraud or material misstatements by the borrower in the loan application, or invalid market value on the collateral property due to deficiencies in the appraisal. From the total population of sold loans, in over eight years of operations the Company has been required to settle nineteen make whole claims or on average one claim per 2,297 loans sold at a total cost of $1,766,000, and has repurchased five loans totaling $1,639,000. Of the five repurchased loans, one has been paid off, and the other four are current and performing in accordance with their loan terms.

Management has recognized the potential risk from costs related to EPD claims and breaches of representations and warranties made in connection with residential loan sales. During the period from 2009 through 2012 the industry experienced a high level of loan "put backs" to lenders on the basis of representation and warranty breaches. It is noteworthy that the Company's loan sale activity began in late 2007 at a time when underwriting requirements had changed and limited documentation conventional (non-government insured) loans were no longer eligible for purchase in the secondary market. Accordingly, the population of conventional loans the Bank has sold was underwritten based on fully documented information. While this will not eliminate all risk of repurchase or indemnification costs, management believes it significantly mitigates that risk as evidenced by the relatively insignificant level of repurchase and indemnification costs incurred to date.

In recognition of risk from potential EPD claims and breaches of representations and warranties, an indemnification reserve has been established and maintained since mortgage banking loan sales began in late 2007 to cover potential costs. Initially we had a limited history of actual costs incurred, so additions to the reserve were made monthly based on a percentage of loan balances sold that month. This approach recognizes that the risk of indemnification costs will rise in relation to the level of loans sold. In August 2013 we evaluated actual loss experience for six years relative to the reserve level and lower new business volume, and based on that analysis the decision was made to suspend further additions to the reserve balance. As a result, the balance of the indemnification reserve was approximately $2,446,000 at December 31, 2013. We updated this evaluation of actual loss experience in September 2014, including a detailed analysis of investor repurchase demands and claims paid over seven years. Based on that updated analysis, management determined that our existing indemnification reserve level should be reduced by $437,000 in 2014, resulting in a balance of the indemnification reserve of $1,938,000 at December 31, 2014. The trend of limited claims activity continued in 2015 with charges against the indemnification reserve of $30,000 during the year ended December 31, 2015. In light of the slightly elevated risk and claims from loans sourced through the national retail group channel (NRG), management made the decision to make monthly additions to the reserve beginning in January 2015 based on a percentage of NRG sourced loans that were sold. The total additions to the reserve for NRG loans sold during 2015 was $54,000. As a result, the balance of the indemnification reserve at December 31, 2015 was $1,962,000 and based on the Company's modest historical loss experience and the current level of indemnification claims under review, management believes this level of reserve is adequate for potential exposure in connection with loan sale indemnification or EPD claims.

Note 15. Commitments and Contingent Liabilities (Continued)

Loan Commitments (Continued)

Management will monitor the reserve level relative to loss experience and business volume levels and may continue the suspension of additions to the reserve or alternatively decide that further additions to the reserve may be appropriate. However, we can provide no assurance that our methodology will not change and that the balance of this indemnification reserve will prove sufficient to cover actual costs in the future.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and loans sold with representations and warranties is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. In most cases, the Company requires collateral to support financial instruments with credit risk.

The following table summarizes our off-balance-sheet financial instruments whose contract amounts represent credit risk as of December 31, 2015 and 2014:

	December 31,	
	2015	2014
Commitments to extend credit	$ 44,027,000	$ 24,593,000
Standby letters of credit	$ 278,000	$ 766,000
Loans sold with representations and warranties	$ 509,068,000	$ 487,236,000

Contingencies

The Company has, from time to time, various lawsuits and claims arising from the conduct of its business. Such items are not expected to have any material adverse effect on the financial position or results of operations of the Company.

Note 16. Concentrations of Credit

The Company makes commercial, residential, construction, agricultural, agribusiness and consumer loans to customers in South Carolina, Florida, and Georgia. The ability of the Company's customers to honor the terms of their loan contracts is dependent on the business economy in the geographical area served by the Company.

Ninety-two percent of the Company's loans are secured by real estate in the Company's primary market area. Accordingly, the ultimate collectability of a majority of the Company's loan portfolio is susceptible to changes in real estate conditions in the Company's primary market area.

Note 17. Shareholders' Equity and Regulatory Matters

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

Federal and state banking agencies have adopted regulations that substantially amend the capital regulations currently applicable. The regulations implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act.

Note 17. Shareholders' Equity and Regulatory Matters (Continued)

Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), the Bank became subject to new capital requirements adopted by the FDIC. These new requirements create a new required ratio for common equity Tier 1 capital, increase the leverage and Tier 1 capital ratios, change the risk weight of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios and change what qualifies as capital for purposes of meeting these various capital requirements. Beginning in 2016, failure to maintain the required capital conservation buffer will limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The Company is exempt from consolidated capital requirements as those requirements do not apply to certain small savings bank holding companies with assets under $1 billion.

Under the new capital regulations, the minimum capital ratios are: (1) common equity Tier 1 capital ratio of 4.5% of risk-weighted assets, (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets, (3) a total capital ratio of 8.0% of risk-weighted assets, and (4) a Tier 1 capital to average assets ratio of 4.0%. Common equity Tier 1 capital generally consists of common stock and retained earnings, subject to applicable regulatory adjustments and deductions.

There are a number of changes in what constitutes regulatory capital, some of which are subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital. The Bank does not use any of these instruments. Under the new requirements for total capital, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common equity Tier 1 capital will be deducted from capital. The Bank has elected to permanently opt-out of the inclusion of accumulated other comprehensive income in our capital calculations, as permitted by the regulations. This opt-out will reduce the impact of market volatility on our regulatory capital levels.

The new requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (increased from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in non-accrual status; a 20% (increased form 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (increased from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital; and increased risk weights (0% to 600%) for equity exposures.

In addition to the minimum common equity Tier 1, Tier 1 and total capital ratios, the Bank will have to maintain a capital conservation buffer consisting of additional common equity Tier 1 capital greater than 2.5% to risk weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.635% of risk-weighted assets and increasing each year until fully implemented in January 2019.

The FDIC's prompt corrective action standards also changed effective January 1, 2015. Under the new standards, in order to be considered well-capitalized, the Bank must have a common equity Tier 1 ratio of 6.5% (new), a Tier 1 ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged) and a leverage ratio of 5.0% (unchanged). The Bank meets all these new requirements, including the full capital conservation buffer.

As of December 31, 2015, the Bank was well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since December 31, 2015, that management believes have changed the Bank's category.

Note 17. Shareholders' Equity and Regulatory Matters (Continued)

The Bank's actual capital amounts and ratios as of December 31, 2015 and 2014, are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015:						
Under Basel III						
Total Capital to Risk Weighted Assets						
CBC National Bank	$ 52,300,000	23.24%	$ 18,005,000	8.00%	$ 22,506,000	10.00%
Tier I Capital to Risk Weighted Assets						
CBC National Bank	$ 49,432,000	21.96%	$ 13,503,000	6.00%	$ 18,005,000	8.00%
Common Equity Tier 1 Capital to Risk Weighted Assets						
CBC National Bank	$ 49,432,000	21.96%	$ 10,128,000	4.50%	$ 14,629,000	6.50%
Tier I Capital to Average Assets						
CBC National Bank	$ 49,432,000	11.75%	$ 16,829,000	4.00%	$ 21,036,000	5.00%

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Under Basel I						
Total Capital to Risk Weighted Assets						
CBC National Bank	$ 46,899,000	22.90%	$ 16,384,000	8.00%	$ 20,480,000	10.00%
Tier I Capital to Risk Weighted Assets						
CBC National Bank	$ 44,287,000	21.62%	$ 8,192,000	4.00%	$ 12,288,000	6.00%
Tier I Capital to Average Assets						
CBC National Bank	$ 44,287,000	10.51%	$ 16,852,000	4.00%	$ 21,064,000	5.00%

There are no current plans to initiate payment of common stock cash dividends and future dividend policy will depend on the Bank's and the Company's earnings, capital requirements, financial condition and other factors considered relevant by the Company's Board of Directors.

On December 5, 2008, Coastal issued and sold 9,950 preferred shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "TARP preferred stock") to the United States Department of the Treasury (the "Treasury) as part of the Capital Purchase Program ("CPP"). The Treasury was also granted a Warrant to purchase 205,579 shares of the Company's common stock at $7.26 per share. On April 10, 2013, the Company repurchased and cancelled 60,000 of these common stock warrants at a price of $1.65 per share. On June 12, 2013, the Company repurchased and cancelled the remaining 145,579 common stock warrants at a price of $1.55 per share. The TARP preferred stock was sold by the Treasury through an action to private investors on March 11, 2013 at which point the Company was no longer subject to TARP related operating restrictions.

Note 17. Shareholders' Equity and Regulatory Matters (Continued)

The preferred stock as originally issued carried an annual 5% cumulative dividend rate which resulted in a quarterly dividend payment of $12.50 per share, payable on February 15, May 15, August 15 and November 15. On February 16, 2014, the annual dividend rate increased to 9% payable quarterly on the same dates, increasing the quarterly dividend payments to $22.50 per share. On November 15, 2015, the Company redeemed all outstanding TARP preferred stock and paid all preferred dividends accrued through the date of redemption. The redemption and dividend payments were funded with the proceeds of a senior note payable to NexBank, SSB (see Note 12 above).

Note 18. Fair Value

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between willing market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on 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 asset or liability.

Level 3 - Valuation is based on 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 determination of fair value requires significant management judgment or estimation.

Note 18. Fair Value (Continued)

Fair Value Hierarchy (Continued)

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset-backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2015, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
State and municipal securities	$ 3,454,013	$ —	$ 3,454,013	$ —
Mortgage-backed securities – residential	17,070,655	—	17,070,655	—
Loans held for sale	35,725,005	—	35,725,005	—
Derivative asset positions	259,854	—	259,854	—
Total fair value of assets measured on a recurring basis	$ 56,509,527	$ —	$ 56,509,527	$ —
Liabilities:				
Derivative liability positions	$ 285,294	$ —	$ 285,294	$ —
Total fair value of liabilities measured on a recurring basis	$ 285,294	$ —	$ 285,294	$ —

Note 18. Fair Value (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis (Continued)

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2014, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
State and municipal securities	$ 3,459,275	$ —	$ 3,459,275	$ —
Mortgage-backed securities – residential	21,377,350	—	21,377,350	—
Loans held for sale	24,491,859	—	24,491,859	—
Derivative asset positions	475,592	—	475,592	—
Total fair value of assets measured on a recurring basis	$ 49,804,076	$ —	$ 49,804,076	$ —
Liabilities:				
Derivative liability positions	$ 510,409	$ —	$ 510,409	$ —
Total fair value of liabilities measured on a recurring basis	$ 510,409	$ —	$ 510,409	$ —

Assets Measured at Fair Value on a Nonrecurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans can be measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less estimated selling costs if the loan is collateral dependent.

The fair value of impaired loans were primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for estimated costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Note 18. Fair Value (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis (Continued)

Other Real Estate Owned

Other real estate owned, consisting of properties obtained through foreclosure or in satisfaction of loans, are initially recorded at fair value less estimated costs to sell upon transfer of the loans to other real estate. Subsequently, other real estate is carried at the lower of carrying value or fair value less estimated costs to sell. Fair values are generally based on third party appraisals of the property and are classified within Level 3 of the fair value hierarchy. The appraisals are sometimes further discounted based on management's historical knowledge, and/or changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts are typically significant unobservable inputs for determining fair value. In cases where the carrying amount exceeds the fair value, less estimated costs to sell, a loss is recognized in noninterest expense.

The Company had no Level 3 assets measured at fair value on a recurring basis at December 31, 2015 or 2014.

The table below presents the Company's assets for which a nonrecurring change in fair value has been recorded during the year ended December 31, 2015, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total losses for the Year Ended December 31, 2015
Assets:					
Impaired loans	$ 6,294,184	$ —	$ —	$ 6,294,184	$ (16,678)
Other real estate owned	6,115,715	—	—	6,115,715	(591,457)
Total fair value of assets measured on a nonrecurring basis	$ 12,409,899	$ —	$ —	$ 12,409,899	$ (608,135)

The table below presents the Company's assets for which a nonrecurring change in fair value has been recorded during the year ended December 31, 2014, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total losses for the Year Ended December 31, 2014
Assets:					
Impaired loans	$ 8,934,310	$ —	$ —	$ 8,934,310	$ (13,320)
Other real estate owned	7,322,404	—	—	7,322,404	(827,380)
Total fair value of assets measured on a nonrecurring basis	$ 16,256,714	$ —	$ —	$ 16,256,714	$ (840,700)

Note 18. Fair Value (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis (Continued)

For Level 3 assets measured at fair value on a nonrecurring basis as of December 31, 2015 and 2014, the significant unobservable inputs used in the fair value measurements are presented below.

	Carrying Amount	Valuation Technique	Significant Unobservable Input
December 31, 2015:			
Nonrecurring:			
Impaired loans	$ 6,294,184	Appraisal	Appraisal discounts (5-15%)
Other real estate owned	$ 6,115,715	Appraisal	Appraisal discounts (5-15%)

	Carrying Amount	Valuation Technique	Significant Unobservable Input
December 31, 2014			
Nonrecurring:			
Impaired loans	$ 8,934,310	Appraisal	Appraisal discounts (5-15%)
Other real estate owned	$ 7,322,404	Appraisal	Appraisal discounts (5-15%)

Fair Value of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties in an orderly transaction. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered as representative of the liquidation value of the Company, but rather represent a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination, or issuance.

The following methods and assumptions were used in this analysis in estimating the fair value of financial instruments:

- ***Cash, due from banks, interest-bearing deposits in banks and federal funds sold***: The carrying amount of cash, due from banks, interest-bearing deposits in banks and federal funds sold approximates fair value.
- ***Securities***: The fair values of securities available for sale are determined by an independent securities accounting service provider using quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. The carrying amount of restricted equity securities with no readily determinable fair value approximates fair value.
- ***Loans***: The carrying amount of variable-rate loans that reprice frequently and have no significant change in credit risk approximates fair value. The fair value of fixed-rate loans is estimated based on discounted contractual cash flows, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The fair value of impaired loans is estimated based on discounted contractual cash flows or underlying collateral values, where applicable.

Note 18. Fair Value (Continued)

Fair Value of Financial Instruments (Continued)

- ***Loans Held for Sale***: Residential mortgage loans are originated for sale as whole loans in the secondary market. These loans are carried at fair value, with changes in the fair value of these loans recognized in mortgage banking noninterest income. Direct loan origination costs and fees are deferred at origination, and then recognized in the gain or loss on loan sales when the loans are sold. Gains and losses on loan sales (sales proceeds minus the carrying value of the loan sold) are recorded as noninterest income.

- ***Loan Sales Receivable:*** In accordance with trade date accounting guidance, the sale of residential mortgage loans is recognized at the time that all conditions precedent to the sale have been met and all material risks and rewards of loan ownership have passed from the Company to the investor purchasing the loans. This typically occurs when the physical loan documents are delivered to the investor. Upon delivery of loan documents, the Company records the gain or loss on sale of the loans and recognizes the receivable from the investor for the proceeds of sale. The carrying amount of loan sales receivable approximates fair value.

- ***SBA Loan Servicing Rights***: Fair value is based upon market prices for comparable loan servicing contracts, when available, or alternatively, is based upon an independent valuation model that calculates the present value of the estimated future net servicing income.

- ***Derivative Asset and Liability Positions***: The fair value of derivative asset and liability positions is based on available quoted market prices.

- ***Deposits***: The carrying amount of demand deposits, savings deposits and variable-rate certificates of deposits approximates fair value. The fair value of fixed-rate certificates of deposit is estimated based on discounted contractual cash flows using interest rates currently being offered for certificates of similar maturities.

- ***Other Borrowings and Senior Note Payable***: The carrying amount of variable rate borrowings and federal funds purchased approximates fair value. The fair value of fixed rate borrowings is estimated based on discounted contractual cash flows using the current incremental borrowing rates for similar type borrowing arrangements.

- ***Junior Subordinated Debentures****:* The fair value of the Company's trust preferred securities is based on discounted contractual cash flows using the current incremental borrowing rates for similar type borrowing arrangements.

- ***Accrued Interest:*** The carrying amount of accrued interest approximates fair value.

- ***Off-Balance-Sheet Instruments***: The carrying amount of commitments to extend credit and standby letters of credit approximates fair value. The carrying amount of the off-balance-sheet financial instruments is based on fees charged to enter into such agreements.

Note 18. Fair Value (Continued)

Fair Value of Financial Instruments (Continued)

The carrying amount and estimated fair value of the Company's financial instruments are as follows:

	December 31,			
	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash, due from banks, and interest-bearing deposits in banks	$ 4,830,568	$ 4,830,568	$ 4,090,193	$ 4,090,193
Federal funds sold	82,642	82,642	87,967	87,967
Securities available for sale	20,524,668	20,524,668	24,836,625	24,836,625
Restricted equity securities	6,781,900	6,781,900	5,392,500	5,392,500
Loans held for sale	35,725,005	35,725,005	24,491,859	24,491,859
Loans, net	280,678,142	272,417,309	267,927,771	262,767,673
Loan sales receivable	92,456,618	92,456,618	70,651,624	70,651,624
SBA loan servicing rights	1,544,682	1,937,924	1,658,706	1,969,954
Derivative asset positions	259,854	259,854	475,592	475,592
Accrued interest receivable	816,324	816,324	831,151	831,151
Financial liabilities:				
Deposits	283,839,384	284,676,608	285,663,436	286,529,532
Other borrowings	120,500,000	121,364,104	83,500,000	84,336,174
Senior note payable	9,916,667	9,916,667	—	—
Junior subordinated debentures	7,217,000	7,217,000	7,217,000	7,217,000
Derivative liability positions	285,294	285,294	510,409	510,409
Accrued interest payable	196,863	196,863	171,718	171,718

Note 19. Derivative Financial Instruments

Mortgage banking derivatives used in the ordinary course of business consist of best efforts and mandatory forward sales contracts and interest rate lock commitments on residential mortgage loan applications. Forward sales contracts represent future commitments to deliver loans at a specified price and by a specified date and are used to manage interest rate risk on loan commitments and mortgage loans held for sale. Rate lock commitments represent commitments to fund loans at a specific rate and by a specified expiration date. These derivatives involve underlying items, such as interest rates, and are designed to mitigate risk. Substantially all of these instruments expire within 60 days from the date of issuance. Notional amounts are amounts on which calculations and payments are based, but which do not represent credit exposure, as credit exposure is limited to the amounts required to be received or paid.

Note 19. Derivative Financial Instruments (Continued)

The following tables include the notional amounts and realized gain (loss) for mortgage banking derivatives recognized in mortgage banking income for the periods ending December 31, 2015 and December 31, 2014:

Derivatives not designated as hedging instruments (in thousands)	December 31, 2015	December 31, 2014
Mandatory forward sales contracts		
Notional amount	$ 133,211	$ 102,640
Loss on change in market value of mandatory forward sales contracts	$ (61)	$ (437)
Derivative asset balance included in other assets	$ 130	$ 21
Derivative liability balance included in other liabilities	$ 191	$ 458
Best efforts forward sales contracts		
Notional amount	$ 2,889	$ 15,212
Gain (loss) on change in market value of best efforts forward sales contracts	$ 2	$ (45)
Derivative liability balance included in other liabilities	$ 2	$ 45
Rate lock loan commitments		
Notional amount	$ 103,783	$ 93,981
Gain on change in market value of rate lock commitments	$ 33	$ 447
Derivative asset balance included in other assets	$ 126	$ 454
Derivative liability balance included in other liabilities	$ 93	$ 7

Forward sales contracts also contain an element of risk in that the counterparties may be unable to meet the terms of such agreements. In the event the parties to deliver commitments are unable to fulfill their obligations, the Company could potentially incur significant additional costs by replacing the positions at then current market rates. The Company manages its risk of exposure by limiting counterparties to those banks and institutions deemed appropriate by management and the Board of Directors. The Company does not expect any counterparty to default on their obligations and therefore, the Company does not expect to incur any cost related to counter-party default.

The Company is exposed to interest rate risk on loans held for sale and rate lock loan commitments. As market interest rates increase or decrease, the fair value of mortgage loans held for sale and rate lock commitments will decrease or increase accordingly. To offset this interest rate risk, the Company enters into derivatives such as forward contracts to sell loans. The fair value of these forward sales contracts will change as market interest rates change, and the change in the value of these instruments is expected to largely, though not entirely, offset the change in fair value of loans held for sale and rate lock commitments. The objective of this activity is to minimize the exposure to losses on rate lock commitments and loans held for sale due to market interest rate fluctuations. The net effect of derivatives on earnings will depend on risk management activities and a variety of other factors, including market interest rate volatility, the amount of rate lock commitments that close, the ability to fill the forward contracts before expiration, and the time period required to close and sell loans.

Notes to Consolidated Financial Statements

Note 20. Condensed Financial Information of Coastal Banking Company (Parent Company Only)

Condensed Balance Sheets

	December 31,	
	2015	2014
Assets		
Cash and due from banks	$ 301,219	$ 74,055
Investment in Coastal Banking Company Statutory Trust I & II	217,000	217,000
Investment in subsidiary bank	49,725,524	44,651,266
Other assets	600,958	581,685
Total assets	$ 50,844,701	$ 45,524,006
Liabilities		
Senior note payable	$ 9,916,667	$ —
Junior subordinated debentures	7,217,000	7,217,000
Other liabilities	452,134	443,404
Total liabilities	17,585,801	7,660,404
Shareholders' Equity		
Preferred stock	—	9,950,000
Shareholder common equity	33,258,900	27,913,602
Shareholders' equity	33,258,900	37,863,602
Total liabilities and shareholders' equity	$ 50,844,701	$ 45,524,006

Condensed Statements of Income

	For the years ended December 31,	
	2015	2014
Income		
Interest income	$ 5,236	$ 5,471
Dividend income from subsidiary	1,300,000	1,000,000
Total income	1,305,236	1,005,471
Expenses		
Interest expense	255,623	170,499
Other operating expenses	672,037	364,134
Total expenses	927,660	534,633
Income before income tax benefits and equity in undistributed earnings of subsidiary	377,576	470,838
Income tax benefits	(312,736)	(139,868)
Income before equity in undistributed earnings of subsidiary	690,312	610,706
Equity in undistributed earnings of subsidiary	5,144,909	2,506,853
Net income	$ 5,835,221	$ 3,117,559

Note 20. Condensed Financial Information of Coastal Banking Company (Parent Company Only) (Continued)

Condensed Statements of Cash Flows

	For the years ended December 31,	
	2015	2014
Cash flows from operating activities:		
Net income	$ 5,835,221	$ 3,117,559
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of Subsidiary	(5,144,909)	(2,506,853)
Stock-based compensation expense	51,134	9,512
Change in other assets and liabilities	(10,543)	(162,467)
Net cash provided by operating activities	730,903	457,751
Cash flows from financing activities:		
Net change in senior note payable	9,916,667	—
Redemption of preferred stock	(9,950,000)	—
Proceeds from employee stock purchase plan	312,477	113,337
Proceeds from exercise of stock options	680	70,714
Dividends paid on preferred stock	(783,563)	(838,860)
Net cash used in financing activities	(503,739)	(654,809)
Net increase (decrease) in cash and due from banks	227,164	(197,058)
Cash and due from banks at beginning of year	74,055	271,113
Cash and due from banks at end of year	$ 301,219	$ 74,055

Note 21. Subsequent Events

The Company announced on November 23, 2015 that it had entered into a definitive agreement to acquire First Avenue National Bank of Ocala, Florida. The terms of the agreement require that the Company issue up to 885,447 shares of common stock in exchange for all outstanding common shares of First Avenue National Bank based on an exchange ratio of 0.4848 shares of Coastal Banking Company for each share of First Avenue. On February 16, 2016, the Company's primary regulator, the Office of the Comptroller of the Currency, approved the Company's application to acquire First Avenue. On February 29, 2016, the Securities and Exchange Commission issued a notice of qualification of the Regulation A Offering Statement for the common shares to be issued in exchange for the First Avenue shares. The completion of the acquisition is subject to approval of the shareholders of First Avenue on April 5, 2016 and the shareholders of the Company on April 6, 2016.

Coastal Banking Company, Inc. and Subsidiaries Corporate Data

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New York, New York 10004
Phone (212) 509-4000

Independent Public Accounting Firm
Mauldin & Jenkins, LLC
2303 Dawson Road
Post Office Box 71549
Albany, Georgia 31708

Stock Information

The Common Stock of Coastal Banking Company, Inc. is not listed on any exchange, however the stock is quoted on the OTCQX® Marketplace under the symbol "CBCO." There were approximately 645 shareholders of record on December 31, 2015. The following table sets forth the high and low bid prices as quoted on the OTCQX® during the periods indicated. The quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commissions, and may not represent actual transactions.

	Years Ended December 31,			
	2015		2014	
	High	Low	High	Low
First quarter	$ 9.99	$ 8.80	$ 7.75	$ 6.41
Second quarter	$ 10.19	$ 9.00	$ 8.75	$ 6.72
Third quarter	$ 13.00	$ 9.60	$ 9.85	$ 6.90
Fourth quarter	$ 12.25	$ 11.60	$ 9.50	$ 8.70

The Company has never declared or paid a cash dividend on common stock and does not expect to do so in the foreseeable future. The ability of the Company to pay cash dividends is dependent upon receiving cash dividends from the Bank. However, federal banking regulations restrict the amount of cash dividends that can be paid to the Company by the Bank. All of our outstanding shares of common stock are entitled to share equally in dividends from funds legally available when, and if, declared by the Board of Directors. Any future determination relating to our dividend policy will be made at the discretion of the Board of Directors.

Copies of the Company's Annual Report for the fiscal year ended December 31, 2015 will be furnished at no charge to shareholders upon written request to: Paul R. Garrigues, Chief Financial Officer, Coastal Banking Company, Inc., 36 Sea Island Parkway, Beaufort, SC 29907.

This Annual Report serves as the Annual Financial Disclosure Statement furnished pursuant to Part 350 of the Federal Deposit Insurance Corporation's Rules and Regulations. This Statement has not been reviewed or confirmed for accuracy or relevance by the Office of the Comptroller of the Currency.