

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

(Mark One)

- ☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2014

OR

- ☐ **TRANSITIONAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 0-26995

HCSB FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina
(State or other jurisdiction of
incorporation or organization)

57-1079444
(I.R.S. Employer
Identification No.)

3640 Ralph Ellis Boulevard
Loris, South Carolina
(Address of principal executive offices)

29569
(Zip Code)

Registrant's telephone number, including area code: (843) 756-6333

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Not applicable	Not Applicable

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.01 par value per share
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☐ Yes ☒ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☒

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

The estimated aggregate market value of the Common Stock held by non-affiliates (shareholders holding less than 5% of an outstanding class of stock, excluding directors and executive officers) of the Company on June 30, 2014 was \$2,383,752. See Part II, Item 5 of this Form 10-K for information on the market for the Company's common stock.

There were 3,816,340 shares of the registrant's common stock outstanding on March 27, 2015.

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Cautionary Note Regarding Forward-Looking Statements

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

- reduced earnings due to higher credit losses as a result of declining real estate values, increasing interest rates, increasing unemployment, or changes in customer payment behavior or other factors;
- reduced earnings due to higher credit losses because our loans are concentrated by loan type, industry segment, borrower type, or location of the borrower or collateral;
- our ability to comply with the Consent Order and the Written Agreement with our regulatory authorities and the potential for regulatory actions if we fail to comply;
- our ability to maintain appropriate levels of capital, including levels of capital required by our higher individual minimum capital ratios and under the capital rules implementing Basel III;
- the adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;
- results of examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write down assets;
- the high concentration of our real estate-based loans collateralized by real estate in a weak commercial real estate market;
- increased funding costs due to market illiquidity, increased competition for funding, and/or increased regulatory requirements with regard to funding;
- significant increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated margins;
- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- general economic conditions, either nationally or regionally and especially in our primary service area, being less favorable than expected, resulting in, among other things, a deterioration in credit quality;
- increased cybersecurity risk, including potential business disruptions or financial losses;
- changes occurring in business conditions and inflation;
- changes in deposit flows;
- changes in technology;
- our current and future products, services, applications and functionality and plans to promote them;
- changes in monetary and tax policies;
- the rate of delinquencies and amount of loans charged-off;
- the rate of loan growth and the lack of seasoning of our loan portfolio;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- loss of consumer confidence and economic disruptions resulting from terrorist activities;
- changes in accounting policies and practices;
- our ability to retain our existing customers, including our deposit relationships;
- changes in the securities markets; and
- other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission (the “SEC”).

If any of these risks or uncertainties materialize, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see “Risk Factors” under Part I, Item 1A of this Annual Report on Form 10-K. We urge readers to consider all of these factors carefully in evaluating the forward-looking statements

contained in this Annual Report on Form 10-K. We make these forward-looking statements as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements.

PART I

Item 1. Business.

General Overview

HCSB Financial Corporation (the “Company”) was incorporated on June 10, 1999 to become a holding company for Horry County State Bank (the “Bank”). The Bank is a state chartered bank which commenced operations on January 4, 1988. Our primary market includes Horry County in South Carolina and Columbus and Brunswick Counties in North Carolina. From our 11 branch locations, we offer a full range of deposit services, including checking accounts, savings accounts, certificates of deposit, money market accounts, and IRAs, as well as a broad range of non-deposit investment services. In addition, we offer a variety of loan products designed for consumers, businesses and farmers. As of December 31, 2014, we had total assets of \$421.6 million, net loans of \$229.8 million, deposits of \$391.3 million and shareholders’ deficit of \$11.2 million.

Recent Developments

On March 24, 2015, the Bank entered into a definitive agreement with Sandhills Bank, North Myrtle Beach, South Carolina, to sell its Socastee, Windy Hill, and Carolina Forest branches with total deposits of approximately \$45.5 million and approximately \$8 million in loans. The deposit premium will be approximately 2.5% of deposits acquired. The transaction, which is subject to regulatory approval and other customary conditions, is expected to close in third quarter of 2015.

Regulatory Matters

Consent Order

As a result of the economic recession, the Bank entered into a Consent Order (the “Consent Order”) with the FDIC and the South Carolina Board of Financial Institutions (the “State Board”) on February 10, 2011. The Consent Order requires the Bank to, among other things, take the following actions: achieve and maintain Total Risk-Based capital at least equal to 10% of risk-weighted assets and Tier 1 capital at least equal to 8% of total assets; reduce the level of the Bank’s classified assets; eliminate all assets or portions of assets classified “Loss” and 50% of those assets classified “Doubtful” in the Bank’s most recent examination report; analyze and assess the Bank’s management and staffing needs to ensure the Bank has qualified management in place as well as the appropriate organizational structure; increase board oversight of the Bank; limit asset growth; eliminate the Bank’s reliance on brokered deposits; ensure the adequacy of the Bank’s allowance for loan and lease losses; formulate and implement a comprehensive financial plan to address profitability, improve income, monitor expenses, and restructure the Bank’s balance sheet; ensure the full implementation of the Bank’s revised written lending and collection policy to provide effective guidance and control over the Bank’s lending function; implement a plan addressing liquidity, contingency funding, and overall balance sheet management; establish an enhanced internal loan review program; correct all violations of law, regulation, and contraventions of policy which are listed in the Bank’s most recent examination report; not extend any additional credit to any borrower who has a loan or other extension of credit from the Bank that has been charged off or classified “Loss” or “Doubtful” and is uncollected; not declare or pay dividends or bonuses without the prior written approval of the FDIC and the State Board; reduce any segment of the Bank’s loan portfolio that is an undue concentration of credit; and supply written progress reports to the FDIC and the State Board.

Even prior to receipt of the Consent Order, the Bank’s board of directors and management adopted and began executing a comprehensive strategic plan to address the matters described in the Consent Order. The Bank’s board of directors and management have been, and continue to be, keenly focused on executing this plan and within a year the Bank was in compliance with a number of the requirements of the Consent Order. However, the Bank still needs a material amount of additional capital to comply with the Consent Order. As described below, the Bank continues not only to search for additional capital but also for a potential merger partner. See Note 2 to our Financial Statements included in this Annual Report for more discussion of the Consent Order.

Written Agreement

On May 9, 2011, the Company entered into a Written Agreement (the “Written Agreement”) with the Federal Reserve Bank of Richmond. The Agreement is designed to enhance the Company’s ability to act as a source of strength to

the Bank. See Note 2 to our Financial Statements included in this Annual Report for more discussion of the Written Agreement.

In addition, the Federal Reserve Bank of Richmond has informed the Company that it is required to contribute \$1 million to the Bank as soon as the Company has the funds available to do so for repayment of a loan deemed made from the Bank to the Company in such amount. The Bank is a general unsecured creditor of the Company with respect to this amount.

Going Concern Considerations

We have prepared the consolidated financial statements contained in this Annual Report assuming that the Company will be able to continue as a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. However, as a result of recurring losses, as well as uncertainties associated with the Bank's ability to increase its capital levels to meet regulatory requirements, management has concluded that there is substantial doubt about the Company's ability to continue as a going concern. In its report dated March 30, 2015, our independent registered public accounting firm stated that these uncertainties raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern. If we are unable to continue as a going concern, our shareholders, subordinated debt holders, and other securities holders will likely lose all of their investment in the Company. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 2-"Regulatory Matters and Going Concern Considerations" to our Consolidated Financial Statements of this Annual Report.

Our Strategic Plan

As a response to the most recent economic recession and the terms of the Consent Order and the Written Agreement, we adopted a new strategic plan, which includes not only a search for a potential merger partner but also a search for additional capital, as well as steps to stabilize the Bank's financial condition, including steps to reduce expenses, decrease the size of the Bank, and improve asset quality. We have continued to take these steps over the last few years, and we believe that they have helped to further stabilize the Bank's financial condition, which will help us as we continue our efforts to secure a merger partner or raise capital. As of December 31, 2014, on a pro forma basis, approximately \$8.5 million in additional capital would have returned the Bank to "adequately capitalized" and approximately \$23.6 million in additional capital would have returned the Bank to "well capitalized" under regulatory guidelines. If we continue to decrease the size of the Bank or can maintain the Bank's profitability, then we could achieve these capital levels with less additional capital, although as noted below, prospective investors would likely require us to raise materially more capital than these minimums. In addition, as noted above, on March 24, 2015, the Bank entered into a definitive agreement pursuant to which we intend to sell the real estate, equipment, substantially all of the loans, and certain other assets, and assume the deposits associated with, three of the Bank's branches. We believe it will be difficult to reduce the size of the Bank much further without selling good earning assets, which would make it harder for us to maintain profitability. The Bank's leverage ratio was 2.53% at December 31, 2014. Although this was an improvement from 2.17% at December 31, 2013, we still do not have much of a cushion above the 2.0% minimum required level. If the Bank's leverage ratio falls below this 2.0% threshold, which could happen if we suffer additional loan losses or losses in our other real estate owned portfolio, then the Bank will be placed into a federal conservatorship or receivership by the FDIC. Further, the Company had negative shareholders' equity of \$11.2 million at December 31, 2014. Although this was an improvement over the total shareholders' deficit of \$16.4 million at December 31, 2013, the fact that we have negative shareholders' equity is nevertheless making it more difficult for us to raise additional capital or find a merger partner. There are no assurances that we will be able to raise additional capital in the near future or at all. If we cannot meet the minimum capital requirements set forth under the Consent Order and return the Bank to a "well capitalized" designation, or if we suffer a further deterioration in our financial condition, we may be placed into a federal conservatorship or receivership by the FDIC. We also recognize that in order to attract investors we may need to raise materially more than the minimum amounts described above so that the Company can repay the subordinated notes, trust preferred securities, and TARP securities and so that the Bank will have sufficient capital to grow. We have been seeking to raise additional capital or find a merger partner since the imposition of the Consent Order, and we are continuing to work diligently to do so, although there are no assurances that we will be successful in doing so.

Decreasing Our Assets. Over the last year, we have continued to reduce the Company's total assets from \$434.6 million at December 31, 2013 to \$421.6 million at December 31, 2014. Total assets of the Company at December 31, 2012 and 2011 were \$469.0 million and \$535.7 million, respectively. Similarly, we reduced the Bank's total assets from \$434.6 million at December 31, 2013 to \$421.5 million at December 31, 2014. Total assets of the Bank at December 31, 2012 and 2011 were \$469.0 and \$535.9 million, respectively. We believe that decreasing the Bank's assets and reducing expenses have helped stabilize the Bank's capital ratios. However, these steps alone will not enable us to achieve compliance with the terms of the Consent Order and the Written Agreement. We continue to search for new capital or a potential merger partner. We will continue to evaluate strategies for reducing the Bank's overall asset size but do not currently anticipate any material additional decrease. At the moment, we would prefer to maintain the Bank's current overall asset size and replace nonperforming assets with earning assets.

Reducing OREO and Other Nonperforming Assets. We have focused substantial time and effort on managing the liquidation of nonperforming assets. Over the past several years, we have initiated workout plans for problem loans that are designed to promptly collect on or rehabilitate these loans in an effort to convert them to earning assets, and we have pursued foreclosure in certain instances. We are currently marketing our inventory of foreclosed real estate, but given that we would likely be required to accept discounted sales prices below appraised value if we tried to dispose of these assets quickly, we have taken a more measured and deliberate approach with these sales efforts.

As a result of these efforts, we believe credit quality indicators continue to show signs of stabilization and improvement. For example, our nonperforming assets decreased from \$35.6 million at December 31, 2013 to \$31.3 million at December 31, 2014. In addition, as we continue to work through our credit issues, our costs related to other real estate owned have decreased from \$3.5 million for 2012 to \$1.4 million for each of 2013 and 2014. In fact, the Bank (as opposed to the Company) has been profitable each of the last two years, with net income for the year ended December 31, 2014 of \$1.1 million and net income of \$2.1 million for the year ended December 31, 2013, although in 2014, the Bank's earnings included \$940 thousand in life insurance proceeds resulting from the passing of a former director and a former insured employee of the Bank. On a consolidated basis, our net loss for the year ended December 31, 2014 was \$291 thousand, primarily due to the accrual of interest expense on the trust preferred securities in the amount of \$179 thousand and the subordinated debentures in the amount of \$1.1 million for the year. Although we had net income of \$1.8 million for the year ended December 31, 2013, this net income was primarily the result of the \$1.0 million gain included in noninterest income recognized on the forgiveness of debt last year and an approximately \$1.5 million negative provision to our allowance for loan loss reserve.

New lending has been minimal due to demand but also due to our focus on restoring the Bank's financial condition. We remain focused on disciplined underwriting practices and prudent credit risk management. In 2011, as part of our strategic plan, we substantially revised our lending policy and credit procedures. We expanded the scope and depth of the initial loan review performed by our loan officers on all loans, and we incorporated more objective measurements in our internal loan analysis which more accurately addresses each borrower's probability of default.

Reducing ADC and CRE Loan Concentrations. In response to the economic recession's impact on acquisition, development and construction ("ADC") and commercial real estate ("CRE") loans, we have reduced the number of ADC and CRE loans we make and the number of these loans in our existing portfolio. We have worked to decrease our concentration by various means, including (i) through the normal sale of real estate by borrowers and their resulting repayments of the borrowed funds, (ii) transfers of problem loans to other real estate owned or charge-off if loss is considered confirmed, and (iii) encouraging customers with these types of loans to seek other financing when their loans mature. Since implementing our strategic plan, we have decreased the Bank's total CRE loan portfolio significantly.

Increasing Operating Earnings. Management is focused on increasing our operating earnings by continuing strategies to improve the core profitability of our franchise. These strategies change the mix of our earning assets while maintaining the size of our balance sheet. Specifically, we are intent on reducing the level of nonperforming assets, controlling our operating expenses, improving our net interest margin and increasing fee income. As we reduce the amount of our nonperforming assets, additional provisions for loan losses may be required so that this may be accomplished within our preferred timeframe. Additionally, we are carefully evaluating all renewing loans in our portfolio to ensure that we are focusing our capital and resources on our best relationship customers.

The benefits of reducing the size of our balance sheet include more disciplined loan and deposit pricing going forward, which we believe will result in an improvement in our net interest margin. Additionally, we will seek to expand our net interest margin as our current loans and deposits reprice and renew. We typically seek to put floors, or minimum interest rates, in our variable rate loans at origination or renewal.

Focusing on Reducing Noninterest Expenses and Collecting Noninterest Income. We continue to review our noninterest income and noninterest expense categories for potential revenue enhancements and expense reductions. Over the last several years, we have implemented several initiatives to help reduce expenses and manage our overhead at an efficient level. Management and the board of directors have already reduced compensation expenses by, among other things, eliminating over 60 employment positions, minimizing salary increases and eliminating bonuses of any type since December 31, 2009, eliminating employer matching contributions to officer and employee 401(k) accounts and reducing the percentage of health and dental insurance benefits paid by the Bank for all of its employees. In addition, certain of the Bank's senior officers accepted salary reductions and forfeited certain retirement benefits and incentive compensation. Management and the Board also determined in 2011, after careful review of hourly customer traffic counts, to reduce the hours of service on Friday afternoons. All of these steps served to enable the Bank to reduce its compensation expenses by over \$4.1 million from 2009 to 2014. In addition, the Board eliminated monthly director fees effective October 1, 2011, and all active directors who had elected to defer their director fees until retirement have forfeited their deferred fees entirely in the aggregate amount of approximately \$857 thousand.

We have also reduced marketing expenses incurred by the Bank. We closed two branches in January 2012, and are continuing to analyze other noninterest expenses for further reduction opportunities. We believe that reduction of our level of nonperforming assets will also reduce our operating costs significantly. Expenses related to other real estate

owned were \$1.4 million for both 2014 and 2013 compared to \$3.5 million for 2012, respectively. We expect expenses related to other real estate owned to continue to decline slightly.

At the same time, we are focused on enhancing revenues from noninterest income sources, such as service charges, residential mortgage loan originations and fees earned from fiduciary activities, as well as from minimizing waivers of fees for late charges on loans and fees charged for insufficient funds checks presented for payment. We will continue to look for additional strategies to increase fee-based income as we expect that these efforts will help to bolster our noninterest income levels.

Location and Service Area

Our primary markets include Horry County, South Carolina and Columbus and Brunswick Counties, North Carolina. Many of the banks in these areas are branches of large regional banks. Although size gives the larger banks certain advantages in competing for business from large corporations, including higher lending limits and the ability to offer services in other areas of South Carolina and North Carolina, we believe that there is a void in the community banking market in our market that we can fill. We generally do not attempt to compete for the banking relationships of large corporations, but concentrate our efforts on small- to medium-sized businesses, individuals, and farmers.

Banking Services

We offer a full range of deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts, and time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to our principal market area at rates competitive to those offered in our market area. In addition, we offer certain retirement account services, such as Individual Retirement Accounts. All deposit accounts are insured by the FDIC up to the maximum amount allowed by law (generally, \$250,000 per depositor, subject to aggregation rules). We solicit these accounts from individuals, businesses, associations and organizations, and governmental authorities.

Lending Activities

Presented below are our general lending activities. In accordance with the Bank's efforts to restructure the balance sheet, the Bank has strictly limited any new lending, particularly with respect to commercial real estate loans.

General. We emphasize a range of lending services, including real estate, commercial, agricultural and consumer loans, to individuals and small to medium-sized businesses and professional concerns that are located in or conduct a substantial portion of their business in our market area. The characteristics of our loan portfolio and our underwriting procedures, collateral types, risks, approval process and lending limits are discussed below.

Real Estate Loans. The primary component of our loan portfolio is loans collateralized by real estate, which made up approximately 84.2% of our loan portfolio at December 31, 2014. Residential real estate loans were 35.9% of the portfolio. These loans are secured generally by first or second mortgages on residential, agricultural or commercial property and consist of commercial real estate loans and residential real estate loans (but exclude home equity loans, which are classified as consumer loans). Consumer and commercial real estate construction and commercial development loans were 14.6% of the portfolio. These loans are secured by the real estate for which construction is planned.

As discussed above under "Our Strategic Plan - *Reducing ADC and CRE Loan Concentrations*", due to concerns regarding the economic recession and our concentration of commercial real estate loans, which as of December 31, 2014 totaled \$113.9 million, or 57.4% of our real estate loans, we have focused on reducing the level of these types of loans in our portfolio.

Commercial Loans. At December 31, 2014, approximately 10.8% of our loan portfolio consisted of commercial loans not including agricultural loans. Commercial loans consist of secured and unsecured loans, lines of credit, and working capital loans. We make these loans to various types of businesses. Included in this category are loans to purchase equipment, finance accounts receivable or inventory, and loans made for working capital purposes.

Consumer Loans. Consumer loans made up approximately 2.7% of our loan portfolio at December 31, 2014. These are loans made to individuals for personal and household purposes, such as secured and unsecured installment and term loans, home equity loans and lines of credit, and revolving lines of credit such as overdraft protection. Automobiles, recreational boats and small recreational vehicles are often pledged as collateral on secured consumer loans.

Agricultural Loans. Approximately 2.3% of our loan portfolio consisted of agricultural loans at December 31, 2014. These are loans made to individuals and businesses for agricultural purposes, including loans to finance crop production and livestock operating expenses, to purchase farm equipment, and to store crops. These loans are secured generally by liens on growing crops and farm equipment. Also included in this category are loans to agri-businesses, which are substantially similar to commercial loans, as discussed above.

Underwriting Procedures, Collateral, and Risk. Although we have generally restricted new lending while we have focused on restoring the Bank's financial condition, we remain attentive to disciplined underwriting practices and prudent credit risk management. We use our established credit policies and procedures when underwriting each type of loan. Although there are minor variances in the characteristics and criteria for each loan type, which may require additional underwriting procedures, we generally evaluate borrowers using the following defined criteria:

- Capacity – we evaluate the borrower's ability to service the debt.
- Capital – we evaluate the borrower's overall financial strength, as well as the equity investment in the asset being financed.
- Collateral – we evaluate whether the collateral is adequate from the standpoint of quality, marketability, value and income potential.
- Character – we evaluate whether the borrower has sound character and integrity by examining the borrower's history.
- Conditions – we underwrite the credit in light of the effects of external factors, such as economic conditions and industry trends.

It is our practice to obtain collateral for most loans to help mitigate the risk associated with lending. We generally limit our loan-to-value ratio to 80%. For example, we obtain a security interest in real estate for loans secured by real estate. For commercial loans, we typically obtain security interests in equipment and other company assets. For agricultural loans, we typically obtain a security interest in growing crops, farm equipment, or real estate. For consumer loans used to purchase vehicles, we obtain appropriate title documentation. For secured loans that are not associated with real estate, or for which the mortgaged real estate does not provide an acceptable loan-to-value ratio, we typically obtain other available collateral such as stocks or savings accounts.

Every loan carries a credit risk, simply defined as the potential that the borrower will not be willing or able to repay the debt. While this risk is common to all loan types, each type of loan may carry risks that distinguish it from other loan types. The following paragraphs discuss certain risks that are associated with each of our loan types.

Each real estate loan is sensitive to fluctuations in the value of the real estate that secures that loan. Certain types of real estate loans have specific risk characteristics that vary according to the type of collateral that secures the loan, the terms of the loan, and the repayment sources for the loan. Construction and development real estate loans generally carry a higher degree of risk than long term financing of existing properties. These projects are usually dependent on the completion of the project on schedule and within cost estimates and on the timely sale of the property. Inferior or improper construction techniques, changes in economic conditions during the construction and marketing period, and rising interest rates which may slow the sale of the property are all risks unique to this type of loan. Residential mortgage loans, in contrast to commercial real estate loans, generally have longer terms and may have fixed or adjustable interest rates.

Commercial loans primarily have risk that the primary source of repayment will be insufficient to service the debt. Often this occurs as the result of changes in economic conditions in the location or industry in which the borrower operates which impact cash flow or collateral value. Consumer loans, other than home equity loan products, are generally considered to have more risk than loans to individuals secured by first or second mortgages on real estate due to dependence on the borrower's employment status as the sole source of repayment. Agricultural loans carry the risk of crop failure, which adversely impacts both the borrower's ability to repay the loan and the value of the collateral, although we partially mitigate these risks by requiring the assignment of multi-peril crop insurance on all such loans.

By following defined underwriting criteria as noted above, we can help to reduce these risks. Additionally we help to reduce the risk that the underlying collateral may not be sufficient to pay the outstanding balance by using appraisals or taking other steps to determine that the value of the collateral is adequate, and lending amounts based upon lower loan-to-value ratios. We also control risks by reducing the concentration of our loan portfolio in any one type of loan.

Loan Approval and Review. Our loan approval policies provide for various levels of officer lending authority. When the amount of aggregate loans to a single borrower exceeds that individual officer's lending authority, the loan request is considered by an officer with a higher lending limit. Any loan in excess of this lending limit is approved by the directors' loan committee. We do not make any loans to any of our directors or executive officers unless the loan is approved by a three-fourth's vote of the board of directors of the Bank and is made on terms not more favorable to such person than would be available to a person not affiliated with us. Aggregate credit in excess of 10% of the Bank's aggregate capital, surplus, retained earnings, and reserve for loan losses must be approved by a three-fourth's vote of our Bank's board of directors.

Residential Mortgage Loans. We offer a variety of residential mortgage lending products, including loans with fixed rates for fifteen and thirty years as well as adjustable rate mortgages (ARMs). Typically, we close these loans with funds provided by a secondary market investor, although we may close them in the Bank's name under a pre-approved commitment to sell the loans to an investor within a few weeks from the date the loan is closed.

Lending Limits. Our lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply to certain loan types or borrowers, in general we are subject to a loan-to-one-borrower limit. These limits increase or decrease as our capital increases or decreases. Unless we sell participations in loans to other financial institutions, we are not able to meet all of the lending needs of loan customers requiring aggregate extensions of credit above these limits.

Other Banking and Related Services

Other services which are offered by the Bank include cash management services, sweep accounts, repurchase agreements, mobile banking, remote deposit capture, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, online banking and automatic drafts for various accounts. We are associated with a shared network of automated teller machines that may be used by our customers throughout South Carolina and other regions. One of our non-executive officers is a registered representative of Investment Professionals Inc. (IPI), and through this individual, we offer investments in securities and other non-deposit investment products. We also offer MasterCard and VISA credit card services through a third party vendor. We continue to seek and evaluate opportunities to offer additional financial services to our customers.

Competition

The banking business is highly competitive. We compete with other commercial banks, savings and loan associations, and money market mutual funds operating in our service area and elsewhere. According to the FDIC data as of June 30, 2014, there were 22 financial institutions operating in Horry County, South Carolina, 12 financial institutions operating in Brunswick County, North Carolina, and six financial institutions operating in Columbus County, North Carolina.

We believe that our community bank focus, with our emphasis on service to small businesses, individuals, farmers and professional concerns, gives us an advantage in our markets. Nevertheless, a number of these competitors are well established in our service area. Some of the larger financial companies in our markets may have greater resources than we have, which afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns. Additionally, due to their size, many competitors may offer a broader range of products and services as well as better pricing for those products and services than we offer. Banks and other financial institutions with larger capitalization and financial intermediaries that are not subject to bank regulatory restrictions may have larger lending limits that allow them to serve the lending needs of larger customers. Because larger competitors have advantages in attracting business from larger corporations, we do not generally compete for that business. Instead, we concentrate our efforts on attracting the business of individuals and small and medium-size businesses. With regard to such accounts, we generally compete on the basis of customer service and responsiveness to customer needs, the convenience of our branches and hours, and the availability and pricing of our products and services.

Employees

As of March 27, 2015, we had 101 full-time employees and one part-time employee. We are not a party to a collective bargaining agreement, and we consider our relations with our employees to be good.

SUPERVISION AND REGULATION

Both the Company and the Bank are subject to extensive state and federal banking laws and regulations that impose specific requirements and restrictions on and provide for general regulatory oversight of their operations. These laws and regulations generally are intended to protect depositors and not shareholders. The following summary is qualified by reference to the statutory and regulatory provisions discussed. Changes in applicable laws or regulations may have a material effect on our business and prospects. Our operations may be affected by legislative changes and the policies of various regulatory authorities. We cannot predict the effect that fiscal or monetary policies, economic control, or new federal or state legislation may have on our business and earnings in the future.

The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on our operations. It is intended only to briefly summarize some material provisions.

Legislative and Regulatory Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was signed into law in July 2010. The Dodd-Frank Act affects financial institutions in numerous ways, including:

- The creation of a Financial Stability Oversight Council responsible for monitoring and managing systemic risk;
- Granting additional authority to the Board of Governors of the Federal Reserve (the “Federal Reserve”) to regulate certain types of non-bank financial companies;
- Granting new authority to the FDIC as liquidator and receiver;
- Changing the manner in which deposit insurance assessments are made;
- Requiring regulators to modify capital standards;
- Establishing the Bureau of Consumer Financial Protection (the “CFPB”);
- Capping interchange fees that banks charge merchants for debit card transactions;
- Imposing more stringent requirements on mortgage lenders; and
- Limiting banks’ proprietary trading activities.

There are many provisions in the Dodd-Frank Act mandating regulators to adopt new regulations and conduct studies upon which future regulation may be based. Governmental intervention and new regulations could materially and adversely affect our business, financial condition and results of operations.

Basel Capital Standards. The Basel Committee on Banking Supervision, an international forum for cooperation on banking supervisory matters, develops and proposes standards for the prudential regulation of banking organizations, including capital standards. In July 2013, the federal bank regulatory agencies issued a final rule that has revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by the Basel Committee on Banking Supervision (“Basel III”) and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, such as the Bank, top-tier bank holding companies with total consolidated assets of \$500 million or more, and top-tier savings and loan holding companies, which we collectively refer to herein as “covered” banking organizations. Bank holding companies with less than \$500 million in total consolidated assets, such as the Company, are not subject to the final rule. The final rule became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions), and all of the requirements in the final rule will be fully phased in by January 1, 2019.

The final rule imposes higher minimum risk-based capital and leverage requirements for covered banking organizations than those currently in place. Specifically, the final rule imposes the following minimum capital requirements:

- a new common equity Tier 1 risk-based capital ratio (sometimes referred to as a CET1 ratio) of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the current 4% requirement);

- a total risk-based capital ratio of 8% (unchanged from current requirements); and
- a leverage ratio of 4% (currently 3% for depository institutions with the highest supervisory composite rating and 4% for other depository institutions).

In addition, the final rule introduces a new CET1 ratio category for the prompt corrective action regulations. The CET1 ratio by prompt corrective action regulations is: 6.5% or greater for well capitalized; 4.5% or greater for adequately capitalized; less than 4.5% for undercapitalized; and less than 3% for significantly undercapitalized.

Under the rule, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as non-cumulative perpetual preferred stock. The rule permits bank holding companies with less than \$15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment.

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

The current capital rules require certain deductions from or adjustments to capital. The final rule retains many of these deductions and adjustments and also provides for new ones. As a result, deductions from Common Equity Tier 1 capital will be required for goodwill (net of associated deferred tax liabilities); intangible assets such as non-mortgage servicing assets and purchased credit card relationships (net of associated deferred tax liabilities); deferred tax assets that arise from net operating loss and tax credit carryforwards (net of any related valuations allowances and net of deferred tax liabilities); any gain on sale in connection with a securitization exposure; any defined benefit pension fund asset (net of any associated deferred tax liabilities) held by a bank holding company (this provision does not apply to a bank or savings association); the aggregate amount of outstanding equity investments (including retained earnings) in financial subsidiaries; and identified losses. Other deductions will be necessary from different levels of capital.

Additionally, the final rule provides for the deduction of three categories of assets: (i) deferred tax assets arising from temporary differences that cannot be realized through net operating loss carrybacks (net of related valuation allowances and of deferred tax liabilities), (ii) mortgage servicing assets (net of associated deferred tax liabilities) and (iii) investments in more than 10% of the issued and outstanding common stock of unconsolidated financial institutions (net of associated deferred tax liabilities). The amount in each category that exceeds 10% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. The remaining, non-deducted amounts are then aggregated, and the amount by which this total amount exceeds 15% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. Amounts of minority investments in consolidated subsidiaries that exceed certain limits and investments in unconsolidated financial institutions may also have to be deducted from the category of capital to which such instruments belong.

Accumulated other comprehensive income (“AOCI”) is presumptively included in Common Equity Tier 1 capital and can operate to reduce this category of capital. The final rule provides a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. The final rule also has the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

The federal banking agencies have not proposed rules implementing the final liquidity framework of Basel III and have not determined to what extent they will apply to U.S. banks that are not large, internationally active banks.

Volcker Rule. Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” prohibits any bank, bank holding company, or affiliate (referred to collectively as “banking entities”) from engaging in two types of activities: “proprietary trading” and the ownership or sponsorship of private equity or hedge funds that are referred to as “covered funds.” On December 10, 2013, our primary federal regulators, the Federal Reserve and the FDIC, together with other federal banking agencies and the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule. The deadline for compliance with the Volcker Rule is July 21, 2015.

Proposed Legislation and Regulatory Action

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank could have a material effect on the business of the Company.

HCSB Financial Corporation

We own 100% of the outstanding capital stock of the Bank, and therefore we are considered to be a bank holding company under the federal Bank Holding Company Act of 1956 (the "Bank Holding Company Act"). As a result, we are primarily subject to the supervision, examination and reporting requirements of the Federal Reserve under the Bank Holding Company Act and its regulations promulgated thereunder. As a bank holding company located in South Carolina, we are also subject to the South Carolina Banking and Branching Efficiency Act and the State Board also regulates and monitors all significant aspects of our operations.

Permitted Activities. Under the Bank Holding Company Act, a bank holding company is generally permitted to engage in, or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in, the following activities:

- banking or managing or controlling banks;
- furnishing services to or performing services for our subsidiaries; and
- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking.

Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

- factoring accounts receivable;
- making, acquiring, brokering or servicing loans and usual related activities;
- leasing personal or real property;
- operating a non-bank depository institution, such as a savings association;
- trust company functions;
- financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- performing selected insurance underwriting activities.

As a bank holding company we also can elect to be treated as a “financial holding company,” which would allow us to engage in a broader array of activities. A financial holding company can engage in activities that are financial in nature or incidental or complementary to financial activities, including insurance underwriting, sales and brokerage activities, financial and investment advisory services, underwriting services and limited merchant banking activities. We have not sought financial holding company status, but may elect such status in the future as our business matures. If we were to elect in writing for financial holding company status, each insured depository institution we control would have to be well capitalized, well managed and have at least a satisfactory rating under the Community Reinvestment Act (CRA) (discussed below).

The Federal Reserve has the authority to order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company’s continued ownership, activity or control constitutes a serious risk to the financial safety, soundness or stability of it or any of its bank subsidiaries.

Change in Control. In addition, and subject to certain exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with regulations promulgated thereunder, require Federal Reserve approval prior to any person or company acquiring “control” of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control will be rebuttably presumed to exist unless a person acquires no more than 33% of the total equity of a bank or bank holding company, of which it may own, control or have the power to vote not more than 15% of any class of voting securities.

Source of Strength. There are a number of obligations and restrictions imposed by law and regulatory policy on bank holding companies with regard to their depository institution subsidiaries that are designed to minimize potential loss to depositors and to the FDIC insurance funds in the event that the depository institution becomes in danger of defaulting under its obligations to repay deposits. Under policy of the Federal Reserve, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), to avoid receivership of its insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become “undercapitalized” within the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency up to the lesser of (i) an amount equal to 5% of the institution’s total assets at the time the institution became undercapitalized, or (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan.

The Federal Reserve also has the authority under the Bank Holding Company Act to require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve’s determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal law grants federal bank regulatory authorities additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution’s financial condition.

In addition, the “cross guarantee” provisions of the Federal Deposit Insurance Act (the “FDIA”) require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated by the FDIC as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. The FDIC’s claim for damages is superior to claims of shareholders of the insured depository institution or its holding company, but is subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institutions.

The FDIA also provides that amounts received from the liquidation or other resolution of any insured depository institution by any receiver must be distributed (after payment of secured claims) to pay the deposit liabilities of the institution prior to payment of any other general or unsecured senior liability, subordinated liability, general creditor or shareholder. This provision would give depositors a preference over general and subordinated creditors and shareholders in the event a receiver is appointed to distribute the assets of our Bank.

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company’s

bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Capital Requirements. The Federal Reserve imposes certain capital requirements on the bank holding company under the Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of “qualifying” capital to risk-weighted assets. These requirements are essentially the same as those that apply to the Bank described below under “Horry County State Bank – Prompt Corrective Action.” 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 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 the Bank’s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. At December 31, 2014, our Bank is “significantly undercapitalized” under the capital requirements as set per bank regulatory agencies.

Subject to capital requirements and certain other restrictions, bank holding companies are able to borrow money to make capital contributions to their bank subsidiaries, and these loans may be repaid from dividends paid from the bank subsidiary to the bank holding company. The Bank’s ability to pay dividends to us is subject to regulatory restrictions as described below in “Horry County State Bank – Dividends” and also affects our ability to pay dividends. We are also able to raise capital for contribution to the Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

South Carolina State Regulation. As a South Carolina bank holding company under the South Carolina Banking and Branching Efficiency Act, we are subject to limitations on sale or merger and to regulation by the State Board. We are not required to obtain the approval of the South Carolina Board prior to acquiring the capital stock of a national bank, but we must notify them at least 15 days prior to doing so. We must receive the State Board’s approval prior to engaging in the acquisition of a South Carolina state chartered bank or another South Carolina bank holding company.

Horry County State Bank

As a South Carolina state bank, the Bank’s primary federal regulator is the FDIC, and the Bank is also regulated and subject to examination by the State Board. Deposits in the Bank are insured by the FDIC up to a maximum amount of \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

The State Board and the FDIC regulate or monitor virtually all areas of the Bank’s operations, including:

- security devices and procedures;
- adequacy of capitalization and loss reserves;
- loans;
- investments;
- borrowings;
- deposits;
- mergers;
- issuances of securities;
- payment of dividends;
- interest rates payable on deposits;
- interest rates or fees chargeable on loans;
- establishment of branches;
- corporate reorganizations;

- maintenance of books and records; and
- adequacy of staff training to carry on safe lending and deposit gathering practices.

The FDIC requires the Bank to maintain specified capital ratios and imposes limitations on the Bank's aggregate investment in real estate, bank premises, and furniture and fixtures. Two categories of regulatory capital are used in calculating these ratios—Tier 1 capital and total capital. Tier 1 capital generally includes common equity, retained earnings, a limited amount of qualifying preferred stock, and qualifying minority interests in consolidated subsidiaries, reduced by goodwill and certain other intangible assets, such as core deposit intangibles, and certain other assets. Total capital generally consists of Tier 1 capital plus Tier 2 capital, which includes the allowance for loan losses, preferred stock that did not qualify as Tier 1 capital, certain types of subordinated debt and a limited amount of other items.

The Bank is required to calculate three ratios: the ratio of Tier 1 capital to risk-weighted assets, the ratio of total capital to risk-weighted assets, and the "leverage ratio," which is the ratio of Tier 1 capital to assets on a non-risk-adjusted basis. For the two ratios of capital to risk-weighted assets, certain assets, such as cash and U.S. Treasury securities, have a zero risk weighting. Others, such as commercial and consumer loans, have a 100% risk weighting. Some assets, notably purchase-money loans secured by first-liens on residential real property, are risk-weighted at 50%. Assets also include amounts that represent the potential funding of off-balance sheet obligations such as loan commitments and letters of credit. These potential assets are assigned to risk categories in the same manner as funded assets. The total assets in each category are multiplied by the appropriate risk weighting to determine risk-adjusted assets for the capital calculations.

The minimum capital ratios for both the Company and the Bank are generally 8% for total capital, 4% for Tier 1 capital and 4% for leverage. To be eligible to be classified as "well capitalized," the Bank must generally maintain a total capital ratio of 10% or more, a Tier 1 capital ratio of 6% or more, and a leverage ratio of 5% or more. Certain implications of the regulatory capital classification system are discussed in greater detail below.

As further described under "Regulation and Supervision—Basel Capital Standards," in July 2013, the federal bank regulatory agencies issued a final rule that has revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards in Basel III and certain provisions of the Dodd-Frank Act. The final rule became effective on January 1, 2015 and applies to all depository institutions, such as the Bank, top-tier bank holding companies with total consolidated assets of \$500 million or more and top-tier savings and loan holding companies.

Prompt Corrective Action. The FDICIA established a "prompt corrective action" program in which every bank is placed in one of five regulatory categories, depending primarily on its regulatory capital levels. The FDIC and the other federal banking regulators are permitted to take increasingly severe action as a bank's capital position or financial condition declines below the "adequately capitalized" level described below. Regulators are also empowered to place in receivership or require the sale of a bank to another depository institution when a bank's leverage ratio reaches two percent. Better capitalized institutions are generally subject to less onerous regulation and supervision than banks with lesser amounts of capital. As an insured depository institution, the Bank is required to comply with these capital requirements promulgated under the FDIA and the regulations thereunder, which set forth five capital categories, each with specific regulatory consequences. Under these regulations, the categories are:

- **Well Capitalized** — The institution exceeds the required minimum level for each relevant capital measure. A well capitalized institution is one (i) having a total capital ratio of 10% or greater, (ii) having a tier 1 capital ratio of 6% or greater, (iii) having a leverage capital ratio of 5% or greater and (iv) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.
- **Adequately Capitalized** — The institution meets the required minimum level for each relevant capital measure. No capital distribution may be made that would result in the institution becoming undercapitalized. An adequately capitalized institution is one (i) having a total capital ratio of 8% or greater, (ii) having a tier 1 capital ratio of 4% or greater and (iii) having a leverage capital ratio of 4% or greater or a leverage capital ratio of 3% or greater if the institution is rated composite 1 under the CAMELS (Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk) rating system.

- Undercapitalized — The institution fails to meet the required minimum level for any relevant capital measure. An undercapitalized institution is one (i) having a total capital ratio of less than 8% or (ii) having a tier 1 capital ratio of less than 4% or (iii) having a leverage capital ratio of less than 4%, or if the institution is rated a composite 1 under the CAMELS rating system, a leverage capital ratio of less than 3%.

- **Significantly Undercapitalized** — The institution is significantly below the required minimum level for any relevant capital measure. A significantly undercapitalized institution is one (i) having a total capital ratio of less than 6% or (ii) having a tier 1 capital ratio of less than 3% or (iii) having a leverage capital ratio of less than 3%.
- **Critically Undercapitalized** — The institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2%.

If the FDIC determines, after notice and an opportunity for hearing, that the Bank is in an unsafe or unsound condition, the regulator is authorized to reclassify the Bank to the next lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition.

If a bank is not well capitalized, it cannot accept brokered deposits without prior FDIC approval. In addition, a bank that is not well capitalized cannot offer an effective yield in excess of 75 basis points over interest paid on deposits of comparable size and maturity in such institution's normal market area for deposits accepted from within its normal market area, or national rate paid on deposits of comparable size and maturity for deposits accepted outside the bank's normal market area. Moreover, the FDIC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be categorized as undercapitalized. Undercapitalized institutions are subject to growth limitations (an undercapitalized institution may not acquire another institution, establish additional branch offices or engage in any new line of business unless determined by the appropriate federal banking agency to be consistent with an accepted capital restoration plan, or unless the FDIC determines that the proposed action will further the purpose of prompt corrective action) and are required to submit a capital restoration plan. The agencies may not accept a capital restoration plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with the capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of an amount equal to 5.0% of the depository institution's total assets at the time it became categorized as undercapitalized or the amount that is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is categorized as significantly undercapitalized.

Significantly undercapitalized categorized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become categorized as adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. The appropriate federal banking agency may take any action authorized for a significantly undercapitalized institution if an undercapitalized institution fails to submit an acceptable capital restoration plan or fails in any material respect to implement a plan accepted by the agency. A critically undercapitalized institution is subject to having a receiver or conservator appointed to manage its affairs and for loss of its charter to conduct banking activities.

An insured depository institution may not pay a management fee to a bank holding company controlling that institution or any other person having control of the institution if, after making the payment, the institution would be undercapitalized. In addition, an institution cannot make a capital distribution, such as a dividend or other distribution, that is in substance a distribution of capital to the owners of the institution if following such a distribution the institution would be undercapitalized. Thus, if payment of such a management fee or the making of such would cause a bank to become undercapitalized, it could not pay a management fee or dividend to the bank holding company.

As of December 31, 2014, the Bank was deemed to be "significantly undercapitalized." As further described under "Management's Discussion and Analysis of Financial Condition and Results of Operations," on February 10, 2011, the Bank entered into a Consent Order with the FDIC and the State Board which, among other things, required the Bank to achieve Tier 1 capital at least equal to 8% of total assets and Total Risk-Based capital at least equal to 10% of total risk-weighted assets by July 20, 2011. The Bank did not meet the capital ratios as specified in the Consent Order and, as a result, submitted a revised capital restoration plan to the FDIC on July 15, 2011. The revised capital restoration plan was determined by the FDIC to be insufficient and, as a result, we submitted a further revised capital restoration plan to the FDIC on September 30, 2011. We received the FDIC's non-objection to the further revised capital restoration plan on December 6, 2011. The Bank is working diligently to increase its capital ratios in order to strengthen its balance sheet and

satisfy the commitments required under the Consent Order. The Bank has engaged independent third parties to assist the Bank in its efforts to increase its capital ratios. As noted elsewhere in this Annual Report, we will need to raise additional capital in order to achieve the capital ratios required under the Consent Order, and there are no assurances that we will be able to do so.

As further described under “Legislative and Regulatory Developments – Basel Capital Standards,” in July 2013, the federal bank regulatory agencies issued a final rule that has revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. The final review became effective on January 1, 2015 and applies to all depository institutions, such as the Bank, top-tier bank holding companies with total consolidated assets of \$500 million or more, and top-tier savings and loan holding companies. Bank holding companies with less than \$500 million in total consolidated assets, such as the Company, are not subject to the final rule.

Standards for Safety and Soundness. The FDIA also requires the federal banking regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions relating to: (i) internal controls, information systems, and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset growth. The agencies also must prescribe standards for asset quality, earnings, and stock valuation, as well as standards for compensation, fees, and benefits. The federal banking agencies have adopted regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness to implement these required standards. These guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Under the regulations, if the FDIC determines that the Bank fails to meet any standards prescribed by the guidelines, the agency may require the Bank to submit to the agency an acceptable plan to achieve compliance with the standard, as required by the FDIC. The final regulations establish deadlines for the submission and review of such safety and soundness compliance plans.

Regulatory Examination. The FDIC and the State Board also require the Bank to prepare annual and quarterly reports on the Bank’s financial condition and to conduct an annual audit of its financial affairs in compliance with minimum standards and procedures.

All insured institutions must undergo regular on-site examinations by their appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the appropriate agency against each institution or affiliate as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC, their federal regulatory agency, and their state supervisor when applicable. The FDIC has developed a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition or any other report of any insured depository institution. The FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to the following:

- internal controls;
- information systems and audit systems;
- loan documentation;
- credit underwriting;
- interest rate risk exposure; and
- asset quality.

Transactions with Affiliates and Insiders. The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. Various legal limitations restrict the Bank from lending or otherwise supplying funds to the Company or its non-bank subsidiaries. The Company and the Bank are subject to Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W.

Section 23A of the Federal Reserve Act places limits on the amount of loans or extensions of credit to, or investments in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank’s capital and surplus and, as to all affiliates combined, to 20% of the Bank’s capital and surplus. Furthermore, within the foregoing limitations as to amount, each covered transaction must meet specified collateral requirements. The Bank is forbidden from purchasing low quality assets from an affiliate.

The Dodd-Frank Act expanded the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act will apply Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The current exemption from Section 23A for transactions with financial subsidiaries will be eliminated. The Dodd-Frank Act will additionally prohibit an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

Section 23B of the Federal Reserve Act, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve decides to treat these subsidiaries as affiliates. The regulation also limits the amount of loans that can be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unrelated third parties and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Branching. Under current South Carolina law, the Bank may open branch offices throughout South Carolina with the prior approval of the State Board. In addition, with prior regulatory approval, the Bank is able to acquire existing banking operations in South Carolina. Furthermore, federal legislation permits interstate branching, including out-of-state acquisitions by bank holding companies, interstate branching by banks, and interstate merging by banks. The Dodd-Frank Act removes previous state law restrictions on de novo interstate branching in states such as South Carolina. This change permits out-of-state banks to open de novo branches in states where the laws of the state where the de novo branch to be opened would permit a bank chartered by that state to open a de novo branch.

Anti-Tying Restrictions. Under amendments to the Bank Holding Company Act and Federal Reserve regulations, a bank is prohibited from engaging in certain tying or reciprocity arrangements with its customers. In general, a bank may not extend credit, lease, sell property, or furnish any services or fix or vary the consideration for these on the condition that (i) the customer obtain or provide some additional credit, property, or services from or to the bank, the bank holding company or subsidiaries thereof or (ii) the customer may not obtain some other credit, property, or services from a competitor, except to the extent reasonable conditions are imposed to assure the soundness of the credit extended. Certain arrangements are permissible: a bank may offer combined-balance products and may otherwise offer more favorable terms if a customer obtains two or more traditional bank products; and certain foreign transactions are exempt from the general rule. Bank holding companies and bank affiliates are also subject to anti-tying requirements in connection with electronic benefit transfer services.

Community Reinvestment Act. The CRA requires that the FDIC evaluate the record of the Bank in meeting the credit needs of its local community, including low and moderate income neighborhoods. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on our Bank.

The Gramm Leach Bliley Act (the "GLBA") made various changes to the CRA. Among other changes CRA agreements with private parties must be disclosed and annual CRA reports must be made available to a bank's primary federal regulator. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the GLBA may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a satisfactory CRA rating in its latest CRA examination.

On January 1, 2015, the date of the most recent examination, the Bank received a satisfactory CRA rating.

Finance Subsidiaries. Under the GLBA, subject to certain conditions imposed by their respective banking regulators, national and state-chartered banks are permitted to form “financial subsidiaries” that may conduct financial or incidental activities, thereby permitting bank subsidiaries to engage in certain activities that previously were impermissible. The GLBA imposes several safeguards and restrictions on financial subsidiaries, including that the parent bank’s equity investment in the financial subsidiary be deducted from the bank’s assets and tangible equity for purposes of calculating the bank’s capital adequacy. In addition, the GLBA imposes new restrictions on transactions between a bank and its financial subsidiaries similar to restrictions applicable to transactions between banks and non-bank affiliates. As of December 31, 2014, the Company did not have any financial subsidiaries.

Consumer Protection Regulations. Activities of the Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank’s loan operations are also subject to federal laws applicable to credit transactions such as:

- the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- the Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act, governing the use and provision of information to credit reporting agencies, certain identity theft protections and certain credit and other disclosures;
- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- the rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The deposit operations of the Bank also are subject to:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that Act, which governs automatic deposits to and withdrawals from deposit accounts and customers’ rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Enforcement Powers. The Bank and its “institution-affiliated parties,” including its management, employees, agents, independent contractors, and consultants such as attorneys and accountants and others who participate in the conduct of the financial institution’s affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a government agency. These practices can include the failure of an institution to timely file required reports or the filing of false or misleading information or the submission of inaccurate reports. Civil penalties may be as high as \$1,000,000 a day for such violations. Criminal penalties for some financial institution crimes have been increased to 20 years. In addition, regulators are provided with greater flexibility to commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance. Furthermore, banking agencies’ power to issue cease-and-desist orders were expanded. Such orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

Anti-Money Laundering. Financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. The Company and the Bank are also prohibited

from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and “knowing your customer” in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and recent laws provide law enforcement authorities with increased access to financial information maintained by banks. Anti-money laundering obligations have been substantially strengthened as a result of the USA Patriot Act, enacted in 2001 and renewed in 2006. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications. The regulatory authorities have been active in imposing “cease and desist” orders and money penalty sanctions against institutions found to be violating these obligations.

USA PATRIOT Act/Bank Secrecy Act. Financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. The USA PATRIOT Act, amended, in part, the Bank Secrecy Act and provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering by enhancing anti-money laundering and financial transparency laws, as well as enhanced information collection tools and enforcement mechanics for the U.S. government, including: (i) standards for verifying customer identification at account opening; (ii) rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (iii) reports by nonfinancial trades and businesses filed with the Treasury Department's Financial Crimes Enforcement Network for transactions exceeding \$10,000; and (iv) suspicious activities reports by brokers and dealers if they believe a customer may be violating U.S. laws and regulations and enhanced due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications.

Under the USA PATRIOT Act, the Federal Bureau of Investigation ("FBI") can send our banking regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. The Bank can be requested to search its records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report and contact the FBI.

The Office of Foreign Assets Control ("OFAC"), which is a division of the Treasury, is responsible for helping to insure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Privacy and Credit Reporting. Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer or when the financial institution is jointly sponsoring a product or service with a nonaffiliated third party. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers. It is the Bank's policy not to disclose any personal information unless required by law.

Like other lending institutions, the Bank utilizes credit bureau data in its underwriting activities. Use of such data is regulated under the Federal Credit Reporting Act on a uniform, nationwide basis, including credit reporting, prescreening, sharing of information between affiliates, and the use of credit data. The Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act") authorizes states to enact identity theft laws that are not inconsistent with the conduct required by the provisions of the FACT Act.

Payment of Dividends. A South Carolina state bank may not pay dividends from its capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. In addition, under the FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. As described above, on February 10, 2011, the Bank entered into a Consent Order with the FDIC and the State Board which, among other things, prohibits the Bank from declaring or paying any dividends on its shares of common stock without the prior approval of the supervisory authorities.

Effect of Governmental Monetary Policies. Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Bank's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board have major effects upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

Insurance of Accounts and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC insured institutions. It also may prohibit any FDIC insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving a bank's regulatory authority an opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

FDIC insured institutions are required to pay a Financing Corporation assessment to fund the interest on bonds issued to resolve thrift failures in the 1980s. The Financing Corporation quarterly assessment for the fourth quarter of 2014 equaled 1.50 basis points for each \$100 of average consolidated total assets minus average tangible equity. These assessments, which may be revised based upon the level of deposits, will continue until the bonds mature in the years 2017 through 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is not aware of any practice, condition or violation that might lead to termination of the Bank's deposit insurance.

Item 1A. Risk Factors.

Our business, financial condition, and results of operations could be harmed by any of the following risks, or other risks that have not been identified or which we believe are immaterial or unlikely. Shareholders should carefully consider the risks described below in conjunction with the other information in this Form 10-K and the information incorporated by reference in this Form 10-K, including our consolidated financial statements and related notes.

Risks Related to Our Business

There is substantial doubt about our ability to continue as a going concern.

We have prepared the consolidated financial statements contained in this Annual Report assuming that the Company will be able to continue as a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. However, as a result of recurring losses, as well as uncertainties associated with the Bank's ability to increase its capital levels to meet regulatory requirements, management has concluded that there is substantial doubt about the Company's ability to continue as a going concern. In its most recent report dated March 30, 2015, our independent registered public accounting firm stated that these uncertainties raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern. If we are unable to continue as a going concern, our shareholders, subordinated debt holders, and other securities holders will likely lose all of their investment in the Company.

We have an immediate need to raise a material amount of additional capital. We have been trying to raise additional capital or find a merger partner for several years, with no success, and there are no assurances that we will be able to do so.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Pursuant to the Consent Order, the Bank is required to achieve Tier 1 capital at least equal to 8% of total assets and Total Risk-Based capital at least equal to 10% of total risk-weighted assets. As of December 31, 2014, the Bank had Tier 1 capital of 3.79% of total assets, Total Risk-Based capital of 5.05% of total risk-weighted assets, and a leverage ratio of 2.53%. Consequently, the Bank is not in compliance with the minimum capital requirements established in the Consent Order and is designated as "significantly undercapitalized." As a result, we have an immediate need to raise capital. As of December 31, 2014, on a pro forma basis, approximately \$8.5 million in additional capital would have returned the bank to "adequately capitalized" and approximately \$23.6 million in additional capital would have returned the Bank to "well capitalized" under regulatory guidelines. In order to attract investors, however, we may need to raise materially more than these amounts so that the Bank will have sufficient capital to grow. We have been seeking to raise additional capital or find a merger partner since the imposition of the Consent Order, and we are continuing to work diligently to do so. Our ability to raise additional capital will depend in part on conditions in the capital markets, which are outside our control, and on our financial performance. In addition, we have found it particularly difficult to attract investors given the amount of our outstanding senior equity and debt securities, including the Series T Preferred Stock issued to the U.S. Treasury under the TARP program, the trust preferred securities that we have issued, and our 2010 subordinated promissory notes. At December 31, 2014, the amount of these outstanding senior securities was \$30.1 million. Under Federal Reserve policy, any new capital issued by the Company will need to be common stock, which will be subordinate to these senior securities. Accordingly, it will be difficult for us to raise the additional capital that we need, even if we are able to negotiate reduced payments to these senior securities holders. If we are successful in raising additional capital, our existing shareholders' percentage ownership interests will be diluted significantly. If we cannot find a merger partner or raise additional capital to meet the minimum capital requirements set forth under the Consent Order, or if we suffer a continued deterioration in our financial condition, we may be placed into a federal conservatorship or receivership by the FDIC. If this were to occur, then our shareholders, our subordinated debt holders, and our other securities holders will lose their investments in the Company.

Our right to defer the payment of interest on our outstanding trust preferred securities expires in March 2016, after which the holders of our trust preferred securities can declare a default and we could be forced into involuntary bankruptcy.

As required by the Federal Reserve Bank of Richmond, beginning in March 2011, we began exercising our right to defer all quarterly distributions on our trust preferred securities. We may defer these interest payments for up to 20 consecutive quarterly periods, although interest will continue to accrue on the trust preferred securities and interest on

such deferred interest will also accrue and compound quarterly from the date such deferred interest would have been payable were it not for the extension period. All of the deferred interest, including interest accrued on such deferred interest, is due and payable at the end of the applicable deferral period, which is in March 2016. At December 31, 2014, total accrued interest equaled \$714 thousand, and total accrued interest as of March 2016 will be approximately \$950 thousand. We will not be able to pay this interest when it becomes due if we are not able to raise a sufficient amount of additional capital for the Bank to be in compliance with the Consent Order and for the Company to make the payments due under the subordinated notes, which are senior to the trust preferred securities. Even if we succeed in raising this capital, we will have to be released from the Written Agreement or obtain approval from the Federal Reserve Bank of Richmond to pay this interest on the trust preferred securities. If this interest is not paid by March 2016, the Company will be in default under the terms of the indenture related to the trust preferred securities. If we fail to pay the deferred and compounded interest at the end of the deferral period, the trustee or the holders of 25% of the aggregate trust preferred securities outstanding, by providing written notice to the Company, may declare the entire principal and unpaid interest amounts of the trust preferred securities immediately due and payable. The aggregate principal amount of these trust preferred securities is \$6.0 million. The trust preferred securities are junior to the subordinated notes, so even if a default is declared, the trust preferred securities cannot be repaid prior to repayment of the subordinated notes. However, if the trustee or the holders of the trust preferred securities declare a default under the trust preferred securities, we could be forced into involuntary bankruptcy.

We are subject to a Consent Order that requires us to take certain actions, and if we do not comply with the Consent Order, or if our condition continues to deteriorate, our Bank may be placed in a federal conservatorship or receivership by the FDIC.

On February 10, 2011, the Bank entered into a Consent Order with the FDIC and the State Board, which contains, among other things, a requirement that our Bank achieve and maintain minimum capital requirements that exceed the minimum regulatory capital ratios for “well-capitalized” banks. Under this enforcement action, the Bank may no longer accept, renew, or roll over brokered deposits. In addition, under the Consent Order, we are required to obtain FDIC approval before making certain payments to departing executives and before adding new directors or senior executives. Our regulators have considerable discretion in whether to grant required approvals, and no assurance can be given that such approvals would be forthcoming. In addition, we are required to take certain other actions in the areas of capital, liquidity, asset quality, and interest rate risk management, as well as to file periodic reports with the FDIC and the State Board regarding our progress in complying with the Consent Order.

The Bank failed to meet the minimum capital requirements by the July 9, 2011 deadline set forth in the Consent Order and, as a result, the Bank submitted a revised Capital Restoration Plan to the FDIC on September 30, 2011 detailing the steps the Bank plans to take to achieve these minimum capital requirements. The Bank is not currently in compliance with the minimum capital requirements and, as of December 31, 2014, the Bank is categorized as “significantly undercapitalized.” As a result, a number of requirements or restrictions can or will be imposed on the Company and the Bank in addition to those set forth under the Consent Order and the Written Agreement. These additional requirements and restrictions: (i) prohibit the Bank from paying any bonus to a senior executive officer or providing compensation to a senior executive officer at a rate exceeding the officer’s average rate of compensation (excluding bonuses, stock options and profit-sharing) during the 12 months preceding the month in which the Bank became undercapitalized, without prior written approval from the FDIC; (ii) require the FDIC to impose one or more of the following on the Bank: (A) require a sale of Bank shares or obligations of the Bank sufficient to return the Bank to adequately capitalized status; (B) if grounds exist for the appointment of a receiver or conservator for the Bank, require the Bank to be acquired or merged with another institution; (C) impose additional restrictions on transactions with affiliates beyond the normal restrictions applicable to all banks; (D) impose more stringent growth restrictions on the Bank, or require the Bank to further reduce its total assets; (E) require the Bank to alter, reduce or terminate any activities the FDIC determines pose excessive risk to the Bank; (F) order a new election of Bank directors; (G) require the Bank to dismiss any senior executive officer or director who held office for more than 180 days before the Bank became undercapitalized; (H) require the Bank to employ “qualified” senior executive officers; (I) require the Company to divest the Bank if the regulators determine that the divestiture would improve the Bank’s financial condition and future prospects; and (J) require the Bank to take any other action that the FDIC determines will better carry out the purposes of the statute requiring the imposition of one or more of the restrictions described in (A)-(I) above; and (iii) require prior regulatory approval for material transactions outside the usual course of business, extending credit for a highly leveraged transactions, amending the Bank’s Articles of Incorporation or bylaws, making a material change to accounting methods, paying excessive compensation or bonuses, and paying interest on new or renewed liabilities at a rate that would increase the Bank’s weighted average cost of funds to a level significantly exceeding the prevailing rates on interest on deposits in the Bank’s normal market areas.

If the Bank were to fall to “critically undercapitalized,” then the FDIC would be required to place the Bank into conservatorship or receivership within 90 days of the Bank becoming critically undercapitalized, unless the FDIC determined that “other action” would better achieve the purposes of the FDIC’s prompt corrective action capital requirements. The Bank will be deemed to be critically undercapitalized if its leverage ratio falls below 2.0%. The Bank’s leverage ratio was 2.53% at December 31, 2014. Although this was an improvement from 2.17% at December 31, 2013, we still do not have much of a cushion above the 2.0% minimum required level. If the Bank were to be taken into receivership, then our shareholders, our subordinated debt holders, and our other securities holders will lose their investments in the Company.

If our nonperforming assets increase, our earnings will be adversely affected.

At December 31, 2014, our nonperforming assets (which consist of nonaccruing loans, loans 90 days or more past due, and other real estate owned) totaled \$31.3 million, or 7.43% of total assets. At December 31, 2013, our nonperforming assets were \$35.6 million, or 8.19% of total assets. Our nonperforming assets adversely affect our net income in various ways:

- We do not record interest income on nonaccrual loans or real estate owned.
- We must provide for probable loan losses through a current period charge to the provision for loan losses.
- Noninterest expense increases when we must write down the value of properties in our other real estate owned portfolio to reflect declining market values.
- There are legal fees associated with the resolution of problem assets, as well as carrying costs, such as taxes, insurance, and maintenance fees related to other real estate owned.
- The resolution of nonperforming assets requires the active involvement of management, which can distract them from more profitable activity.

If additional borrowers become delinquent and do not pay their loans and we are unable to successfully manage our nonperforming assets, our losses and troubled assets could increase significantly, which could have a material adverse effect on our results of operations. As described above, if the Bank's leverage ratio falls below 2.0%, which could happen if we suffer additional loan losses or losses in our other real estate owned portfolio, then the Bank will be placed into a federal conservatorship or receivership by the FDIC.

We have sustained losses from a decline in credit quality and may see further losses.

Our ability to generate earnings is significantly affected by our ability to properly originate, underwrite and service loans. In recent years we sustained historically abnormal losses primarily because borrowers, guarantors or related parties failed to perform in accordance with the terms of their loans and we failed to detect or respond to deterioration in asset quality in a timely manner. We could sustain additional future losses for these same reasons. Further problems with credit quality or asset quality could cause our interest income and net interest margin to further decrease, which could adversely affect our business, financial condition and results of operations and could cause our leverage ratio to fall below 2.0%. Although we believe credit quality indicators continue to show signs of stabilization, deterioration in the coastal South Carolina real estate market as a whole may cause management to adjust its opinion of the level of credit quality in our loan portfolio. Such a determination may lead to an additional increase in our provisions for loan losses, which could also adversely affect our business, financial condition, and results of operations.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2014, approximately 84.2% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Deterioration of the real estate market in our market areas, and particularly in our Myrtle Beach market area, could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, each of which may be exacerbated by global climate change and may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

We have a concentration of credit exposure in commercial real estate and challenges faced by the commercial real estate market could adversely affect our business, financial condition, and results of operations.

As of December 31, 2014, we had approximately \$113.9 million in loans outstanding to borrowers in which the collateral securing the loan was commercial real estate, representing approximately 48.3% of our total loans outstanding as of that date. Approximately 31.8% of this real estate are owner-occupied properties. Commercial real estate loans are generally viewed as having more risk of default than residential real estate loans. They are also typically larger than residential real estate loans and consumer loans and depend on cash flows from the owner's business or the property to service the debt. Cash flows may be affected significantly by general economic conditions, and a downturn in the local economy or in occupancy rates in the local economy where the property is located could increase the likelihood of default. Because our loan portfolio contains a number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in our level of non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the related provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

The banking regulators are giving commercial real estate lending greater scrutiny, and may require banks with higher levels of commercial real estate loans to implement more stringent underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital levels as a result of commercial real estate lending growth and exposures.

If our allowance for loan losses is not sufficient to cover actual loan losses, or if credit delinquencies increase, our losses could increase.

Our success depends, to a significant extent, on the quality of our assets, particularly loans. Like other financial institutions, we face the risk that our customers will not repay their loans, that the collateral securing the payment of those loans may be insufficient to assure repayment, and that we may be unsuccessful in recovering the remaining loan balances. The risk of loss varies with, among other things, general economic conditions, the type of loan, the creditworthiness of the borrower over the term of the loan and, for many of our loans, the value of the real estate and other assets serving as collateral. Management makes various assumptions and judgments about the collectability of our loan portfolio after considering these and other factors. Based in part on those assumptions and judgments, we maintain an allowance for loan losses in an attempt to cover any loan losses that may occur. In determining the size of the allowance, we also rely on an analysis of our loan portfolio based on historical loss experience, volume and types of loans, trends in classification, delinquencies and nonaccruals, national and local economic conditions and other pertinent information, including the results of external loan reviews. Despite our efforts, our loan assessment techniques may fail to properly account for potential loan losses, and, as a result, our established loan loss reserves may prove insufficient. If we are unable to generate income to compensate for these losses, they could have a material adverse effect on our operating results.

In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our allowance for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Higher charge-off rates and an increase in our allowance for loan losses may hurt our overall financial performance and may increase our cost of funds. As of December 31, 2014, we had 55 loans on nonaccrual status totaling approximately \$11.7 million, and our allowance for loan loss was \$5.8 million. For the year ended December 31, 2014, we recognized provision expense of approximately \$1.1 million as compared to recaptured provisions of \$1.5 million for the year ended December 31, 2013. Our current and future allowances for loan losses may not be adequate to cover future loan losses given current and future market conditions.

A percentage of the loans in our portfolio currently include exceptions to our loan policies and supervisory guidelines.

All of the loans that we make are subject to written loan policies adopted by our board of directors and to supervisory guidelines imposed by our regulators. Our loan policies are designed to reduce the risks associated with the loans that we make by requiring our loan officers to take certain steps that vary depending on the type and amount of the loan, prior to closing a loan. These steps include, among other things, making sure the proper liens are documented and perfected on property securing a loan, and requiring proof of adequate insurance coverage on property securing loans. Loans that do not fully comply with our loan policies are known as "exceptions." We categorize exceptions as policy exceptions, financial statement exceptions and collateral exceptions. As a result of these exceptions, such loans may have a higher risk of loan loss than the other loans in our portfolio that fully comply with our loan policies. In addition, we may

be subject to regulatory action by federal or state banking authorities if they believe the number of exceptions in our loan portfolio represents an unsafe banking practice. Although we have taken steps to enhance the quality of our loan portfolio, we may not be successful in reducing the number of exceptions.

Liquidity risks could affect operations and jeopardize our financial condition.

The goal of liquidity management is to ensure that we can meet customer loan requests, customer deposit maturities and withdrawals, and other cash commitments under both normal operating conditions and under unpredictable circumstances of industry or market stress. To achieve this goal, our asset/liability committee establishes liquidity guidelines that require sufficient asset-based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding sources.

Liquidity is essential to our business. An inability to raise funds through traditional deposits, borrowings, the sale of securities or loans, issuance of additional equity securities, and other sources could have a substantial negative impact on our liquidity. Our access to funding sources in amounts adequate to finance our activities and with terms acceptable to us could be impaired by factors that impact us specifically or the financial services industry in general. Factors that could detrimentally impact access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated, the change in our status from well-capitalized to significantly undercapitalized, or regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as the current disruption in the financial markets and negative views and expectations about the prospects for the financial services industry as a result of the continuing turmoil and deterioration in the credit markets.

Traditionally, the primary sources of funds of our Bank have been customer deposits and loan repayments. As of December 31, 2014, we had brokered deposits of \$14.1 million, representing 3.6% of our total deposits, of which all will mature during 2015. Because of the Consent Order, we may not accept brokered deposits unless a waiver is granted by the FDIC. We may need to find other sources of liquidity to replace these deposits as they mature. Secondary sources of liquidity may include proceeds from Federal Home Loan Bank (the "FHLB") advances and QwickRate CDs obtained via the Internet. The Bank's credit risk rating at the FHLB has been negatively impacted, resulting in more restrictive borrowing requirements. Because we are significantly undercapitalized, we are required to pledge additional collateral for FHLB advances. Also, as of December 31, 2014, the Company has no approved federal funds lines of credit available from any correspondent bank.

We actively monitor the depository institutions that hold our due from banks cash balances. All of our federal funds sold are sold to the Federal Reserve Bank of Richmond. We cannot provide assurances that access to our cash and cash equivalents and federal funds sold will not be impacted by adverse conditions in the financial markets. Our emphasis is primarily on safety of principal, and we diversify cash, due from banks, and federal funds sold among counterparties to minimize exposure relating to any one of these entities. We routinely review the financials of our counterparties as part of our risk management process. Balances in our accounts with financial institutions in the U.S. may exceed the FDIC insurance limits. While we monitor and adjust the balances in our accounts as appropriate, these balances could be impacted if the correspondent financial institutions fail.

There can be no assurance that our sources of funds will be adequate for our liquidity needs, and we may be compelled to seek additional sources of financing in the future. Specifically, we may seek additional debt in the future to achieve our business objectives. There can be no assurance that additional borrowings, if sought, would be available to us or, if available, would be on favorable terms. Bank and holding company stock prices have been negatively impacted by the recent adverse economic conditions, as has the ability of banks and holding companies to raise capital or borrow in the debt markets. If additional financing sources are unavailable or not available on reasonable terms, our business, financial condition, results of operations, cash flows, and future prospects could be materially adversely impacted.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

Our deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC and are subject to deposit insurance assessments to maintain deposit insurance. As an FDIC-insured institution, we are required to pay quarterly deposit insurance premium assessments to the FDIC. Although we cannot predict what the insurance assessment rates will be in the future, either a deterioration in our tangible equity capital or adjustments to the base assessment rates could have a material adverse impact on our business, financial condition, results of operations, and cash flows.

We are dependent on key individuals and the loss of one or more of these key individuals could curtail our growth and adversely affect our prospects.

James R. Clarkson, our president and chief executive officer, has extensive and long-standing ties within our primary market area and he has contributed significantly to our growth. If we lose the services of Mr. Clarkson, he would be difficult to replace, and our business and development could be materially and adversely affected.

Our success also depends, in part, on our continued ability to attract and retain experienced loan originators, as well as other management personnel. The loss of the services of several of such key personnel could adversely affect our growth strategy and prospects to the extent we are unable to replace such personnel.

We are subject to extensive regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to receive dividends from our Bank.

We are subject to Federal Reserve regulation. Our Bank is subject to extensive regulation, supervision, and examination by our primary federal regulator, the FDIC, the regulating authority that insures customer deposits, as well as the State Board. Also, as a member of the FHLB, our Bank must comply with applicable regulations of the Federal Housing Finance Board and the FHLB. Regulation by these agencies is intended primarily for the protection of our depositors and the deposit insurance fund and not for the benefit of our shareholders. Our Bank's activities are also regulated under consumer protection laws applicable to our lending, deposit, and other activities. A sufficient claim against our Bank under these laws could have a material adverse effect on our results of operations.

New capital rules that were recently issued generally require insured depository institutions and certain holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

On July 9, 2013, the federal bank regulatory agencies issued a final rule that will revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. The rule applies to all national and state banks, such as the Bank, and savings associations and most bank holding companies and savings and loan holding companies, which we collectively refer to herein as "covered" banking organizations. Bank holding companies with less than \$500 million in total consolidated assets, such as the Company, are not subject to the final rule, nor are savings and loan holding companies substantially engaged in commercial activities or insurance underwriting. The requirements in the rule began to phase in on January 1, 2015 for covered banking organizations such as the Bank. The requirements in the rule will be fully phased in by January 1, 2019.

The final rules increase capital requirements and generally include two new capital measurements that will affect the Bank, a risk-based common equity Tier 1 ratio and a capital conservation buffer. Common Equity Tier 1 ("CET1") capital is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including non-cumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital and must be phased out over a period of nine years, which began in 2014. The rules permit bank holding companies with less than \$15 billion in assets to continue to include trust preferred securities and non-cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not CET1. Tier 2 capital consists of instruments that have historically been placed in Tier 2, as well as cumulative perpetual preferred stock.

Beginning in 2015, the minimum capital requirements for the Bank will be (i) a CET1 ratio of 4.5%, (ii) a Tier 1 capital (CET1 plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement will remain at the 4% level now required. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the CET1, Tier 1 and total capital requirements, resulting in a required CET1 ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions. While the final rules will result in higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to us.

In addition to the higher required capital ratios and the new deductions and adjustments, the final rules increase the risk weights for certain assets, meaning that we will have to hold more capital against these assets. For example, commercial real estate loans that do not meet certain new underwriting requirements must be risk-weighted at 150%, rather than the current 100%. There are also new risk weights for unsettled transactions and derivatives. We also will be required to hold capital against short-term commitments that are not unconditionally cancelable; currently, there are no capital requirements for these off-balance sheet assets. All changes to the risk weights take effect in full in 2015.

In addition, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more

stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, may cause management to modify our business strategy and may limit our ability to make distributions, including paying dividends or buying back our shares in the future.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could have serious reputational consequences for us.

The BSA, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the “Patriot Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury to administer the BSA, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with BSA and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations.

Consumer lending laws may restrict our ability to originate certain mortgage loans or increase our risk of liability with respect to such loans and could increase our cost of doing business.

Consumer lending laws have been adopted that are intended to eliminate certain lending practices considered “predatory.” These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. In 2013, the CFPB issued several rules on mortgage lending, notably a rule requiring all home mortgage lenders to determine a borrower’s ability to repay the loan. Loans with certain terms and conditions and that otherwise meet the definition of a “qualified mortgage” may be protected from liability to a borrower for failing to make the necessary determinations. In either case, we may find it necessary to tighten our mortgage loan underwriting standards in response to the CFPB rules, which may constrain our ability to make loans consistent with our business strategies. It is our policy not to make predatory loans and to determine borrowers’ ability to repay, but the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution’s performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the CRA and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

Failure to comply with government regulation and supervision could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation.

Our operations are subject to extensive regulation by federal, state, and local governmental authorities. Given the current disruption in the financial markets, we expect that the government will continue to pass new regulations and laws that will impact us. Compliance with such regulations may increase our costs and limit our ability to pursue business opportunities. Failure to comply with laws, regulations, and policies could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation. While we have policies and procedures in place that are designed to prevent violations of these laws, regulations, and policies, there can be no assurance that such violations will not occur.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by the Bank cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Bank. Any such losses could have a material adverse effect on our financial condition and results of operations.

We could experience a loss due to competition with other financial institutions.

The banking and financial services industry is very competitive. Legal and regulatory developments have made it easier for new and sometimes unregulated competitors to compete with us. The financial services industry has and is experiencing an ongoing trend towards consolidation in which fewer large national and regional banks and other financial institutions are replacing many smaller and more local banks. These larger banks and other financial institutions hold a large accumulation of assets and have significantly greater resources and a wider geographic presence or greater accessibility. In some instances, these larger entities operate without the traditional brick and mortar facilities that restrict geographic presence. Some competitors are able to offer more services, more favorable pricing or greater customer convenience than the Company. In addition, competition has increased from new banks and other financial services providers that target our existing or potential customers. As consolidation continues among large banks, we expect other smaller institutions to try to compete in the markets we serve. If we are unable to remain competitive, our financial condition and results of operations will be adversely affected.

If we are unable to implement, maintain and use technologies effectively, our financial condition and results of operations will be adversely affected.

Technological developments have allowed competitors, including some non-depository institutions, to compete more effectively in local markets and have expanded the range of financial products, services and capital available to our target customers. If we are unable to implement, maintain and use such technologies effectively, we may not be able to offer products or achieve cost-efficiencies necessary to compete in the industry. In addition, some of these competitors have fewer regulatory constraints and lower cost structures.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

We depend on the accuracy and completeness of information about clients and counterparties.

In deciding whether to extend credit or enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, we may assume that a customer’s audited financial statements conform to accounting principles generally accepted in the United States of America (“GAAP”) and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our earnings are significantly affected by our ability to properly originate, underwrite and service loans. Our financial condition and results of operations could be negatively impacted to the extent we incorrectly assess the creditworthiness of our borrowers, fail to detect or respond to deterioration in asset quality in a timely manner, or rely on financial statements that do not comply with GAAP or are materially misleading.

The accuracy of our financial statements and related disclosures could be affected because we are exposed to conditions or assumptions different from the judgments, assumptions or estimates used in our critical accounting policies.

The preparation of financial statements and related disclosure in conformity with GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, included in this document, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that are considered “critical” by us because they require judgments, assumptions and estimates that materially impact our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies, such events or assumptions could have a material impact on our audited consolidated financial statements and related disclosures.

A failure in or breach of our operational or security systems or infrastructure, or those of our third party vendors and other service providers or other third parties, including as a result of cyber attacks, could disrupt our businesses, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs, and cause losses.

We rely heavily on communications and information systems to conduct our business. Information security risks for financial institutions such as ours have generally increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, and terrorists, activists, and other external parties. As customer, public, and regulatory expectations regarding operational and information security have increased, our operating systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. Our business, financial, accounting, and data processing systems, or other operating systems and facilities may stop operating properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond our control. For example, there could be electrical or telecommunication outages; natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics; events arising from local or larger scale political or social matters, including terrorist acts; and as described below, cyber attacks.

As noted above, our business relies on our digital technologies, computer and email systems, software and networks to conduct its operations. Although we have information security procedures and controls in place, our technologies, systems, networks, and our customers' devices may become the target of cyber attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of our or our customers' or other third parties' confidential information. Third parties with whom we do business or that facilitate our business activities, including financial intermediaries, or vendors that provide service or security solutions for our operations, and other unaffiliated third parties, including the South Carolina Department of Revenue, which had customer records exposed in a 2012 cyber attack, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints.

While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. Our risk and exposure to these matters remains heightened because of the evolving nature of these threats. As a result, cyber security and the continued development and enhancement of our controls, processes, and practices designed to protect our systems, computers, software, data, and networks from attack, damage or unauthorized access remain a focus for us. As threats continue to evolve, we may be required to expend additional resources to continue to modify or enhance our protective measures or to investigate and remediate information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support our businesses and clients, or cyber attacks or security breaches of the networks, systems or devices that our clients use to access our products and services could result in client attrition, regulatory fines, penalties or intervention, reputation damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could have a material effect on our results of operations or financial condition.

Negative public opinion surrounding our Company and the financial institutions industry generally could damage our reputation and adversely impact our earnings.

Reputation risk, or the risk to our business, earnings and capital from negative public opinion surrounding our Company and the financial institutions industry generally, is inherent in our business. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees and can expose us to litigation and regulatory action. Although we take steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

The downgrade of the U.S. credit rating could negatively impact our business, results of operations and financial condition.

Recent U.S. debt ceiling and budget deficit concerns together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns in the U.S. Although U.S. lawmakers passed legislation to raise the federal debt ceiling in 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from "AAA" to "AA+" in August 2011. The impact of any further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness could adversely affect the U.S. and global financial markets and economic conditions. In January 2013, the U.S. government adopted legislation to suspend the debt limit until May 19, 2013. In October 2013, the debt ceiling was suspended until February 7, 2014. Moody's and Fitch have each warned that they may downgrade the U.S. government's rating if the federal debt is not stabilized. A downgrade of the U.S. government's credit rating or a default by the U.S. government to satisfy its debt obligations likely would create broader financial turmoil and uncertainty, which would weigh heavily on the global banking system. It is possible that any such impact could have a material adverse effect on our business, results of operations and financial condition.

Because of our participation in the U.S. Treasury's Capital Purchase Program, we are subject to several restrictions including restrictions on compensation paid to our executives.

On March 6, 2009, as part of the Capital Purchase Program established by the U.S. Treasury under the Emergency Economic Stabilization Act of 2008, we entered into a Letter of Agreement with Treasury pursuant to which we issued and sold to Treasury (i) 12,895 shares of our Series T Preferred Stock, and (ii) a ten-year warrant to purchase up to 91,714 shares of our common stock at an initial exercise price of \$21.09 per share, for an aggregate purchase price of \$12,895,000 in cash. Pursuant to the terms of the Letter Agreement, we adopted certain standards for executive compensation and corporate governance for the period during which Treasury holds the equity issued pursuant to the Letter Agreement, including the common stock which may be issued pursuant to the warrant. These standards generally apply to our named executive officers. The standards include (i) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (ii) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) prohibition on making golden parachute payments to senior executives; (iv) prohibition on providing tax gross-up provisions; and (v) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive. In particular, the change to the deductibility limit on executive compensation may likely increase the overall cost of our compensation programs in future periods and may make it more difficult to attract suitable candidates to serve as executive officers.

Given the geographic concentration of our operations, we could be significantly affected by any hurricane that affects coastal South Carolina.

Our loan portfolio consists predominantly of loans to persons and businesses located in coastal South Carolina. The collateral for many of our loans consists of real and personal property located in this area, which is susceptible to hurricanes that can cause extensive damage to the general region. Disaster conditions resulting from any hurricane that hits in this area would adversely affect the local economies and real estate markets, which could negatively impact our business. Adverse economic conditions resulting from such a disaster could also negatively affect the ability of our customers to repay their loans and could reduce the value of the collateral securing these loans. Furthermore, damage resulting from any hurricane could also result in continued economic uncertainty that could negatively impact businesses in those areas. Consequently, our ability to continue to originate loans may be impaired by adverse changes in local and regional economic conditions in this area following any hurricane.

Risks Related to Our Common Stock

The Series T Preferred Stock impacts net income available to our common shareholders and earnings per common share, and the warrant we issued to Treasury may be dilutive to holders of our common stock.

The dividends declared on the Series T Preferred Stock issued to Treasury through the Capital Purchase Program will reduce the net income available to common shareholders and our earnings per common share. Notably, because we did not redeem the Series T Preferred Stock prior to March 6, 2014, the cost of this capital increased on that date from 5.0% per annum (approximately \$644,750 annually) to 9.0% per annum (approximately \$1,160,550 annually). Also, we have been forced to defer and accrue sixteen quarterly dividend payments to Treasury and, thus, are prohibited from paying dividends on our common stock until all deferred dividends on the Series T Preferred Stock are paid in full. The Series T Preferred Stock will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company.

Additionally, the ownership interest of the existing holders of our common stock will be diluted to the extent the warrant we issued to Treasury in conjunction with the sale to Treasury of the Series T Preferred Stock is exercised. The 91,714 shares of common stock underlying the warrant represent approximately 2.4% of the shares of our common stock outstanding as of December 31, 2014 (including the shares issuable upon exercise of the warrant in total shares outstanding). Although Treasury has agreed not to vote any of the shares of common stock it receives upon exercise of the warrant, a transferee of any portion of the warrant or of any shares of common stock acquired upon exercise of the warrant is not bound by this restriction. We note, however, that the exercise price on Treasury's warrant is \$21.09 and the Company's current trading price was approximately \$0.15 at December 31, 2014.

We are currently prohibited from paying cash dividends, and we may be unable to pay future dividends even if we desire to do so.

Our ability to pay cash dividends is limited by our Bank's ability to pay cash dividends to our Company and by our need to maintain sufficient capital to support our operations. The ability of our Bank to pay cash dividends to our Company is currently prohibited by the restrictions of the Consent Order. Further, the Bank currently has negative retained earnings due to losses incurred over the past few years and therefore would be unable to pay cash dividends, regardless of the restrictions imposed by the Consent Order. In addition, our Company also has negative retained earnings and is prohibited from paying dividends without the prior approval of the Federal Reserve Bank of Richmond. Consequently, we do not anticipate paying cash dividends on shares of our common stock in the foreseeable future.

There is no active public trading market for our common stock, and no market is expected to develop.

Our common stock is not listed for trading on any securities exchange, and we presently do not intend to apply to list our common stock on any national securities exchange at any time in the foreseeable future. Consequently, the liquidity of our common stock, and our investors' ability to sell shares of our common stock, will depend upon the interest of the Company, existing shareholders and other potential purchasers. As a result of this limited market, it may be difficult to identify buyers to whom our investors can sell their shares of our common stock, and our investors may be unable to sell their shares at an established market price, at a price that is favorable to the investors, or at all. This limited market will restrict our investors' ability to sell shares of our common stock at a desirable or stable price, or at all, at any one time. Our investors should be prepared to own our common stock indefinitely.

Shares of our preferred stock may be issued in the future which could materially adversely affect the rights of the holders of our common stock.

Pursuant to our Articles of Incorporation, we have the authority to issue additional series of preferred stock and to determine the designations, preferences, rights and qualifications or restrictions of those shares without any further vote or action of the shareholders. The rights of the holders of our common stock will be subject to, and may be materially adversely affected by, the rights of the holders of any preferred stock that may be issued by us in the future.

Shares of our common stock are not insured bank deposits and are subject to market risk.

Our shares of common stock are not deposits, savings accounts or other obligations of us, our Bank or any other depository institution; are not guaranteed by us or any other entity; and are not insured by the FDIC or any other governmental agency.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The main office of the Bank is located at 5009 Broad Street, Loris, South Carolina, 29569. Our operational support services and executive offices are located in our Operations Center at 3640 Ralph Ellis Boulevard, Loris, South Carolina, 29569. Our operational support services include central deposit and central credit operations, computer operations, audit and compliance operations, human resources, training, marketing and credit administration operations. We have listed for sale or lease our former Operations Center at 5201 Broad Street, Loris, South Carolina, 29569 as well as our former Homewood branch at 3201 Highway 701 North, Conway, South Carolina, 29526.

The Bank presently owns 11 lots, on which we have branch banking facilities and our Operations Center, in addition to the previously mentioned available for sale lots. The Bank has also entered into a long-term lease agreement for a lot on which we have built a branch banking facility at 3210 Highway 701 Bypass, Loris, South Carolina, 29569.

Item 3. Legal Proceedings.

In the ordinary course of operations, we may be a party to various legal proceedings from time to time. As of December 31, 2014 and the date of this Report, except as noted below we do not believe that there is any pending or threatened proceeding against us, which, if determined adversely, would have a material effect on our business, results of operations, or financial condition.

- On April 26, 2012, Samuel C. Thomas, Jr. and Pamela A. Thomas filed a lawsuit in the Court of Common Pleas for the Fifteenth Judicial District, State of South Carolina, County of Horry, Case No. 2012-CP-26-3295. The Complaint names the Company and the Bank and current and former members of the Bank's and/or Company's Board of Directors as defendants. The Complaint alleges that the Plaintiffs were misled into investing \$2 million in the Company's subordinated promissory notes offering in the second and third quarters of 2010. The Complaint alleges that the Bank promised to loan the Plaintiffs up to 90% of the amount that the Plaintiffs would invest in the subordinated notes offering in the event that Plaintiffs needed access to these funds prior to the maturity of the subordinated notes, and, once the Plaintiffs applied for the loan, the Bank denied the loan request. The Complaint seeks actual damages, consequential damages, punitive damages as allowed by law, pre-judgment and post-judgment interest as allowed by law, penalties as mandated by statute, set-off against other obligations of the Plaintiffs due to the Company and the Bank, attorney's fees and costs. All Defendants moved to stay the litigation and compel arbitration and the Court granted the motion. Arbitration proceedings were held in March 2015, and upon conclusion of the hearing, 17 of the initial 20 individual Defendants were dismissed through summary judgment and directed verdict motions. Both the Plaintiffs and the remaining Defendants have until April 6, 2015 to present proposed orders to the three-member arbitration panel, upon which the panel will deliberate and issue a final ruling.
- On July 19, 2012, Robert Shelley, in his individual capacity and on behalf of a proposed class of other similarly situated persons, filed a lawsuit in the Court of Common Pleas for the Fifteenth Judicial Circuit, State of South Carolina, County of Horry, Case No. 2012-CP-26-5546. The Complaint named the Company and the Bank as Defendants. However, the Complaint was never served on the Company or Bank. On September 27, 2012, Plaintiff filed an Amended Complaint. The Amended Complaint alleges that Plaintiff and other similarly situated persons were contacted by employees of the Bank, who then solicited a sale of Bank stock. The Amended Complaint further alleges that Bank employees did not disclose material information about the Bank's financial condition to the Plaintiff and others prior to their respective purchases of stock. The Amended Complaint seeks the certification of a class action to include all those purchasers of Bank stock who were solicited to purchase such stock between July 1, 2009 and December 31, 2011. Plaintiff has asserted causes of action for violation of the South Carolina Uniform Securities Act, negligence and civil conspiracy, and seeks actual, punitive and treble damages and attorneys' fees and costs. The Company and the Bank made a motion for summary judgment in March 2014, and the court granted the motion for summary judgment on April 8, 2014. Robert Shelley subsequently filed a motion to reconsider, and when the motion to reconsider was denied, Mr. Shelly filed a notice of appeal with the South Carolina Court of Appeals. As of the date of this Annual Report, the briefing deadlines have not yet been issued.

- On or about October 4, 2012, the United States Attorney for the District of South Carolina served the Company and Bank with a subpoena requesting the production of documents related to the Company's offering and sale of subordinated debt notes. The subpoena number is GJ #2/2012-0215 and the Company and Bank are working closely with the appropriate contacts to provide them with the requested documents.

- On or about November 7, 2012, the South Carolina Attorney General served the Company and Bank with a subpoena requesting the production of documents related to: (1) names of certain officers, directors, shareholders, employees, and agents, as well as meetings of the Board of Directors or shareholders of the Company and/or the Bank; (2) the Company's offering and sale of subordinated debt notes; and (3) the offering and/or sale of Company stock and related filings. The South Carolina Attorney General's file number is 12063 and the Company and Bank are working closely with the appropriate contacts to provide them with the requested documents. The Company believes that the proceedings will not have any material adverse effect on the financial condition or operations of the Company.
- Plaintiffs Jan W. Snyder, Acey Livingston, and Mark Josephs purchased subordinated debt notes in or around March 2010. After making three semi-annual interest payments, the Company was precluded from making further payments by the Federal Reserve Bank of Richmond. On January 14, 2014, Plaintiffs sued the Company, the Bank, and several current and former officers, directors and employees in the Court of Common Pleas for the Fifteenth Judicial District, State of South Carolina, County of Horry, Case No. 2014-CP-26-0204. Plaintiffs have brought this case on their behalf and as representatives of a class of similarly situated purchasers of subordinated debt notes. Plaintiffs allege that they and a similarly situated class of subordinated debt purchasers have suffered an unspecified amount of damages resulting from the Defendants' wrongful conduct leading up to their respective purchases of subordinated debt notes. There are several causes of action alleged, including fraud, violation of state securities statutes, negligence and others. All Defendants have filed motions to dismiss, and a hearing on same has not been set at this time. The Company, as well as all Defendants, will deny liability and will oppose Plaintiffs' request to certify the case as a class action. The Company and the Bank have engaged legal counsel and intend to vigorously defend against this lawsuit.
- Plaintiff Mazingo + Wallace Architects, LLC, was a depositor with the Bank. An employee named Debor Guear was charged with being responsible for the Mazingo + Wallace Architects, LLC's finances, including the receipt and review of account statements, payment of invoices, and reconciling all financial accounts. In 2013, another bank advised Mazingo + Wallace Architects, LLC that it had been receiving an unusually high number of checks issued by Mazingo + Wallace Architects, LLC to Ms. Guear's account. Mazingo + Wallace Architects, LLC obtained records of its account at the Bank and alleges that Ms. Guear had been making unauthorized transactions from its account to herself, her husband, and her husband's business. On September 25, 2013, Mazingo + Wallace Architects, LLC sued the Company and the Bank in the Court of Common Pleas for the Fifteenth Judicial District, State of South Carolina, County of Horry, Case No. 2013-CP-26-6494, alleging that the Bank improperly allowed Ms. Guear to control and access account statements so that Mazingo + Wallace Architects, LLC could not discover the unauthorized transactions and seeking damages in an unspecified amount. The case is pending in Horry County, South Carolina. The parties have exchanged initial discovery responses and documents and all depositions of Plaintiff's employees and expert have been taken. Also, the Company's motion to file claims against the Plaintiff's employee who misappropriated the funds was granted. The Company moved to add Ms. Guear as a party to this case, and the motion was granted. Ms. Guear has retained counsel and appeared in the case. After the Plaintiff's majority owner was deposed and questioned about his accountant's apparent knowledge of the unauthorized transactions, Plaintiff's counsel filed a motion to dismiss the case without prejudice so that they could bring in the accountant as a Defendant. This motion was heard on March 25, 2015, in Conway, South Carolina. The chief administrative judge granted Plaintiff's motion to add Plaintiff's accountant as a new defendant. Once this new party is added, the case will be assigned a new case number and discovery will commence. This case will not be moved to the active trial roster for at least 180 days.
- On or about January 10, 2013 and January 9, 2014, the SEC served the Company and Bank with subpoenas requesting the production of documents related to the Company's offering and sale of subordinated debt notes. The case/investigation number is A-3459. The Company and Bank provided timely responses to both subpoenas and continues to work closely with the SEC to provide them with any further documents they may need.

The Company has engaged legal counsel for the litigation and intends to vigorously defend itself. The ultimate outcome of the litigation and subpoena production is unknown at this time. However, given the Company's current troubled financial condition, any expenses incurred by the Company for defense costs, governmental sanctions, or settlement or other litigation awards could have a material adverse effect on the Company's financial condition.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II**Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****Market for Common Shares and Dividends**

As of March 27, 2015, there were 3,816,340 shares of our common stock outstanding held by approximately 2,400 shareholders of record. There is currently no established public trading market in our common stock and trading and quotations of our common stock have been limited and sporadic. Most of the trades of which the Company is aware have been privately negotiated by local buyers and sellers. In addition to these trades, the Company is aware of a number of quotations on the OTC Bulletin Board between January 1, 2014 and December 31, 2014 that ranged from \$0.15 to \$0.68. Over-the-counter market quotations reflect inter-dealer prices, without retailer mark-up, mark-down, or commission and may not necessarily represent actual transactions. The following table sets forth the high and low bid information for our common stock of which we are aware for the periods indicated. Private trading of our common stock has been limited but has been conducted through the Private Trading System, which is operated by the Bank on its website www.hcsbaccess.com. The Private Trading System is a passive mechanism created to assist buyers and sellers in facilitating trades in our common stock. Because there has not been an established market for our common stock, we may not be aware of all prices at which our common stock has been traded. We have not determined whether the trades of which we are aware were the result of arm's-length negotiations between the parties. Based on information available to us, we believe transactions in our common stock can be fairly summarized as follows for the periods indicated:

2014	Low	High
Fourth Quarter	\$ 0.15	\$ 0.55
Third Quarter	\$ 0.20	\$ 0.68
Second Quarter	\$ 0.16	\$ 0.68
First Quarter	\$ 0.19	\$ 0.51

2013	Low	High
Fourth Quarter	\$ 0.01	\$ 0.26
Third Quarter	\$ 0.05	\$ 0.26
Second Quarter	\$ 0.05	\$ 0.26
First Quarter	\$ 0.07	\$ 0.29

Under the terms of the Written Agreement, the Company is currently prohibited from declaring or paying any dividends without the prior written approval of the Federal Reserve Bank of Richmond. In addition, because the Company is a legal entity separate and distinct from the Bank and has little direct income itself, the Company relies on dividends paid to it by the Bank in order to pay dividends on its common stock. As a South Carolina state bank, the Bank may only pay dividends out of its net profits, after deducting expenses, including losses and bad debts. Under FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. As of December 31, 2014, the Bank was classified as "significantly undercapitalized," and therefore it is prohibited under FDICIA from paying dividends until it increases its capital levels. In addition, even if it increases its capital levels, under the terms of the Consent Order, the Bank is prohibited from declaring a dividend on its shares of common stock unless it receives approval from the FDIC and State Board. Further, as a result of the Company's deferral of dividend payments on the 12,895 shares of preferred stock issued to the U.S. Treasury in March 2009 pursuant to the CPP and interest payments on the \$6.0 million of trust preferred securities issued in December 2004, the Company is prohibited from paying any dividends on its common stock until all deferred payments have been made in full.

As a result of these restrictions on the Company, including the restrictions on the Bank's ability to pay dividends to the Company, the Company does not anticipate paying dividends for the foreseeable future, and all future dividends will be dependent on the Company's financial condition, results of operations, and cash flows, as well as capital regulations and dividend restrictions from the Federal Reserve Bank of Richmond, the FDIC, and the State Board.

Item 6. Selected Financial Data.**Selected Financial Data**

The following table sets forth certain selected financial data concerning the Company. The selected financial data has been derived from the financial statements. This information should be read in conjunction with the financial statements of the Company, including the accompanying notes, included elsewhere herein.

Year Ended December 31, <i>(Dollars in thousands, except per share)</i>	2014	2013	2012	2011	2010
Financial Condition:					
Investment securities, available for sale	\$ 106,674	\$ 94,602	\$ 77,320	\$ 100,207	\$ 265,190
Allowance for loan losses	5,787	9,443	14,150	21,178	14,489
Net loans	229,756	246,981	288,084	345,817	431,185
Premises and equipment, net	20,292	20,802	21,694	22,514	23,389
Total assets	421,571	434,586	468,996	535,698	787,441
Noninterest-bearing deposits	40,172	33,081	33,103	37,029	38,255
Interest-bearing deposits	351,165	372,963	402,758	453,824	590,706
Total deposits	391,337	406,044	435,861	490,853	628,961
Advances from the Federal Home Loan Bank	17,000	22,000	22,000	22,000	104,200
Total liabilities	432,818	451,028	480,758	540,914	760,942
Total shareholders' equity (deficit)	(11,247)	(16,442)	(11,762)	(5,216)	26,499
Results of Operations:					
Interest income	\$ 16,095	\$ 17,071	\$ 20,371	\$ 25,654	\$ 32,550
Interest expense	5,054	5,301	6,261	8,924	14,567
Net interest income	11,041	11,770	14,110	16,730	17,983
Provision for (recovery of) loan losses	1,061	(1,497)	10,530	25,271	23,084
Net interest income (loss) after provision for loan losses	9,980	13,267	3,580	(8,541)	(5,101)
Other income	3,556	3,956	4,574	6,217	4,090
Other expense	13,749	15,460	17,681	21,695	20,641
Income (loss) before income taxes	(213)	1,763	(9,527)	(24,019)	(21,652)
Income tax expense (benefit)	78	—	—	4,998	(4,383)
Net income (loss)	(291)	1,763	(9,527)	(29,017)	(17,269)
Accretion of preferred stock to redemption value	(57)	(199)	(217)	(203)	(190)
Preferred dividends	(1,055)	(653)	(652)	(652)	(644)
Net income (loss) available to common shareholders	<u>\$ (1,403)</u>	<u>\$ 911</u>	<u>\$ (10,396)</u>	<u>\$ (29,872)</u>	<u>\$ (18,103)</u>
Per Share Data:					
Net income (loss) – basic	\$ (0.37)	\$ 0.24	\$ (2.78)	\$ (7.98)	\$ (4.78)
Period end book value	\$ (6.33)	\$ (7.83)	\$ (6.53)	\$ (4.72)	\$ 3.79

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

INTRODUCTION

The following discussion describes our results of operations for 2014 as compared to 2013, and 2013 as compared to 2012, and also analyzes our financial condition as of December 31, 2014 as compared to December 31, 2013, and December 31, 2013 as compared to December 31, 2012. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, both interest-bearing and noninterest-bearing. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowed funds. In order to maximize our net interest income, we must not only manage the volume of these balance sheet items, but also the yields that we earn on our interest-earning assets, such as loans and investments, and the rates that we pay on interest-bearing liabilities, such as deposits and borrowings.

We have included a number of tables to assist in our description of these measures. For example, the "Average Balances" table shows the average balance during 2014, 2013, and 2012 of each category of our assets and liabilities, as well as the yield we earned or the rate we paid with respect to each category. A review of this table shows that our loans typically provide higher interest yields than do other types of interest earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the "Rate/Volume Analysis" table helps demonstrate the impact of changing interest rates and changing volume of assets and liabilities during the years shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included an "Interest Rate Sensitivity Analysis" table to help explain this. Finally, we have included a number of tables that provide details about our investment securities, our loans, and our deposits and other borrowings.

There are risks inherent in all loans so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings. In the "Loan Portfolio" section we have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses and the allocation of this allowance among our various categories of loans.

In addition to earning interest on our loans and investments, we earn income through fees that we charge to our customers. Likewise, we incur other operating expenses as well. We describe the various components of this noninterest income, as well as our noninterest expense, in the following discussion.

RESULTS OF OPERATIONS

Net loss for the year ended December 31, 2014 was \$291 thousand compared to net income of \$1.8 million and a net loss of \$9.5 million for the years ended December 31, 2013 and 2012, respectively. A portion of the large provision expenses recognized in prior years was recaptured in 2013 resulting in net interest income after provision for loan losses of \$13.3 million compared to \$10.0 million for the year ended December 31, 2014 and \$3.6 million for the year ended December 31, 2012. The primary reason for this related to the fact that the 2013 and 2012 financial statements were issued simultaneously. The collectability of several loans reviewed in 2013 and the estimate of potential loss for these loans were included in the 2012 financial statements. Based on this timing issue, the results for 2013 and 2012 may have been individually different if the 2012 financial statements had been filed timely; however, the collective results for these two periods would not change. Net interest income before provision for loan losses was \$11.0 million for the year ended December 31, 2014 compared to \$11.8 million for the year ended December 31, 2013 and \$14.1 million for the year ended December 31, 2012. Noninterest income decreased \$400 thousand from 2013 to 2014 due primarily to \$1.0 million recognized in 2013 from the forgiveness of a portion of the Company's subordinated debentures. However, noninterest income also included \$940 thousand from life insurance proceeds on a former director and another insured employee during 2014. Noninterest income previously decreased \$1.6 million from 2012 to 2013 due to lower gains recognized on sales of investment securities available for sale. Noninterest expenses also decreased from 2012 through 2014 as a result of management efforts to reduce operating expenses.

ASSETS, LIABILITIES, AND SHAREHOLDERS' EQUITY

During the twelve months ended December 31, 2014, total assets decreased \$13.0 million, or 2.99%, when compared to December 31, 2013. During the twelve months ended December 31, 2013, total assets decreased \$34.4 million or 7.33%, when compared to December 31, 2012, reflecting our strategy to reduce the balance sheet in an effort to preserve capital ratios. Our loan portfolio decreased \$20.9 million, or 8.14%, to \$235.5 million as of December 31, 2014 from \$256.4 million at December 31, 2013. Other real estate owned decreased \$5.5 million or 21.91% from 2013 to 2014. These decreases were offset by a \$11.7 million increase in our investment securities portfolio in 2014. Our loan portfolio decreased \$45.8 million, or 15.16%, to \$256.4 million as of December 31, 2013 from \$302.2 million at December 31, 2012, which was partially offset by an increase in other real estate owned of \$5.5 million from 2012 to 2013.

Total deposits decreased \$14.7 million, or 3.62%, from the December 31, 2013 amount of \$406.0 million. Interest-bearing deposits decreased \$21.8 million and noninterest-bearing deposits increased \$7.1 million during 2014. Total deposits decreased \$29.8 million, or 6.84%, from the December 31, 2012 amount of \$435.9 million. Interest-bearing deposits decreased \$29.8 million and noninterest-bearing deposits decreased \$22 thousand during 2013. The decreases in total deposits in 2013 and 2014 were primarily due to the decreases in our time deposits each year.

Total shareholders' deficit decreased from a deficit of \$16.4 million at December 31, 2013 to a deficit of \$11.2 million at December 31, 2014. Total shareholders' deficit increased from a deficit of \$11.8 million at December 31, 2012 to a deficit of \$16.4 million at December 31, 2013.

On March 24, 2015, the Bank entered into a definitive agreement with Sandhills Bank, North Myrtle Beach, South Carolina, to sell its Socastee, Windy Hill, and Carolina Forest branches with total deposits of approximately \$45.5 million and approximately \$8 million in loans. The deposit premium will be approximately 2.5% of deposits acquired. The transaction, which is subject to regulatory approval and other customary conditions, is expected to close in third quarter of 2015.

DISTRIBUTION OF ASSETS, LIABILITIES, AND SHAREHOLDERS' EQUITY

The Company has sought to maintain a conservative approach in determining the distribution of its assets and liabilities. The following table presents the percentage relationships of significant components of the Company's average balance sheets for the last three fiscal years.

Balance Sheet Categories as a Percent of Average Total Assets

<u>Year ended December 31, (in thousands)</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Assets:			
Interest earning assets:			
Interest-bearing deposits in other banks	6.25%	7.70%	6.67%
Investment securities	26.05	18.82	20.20
Loans	56.07	61.05	64.74
Total interest earning assets	88.37	87.57	91.61
Cash and due from banks	0.64	1.58	1.23
Allowance for loan losses	(1.73)	(2.41)	(3.75)
Premises and equipment	4.62	4.38	4.10
Other assets	8.10	8.88	6.81
Total assets	100.00%	100.00%	100.00%
Liabilities and shareholders' equity:			
Interest-bearing liabilities:			
Interest-bearing deposits	83.62%	85.01%	84.29%
Advances from the Federal Home Loan Bank	4.88	4.79	4.22
Repurchase agreements	0.25	0.30	1.20
Subordinate debentures	2.49	2.57	2.31
Junior Subordinated debentures	1.39	1.35	1.19
Total interest-bearing liabilities	92.63	94.02	93.21
Noninterest-bearing deposits	9.00	7.75	7.04
Accrued interest and other liabilities	1.26	0.94	0.73
Total liabilities	102.89	102.71	100.98
Shareholders' deficit	(2.89)	(2.71)	(0.98)
Total liabilities and shareholders' deficit	100.00%	100.00%	100.00%

NET INTEREST INCOME

Earnings are dependent to a large degree on net interest income. Net interest income represents the difference between gross interest earned on earning assets, primarily loans and investment securities, and interest paid on interest-bearing liabilities, primarily deposits and borrowed funds. Net interest income is affected by the interest rates earned or paid and by volume changes in loans, investment securities, deposits, and borrowed funds. The interest rate spread and the net yield on earning assets are two significant elements in analyzing the Company's net interest income. The interest rate spread is the difference between the yield on average earning assets and the rate on average interest-bearing liabilities. The net yield on earning assets is computed by dividing net interest income by average earning assets.

For the year ended December 31, 2014, net interest income was \$11.0 million, a decrease of \$729 thousand, or 6.19%, from net interest income of \$11.8 million in 2013, which had decreased \$2.3 million, or 16.58%, from net interest income of \$14.1 million in 2012. The decline in our net interest income was the result of the decrease in our interest income on loans, including fees, of \$2.6 million, or 15.07%, from \$17.3 million for the year ended December 31, 2012 to \$14.7 million for the year ended December 31, 2013, and a decrease of \$1.3 million, or 8.68%, from \$14.7 million for the year ended December 31, 2013 to \$13.4 million for the year ended December 31, 2014. These decreases were attributable to the decreases in the average volume of our loan portfolio from \$337.4 million as of December 31, 2012, to \$280.2 million as of December 31, 2013, and to \$249.4 million as of December 31, 2014 as we continued our efforts to decrease total assets through the years to help improve our capital position. Interest expense for the year ended December 31, 2014 was

\$5.1 million, compared to \$5.3 million for 2013 and \$6.3 million for 2012. The net yield realized on earning assets was 2.81% for 2014, compared to 2.93% in 2013 and 2.96% in 2012. The interest rate spread was 2.87%, 3.02%, and 2.98% in 2014, 2013, and 2012, respectively.

NET INTEREST INCOME – continued

The following table sets forth, for the periods indicated, the weighted-average yields earned, the weighted-average yields paid, the interest rate spread, and the net yield on earning assets. The table also indicates the average daily balance and the interest income or expense by specific categories.

Average Balances, Income and Expenses, and Rates

Years ended December 31,
(in thousands)

	2014			2013			2012		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
ASSETS									
Loans ⁽¹⁾	\$ 249,358	\$ 13,417	5.38%	\$ 280,208	\$ 14,693	5.24%	\$ 337,445	\$ 17,301	5.13%
Securities, taxable	112,679	2,542	2.26%	81,560	2,212	2.71%	94,901	2,818	2.97%
Securities, nontaxable	1,747	14	0.80%	3,227	45	1.39%	7,735	115	1.49%
Nonmarketable equity securities	1,407	60	4.26%	1,612	44	2.73%	2,616	47	1.80%
Interest-bearing deposits	27,794	62	0.22%	35,339	77	0.22%	34,779	90	0.26%
Total earning assets	<u>392,985</u>	<u>16,095</u>	<u>4.10%</u>	<u>401,946</u>	<u>17,071</u>	<u>4.25%</u>	<u>477,476</u>	<u>20,371</u>	<u>4.27%</u>
Cash and due from banks	2,874			7,255			6,433		
Allowance for loan losses	(7,715)			(11,065)			(19,561)		
Premises and equipment	20,572			20,110			21,369		
Other assets	36,004			40,754			35,488		
Total assets	<u>\$ 444,720</u>			<u>\$ 459,000</u>			<u>\$ 521,205</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Deposits	\$ 371,865	2,995	0.81%	\$ 390,177	3,273	0.84%	\$ 439,317	3,961	0.90%
Borrowings	<u>40,045</u>	<u>2,059</u>	<u>5.14%</u>	<u>41,375</u>	<u>2,028</u>	<u>4.90%</u>	<u>46,475</u>	<u>2,300</u>	<u>4.95%</u>
Total interest-bearing liabilities	411,910	5,054	1.23%	431,552	5,301	1.23%	485,792	6,261	1.29%
Non-interest deposits	40,046			35,583			36,681		
Other liabilities	5,614			4,300			3,825		
Shareholders' deficit	<u>(12,850)</u>			<u>(12,435)</u>			<u>(5,093)</u>		
Total liabilities and deficit	<u>\$ 444,720</u>			<u>\$ 459,000</u>			<u>\$ 521,205</u>		
Net interest income/interest rate spread	<u>\$ 11,041</u>	<u>2.87%</u>		<u>\$ 11,770</u>	<u>3.02%</u>		<u>\$ 14,110</u>	<u>2.98%</u>	
Net yield on earning assets		<u>2.81%</u>			<u>2.93%</u>			<u>2.96%</u>	

(1) Average loan balances include nonaccrual loans.

RATE/VOLUME ANALYSIS

Net interest income can also be analyzed in terms of the impact of changing rates and changing volume. The following table describes the extent to which changes in interest rates and changes in the volume of earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information on changes in each category attributable to (i) changes due to volume (change in volume multiplied by prior period rate), (ii) changes due to rates (changes in rates multiplied by prior period volume), and (iii) changes in rate and volume (change in rate multiplied by the change in volume) is provided as follows:

RATE/VOLUME ANALYSIS – continued**Rate/Volume Variance Analysis**

December 31, (In thousands)	2014 Compared to 2013			2013 Compared to 2012		
	Increase (Decrease)			Increase (Decrease)		
	Due To ⁽¹⁾			Due To ⁽¹⁾		
	Total	Rate	Volume	Total	Rate	Volume
Interest-earning assets:						
Interest-bearing deposits	\$ (15)	\$ 2	\$ (17)	\$ (13)	\$ (14)	\$ 1
Securities, taxable	330	(260)	590	(606)	(231)	(375)
Securities, nontaxable	(31)	(15)	(16)	(70)	(7)	(63)
Nonmarketable equity securities	16	21	(5)	(3)	19	(22)
Loans	(1,276)	397	(1,673)	(2,608)	403	(3,011)
Total	<u>(976)</u>	<u>145</u>	<u>(1,121)</u>	<u>(3,300)</u>	<u>170</u>	<u>(3,470)</u>
Interest-bearing liabilities:						
Deposits	(278)	(128)	(150)	(688)	(264)	(424)
Borrowings	31	90	(59)	(272)	(22)	(250)
Total	<u>(247)</u>	<u>(38)</u>	<u>(209)</u>	<u>(960)</u>	<u>(286)</u>	<u>(674)</u>
Net interest income	<u>\$ (729)</u>	<u>\$ 183</u>	<u>\$ (912)</u>	<u>\$ (2,340)</u>	<u>\$ 456</u>	<u>\$ (2,796)</u>

⁽¹⁾ Volume-rate changes have been allocated to each category based on a consistent basis between rate and volume.

RATE SENSITIVITY

Interest rates paid on deposits and borrowed funds and interest rates earned on loans and investment securities have generally followed the fluctuations in market rates in 2014, 2013 and 2012. However, fluctuations in market interest rates do not necessarily have a significant impact on net interest income, depending on the Company's interest rate sensitivity position. A rate-sensitive asset or liability is one that can be repriced either up or down in interest rate within a certain time interval. When a proper balance exists between rate-sensitive assets and rate-sensitive liabilities, market interest rate fluctuations should not have a significant impact on liquidity and earnings. The larger the imbalance, the greater the interest rate risk assumed and the greater the positive or negative impact of interest fluctuations on liquidity and earnings.

Interest rate sensitivity management is concerned with the management of both the timing and the magnitude of repricing characteristics of interest-earning assets and interest-bearing liabilities and is an important part of asset/liability management. The objectives of interest rate sensitivity management are to ensure the adequacy of net interest income and to control the risks to net interest income associated with movements in interest rates. The following table, "Interest Rate Sensitivity Analysis," indicates that, for all periods presented, rate-sensitive liabilities exceeded rate-sensitive assets, resulting in a liability sensitive position. For a bank with a liability-sensitive position, or negative gap, falling interest rates would generally be expected to have a positive effect on net interest income, and rising interest rates would generally be expected to have the opposite effect.

The following table presents the Company's rate sensitivity at each of the time intervals indicated as of December 31, 2014 and may not be indicative of the Company's rate-sensitivity position at other points in time:

RATE SENSITIVITY – *continued*

Interest Rate Sensitivity Analysis

December 31, 2014	Within One	After One Through Three	After Three Through Twelve	Within One	Greater Than One Year or Non- Sensitive	Total
<i>(Dollars in thousands)</i>	<u>Month</u>	<u>Months</u>	<u>Months</u>	<u>Year</u>		
Assets						
Interest-earning assets						
Loans	\$ 56,141	\$ 21,004	\$ 57,962	\$ 135,107	\$ 100,436	\$ 235,543
Securities ¹	16,684	6,403	25,110	48,197	59,322	107,519
Total earning assets	<u>72,825</u>	<u>27,407</u>	<u>83,072</u>	<u>183,304</u>	<u>159,758</u>	<u>343,062</u>
Liabilities						
Interest-bearing liabilities:						
Interest-bearing deposits:						
Demand deposits	44,283	—	—	44,283	—	44,283
Money Market and savings deposits	86,083	—	—	86,083	—	86,083
Time deposits	<u>17,538</u>	<u>21,499</u>	<u>76,455</u>	<u>115,492</u>	<u>105,307</u>	<u>220,799</u>
Total interest-bearing deposits	147,904	21,499	76,455	245,858	105,307	351,165
Other borrowings	1,612	—	—	1,612	17,000	18,612
Subordinated debentures	—	—	—	—	11,062	11,062
Junior subordinated debentures	<u>—</u>	<u>6,186</u>	<u>—</u>	<u>6,186</u>	<u>—</u>	<u>6,186</u>
Total interest-bearing liabilities	<u>\$ 149,516</u>	<u>\$ 27,685</u>	<u>\$ 76,455</u>	<u>\$ 253,656</u>	<u>\$ 133,369</u>	<u>\$ 387,025</u>
Period gap	<u>\$ (76,691)</u>	<u>\$ (278)</u>	<u>\$ 6,617</u>	<u>\$ (70,352)</u>	<u>\$ 26,389</u>	<u>\$ (43,963)</u>
Cumulative gap	<u>\$ (76,691)</u>	<u>\$ (76,969)</u>	<u>\$ (70,352)</u>	<u>\$ (70,352)</u>	<u>\$ (43,963)</u>	
Ratio of cumulative gap to total earning assets	(22.35)%	(22.44)%	(20.51)%	(20.51)%	(12.81)%	
December 31, 2013	Within One	After One Through Three	After Three Through Twelve	Within One	Greater Than One Year or Non- Sensitive	Total
<i>(Dollars in thousands)</i>	<u>Month</u>	<u>Months</u>	<u>Months</u>	<u>Year</u>		
Assets						
Interest-earning assets						
Loans	\$ 65,248	\$ 26,419	\$ 65,561	\$ 157,228	\$ 99,196	\$ 256,424
Securities ¹	15,543	4,108	4,629	24,280	76,595	100,875
Total earning assets	<u>80,791</u>	<u>30,527</u>	<u>70,190</u>	<u>181,508</u>	<u>175,791</u>	<u>357,299</u>
Liabilities						
Interest-bearing liabilities:						
Interest-bearing deposits:						
Demand deposits	—	—	—	—	42,723	42,723
Money Market and savings deposits	87,701	—	—	87,701	—	87,701

Time deposits	<u>15,693</u>	<u>25,759</u>	<u>93,304</u>	<u>134,756</u>	<u>107,783</u>	<u>242,539</u>
Total interest-bearing deposits	103,394	25,759	93,304	222,457	150,506	372,963
Other borrowings	1,337	—	5,000	6,337	17,000	23,337
Subordinated debentures	—	—	—	—	11,062	11,062
Junior subordinated debentures	—	6,186	—	6,186	—	6,186
Total interest-bearing liabilities	<u>\$ 104,731</u>	<u>\$ 31,945</u>	<u>\$ 98,304</u>	<u>\$ 234,980</u>	<u>\$ 178,568</u>	<u>\$ 413,548</u>
Period gap	<u>\$ (23,940)</u>	<u>\$ (1,418)</u>	<u>\$ (28,114)</u>	<u>\$ (53,472)</u>	<u>\$ (2,777)</u>	<u>\$ (56,249)</u>
Cumulative gap	<u>\$ (23,940)</u>	<u>\$ (25,358)</u>	<u>\$ (53,472)</u>	<u>\$ (53,472)</u>	<u>\$ (56,249)</u>	
Ratio of cumulative gap to total earning assets	(6.70)%	(7.10)%	(14.97)%	(14.97)%	(15.74)%	

¹ Securities are presented at amortized cost basis.

PROVISION FOR LOAN LOSSES

The provision for loan losses is charged to earnings based upon management's evaluation of specific loans in its portfolio and general economic conditions and trends in the marketplace. During the year ended December 31, 2014, a provision expense of \$1.1 million was recognized. Provisions previously recognized of \$1.5 million were recaptured during the year ended December 31, 2013. Provisions expensed for the year ended December 31, 2012 were \$10.5 million. Please refer to the section "Loan Portfolio" for a discussion of management's evaluation of the adequacy of the allowance for loan losses.

NONINTEREST INCOME

Noninterest income was \$3.6 million for the year ended December 31, 2014, a decrease of \$400 thousand, or 10.11%, when compared with the year ended December 31, 2013. Noninterest income was \$4.0 million for the year ended December 31, 2013, a decrease of \$600 thousand, or 13.04%, when compared with the year ended December 31, 2012. While almost every category of noninterest income decreased from 2013 to 2014, other operating income increased \$884 thousand. During 2014, we received \$940 thousand of proceeds from the Bank's owned life insurance as a result of the passing of one former director and one former insured employee. Noninterest income for 2013 also included \$1.0 million as a result of the forgiveness of a portion of the Company's subordinated debentures. Gains on sales of investment securities available for sale were \$298 thousand for the year ended December 31, 2013, compared to \$1.6 million for the year ended December 31, 2012.

NONINTEREST EXPENSES

Noninterest expenses continued to decrease from \$17.7 million for 2012 to \$15.5 million for 2013 to \$13.7 million for 2014. Management continues to evaluate noninterest expenses and make reductions when possible. Salaries and employee benefits were \$6.1 million for the year ended December 31, 2012 compared to \$6.0 million for the year ended December 31, 2013 and \$5.6 million for the year ended December 31, 2014. FDIC insurance premiums decreased from \$1.8 million in 2012 to \$1.6 million for both 2013 and 2014 as the Bank's assessment base has decreased. In addition, as we continue to work through our credit issues, our costs related to other real estate owned have decreased from \$3.5 million for 2012 to \$1.4 million for each of 2013 and 2014. Other operating expenses decreased from \$4.3 million in 2013 to \$2.9 million in 2014 as a result of a decrease in legal expenses. In 2013, the Company incurred legal expenses of \$1.9 million primarily due to the cost of legal representation in various lawsuits and foreclosure activity. Other operating expenses increased to \$4.3 million in 2013 from \$3.9 million in 2012 as a result of higher legal expenses incurred in 2013 as previously discussed.

INCOME TAXES

The Company recognized income tax expense of \$78 thousand for the year ended December 31, 2014 as a result of state income taxes related to net income at the Bank level. The Company did not recognize any income tax expense for the years ended December 31, 2013 or 2012. Deferred tax assets are reduced by 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. Management has determined that it is more likely than not that the deferred tax asset related to continuing operations at December 31, 2014 will not be realized, and accordingly, has maintained a full valuation allowance.

LIQUIDITY

Liquidity is the ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. The Company manages both assets and liabilities to achieve appropriate levels of liquidity. Cash and federal funds sold are the Company's primary sources of asset liquidity. These funds provide a cushion against short-term fluctuations in cash flow from both deposits and loans. The investment securities portfolio is the Company's principal source of secondary asset liquidity. However, the availability of this source of funds is influenced by market conditions. Individual and commercial deposits are the Company's primary source of funds for credit activities. Although not historically used as principal sources of liquidity, federal funds purchased from correspondent banks and advances from the FHLB are other options available to management. Management believes that the Company's liquidity sources will enable it to successfully meet its long-term operating needs.

As of December 31, 2014, the Company had no available lines of credit; however, the Bank's greatest source of liquidity resides in its unpledged securities portfolio. Unpledged securities available-for-sale totaled \$64.4 million at December 31, 2014. This source of liquidity may be adversely impacted by changing market conditions, reduced access to borrowing lines, or increased collateral pledge requirements imposed by lenders. The Bank has implemented a plan to address these risks and strengthen its liquidity position. To accomplish the goals of this liquidity plan, the Bank will maintain cash liquidity at a minimum of 4% of total outstanding deposits and borrowings. In addition to cash liquidity, the Bank will also maintain a minimum of 15% off balance sheet liquidity. These objectives have been established by extensive contingency funding stress testing and analytics that indicate these target minimum levels of liquidity to be appropriate and prudent.

Comprehensive weekly and quarterly liquidity analyses serve management as vital decision-making tools by providing summaries of anticipated changes in loans, investments, core deposits, and wholesale funds. These internal funding reports provide management with the details critical to anticipate immediate and long-term cash requirements, such as expected deposit runoff, loan and securities paydowns and maturities. These liquidity analyses act as a cash forecasting tool and are subject to certain assumptions based on past market and customer trends. Through consideration of the information provided in these reports, management is better able to maximize our earning opportunities by wisely and purposefully choosing our immediate, and more critically, our long-term funding sources.

To better manage our liquidity position, management also stress tests our liquidity position on a semi-annual basis under two scenarios: short-term crisis and a longer-term crisis. In the short term crisis, we would be cut off from our normal funding along with the market in general. In this scenario, the Bank would replenish our funding through the most likely sources of funding that would exist in the order of price efficiency. In the longer term crisis, we would be cut off from several of our normal sources of funding as our Bank's financial situation deteriorated. In such a case, we would not be able to utilize our federal funds borrowing lines or renew, without FDIC approval, any brokered CDs that became due, but would be allowed to utilize our unpledged securities to raise funds in the reverse repurchase market or borrow from the FHLB. On a quarterly basis, management monitors the market value of our securities portfolio to ensure its ability to be pledged if liquidity needs should arise.

We believe our liquidity sources are adequate to meet our needs for at least the next 12 months. However, if we are unable to meet our liquidity needs, the Bank may be placed into a federal conservatorship or receivership by the FDIC, with the FDIC appointed conservator or receiver.

IMPACT OF OFF-BALANCE SHEET INSTRUMENTS

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are legally binding agreements to lend to a customer at predetermined interest rates as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The Company's exposure to credit loss in the event of nonperformance 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. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities. Standby letters of credit often expire without being used. Management believes that through various sources of liquidity, the Company has the necessary resources to meet obligations arising from these financial instruments.

The Company uses the same credit underwriting procedures for commitments to extend credit and standby letters of credit as for on-balance-sheet instruments. The credit worthiness of each borrower is evaluated and the amount of collateral, if deemed necessary, is based on the credit evaluation. Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties, as well as liquid assets such as time deposit accounts, brokerage accounts, and cash value of life insurance.

The Company is not involved in off-balance sheet contractual relationships, other than those disclosed in this report, which it believes could result in liquidity needs or other commitments or that could significantly impact earnings.

As of December 31, 2014, commitments to extend credit totaled \$27.0 million and standby letters of credit totaled \$247 thousand. The following table sets forth the length of time until maturity for unused commitments to extend credit and standby letters of credit at December 31, 2014.

<i>(Dollars in thousands)</i>	Within One Month	After One Through Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year	Total
Unused commitments to extend credit	\$ 2,193	\$ 1,537	\$ 10,209	\$ 13,939	\$ 13,078	\$ 27,017
Standby letters of credit	—	—	243	243	4	247
Totals	\$ 2,193	\$ 1,537	\$ 10,452	\$ 14,182	\$ 13,082	\$ 27,264

IMPACT OF INFLATION AND CHANGING PRICES

The financial statements and related financial data presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in relative purchasing power over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than does the effect of inflation.

While the effect of inflation on a bank is normally not as significant as its influence on those businesses that have large investments in plant and inventories, it does have an effect. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same. While interest rates have traditionally moved with inflation, the effect on income is diminished because both interest earned on assets and interest paid on liabilities vary directly with each other unless the Company is in a high liability sensitive position. Also, general increases in the price of goods and services will result in increased operating expenses.

CAPITAL RESOURCES

Total shareholders' deficit improved from a deficit of \$16.4 million at December 31, 2013 to a deficit of \$11.2 million at December 31, 2014. The improvement in equity of \$5.2 million is primarily attributable to a decrease in unrealized losses of \$5.4 million on our available-for-sale investment securities portfolio. As the investments have matured, management has reinvested in higher-yielding securities.

Total shareholders' deficit increased from a deficit of \$11.8 million at December 31, 2012 to a deficit of \$16.4 million at December 31, 2013. The increase in deficit of \$4.7 million was primarily attributable to an increase in unrealized losses of \$6.4 million on our available-for-sale investment securities portfolio, partially offset by net income for the year of \$1.8 million. The increase in unrealized losses was a result of the rising interest rate environment relative to the interest rate environment in which the investment securities were purchased. Management did not believe the unrealized losses represented an other-than-temporary impairment.

The Company uses several indicators of capital strength. The most commonly used measure is average common equity to average assets (average equity divided by average total assets), which was (2.89)% in 2014 compared to (2.71)% in 2013 and (0.98)% in 2012. The following table shows the return on average assets (net income (loss) divided by average total assets), return on average equity (net income (loss) divided by average equity), and average equity to average assets ratio for the years ended December 31, 2014, 2013 and 2012.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Return on average assets	(0.07)%	0.38%	(1.83)%
Return on average equity	n/a	n/a	n/a
Equity to assets ratio	(2.89)%	(2.71)%	(0.98)%

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum ratios of Tier 1 and total capital as a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. Tier 1 capital consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital. The Company and the Bank are also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio.

To be considered "well-capitalized," the Bank must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. To be considered "adequately capitalized" under these capital guidelines, the Bank must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital.

In addition, Bank must maintain a minimum Tier 1 leverage ratio of at least 4%. Further, pursuant to the terms of the Consent Order with the FDIC and the State Board, the Bank must achieve and maintain Tier 1 capital at least equal to 8% and total risk-based capital at least equal to 10%. For a more detailed description of the capital amounts required to be obtained in order for the Bank to be considered "well-capitalized," see Note 16 to our Financial Statements included in this Annual Report.

If a bank is not well capitalized, it cannot accept brokered deposits without prior FDIC approval. In addition, a bank that is not well capitalized cannot offer an effective yield in excess of 75 basis points over interest paid on deposits of comparable size and maturity in such institution's normal market area for deposits accepted from within its normal market area, or in excess of national rates paid on deposits of comparable size and maturity for deposits accepted outside the Bank's normal market area. Moreover, the FDIC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be categorized as undercapitalized. Undercapitalized institutions are subject to growth limitations (an undercapitalized institution may not acquire another institution, establish additional branch offices or engage in any new line of business unless determined by the appropriate federal banking agency to be consistent with an accepted capital restoration plan, or unless the FDIC

determines that the proposed action will further the purpose of prompt corrective action) and are required to submit a capital restoration plan. The agencies may not accept a capital

CAPITAL RESOURCES – continued

restoration plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's

parent holding company must guarantee that the institution will comply with the capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of an amount equal to 5.0% of the depository institution's total assets at the time it became categorized as undercapitalized or the amount that is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is categorized as significantly undercapitalized.

Depository institutions categorized as significantly undercapitalized may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become categorized as adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. The appropriate federal banking agency may take any action authorized for a significantly undercapitalized institution if an undercapitalized institution fails to submit an acceptable capital restoration plan or fails in any material respect to implement a plan accepted by the agency. A critically undercapitalized institution is subject to having a receiver or conservator appointed to manage its affairs and for loss of its charter to conduct banking activities.

An insured depository institution may not pay a management fee to a bank holding company controlling that institution or any other person having control of the institution if, after making the payment, the institution would be undercapitalized. In addition, an institution cannot make a capital distribution, such as a dividend or other distribution, that is in substance a distribution of capital to the owners of the institution if following such a distribution the institution would be undercapitalized. Thus, if payment of such a management fee or the making of such would cause a bank to become undercapitalized, it could not pay a management fee or dividend to the bank holding company.

The following table summarizes the capital amounts and ratios of the Company and the Bank at December 31, 2014, 2013, and 2012.

December 31,	2014	2013	2012
<i>(Dollars in thousands)</i>			
The Company			
Tier 1 capital	\$ (10,402)	\$ (10,169)	\$ (11,932)
Tier 2 capital	—	—	—
Total qualifying capital	<u><u>\$ (10,402)</u></u>	<u><u>\$ (10,169)</u></u>	<u><u>\$ (11,932)</u></u>
Risk-adjusted total assets (including off-balance sheet exposures)	<u><u>\$ 287,892</u></u>	<u><u>\$ 318,900</u></u>	<u><u>\$ 346,929</u></u>
Tier 1 risk-based capital ratio	(3.61%)	(3.19%)	(3.44%)
Total risk-based capital ratio	(3.61%)	(3.19%)	(3.44%)
Tier 1 leverage ratio	(2.36%)	(2.23%)	(2.34%)
The Bank			
Tier 1 capital	\$ 10,911	\$ 9,789	\$ 7,720
Tier 2 capital	3,622	4,053	4,455
Total qualifying capital	<u><u>\$ 14,533</u></u>	<u><u>\$ 13,842</u></u>	<u><u>\$ 12,175</u></u>
Risk-adjustment total assets (including off-balance sheet exposures)	<u><u>\$ 287,598</u></u>	<u><u>\$ 318,813</u></u>	<u><u>\$ 346,667</u></u>
Tier 1 risk-based capital ratio	3.79%	3.07%	2.23%
Total risk-based capital ratio	5.05%	4.34%	3.51%
Tier 1 leverage ratio	2.53%	2.17%	1.56%

At December 31, 2014, the Company was categorized as “critically undercapitalized” and the Bank was categorized as “significantly undercapitalized.” Our losses over the past few years have adversely impacted our capital. As a result, we have been pursuing a plan to increase our capital ratios in order to strengthen our balance sheet and satisfy the

commitments required under the Consent Order which requires us to achieve and maintain Total Risk Based capital at least equal to 10% of risk-weighted assets and Tier 1 capital at least equal to 8% of total assets.

CAPITAL RESOURCES – *continued*

Approximately \$8.5 million in additional capital as of December 31, 2014 would have returned the Bank to “adequately capitalized” and \$23.6 million in capital would have returned the Bank to “well capitalized” under regulatory guidelines on a pro forma basis. If we continue to decrease the size of the Bank or can maintain the Bank’s profitability, then we could achieve these capital levels with less additional capital, although prospective investors would likely require us to raise materially more capital than these minimums, including sufficient funds to repay our outstanding senior equity and debt securities, including the Series T Preferred Stock issued to the U.S. Treasury under the TARP program, the trust preferred securities that we have issued, and our 2010 subordinated promissory notes. At December 31, 2014, the amount of these outstanding senior securities was \$30.1 million. Under Federal Reserve policy, any new capital issued by the Company will need to be common stock, which will be subordinate to these senior securities. Accordingly, it will be difficult for us to raise the additional capital that we need, even if we are able to negotiate reduced payments to these senior securities holders. There are no assurances that we will be able to raise this capital or find a merger partner.

If we cannot find a merger partner or raise additional capital to meet the minimum capital requirements set forth under the Consent Order, or if we suffer a continued deterioration in our financial condition, we may be placed into a federal conservatorship or receivership by the FDIC. If this were to occur, then our shareholders, our subordinated debt holders, and our other securities holders will lose their investments in the Company.

The Company does not anticipate paying dividends for the foreseeable future, and all future dividends will be dependent on the Company’s financial condition, results of operations, and cash flows, as well as capital regulations and dividend restrictions from the Federal Reserve Bank of Richmond, the FDIC, and the State Board. For information on dividends, including the Company’s policy on dividends, see “Market for Common Shares and Dividends” contained elsewhere in this Report.

As noted above, in July 2013, the federal bank regulatory agencies issued a final rule that has revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by Basel III and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, such as the Bank, top-tier bank holding companies with total consolidated assets of \$500 million or more, and top-tier savings and loan holding companies, which we collectively refer to herein as “covered” banking organizations. Bank holding companies with less than \$500 million in total consolidated assets, such as the Company, are not subject to the final rule. The final rule became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions), and all of the requirements in the final rule will be fully phased in by January 1, 2019.

Effective January 1, 2015, the final rules require the Company to comply with the following new minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets (increased from the current requirement of 4.0%); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from current requirement); and (iv) a leverage ratio of 4.0% of total assets. These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

With respect to the Bank, the rules also revised the “prompt corrective action” regulations pursuant to Section 38 of the FDIA by (i) introducing a common equity Tier 1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital

ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0% (as compared to the current 6.0%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized.

CAPITAL RESOURCES – continued

The new capital 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 (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and nonresidential mortgage loans that are 90 days past due or otherwise on nonaccrual status, a 20% (up from 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 (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital, and increased risk-weights (from 0% to up to 600%) for equity exposures. If the new minimum capital ratios described above had been effective as of December 31, 2014, based on management's interpretation and understanding of the new rules, the Company would have remained critically undercapitalized and the Bank would have remained significantly undercapitalized as of such date.

INVESTMENT PORTFOLIO

Management classifies investment securities as either held-to-maturity or available-for-sale based on our intentions and the Company's ability to hold them until maturity. In determining such classifications, securities that management has the positive intent and the Company has the ability to hold until maturity are classified as held-to-maturity and carried at amortized cost. All other securities are designated as available-for-sale and carried at estimated fair value with unrealized gains and losses included in shareholders' equity on an after-tax basis. As of December 31, 2014, 2013 and 2012, all securities were classified as available-for-sale.

The portfolio of available-for-sale securities increased \$17.3 million, or 22.35%, from \$77.3 million at December 31, 2012 to \$94.6 million at December 31, 2013, and \$12.1 million, or 12.76%, from \$94.6 million at December 31, 2013 to \$106.7 million at December 31, 2014. Our securities portfolio consisted primarily of high quality mortgage securities, government agency bonds, and high quality municipal bonds. As of December 31, 2014, the amortized cost of the available-for-sale investment securities portfolio exceeded fair value by \$845 thousand. This unrealized loss is believed to be temporary and a result of the current interest rate environment.

The following tables summarize the carrying value of investment securities as of the indicated dates and the weighted-average yields of those securities at December 31, 2014.

December 31, 2014*(in thousands)*

	Amortized Cost Due					
	Due Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total	Market Value
Investment securities						
Government sponsored enterprises	\$ —	\$ —	\$ 8,000	\$ 32,952	\$ 40,952	\$ 40,082
Mortgage backed securities	—	1,492	7,736	56,100	65,328	65,348
State and political subdivisions	—	—	628	611	1,239	1,244
Total	<u>\$ —</u>	<u>\$ 1,492</u>	<u>\$ 16,364</u>	<u>\$ 89,663</u>	<u>\$ 107,519</u>	<u>\$ 106,674</u>

Weighted average yields

Government sponsored enterprises	— %	— %	2.44%	2.86%	
Mortgage backed securities	— %	2.00%	1.43%	1.93%	
State and political subdivisions	— %	— %	2.55%	4.09%	
Total	<u>— %</u>	<u>2.00%</u>	<u>1.97%</u>	<u>2.29%</u>	<u>2.23%</u>

December 31, 2013 (in thousands)**Investment securities**

Book Value	Market Value
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Government sponsored enterprises	\$ 60,628	\$ 55,075
Mortgage backed securities	37,731	37,034
State and political subdivisions	2,516	2,493
Total	<u>\$100,875</u>	<u>\$ 94,602</u>

<u>December 31, 2012</u> <i>(in thousands)</i>	<u>Book Value</u>	<u>Market Value</u>
Investment securities		
Government sponsored enterprises	\$ 27,024	\$ 27,108
Mortgage backed securities	44,557	44,462
State and political subdivisions	5,569	5,750
Total	<u>\$ 77,150</u>	<u>\$ 77,320</u>

LOAN PORTFOLIO

We have continued our efforts to decrease total assets each year. As a result, the loan portfolio decreased \$20.9 million and \$45.8 million in 2014 and 2013, respectively. Net loans charged-off during 2014 were \$4.7 million compared to \$3.2 million in 2013 and \$17.6 million in 2012. Loan balances transferred to other real estate owned were \$2.2 million for 2014, compared to \$17.7 million for 2013. The remaining decrease was a result of focusing our lenders more on asset quality and resolving existing issues and less on loan originations. The primary component of our loan portfolio is loans collateralized by real estate, which made up approximately 84.24% of our loan portfolio at December 31, 2014. These loans are secured generally by first or second mortgages on residential, agricultural or commercial property. Commercial loans and consumer loans account for 13.12% and 2.64% of the loan portfolio at December 31, 2014, respectively.

The following table sets forth the composition of the loan portfolio by category for the five years ended December 31, 2014 and highlights the Company's general emphasis on mortgage lending.

December 31, <i>(Dollars in thousands)</i>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Real estate:					
Commercial construction and land development	\$ 31,470	\$ 38,899	\$ 58,274	\$ 61,776	\$ 82,028
Other commercial real estate	82,382	91,551	103,061	134,803	154,455
Residential construction	2,838	3,038	2,422	5,101	8,036
Other residential	81,730	81,297	89,184	104,307	122,813
Commercial and industrial	30,894	33,711	41,200	52,272	65,896
Consumer	6,229	7,928	8,093	8,736	12,446
	<u>\$ 235,543</u>	<u>\$ 256,424</u>	<u>\$ 302,234</u>	<u>\$ 366,995</u>	<u>\$ 445,674</u>

Maturities and Sensitivity of Loans to Changes in Interest Rates:

The following table summarizes the loan maturity distribution, by type, at December 31, 2014 and related interest rate characteristics:

December 31, 2014 <i>(Dollars in thousands)</i>	One Year or Less	Over One Year Through Five Years	Over Five Years	Total
Commercial real estate	\$ 25,001	\$ 73,150	\$ 15,701	\$ 113,852
Residential	13,276	32,105	39,187	84,568
Commercial	12,082	12,761	6,051	30,894
Consumer	2,123	3,880	226	6,229
	<u>\$ 52,482</u>	<u>\$ 121,896</u>	<u>\$ 61,165</u>	<u>\$ 235,543</u>

Loans maturing after one year with:

Fixed interest rates	\$ 142,651
Floating interest rates	40,410
	<u>\$ 183,061</u>

LOAN PORTFOLIO - continued***Risk Elements***

The downturn in general economic conditions over the past few years has resulted in increased loan delinquencies, defaults and foreclosures within our loan portfolio. The declining real estate market has had a significant impact on the performance of our loans secured by real estate. In some cases, this downturn has resulted in a significant impairment to the value of our collateral and our ability to sell the collateral upon foreclosure. Although the real estate collateral provides an alternate source of repayment in the event of default by the borrower, in our current market the value of the collateral has deteriorated during the time the credit is extended. There is a risk that this trend will continue, which could result in additional losses of earnings and increases in our provision for loan losses and loan charge-offs.

Past due payments are often one of the first indicators of a problem loan. We perform a continuous review of our past due report in order to identify trends that can be resolved quickly before a loan becomes significantly past due. We determine past due and delinquency status based on the contractual terms of the note. When a borrower fails to make a scheduled loan payment, we attempt to cure the default through several methods including, but not limited to, collection contact and assessment of late fees.

Generally, a loan will be placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the loan is doubtful. When a loan is placed in nonaccrual status, interest accruals are discontinued and income earned but not collected is reversed. Cash receipts on nonaccrual loans are not recorded as interest income, but are used to reduce principal. If the borrower is able to bring the account current and establish a pattern of keeping the loan current for a specified time period, the loan is then placed back on regular accrual status.

For loans to be in excess of 90 days delinquent and still accruing interest, the borrowers must be either remitting payments although not able to get current, liquidation on loans deemed to be well secured must be near completion, or the Company must have a reason to believe that correction of the delinquency status by the borrower is near. The amount of both nonaccrual loans and loans past due 90 days or more were considered in computing the allowance for loan losses as of December 31, 2014.

Nonperforming loans include nonaccrual loans and loans past due 90 days or more and still accruing interest. Nonperforming assets include nonperforming loans plus other real estate and repossessions that we own as a result of loan foreclosures.

Nonperforming loans have declined since 2011 as we have sought to identify and aggressively work through our credit issues. As a result, nonperforming loans as of December 31, 2012 decreased to \$22.7 million, or 7.52% of total loans, and to \$10.6 million, or 4.15% of total loans, at December 31, 2013. Nonperforming loans increased slightly to \$11.8 million, or 5.02% of total loans, as of December 31, 2014.

Nonperforming assets also continued to decrease. At December 31, 2014, nonperforming assets were \$31.3 million compared to \$35.6 million at December 31, 2013 and \$42.2 million at December 31, 2012. As a percentage of total assets, nonperforming assets were 7.43%, 8.19%, and 9.00% as of December 31, 2014, 2013, and 2012, respectively.

The following table summarizes nonperforming assets for the five years ended December 31, 2014:

Nonperforming Assets <i>(Dollars in thousands)</i>	2014	2013	2012	2011	2010
Nonaccrual loans	\$ 11,661	\$ 10,631	\$ 22,567	\$ 44,682	\$ 25,197
Loans past due 90 days or more and still accruing interest	170	—	157	76	—
Total nonperforming loans	11,831	10,631	22,724	44,758	25,197
Other real estate owned	19,501	24,972	19,464	15,665	16,891
Total nonperforming assets	<u>\$ 31,332</u>	<u>\$ 35,603</u>	<u>\$ 42,188</u>	<u>\$ 60,423</u>	<u>\$ 42,088</u>
Nonperforming assets to total assets	<u>7.43%</u>	<u>8.19%</u>	<u>9.00%</u>	<u>11.28%</u>	<u>5.34%</u>

Nonperforming loans to total loans	<u>5.02%</u>	<u>4.15%</u>	<u>7.52%</u>	<u>12.20%</u>	<u>5.65%</u>
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LOAN PORTFOLIO - continued***Credit Risk Management***

Another method used to monitor the loan portfolio is credit grading. Credit risk entails both general risk, which is inherent in the process of lending, and risk that is specific to individual borrowers. The management of credit risk involves the processes of loan underwriting and loan administration. The Company seeks to manage credit risk through a strategy of making loans within the Company's primary marketplace and within the Company's limits of expertise. Although management seeks to avoid concentrations of credit by loan type or industry through diversification, a substantial portion of the borrowers' ability to honor the terms of their loans is dependent on the business and economic conditions in Horry County in South Carolina and Columbus and Brunswick Counties in North Carolina. A continuation of the economic downturn could result in the deterioration of the quality of our loan portfolio and reduce our level of deposits, which in turn would have a negative impact on our business. Additionally, since real estate is considered by the Company as the most desirable nonmonetary collateral, a significant portion of the Company's loans are collateralized by real estate; however, the cash flow of the borrower or the business enterprise is generally considered as the primary source of repayment. Generally, the value of real estate is not considered by the Company as the primary source of repayment for performing loans. The Company also seeks to limit total exposure to individual and affiliated borrowers. The Company seeks to manage risk specific to individual borrowers through the loan underwriting process and through an ongoing analysis of the borrower's ability to service the debt as well as the value of the pledged collateral.

The Company's loan officers and loan administration staff are charged with monitoring the Company's loan portfolio and identifying changes in the economy or in a borrower's circumstances which may affect the ability to repay the debt or the value of the pledged collateral. In order to assess and monitor the degree of risk in the Company's loan portfolio, several credit risk identification and monitoring processes are utilized. The Company assesses credit risk initially through the assignment of a risk grade to each loan based upon an assessment of the borrower's financial capacity to service the debt and the presence and value of any collateral. Commercial loans are individually graded at origination and credit grades are reviewed on a regular basis in accordance with our loan policy. Consumer loans are assigned a "pass" credit rating unless something within the loan warrants a specific classification grade.

Credit grading is adjusted during the life of the loan to reflect economic and individual changes having an impact on the borrowers' abilities to honor the terms of their commitments. Management uses the risk grades as a tool for identifying known and inherent losses in the loan portfolio and for determining the adequacy of the allowance for loan losses.

LOAN PORTFOLIO - continued

The following table summarizes management's internal credit risk grades, by portfolio class, as of December 31, 2014.

<i>(Dollars in thousands)</i>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Grade 1 - Minimal	\$ 1,093	\$ —	\$ 531	\$ —	\$ 1,624
Grade 2 – Modest	1,164	679	93	1,216	3,152
Grade 3 – Average	3,868	5,618	156	4,688	14,330
Grade 4 – Satisfactory	16,367	59,536	4,928	56,758	137,589
Grade 5 – Watch	2,905	16,091	178	4,695	23,869
Grade 6 – Special Mention	1,191	4,249	132	3,747	9,319
Grade 7 – Substandard	4,306	27,679	211	13,464	45,660
Grade 8 – Doubtful	—	—	—	—	—
Grade 9 – Loss	—	—	—	—	—
Total Loans	<u>\$ 30,894</u>	<u>\$ 113,852</u>	<u>\$ 6,229</u>	<u>\$ 84,568</u>	<u>\$ 235,543</u>

The following table summarizes management's internal credit risk grades, by portfolio class, as of December 31, 2013.

<i>(Dollars in thousands)</i>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Grade 1 - Minimal	\$ 1,364	\$ —	\$ 775	\$ —	\$ 2,139
Grade 2 – Modest	314	1,066	98	1,835	3,313
Grade 3 – Average	4,782	6,412	914	3,437	15,545
Grade 4 – Satisfactory	17,092	67,453	5,045	53,868	143,458
Grade 5 – Watch	3,204	17,288	221	6,933	27,646
Grade 6 – Special Mention	1,788	10,028	133	5,127	17,076
Grade 7 – Substandard	5,167	28,203	742	13,135	47,247
Grade 8 – Doubtful	—	—	—	—	—
Grade 9 – Loss	—	—	—	—	—
Total Loans	<u>\$ 33,711</u>	<u>\$ 130,450</u>	<u>\$ 7,928</u>	<u>\$ 84,335</u>	<u>\$ 256,424</u>

Loans graded one through four are considered “pass” credits. As of December 31, 2014 and 2013, approximately \$156.7 million, or 66.5%, and \$164.5 million, or 64.1%, respectively, of the loan portfolio had a credit grade of Minimal, Modest, Average or Satisfactory. For loans to qualify for this grade, they must be performing relatively close to expectations, with no significant departures from the intended source and timing of repayment.

Loans with a credit grade of “watch” and “special mention” are not considered classified; however, they are categorized as a watch list credit and are considered potential problem loans. This classification is utilized by us when we have an initial concern about the financial health of a borrower. These loans are designated as such in order to be monitored more closely than other credits in our portfolio. We then gather current financial information about the borrower and evaluate our current risk in the credit. We will then either reclassify the loan as “substandard” or back to its original risk rating after a review of the information. There are times when we may leave the loan on the watch list, if, in management's opinion, there are risks that cannot be fully evaluated without the passage of time, and we determine to review the loan on a more regular basis. Loans on the watch list are not considered problem loans until they are determined by management to be classified as substandard. As of December 31, 2014, loans with a credit grade of “watch” and “special mention” totaled \$33.2 million. As of December 31, 2013, those loans totaled \$44.7 million. Watch list loans are considered potential problem loans and are monitored as they may develop into problem loans in the future.

Loans graded “substandard” or greater are considered classified credits. At December 31, 2014 and 2013, classified loans totaled \$45.7 million and \$47.3 million, respectively, with \$41.1 million and \$41.3 million, respectively, being collateralized by real estate. Classified credits are evaluated for impairment on a quarterly basis. This amount included \$33.2 million in TDRs, of which \$28.2 million were considered to be performing at December 31, 2014. Classified loans included \$31.5 million in TDRs, of which \$25.0 million were considered to be performing at December 31, 2013.

LOAN PORTFOLIO - *continued*

We identify impaired loans through our normal internal loan review process. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan-by-loan basis by calculating either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Any resultant shortfall is charged to provision for loan losses and is classified as a specific reserve. When an impaired loan is ultimately charged-off, the charge-off is taken against the specific reserve.

Impaired loans are valued on a nonrecurring basis at the lower of cost or market value of the underlying collateral. Market values were obtained using independent appraisals, updated in accordance with our reappraisal policy, or other market data such as recent offers to the borrower. At December 31, 2014, the recorded investment in impaired loans was \$41.4 million compared to \$45.7 million at December 31, 2013.

Troubled debt restructurings are loans which have been restructured from their original contractual terms and include concessions that would not otherwise have been granted outside of the financial difficulty of the borrower. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. The purpose of a troubled debt restructuring is to facilitate ultimate repayment of the loan.

At December 31, 2014 and 2013, the principal balance of troubled debt restructurings totaled \$33.2 million and \$31.5 million, respectively. At December 31, 2014, \$28.2 million of these restructured loans were performing as expected under the new terms, and \$5.0 million were considered nonperforming and evaluated for reserves on the basis of the fair value of the collateral. At December 31, 2013, \$25.0 million of these restructured loans were performing as expected under the new terms, and \$6.4 million were considered nonperforming and evaluated for reserves on the basis of the fair value of the collateral. A troubled debt restructuring can be removed from nonperforming status once there is sufficient history of demonstrating the borrower can service the credit under market terms. We currently consider sufficient history to be approximately six months.

Provision and Allowance for Loan Losses

We have established an allowance for loan losses through a provision for loan losses charged to expense on our statements of operations. The allowance represents an amount which management believes will be adequate to absorb probable losses on existing loans that may become uncollectible. We do not allocate specific percentages of our allowance for loan losses to the various categories of loans but evaluates the adequacy on an overall portfolio basis utilizing several factors. The primary factor considered is the credit risk grading system, which is applied to each loan. The amount of both nonaccrual loans and loans past due 90 days or more is also considered. The historical loan loss experience, the size of our lending portfolio, changes in the lending policies and procedures, 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, and current and anticipated economic conditions are also considered in determining the provision for loan losses. The amount of the allowance is adjusted periodically based on changing circumstances. The Bank changed its historical look back period during the quarter ended December 31, 2012 from twelve quarters to six quarters. We believe this change more accurately reflected the loss history of the loan portfolio. There were no changes to the historical look back period in 2013 or 2014. Recognized losses are charged to the allowance for loan losses, while subsequent recoveries are added to the allowance.

We regularly monitor past due and classified loans. However, it should be noted that no assurances can be made that future charges to the allowance for loan losses or provisions for loan losses may not be significant to a particular accounting period. Our judgment as to the adequacy of the allowance is based upon a number of assumptions about future events which we believe to be reasonable, but which may or may not prove to be accurate. Because of the inherent uncertainty of assumptions made during the evaluation process, there can be no assurance that loan losses in future periods will not exceed the allowance for loan losses or that additional allocations will not be required. Our losses will undoubtedly vary from our estimates, and there is a possibility that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time.

LOAN PORTFOLIO - continued

At December 31, 2014, \$1.9 million of the allowance was reserved for impaired loans compared to \$3.8 million at December 31, 2013 and \$5.6 million at December 31, 2012. Net loan charge-offs decreased significantly from \$17.6 million for the year ended December 31, 2012 to \$3.2 million for the year ended December 31, 2013 and slightly increased to \$4.7 million for the year ended December 31, 2014.

The following table presents the Allowance for Loan Losses by loan category and the loan category as a percentage of total loans. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(in thousands)	December 31,									
	2014		2013		2012		2011		2010	
	\$	% ⁽¹⁾	\$	% ⁽¹⁾	\$	% ⁽¹⁾	\$	% ⁽¹⁾	\$	% ⁽¹⁾
Commercial	\$ 597	13.1%	\$ 1,020	13.1%	\$ 1,982	13.6%	\$ 3,239	14.2%	\$ 1,822	14.8%
Commercial Real Estate	3,591	48.3%	5,312	50.9%	7,587	53.4%	10,240	53.6%	7,237	53.1%
Consumer	185	2.7%	144	3.1%	124	2.7%	103	2.4%	131	2.8%
Residential	1,414	35.9%	2,967	32.9%	4,457	30.3%	7,596	29.8%	5,299	29.3%
	<u>\$ 5,787</u>	<u>100.0%</u>	<u>\$ 9,443</u>	<u>100.0%</u>	<u>\$ 14,150</u>	<u>100.0%</u>	<u>\$ 21,178</u>	<u>100.0%</u>	<u>\$ 14,489</u>	<u>100.0%</u>

(1) Loan category as a percentage of total loans.

The following table summarizes the activity related to our allowance for loan losses.

Summary of Loan Loss Experience

(Dollars in thousands)	2014	2013	2012	2011	2010
Total loans outstanding at end of period	<u>\$ 235,543</u>	<u>\$ 256,424</u>	<u>\$ 302,234</u>	<u>\$ 366,995</u>	<u>\$ 445,674</u>
Average loans outstanding	<u>\$ 249,358</u>	<u>\$ 280,208</u>	<u>\$ 337,445</u>	<u>\$ 410,043</u>	<u>\$ 483,570</u>
Balance of allowance for loan losses at beginning of period	<u>\$ 9,443</u>	<u>\$ 14,150</u>	<u>\$ 21,178</u>	<u>\$ 14,489</u>	<u>\$ 7,525</u>
Charge offs:					
Real estate	(5,620)	(5,568)	(15,193)	(16,217)	(14,080)
Commercial	(1,068)	(1,691)	(3,242)	(3,229)	(2,396)
Consumer and credit card	(343)	(217)	(106)	(193)	(222)
Other loans	—	—	—	(196)	(28)
Total charge-offs	<u>(7,031)</u>	<u>(7,476)</u>	<u>(18,541)</u>	<u>(19,835)</u>	<u>(16,726)</u>
Recoveries of loans previously charged off	2,314	4,266	983	1,253	606
Net charge-offs	<u>(4,717)</u>	<u>(3,210)</u>	<u>(17,558)</u>	<u>(18,582)</u>	<u>(16,120)</u>
Provision charged to operations	<u>1,061</u>	<u>(1,497)</u>	<u>10,530</u>	<u>25,271</u>	<u>23,084</u>
Balance of allowance for loan losses at end of period	<u>\$ 5,787</u>	<u>\$ 9,443</u>	<u>\$ 14,150</u>	<u>\$ 21,178</u>	<u>\$ 14,489</u>
Ratios:					
Net charge-offs to average loans outstanding	1.89%	1.15%	5.20%	4.53%	3.33%
Net charge-offs to loans at end of year	2.00%	1.25%	5.81%	5.06%	3.62%
Allowance for loan losses to average loans	2.32%	3.37%	4.19%	5.16%	3.00%
Allowance for loan losses to loans at end of year	2.46%	3.68%	4.68%	5.77%	3.25%
Net charge-offs to allowance for loan losses	81.51%	33.99%	124.08%	87.74%	111.26%
	444.58%	n/a	166.74%	73.53%	69.83%

Net charge-offs to provisions for loan
losses

AVERAGE DAILY DEPOSITS

The following table summarizes our average daily deposits during the years ended December 31, 2014, 2013, and 2012. These totals include time deposits \$100 thousand and over. At December 31, 2014 time deposits \$100,000 and over totaled \$150.0 million. Of this total, scheduled maturities within three months were \$21.5 million; over three through 12 months were \$41.7 million; and over 12 months were \$86.8 million.

The adverse economic environment placed greater pressure on our deposits, and the Consent Order prohibited the Bank from the acceptance, renewal or rollover of any brokered deposits. Therefore, we took steps to decrease our reliance on brokered deposits. As of December 31, 2014, we had brokered deposits of \$14.1 million as compared to \$18.6 million as of December 31, 2013 and \$43.1 million as of December 31, 2012. We may need other sources of liquidity to replace these deposits as they mature. Secondary sources of liquidity may include proceeds from FHLB advances and Qwickrate CDs.

	2014		2013		2012	
	Average Amount	Average Rate Paid	Average Amount	Average Rate Paid	Average Amount	Average Rate Paid
<i>(Dollars in thousands)</i>						
Noninterest-bearing demand	\$ 40,046	n/a	\$ 35,583	n/a	\$ 36,681	n/a
Interest-bearing transaction accounts	41,010	0.17%	41,469	0.19%	43,086	0.22%
Money market savings account	81,688	0.44%	84,519	0.42%	105,727	0.43%
Other savings accounts	9,862	0.25%	8,681	0.25%	7,961	0.25%
Time deposits	<u>239,305</u>	1.06%	<u>255,508</u>	1.10%	<u>282,543</u>	1.20%
Total average deposits	<u>\$411,911</u>		<u>\$425,760</u>		<u>\$475,998</u>	

ADVANCES FROM THE FEDERAL HOME LOAN BANK

The following table summarizes the Company's FHLB borrowings for the years ended December 31, 2014, 2013 and 2012.

	Maximum Outstanding at any		Average	Weighted Average Interest	Balance December 31
	Month End	Balance			
<i>(Dollars in thousands)</i>					
2014					
Advances from Federal Home Loan Bank	\$ 22,000	\$ 21,685	3.44%	\$ 17,000	
2013					
Advances from Federal Home Loan Bank	\$ 22,000	\$ 22,000	3.39%	\$ 22,000	
2012					
Advances from Federal Home Loan Bank	\$ 22,000	\$ 22,000	3.39%	\$ 22,000	

Advances from the FHLB are collateralized by one-to-four family residential mortgage loans, certain commercial real estate loans, certain securities in the Bank's investment portfolio and the Company's investment in FHLB stock. Although we expect to continue using FHLB advances as a secondary funding source, core deposits will continue to be our primary funding source. Of the \$17.0 million advances from the FHLB outstanding at December 31, 2014, \$12.0 million have scheduled principal reductions in 2018, and the remainder in 2019. As a result of negative financial performance indicators, there is a risk that the Bank's ability to borrow from the FHLB could be curtailed or eliminated. Although to date the Bank has not been denied advances from the FHLB, the Bank has had its collateral maintenance requirements altered to reflect the increase in our credit risk. Thus, we can make no assurances that this funding source will continue to be available to us.

SUBORDINATED DEBENTURES

On July 31, 2010, the Company completed a private placement of subordinated promissory notes that totaled \$12.1 million. The notes initially bear interest at a rate of 9% per annum payable semiannually on April 5th and October 5th and are callable by the Company four years after the date of issuance and mature 10 years from the date of issuance. After October 5, 2014 and until maturity, the notes bear interest at a rate equal to the current Prime Rate in effect, as published by the Wall Street Journal, plus 3%; provided, that the rate of interest shall not be less than 8% per annum or more than 12% per annum. The subordinated notes have been structured to fully count as Tier 2 regulatory capital on a consolidated basis.

During 2013, \$1.0 million of the subordinated notes were cancelled by the holder as part of a settlement of litigation between the holder, the Bank, and the Company. The Company is obligated to downstream funds in this amount to the Bank when it is able to do so, but the forgiveness of this debt has been included in noninterest income in the consolidated statements of operations.

The Federal Reserve Bank of Richmond has prohibited the Company from paying interest due on the subordinated notes since October 2011 and, as a result, the Company has deferred interest payments in the amount of approximately \$3.7 million as of December 31, 2014. We expect that the Federal Reserve Bank of Richmond will continue to prohibit the Company from making interest payments on the subordinated notes until and unless we raise a sufficient amount of additional capital for the Bank to be in compliance with the Consent Order.

TRUST PREFERRED SECURITIES

On December 21, 2004, HCSB Financial Trust I (the "Trust"), a non-consolidated subsidiary of the Company, issued and sold a total of 6,000 trust preferred securities, with \$1,000 liquidation amount per capital security, to institutional buyers in a pooled trust preferred issue. The trust preferred securities, which are reported on the consolidated balance sheet as junior subordinated debentures, generated proceeds of \$6.0 million. The Trust loaned these proceeds to the Company to use for general corporate purposes. The junior subordinated debentures qualify as Tier 1 capital under Federal Reserve guidelines, subject to limitations. See Note 11 to the consolidated financial statements for more information about the terms of the junior subordinated debentures.

Debt issuance costs, net of accumulated amortization, from junior subordinated debentures totaled \$73 thousand, \$77 thousand and \$80 thousand at December 31, 2014, 2013 and 2012, respectively, and are included in other assets on the consolidated balance sheet. Amortizations of debt issuance costs from junior subordinated debentures totaled approximately \$4 thousand for the years ended December 31, 2014, 2013 and 2012, and are reported in other expenses on the consolidated statements of operations.

As required by the Federal Reserve Bank of Richmond, beginning in March 2011, we began exercising our right to defer all quarterly distributions on our trust preferred securities. We may defer these interest payments for up to 20 consecutive quarterly periods, although interest will continue to accrue on the trust preferred securities and interest on such deferred interest will also accrue and compound quarterly from the date such deferred interest would have been payable were it not for the extension period. At December 31, 2014, total accrued interest equaled \$714 thousand. All of the deferred interest, including interest accrued on such deferred interest, is due and payable at the end of the applicable deferral period, which is in March 2016. We will not be able to pay this interest when it becomes due if we are not able to raise a sufficient amount of additional capital for the Bank to be in compliance with the Consent Order and for the Company to make the payments due under the subordinated notes, which are senior to the trust preferred securities. Even if we succeed in raising this capital, we will have to be released from the Written Agreement or obtain approval from the Federal Reserve Bank of Richmond to pay this interest on the trust preferred securities. If this interest is not paid by March 2016, the Company will be in default under the terms of the indenture related to the trust preferred securities. If we fail to pay the deferred and compounded interest at the end of the deferral period, the trustee or the holders of 25% of the aggregate trust preferred securities outstanding, by providing written notice to the Company, may declare the entire principal and unpaid interest amounts of the trust preferred securities immediately due and payable. The aggregate principal amount of these trust preferred securities is \$6.0 million. If the trustee or the holders of the trust preferred securities demand immediate payment in full of the entire principal and unpaid interest amounts of the trust preferred securities, we could be forced into involuntary bankruptcy.

SERIES T PREFERRED STOCK

In March 2009, in connection with the CPP, we issued to the U.S. Treasury 12,895 shares of the Company's Series T Preferred Stock, having a liquidation preference of \$1,000 per share. The Series T Preferred Stock has a dividend rate of 5% for the first five years and 9% thereafter, and has a call feature after three years. In connection with the sale of the Series T Preferred Stock, we also issued to the U.S. Treasury a ten-year warrant to purchase up to 91,714 shares of the Company's common stock at an initial exercise price of \$21.09 per share. The Series T Preferred Stock and the CPP warrant were sold to the U.S. Treasury for an aggregate purchase price of \$12.9 million in cash.

SERIES T PREFERRED STOCK - *continued*

As required under the CPP, dividend payments on and repurchases of the Company's common stock are subject to certain restrictions. For as long as the Series T Preferred Stock is outstanding, no dividends may be declared or paid on the Company's common stock until all accrued and unpaid dividends on the Series T Preferred Stock are fully paid. In addition, the U.S. Treasury's consent is required for any increase in dividends on common stock before the third anniversary of issuance of the Series T Preferred Stock and for any repurchase of any common stock except for repurchases of common shares in connection with benefit plans.

As of February 2011, the Federal Reserve Bank of Richmond has required the Company to defer dividend payments on the 12,895 shares of the Series T Preferred Stock, and therefore, for each quarterly period beginning in February 2011, the Company notified the U.S. Treasury of its deferral of quarterly dividend payments on the 12,895 shares of Series T Preferred Stock and also informed the Trustee of the \$6.0 million of trust preferred securities of its deferral of the quarterly interest payments. As of December 31, 2014, the Company had \$3.0 million of deferred dividend payments due on the Series T Preferred Stock issued to the U.S. Treasury. Because the Company has deferred these sixteen payments, the Company is prohibited from paying any dividends on its common stock until all deferred payments have been made in full. In addition, whenever dividends payable on the shares of the Series T Preferred Stock have been deferred for an aggregate of six or more quarterly dividend periods, the holders of the Series T Preferred Stock have the right to elect two directors to fill newly created directorships at the Company's next annual meeting of the shareholders. As a result of the Company's deferral of dividend payments on the Series T Preferred Stock, the U.S. Treasury, the current holder of all 12,895 shares of the Series T Preferred Stock, requested the Company's non-objection to appoint a representative to observe monthly meetings of the Company's board of directors. The Company granted the U.S. Treasury's request and a representative of the U.S. Treasury has attended the Company's monthly board meetings since June 2012. As of the date of this report, the U.S. Treasury has not notified the Company whether it intends to elect two directors to fill newly created directorships at the Company's 2015 annual meeting of the shareholders. The Company has never paid a cash dividend, but as a result of the Company's financial condition and these restrictions on the Company, including the restrictions on the Bank's ability to pay dividends to the Company, the Company has not been permitted to pay a dividend on its common stock since 2009.

ACCOUNTING AND FINANCIAL REPORTING ISSUES

We have adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to the consolidated financial statements for the year ended December 31, 2014. Certain accounting policies involve significant judgments and assumptions by us which have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a material impact on our carrying values of assets and liabilities and our results of operations.

We believe the allowance for loan losses is a critical accounting policy that requires significant judgment and estimates used in preparation of our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a description of our processes and methodology for determining our allowance for loan losses.

The determination of the value of other real estate owned is also considered a critical accounting policy as management must use significant judgment and estimates when considering the reasonableness of the value.

Income tax provision is also an accounting policy that requires judgment as the Company seeks strategies to minimize the tax effect of implementing their business strategies. The Company's tax returns are subject to examination by both federal and state authorities. Such examinations may result in assessment of additional taxes, interest and penalties. As a result, the ultimate outcome, and the corresponding financial statement impact, can be difficult to predict with accuracy.

Fair value determination and other-than-temporary impairment is subject to management's evaluation to determine if it is probable that all amounts due according to contractual terms will be collected to determine if any other-than-temporary impairment exists. The process of evaluating other-than-temporary impairment is inherently judgmental, involving the weighing of positive and negative factors and evidence that may be objective or subjective.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Not required.

Item 8. Financial Statements and Supplementary Data.**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders
HCSB Financial Corporation and Subsidiary
Loris, South Carolina

We have audited the accompanying consolidated balance sheets of HCSB Financial Corporation, and Subsidiary (the "Company") as of December 31, 2014, 2013, and 2012, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HCSB Financial Corporation and Subsidiary as of December 31, 2014 2013, and 2012, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses that have eroded regulatory capital ratios and the Company's wholly owned subsidiary, Horry County State Bank, is under a regulatory Consent Order with the Federal Deposit Insurance Corporation (FDIC) that requires, among other provisions, capital ratios to be maintained at certain levels. As of December 31, 2014 the Company's subsidiary is considered significantly undercapitalized based on its regulatory capital levels. These considerations raise substantial doubt about the Company's ability to continue as a going concern. The Company also has deferred interest payments on its junior subordinated debentures for 16 consecutive quarters as of December 31, 2014. Under the terms of the debentures, the Company may defer payments for up to 20 consecutive quarters without creating a default. Payment for the 20th quarter interest deferral period will be due in March 2016. If the Company fails to pay the deferred and compounded interest at the end of the deferral period, the trustees of the corresponding trusts, would have the right, after any applicable grace period, to exercise various remedies, including demanding immediate payment in full of the entire outstanding principal amount of the debentures. The balance of the debentures and accrued interest as of December 31, 2014 were \$6,186,000 and \$714,000, respectively. These events also raise substantial doubt about the Company's ability to continue as a going concern as of December 31, 2014. Management's plans in regard to these matters are discussed in Note 2. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Elliott Davis Decosimo, LLC

Columbia, South Carolina
March 30, 2015

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	December 31,		
<i>(Dollars in thousands except share amounts)</i>	2014	2013	2012
Assets:			
Cash and cash equivalents:			
Cash and due from banks	\$ 28,527	\$ 28,081	\$ 46,600
Investment securities:			
Securities available-for-sale	106,674	94,602	77,320
Nonmarketable equity securities	1,342	1,743	1,983
Total investment securities	<u>108,016</u>	<u>96,345</u>	<u>79,303</u>
Loans receivable	235,543	256,424	302,234
Less allowance for loan losses	(5,787)	(9,443)	(14,150)
Loans, net	<u>229,756</u>	<u>246,981</u>	<u>288,084</u>
Premises, furniture and equipment, net	20,292	20,802	21,694
Accrued interest receivable	1,973	2,197	2,370
Cash value of life insurance	11,002	11,002	10,655
Other real estate owned	19,501	24,972	19,464
Other assets	2,504	4,206	826
Total assets	<u>\$ 421,571</u>	<u>\$ 434,586</u>	<u>\$ 468,996</u>
Liabilities:			
Deposits:			
Noninterest-bearing transaction accounts	\$ 40,172	\$ 33,081	\$ 33,103
Interest-bearing transaction accounts	44,283	42,723	43,053
Money market savings accounts	75,811	78,829	84,776
Other savings accounts	10,272	8,872	7,900
Time deposits \$100 and over	150,020	156,582	155,786
Other time deposits	70,779	85,957	111,243
Total deposits	<u>391,337</u>	<u>406,044</u>	<u>435,861</u>
Repurchase agreements	1,612	1,337	1,303
Advances from the Federal Home Loan Bank	17,000	22,000	22,000
Subordinated debentures	11,062	11,062	12,062
Junior subordinated debentures	6,186	6,186	6,186
Accrued interest payable	4,583	3,305	2,207
Other liabilities	1,038	1,094	1,139
Total liabilities	<u>432,818</u>	<u>451,028</u>	<u>480,758</u>
Commitments and contingencies (Notes 5, 13, & 14)			
Shareholders' Equity:			
Preferred stock, \$1,000 par value; 5,000,000 shares authorized; 12,895 shares issued and outstanding	12,895	12,838	12,639
Common stock, \$0.01 par value; 500,000,000 shares authorized; 3,816,340, 3,738,337 and 3,738,337 issued and outstanding at December 31, 2014, 2013 and 2012, respectively	38	37	37
Capital surplus	30,214	30,157	30,157
Common stock warrant	1,012	1,012	1,012
Retained deficit	(54,561)	(54,213)	(55,777)
Accumulated other comprehensive income (loss)	(845)	(6,273)	170
Total shareholders' deficit	<u>(11,247)</u>	<u>(16,442)</u>	<u>(11,762)</u>
Total liabilities and shareholders' deficit	<u>\$ 421,571</u>	<u>\$ 434,586</u>	<u>\$ 468,996</u>

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The accompanying notes are an integral part of the consolidated financial statements.

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31,		
	2014	2013	2012
<i>(Dollars in thousands except share amounts)</i>			
Interest income:			
Loans, including fees	\$ 13,417	\$ 14,693	\$ 17,301
Investment securities:			
Taxable	2,542	2,212	2,818
Tax-exempt	14	45	115
Nonmarketable equity securities	60	44	47
Other interest income	62	77	90
Total	<u>16,095</u>	<u>17,071</u>	<u>20,371</u>
Interest expense:			
Deposits	2,995	3,273	3,961
Borrowings	2,059	2,028	2,300
Total	<u>5,054</u>	<u>5,301</u>	<u>6,261</u>
Net interest income	11,041	11,770	14,110
Provision for loan losses	1,061	(1,497)	10,530
Net interest income after provision for loan losses	9,980	13,267	3,580
Noninterest income:			
Service charges on deposit accounts	880	927	1,114
Credit life insurance commissions	9	12	18
Gain on sale of residential mortgage loans	229	254	375
Brokerage commissions	79	165	140
Other fees and commissions	438	472	402
Gains on sales of securities available-for-sale	201	298	1,643
Income from cash value of life insurance	440	448	465
Net gains (losses) on sales of assets	6	(10)	155
Forgiveness of debt	—	1,000	—
Proceeds from bank owned life insurance	940	—	—
Other operating income	334	390	262
Total	<u>3,556</u>	<u>3,956</u>	<u>4,574</u>
Noninterest expenses:			
Salaries and employee benefits	5,606	5,985	6,093
Net occupancy	1,220	1,200	1,220
Furniture and equipment	1,023	1,026	1,171
Net cost of operations of other real estate owned	1,411	1,373	3,539
FDIC insurance premiums	1,574	1,564	1,759
Other operating expenses	2,915	4,312	3,899
Total	<u>13,749</u>	<u>15,460</u>	<u>17,681</u>
Net income (loss) before income taxes	(213)	1,763	(9,527)
Income tax expense	78	—	—
Net income (loss)	(291)	1,763	(9,527)
Accretion of preferred stock to redemption value	(57)	(199)	(217)
Preferred dividends	(1,055)	(653)	(652)
Net income (loss) available to common shareholders	\$ (1,403)	\$ 911	\$ (10,396)
Net income (loss) per common share, basic	\$ (0.37)	\$ 0.24	\$ (2.78)
Net income (loss) per common share, diluted	\$ (0.37)	\$ 0.24	\$ (2.78)
Weighted average common shares outstanding			

Basic and diluted	<u>3,770,355</u>	<u>3,738,337</u>	<u>3,738,337</u>
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The accompanying notes are an integral part of the consolidated financial statements.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

<i>(Dollars in thousands)</i>	Years ended December 31,		
	2014	2013	2012
Net income (loss)	\$ (291)	\$ 1,763	\$ (9,527)
Other comprehensive income (loss):			
Unrealized gains (losses) on securities available-for-sale:			
Unrealized holding gains (losses) arising during the period	5,629	(6,145)	3,815
Tax expense	—	—	—
Reclassification to realized gains	(201)	(298)	(1,643)
Tax expense	—	—	—
Valuation allowance on deferred tax asset on available-for-sale securities	—	—	809
Other comprehensive income (loss)	<u>5,428</u>	<u>(6,443)</u>	<u>2,981</u>
Comprehensive income (loss)	<u>\$ 5,137</u>	<u>\$ (4,680)</u>	<u>\$ (6,546)</u>

The accompanying notes are an integral part of the consolidated financial statements.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years ended December 31, 2014, 2013 and 2012

	Common Shares	Stock Amount	Common Stock Warrant	Preferred Stock Shares	Preferred Stock Amount	Capital Surplus	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total
<i>(Dollars in thousands)</i>									
Balance, December 31, 2011	3,738,337	\$ 37	\$ 1,012	12,895	\$ 12,422	\$ 30,157	(46,033)	\$ (2,811)	\$ (5,216)
Net loss	—	—	—	—	—	—	(9,527)	—	(9,527)
Other comprehensive income	—	—	—	—	—	—	—	2,981	2,981
Accretion of preferred stock to redemption value	—	—	—	—	217	—	(217)	—	—
Balance, December 31, 2012	3,738,337	37	1,012	12,895	12,639	30,157	(55,777)	170	(11,762)
Net income	—	—	—	—	—	—	1,763	—	1,763
Other comprehensive loss	—	—	—	—	—	—	—	(6,443)	(6,443)
Accretion of preferred stock to redemption value	—	—	—	—	199	—	(199)	—	—
Balance, December 31, 2013	3,738,337	37	1,012	12,895	12,838	30,157	(54,213)	(6,273)	(16,442)
Net loss	—	—	—	—	—	—	(291)	—	(291)
Other comprehensive income	—	—	—	—	—	—	—	5,428	5,428
Sale of common stock	78,003	1	—	—	—	57	—	—	58
Accretion of preferred stock to redemption value	—	—	—	—	57	—	(57)	—	—
Balance, December 31, 2014	<u>3,816,340</u>	<u>\$ 38</u>	<u>\$ 1,012</u>	<u>12,895</u>	<u>\$ 12,895</u>	<u>\$ 30,214</u>	<u>\$ (54,561)</u>	<u>\$ (845)</u>	<u>\$ (11,247)</u>

The accompanying notes are an integral part of the consolidated financial statements.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years ended December 31,		
	2014	2013	2012
Cash flows from operating activities:			
Net income (loss)	\$ (291)	\$ 1,763	\$ (9,527)
Adjustments to reconcile net income (loss) to net cash provided by (used by) operating activities:			
Provision for loan losses	1,061	(1,497)	10,530
Depreciation expense	789	824	923
Forgiveness of debt	—	(1,000)	—
Amortization, net of accretion on investments	266	151	(180)
Gains on sales of securities available-for-sale	(201)	(298)	(1,643)
(Gains) losses on sales of other real estate owned	26	(721)	658
Writedowns of other real estate owned	317	768	2,760
Gain (loss) on sale of other assets	(6)	10	(155)
Decrease in accrued interest receivable	224	173	406
Increase (decrease) in accrued interest payable	1,278	1,098	1,192
(Increase) decrease in other assets	1,708	(3,390)	116
Income (net of mortality costs) on cash value of life insurance	—	(347)	(370)
Decrease in other liabilities	(56)	(45)	(167)
Net cash provided by (used by) operating activities	<u>5,115</u>	<u>(2,511)</u>	<u>4,543</u>
Cash flows from investing activities:			
Purchases of securities available-for-sale	(59,354)	(62,559)	(78,053)
Maturities and paydowns of securities available-for-sale	19,822	13,095	59,016
Proceeds from sales of securities available-for-sale	32,823	25,886	46,728
Net decrease in loans to customers	13,981	24,941	32,805
Net purchases of premises, furniture and equipment	(279)	68	(103)
Proceeds from sales of other real estate owned	7,311	12,104	7,181
Redemptions of nonmarketable equity securities	401	240	1,992
Net cash provided by investing activities	<u>14,705</u>	<u>13,775</u>	<u>69,566</u>
Cash flows from financing activities:			
Net increase (decrease) in demand deposits, interest-bearing transaction and savings accounts	7,033	(5,327)	(45,788)
Net decrease in time deposits	(21,740)	(24,490)	(9,204)
Net decrease in FHLB advances	(5,000)	—	—
Net increase (decrease) in repurchase agreements	275	34	(6,189)
Sale of common stock	58	—	—
Net cash used by financing activities	<u>(19,374)</u>	<u>(29,783)</u>	<u>(61,181)</u>
Net increase (decrease) in cash and cash equivalents	<u>446</u>	<u>(18,519)</u>	<u>12,928</u>
Cash and cash equivalents, beginning of year	<u>28,081</u>	<u>46,600</u>	<u>33,672</u>
Cash and cash equivalents, end of year	<u><u>\$ 28,527</u></u>	<u><u>\$ 28,081</u></u>	<u><u>\$ 46,600</u></u>
Supplemental information:			
Cash paid for interest	<u>\$ 3,776</u>	<u>\$ 4,203</u>	<u>\$ 5,069</u>
Cash paid for income taxes	<u>\$ 78</u>	<u>\$ —</u>	<u>\$ —</u>
Supplemental noncash investing and financing activities:			
Transfers of loans to other real estate owned	<u>\$ 2,183</u>	<u>\$ 17,659</u>	<u>\$ 14,398</u>

The accompanying notes are an integral part of the consolidated financial statements.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation - The accompanying consolidated financial statements include the accounts of HCSB Financial Corporation which was incorporated on June 10, 1999 (the "Company") to serve as a bank holding company for its wholly owned subsidiary, Horry County State Bank (the "Bank"). The Bank was incorporated on December 18, 1987, and opened for operations on January 4, 1988. The principal business activity of the Company is to provide commercial banking services in Horry County, South Carolina, and in Columbus and Brunswick Counties, North Carolina. The Bank is a state-chartered bank, and its deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC"). HCSB Financial Trust I (the "Trust") is a special purpose subsidiary organized for the sole purpose of issuing trust preferred securities. The operations of the Trust have not been consolidated in these financial statements.

Management's Estimates - In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and income and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, including valuation allowances for impaired loans, and the carrying amount of real estate acquired in connection with foreclosures or in satisfaction of loans. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowance 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 Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances 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 allowances for losses on loans and foreclosed real estate may change materially in the near term.

Investment Securities - Investment securities available-for-sale owned by the Company are carried at amortized cost and adjusted to their estimated fair value for reporting purposes. The unrealized gain or loss is recorded in shareholders' equity net of any deferred tax effects. Management does not actively trade securities classified as available-for-sale, but intends to hold these securities for an indefinite period of time and may sell them prior to maturity to achieve certain objectives. Reductions in fair value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis in the security. The adjusted cost basis of securities available-for-sale is determined by specific identification and is used in computing the realized gain or loss from a sales transaction.

Nonmarketable Equity Securities - Nonmarketable equity securities include the Company's investments in the stock of the Federal Home Loan Bank (the "FHLB"). The stocks are carried at cost because they have no quoted market value and no ready market exists. Investment in Federal Home Loan Bank stock is a condition of borrowing from the Federal Home Loan Bank, and the stock is pledged to collateralize the borrowings. Dividends received on Federal Home Loan Bank stock are included as a separate component in interest income.

At December 31, 2014, 2013 and 2012, the investment in FHLB stock was \$1.2 million, \$1.6 million and \$1.8 million, respectively. The Company also had an investment in the holding company of a community bank originally purchased at \$25 thousand. This investment was written down to zero in 2012. Also included in nonmarketable equities is investment in the Trust, which totaled \$186 thousand at December 31, 2014, 2013 and 2012.

Loans Receivable - Loans receivable are stated at their unpaid principal balance less any charge-offs. Interest income on loans is computed based upon the unpaid principal balance. Interest income is recorded in the period earned.

The accrual of interest income is generally discontinued when a loan becomes contractually 90 days past due as to principal or interest. Management may elect to continue the accrual of interest when the estimated net realizable value of collateral exceeds the principal balance and accrued interest.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using the straight-line method.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Loans Receivable (continued) - Loans are impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans are subject to these criteria except for smaller balance homogeneous loans that are collectively evaluated for impairment and loans measured at fair value or at the lower of cost or fair value. The Company considers its consumer installment portfolio and home equity lines as such exceptions. Therefore, loans within the real estate and commercial loan portfolios are reviewed individually.

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. When management determines that a loan is impaired, the difference between the Company's investment in the related loan and the present value of the expected future cash flows, or the fair value of the collateral, is charged off with a corresponding entry to the allowance for loan losses. The accrual of interest is discontinued on an impaired loan when management determines the borrower may be unable to meet payments as they become due.

Concentrations of Credit Risk - Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily throughout Horry County in South Carolina and Columbus and Brunswick counties of North Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions except for loans secured by residential and commercial real estate and commercial and industrial non-real estate loans. These concentrations of residential and commercial real estate loans and commercial and industrial non-real estate loans totaled \$198.4 million and \$30.9 million, respectively, at December 31, 2014, representing 84.24% and 13.12%, respectively, of gross loans receivable for the Company at December 31, 2014.

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 from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. 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. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

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 its 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.

Allowance for Loan Losses - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experiences, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Management's judgments about the adequacy of the allowance are based on numerous assumptions about current events, which management believes to be reasonable, but which may or may not prove to be accurate. Thus, there can be no assurance that loan losses in future periods will not exceed the current allowance amount or that future increases in the allowance will not be required. No assurance can be

given that management's ongoing evaluation of the loan portfolio in light of changing economic conditions and other relevant circumstances will not require significant future additions to the allowance, thus adversely affecting the operating results of the Company.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Allowance for Loan Losses (continued) - The allowance is subject to examination by regulatory agencies, which may consider such factors as the methodology used to determine adequacy and the size of the allowance relative to that of peer institutions, and other adequacy tests. In addition, such regulatory agencies could require the Company to adjust its allowance based on information available to them at the time of their examination.

The methodology used to determine the reserve for unfunded lending commitments, which is included in other liabilities, is inherently similar to that used to determine the allowance for loan losses adjusted for factors specific to binding commitments, including the probability of funding and historical loss ratio.

Premises, Furniture and Equipment - Premises, furniture and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed by the straight-line method. Rates of depreciation are generally based on the following estimated useful lives: buildings - 40 years; furniture and equipment - 3 to 25 years. The cost of assets sold or otherwise disposed of and the related accumulated depreciation is eliminated from the accounts, and the resulting gains or losses are reflected in the income statement.

Maintenance and repairs are charged to current expense as incurred, and the costs of major renewals and improvements are capitalized.

Other Real Estate Owned - Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is initially recorded at appraised value, less estimated costs to sell.

Any write-downs at the dates of acquisition are charged to the allowance for loan losses. Expenses to maintain such assets, subsequent write-downs, and gains and losses on disposal are included in net cost of operations of other real estate.

Income and Expense Recognition - The accrual method of accounting is used for all significant categories of income and expense. Immaterial amounts of insurance commissions and other miscellaneous fees are reported when received.

Income Taxes - The Company files consolidated federal and state income tax returns. Federal income tax expense or benefit has been allocated to subsidiaries on a separate return basis. The Company accounts for income taxes based on two components of income tax expense: current and deferred. Current income tax expense approximates taxes to be paid or refunded for the current period and includes income tax expense related to uncertain tax positions, if any.

Deferred income taxes are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax impacts of the differences between the book and tax bases of assets and liabilities and recognizes enacted changes in tax rates and laws 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 subject to the Company's judgment that realization is more likely than not. A tax position that meets the more likely than not recognition threshold is measured to determine the amount of benefit to recognize. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties, if any, are recognized as a component of income tax expense.

The Company reviews the deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income available under tax law, including future reversals of existing temporary differences, future taxable income exclusive of reversing differences, taxable income in prior carryback years, projections of future operating results, cumulative tax losses over the past three years, tax loss deductibility limitations, and available tax planning strategies. If, based on available information, it is more likely than not that the deferred income tax asset will not be realized, a valuation allowance against the deferred tax asset must be established with a corresponding charge to income tax expense. The deferred tax assets and valuation allowance are evaluated each quarter, and a portion of the valuation allowance may be reversed in future periods. The determination of how much of the valuation allowance that may be reversed and the timing is based on future results of operation and the amount and timing of actual loan charge-offs and asset write-downs. At December 31, 2014, 2013 and 2012, the Company's deferred tax asset was offset in its entirety by a valuation allowance.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Income Taxes (continued) – The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company’s financial condition, results of operations, or cash flow. Therefore no reserves for uncertain income tax positions have been recorded.

Advertising Expense - Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs of \$16 thousand, \$19 thousand and \$22 thousand were included in the Company’s results of operations in marketing and advertising expense for 2014, 2013 and 2012, respectively.

Net Income (Loss) Per Common Share - Basic income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the year. Diluted net income per common share is computed based on net income divided by the weighted average number of common and potential common shares. The computation of diluted net loss per share does not include potential common shares as their effect would be anti-dilutive. The only potential common share equivalents are those related to the warrant issued to the U.S. Treasury under the Capital Purchase Program (the “CPP”).

Comprehensive Income - Accounting principles generally require recognized income, expenses, gains, and losses to 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 and are also presented in a separate statement of comprehensive income. Accumulated other comprehensive income consists entirely of unrealized holding gains and losses on available for sale securities.

Statements of Cash Flows - For purposes of reporting cash flows, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, federal funds sold, and interest-bearing deposits with other banks.

Off-Balance Sheet Financial Instruments - In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Recently Issued Accounting Pronouncements – The following is a summary of recent authoritative pronouncements.

In January 2014, the Financial Accounting Standards Board (“FASB”) amended Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned (“OREO”). In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments will be effective for the Company for annual periods, and interim periods within those annual period beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective

for the Company for reporting periods beginning after December 15, 2016. The Company does not expect these amendments to have a material effect on its financial statements.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Recently Issued Accounting Pronouncements (continued) – In June 2014, the FASB issued guidance which makes limited amendments to the guidance on accounting for certain repurchase agreements. The new guidance (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The amendments will be effective for the Company for the first interim or annual period beginning after December 15, 2014. The Company will apply the guidance by making a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2014, the FASB issued guidance that is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements, management will need to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the organization's ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will be effective for the Company for annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2015, the FASB issued guidance that eliminated the concept of extraordinary items from U.S. GAAP. Existing U.S. GAAP required that an entity separately classify, present, and disclose extraordinary events and transactions. The amendments will eliminate the requirements for reporting entities to consider whether an underlying event or transaction is extraordinary, however, the presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include items that are both unusual in nature and infrequently occurring. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The amendments may be applied either prospectively or retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Risks and Uncertainties - In the normal course of its business, the Company encounters two significant types of risks: 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 basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental 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 from the regulators' judgments based on information available to them at the time of their examination.

Additionally, the Company is subject to certain regulations due to our participation in the CPP. Pursuant to the terms of the CPP Purchase Agreement between us and the Treasury, we adopted certain standards for executive compensation and corporate governance for the period during which the Treasury holds the equity issued pursuant to the CPP Purchase Agreement, including the common stock which may be issued pursuant to the CPP Warrant. These standards generally apply to our named executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2)

required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; (4) prohibition on providing tax gross-up provisions; and (5) agreement not to deduct for tax purposes executive compensation in excess of \$500 thousand for each senior executive. In particular, the change to the deductibility limit on executive compensation will likely increase the overall cost of our compensation programs in future periods and may make it more difficult to attract suitable candidates to serve as executive officers.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Risks and Uncertainties (continued) -In February 2005 the Bank purchased a \$500 thousand 15-year renewable and convertible term life insurance policy through Banner Life Insurance Company on the life of James R. Clarkson, President and CEO. The Bank is both the owner and the beneficiary of this key person policy. The purpose of securing this policy was to provide the Bank with financial protection in the event of the unexpected death of Mr. Clarkson and better enable the Bank to attract a qualified replacement for Mr. Clarkson in such a situation.

Legislation that has been adopted after we closed on our sale of Series T Preferred Stock and Warrant to the Treasury for \$12.9 million pursuant to the CPP on March 6, 2009, or any legislation or regulations that may be implemented in the future, may have a material impact on the terms of our CPP transaction with the Treasury. If we determine that any such legislation or any regulations, in whole or in part, alter the terms of our CPP transaction with the Treasury in ways that we believe are adverse to our ability to effectively manage our business, then it is possible that we may seek to unwind, in whole or in part, the CPP transaction by repurchasing some or all of the preferred stock and warrants that we sold to the Treasury pursuant to the CPP. If we were to repurchase all or a portion of such preferred stock or warrants, then our capital levels could be materially reduced.

Reclassifications - Certain captions and amounts in the 2013 and 2012 financial statements were reclassified to conform to the 2014 presentation.

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS

Consent Order with the Federal Deposit Insurance Corporation and South Carolina Board of Financial Institutions

On February 10, 2011, the Bank entered into a Consent Order with the FDIC and the State Board.

The Consent Order conveys specific actions needed to address the Bank's current financial condition, primarily related to capital planning, liquidity/funds management, policy and planning issues, management oversight, loan concentrations and classifications, and non-performing loans. A summary of the requirements of the Consent Order and the Bank's status on complying with the Consent Order is as follows:

Requirements of the Consent Order	Bank's Compliance Status
Achieve and maintain, by July 10, 2011, Total Risk Based capital at least equal to 10% of risk-weighted assets and Tier 1 capital at least equal to 8% of total assets.	The Bank did not meet the capital ratios as specified in the Consent Order and, as a result, submitted a revised capital restoration plan to the FDIC on July 15, 2011. The revised capital restoration plan was determined by the FDIC to be insufficient and, as a result, we submitted a further revised capital restoration plan to the FDIC on September 30, 2011. We received the FDIC's non-objection to the further revised capital restoration plan on December 6, 2011. The Bank is working diligently to increase its capital ratios in order to strengthen its balance sheet and satisfy the commitments required under the Consent Order. The Bank has engaged independent third parties to assist the Bank in its efforts to increase its capital ratios. In addition to continuing to search for additional capital, the Bank is also searching for a potential merger partner. Although the Bank is pursuing both of these approaches simultaneously, given the lack of a market for bank mergers, particularly in the Southeast, as a result of the current economic and regulatory climate, and the lack of success the Company has had to date in attempting to

	raise capital, there can be no assurances the Company will either raise additional capital or find a merger partner.
Submit, by April 11, 2011, a written capital plan to the supervisory authorities.	We believe we have complied with this provision of the Consent Order.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS - continued

Establish, by March 12, 2011, a plan to monitor compliance with the Consent Order, which shall be monitored by the Bank's Directors' Committee.	We believe we have complied with this provision of the Consent Order. The Directors' Committee meets monthly and each meeting includes reviews and discussions of all areas required in the Consent Order.
Develop, by May 11, 2011, a written analysis and assessment of the Bank's management and staffing needs.	We believe we have complied with this provision of the Consent Order. In 2011, the Bank engaged an independent third party to perform an assessment of the Bank's staffing needs to ensure the Bank has an appropriate organizational structure with qualified management in place. The Board of Directors has reviewed all recommendations regarding the Bank's organizational structure.
Notify the supervisory authorities in writing of the resignation or termination of any of the Bank's directors or senior executive officers.	We believe we have complied with this provision of the Consent Order.
Eliminate, by March 12, 2011, by charge-off or collection, all assets or portions of assets classified "Loss" and 50% of those assets classified "Doubtful."	We believe we have complied with this provision of the Consent Order.
Review and update, by April 11, 2011, its policy to ensure the adequacy of the Bank's allowance for loan and lease losses, which must provide for a review of the Bank's allowance for loan and lease losses at least once each calendar quarter.	We believe we have complied with this provision of the Consent Order.
Submit, by April 11, 2011, a written plan to the supervisory authorities to reduce classified assets, which shall include, among other things, a reduction of the Bank's risk exposure in relationships with assets in excess of \$750,000 which are criticized as "Substandard" or "Doubtful". In accordance with the approved plan, reduce assets classified in the June 30, 2010 Report of Examination by 65% by August 11, 2012 and by 75% by February 9, 2013.	We were not in compliance with this provision of the Consent Order on December 31, 2014. The written plan was submitted and approved; however, assets classified in the June 30, 2010 Report of Examination had only been reduced by 74.7% as of December 31, 2014. As of January 31, 2015, however, those assets had been reduced by 75.9%.
Revise, by April 11, 2011, its policies and procedures for managing the Bank's Adversely Classified Other Real Estate Owned.	We believe we have complied with this provision of the Consent Order.
Not extend any additional credit to any borrower who has a loan or other extension of credit from the Bank that has been charged-off or classified, in whole or in part, "Loss" or "Doubtful" and is uncollected. In addition, the Bank may not extend any additional credit to any borrower who has a loan or other extension of credit from the Bank that has been criticized, in whole or in part, "Substandard" and is uncollected, unless the Bank's board of directors determines that failure to extend further credit to a particular borrower would be detrimental to the best interests of the Bank.	We believe we have complied with this provision of the Consent Order. In the second quarter of 2010, the Bank engaged the services of an independent firm to perform an extensive review of the Bank's credit portfolio and help management implement a more comprehensive lending and collection policy and more enhanced loan review. An independent review of the Bank's credit portfolio was most recently completed in the second quarter of 2014.

Perform, by April 11, 2011, a risk segmentation analysis with respect to the Bank's Concentrations of Credit and develop a written plan to systematically reduce any segment of the portfolio that is an undue concentration of credit.	We believe we have complied with this provision of the Consent Order.
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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS - *continued*

Review, by April 11, 2011 and annually thereafter, the Bank's loan policies and procedures for adequacy and, based upon this review, make all appropriate revisions to the policies and procedures necessary to enhance the Bank's lending functions and ensure their implementation.	We believe we have complied with this provision of the Consent Order. As noted above, the Bank engaged the services of an independent firm to perform an extensive review of the Bank's credit portfolio and help management implement a more comprehensive lending and collection policy and more enhanced loan review.
Adopt, by May 11, 2011, an effective internal loan review and grading system to provide for the periodic review of the Bank's loan portfolio in order to identify and categorize the Bank's loans, and other extensions of credit which are carried on the Bank's books as loans, on the basis of credit quality.	We believe we have complied with this provision of the Consent Order. As noted above, the Bank engaged the services of an independent firm to perform an extensive review of the Bank's credit portfolio and help management implement a more comprehensive lending and collection policy and more enhanced loan review.
Review and update, by May 11, 2011, its written profit plan to ensure the Bank has a realistic, comprehensive budget for all categories of income and expense, which must address, at minimum, goals and strategies for improving and sustaining the earnings of the Bank, the major areas in and means by which the Bank will seek to improve the Bank's operating performance, realistic and comprehensive budgets, a budget review process to monitor income and expenses of the Bank to compare actual results with budgetary projections, assess that operating assumptions that form the basis for budget projections and adequately support major projected income and expense components of the plan, and coordination of the Bank's loan, investment, and operating policies and budget and profit planning with the funds management policy.	We believe we have complied with this provision of the Consent Order. The Bank engaged an independent third party to assist management with a strategic plan to help restructure its balance sheet, increase capital ratios, return to profitability and maintain adequate liquidity.
Review and update, by May 11, 2011, its written plan addressing liquidity, contingent funding, and asset liability management.	We believe we have complied with this provision of the Consent Order. In 2011, the Bank engaged an independent third party to assist management in its development of a strategic plan that achieves all requirements of the Consent Order. The strategic plan reflects the Bank's plans to restructure its balance sheet, increase capital ratios, return to profitability, and maintain adequate liquidity. The Board of Directors has reviewed and adopted the Bank's strategic plan.
Eliminate, by March 12, 2011, all violations of law and regulation or contraventions of policy set forth in the FDIC's safety and soundness examination of the Bank in November 2009.	We believe we have complied with this provision of the Consent Order.
Not accept, renew, or rollover any brokered deposits unless it is in compliance with the requirements of 12 C.F.R. § 337.6(b).	Since entering into the Consent Order, the Bank has not accepted, renewed, or rolled-over any brokered deposits. Therefore we believe we have complied with this provision of the Consent Order.
Limit asset growth to 5% per annum.	

	We believe we have complied with this provision of the Consent Order.
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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS - *continued*

Not declare or pay any dividends or bonuses or make any distributions of interest, principal, or other sums on subordinated debentures without the prior approval of the supervisory authorities.	We believe we have complied with this provision of the Consent Order.
The Bank shall comply with the restrictions on the effective yields on deposits as described in 12 C.F.R. § 337.6.	We believe we have complied with this provision of the Consent Order.
Furnish, by March 12, 2011 and within 30 days of the end of each quarter thereafter, written progress reports to the supervisory authorities detailing the form and manner of any actions taken to secure compliance with the Consent Order.	We believe we have complied with this provision of the Consent Order, and we have submitted the required progress reports to the supervisory authorities.
Submit, by March 12, 2011, a written plan to the supervisory authorities for eliminating its reliance on brokered deposits.	We believe we have complied with this provision of the Consent Order.
Adopt, by April 11, 2011, an employee compensation plan after undertaking an independent review of compensation paid to all of the Bank's senior executive officers.	We believe we have complied with this provision of the Consent Order.
Prepare and submit, by May 11, 2011, its written strategic plan to the supervisory authorities.	We believe we have complied with this provision of the Consent Order. In 2011, the Bank engaged an independent third party to assist management in its development of a strategic plan that achieves all requirements of the Consent Order. The Board of Directors has reviewed and adopted the Bank's strategic plan.

There can be no assurance that the Bank will be able to comply fully with the provisions of the Consent Order, and the determination of the Bank's compliance will be made by the FDIC and the State Board. However, we believe we are currently in substantial compliance with the Consent Order except for the requirements to achieve and maintain Total Risk Based capital at least equal to 10% of risk-weighted assets and Tier 1 capital at least equal to 8% of total assets. Should we fail to comply with the capital requirements in the Consent Order, or suffer a continued deterioration in our financial condition, the Bank may be placed into a federal conservatorship or receivership by the FDIC, with the FDIC appointed as conservator or receiver. In addition, the supervisory authorities may amend the Consent Order based on the results of their ongoing examinations.

As of December 31, 2014, the Company was categorized as "critically undercapitalized" and the Bank was categorized as "significantly undercapitalized." Our losses over the past few years have materially adversely impacted our capital. As a result, we have been pursuing a plan through which to achieve the capital requirements set forth under the Consent Order which includes, among other things, the sale of assets, reduction in total assets, and reduction of overhead expenses, as well as raising additional capital at either the Bank or the holding company level and attempting to find a merger partner for the Company or the Bank.

We anticipate that we will need to raise a material amount of capital to return the Bank to an adequate level of capitalization and have been exploring a number of potential sources of capital. We have not had any success to date in raising this capital, and there are no assurances that we will be able to raise this capital on a timely basis or at all.

We are also working to improve asset quality and to reduce the Bank's investment in commercial real estate loans as a percentage of Tier 1 capital. The Company is reducing its reliance on brokered deposits and is committed to improving the Bank's capital position.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS - continued

Written Agreement

On May 9, 2011, the Company entered into a Written Agreement with the Federal Reserve Bank of Richmond. The Written Agreement is designed to enhance the Company's ability to act as a source of strength to the Bank.

The Written Agreement contains provisions similar to those in the Bank's Consent Order. Specifically, pursuant to the Written Agreement, the Company agreed, among other things, to seek the prior written approval of the Federal Reserve Bank of Richmond before undertaking any of the following activities:

- declaring or paying any dividends,
- directly or indirectly taking dividends or any other form of payment representing a reduction in capital from the Bank,
- making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities,
- directly or indirectly, incurring, increasing or guarantying any debt, and
- directly or indirectly, purchasing or redeeming any shares of its stock.

The Company also agreed to comply with certain notice provisions set forth in the Federal Deposit Insurance Act and regulations of the Board of Governors of the Federal Reserve System (the "Federal Reserve") in appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position. The Company is also required to comply with certain restrictions on indemnification and severance payments pursuant to the Federal Deposit Insurance Act and FDIC regulations.

We believe we are currently in substantial compliance with the Written Agreement.

In addition, the Federal Reserve Bank of Richmond has informed the Company that it is required to contribute \$1 million to the Bank as soon as the Company has the funds available to do so for repayment of a loan deemed made from the Bank to the Company in such amount. The Bank is a general unsecured creditor of the Company with respect to this amount.

Going Concern Considerations

The going concern assumption is a fundamental principle in the preparation of financial statements. It is the responsibility of management to assess the Company's ability to continue as a going concern. In assessing this assumption, the Company has taken into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date of December 31, 2014. The Company had a history of profitable operations and sufficient sources of liquidity to meet its short-term and long-term funding needs. However, the Bank's financial condition has suffered during the past few years from the extraordinary effects of what may ultimately be the worst economic downturn since the Great Depression.

The effects of the current economic environment are being felt across many industries, with financial services and residential real estate being particularly hard hit. The Bank, with a loan portfolio consisting of a concentration in commercial real estate loans, has seen a decline in the value of the collateral securing its portfolio as well as rapid deterioration in its borrowers' cash flow and ability to repay their outstanding loans to the Bank. As a result, the Bank's level of nonperforming assets increased substantially during 2010 and 2011. However, since 2012, the Bank's nonperforming assets have begun to stabilize. The Bank's nonperforming assets equaled \$31.3 million, or 7.43% of assets, as of December 31, 2014 compared to \$35.6 million and \$42.2 million, or 8.19% and 9.00% of assets, as of December 31, 2013 and 2012, respectively. While management recognizes the possibility of further deterioration in the loan portfolio, net loan charge-offs decreased from \$17.6 million in 2012 to \$3.2 million in 2013. Net charge-offs were \$4.7 million for the year ended December 31, 2014.

The Company and the Bank operate in a highly regulated industry and must plan for the liquidity needs of each entity separately. A variety of sources of liquidity have historically been available to the Bank to meet its short-term and long-

term funding needs. Although a number of these sources have been limited following execution of the Consent Order, management has prepared forecasts of these sources of funds and the Bank's projected uses of funds during 2014 in an effort to ensure that the sources available are sufficient to meet the Bank's projected liquidity needs for this period.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – REGULATORY MATTERS AND GOING CONCERN CONSIDERATIONS - *continued*

Prior to the economic downturn, the Company, if needed, would have relied on dividends from the Bank as its primary source of liquidity. Currently, however, the Company has no available sources of liquidity. The Company is a legal entity separate and distinct from the Bank. Various legal limitations restrict the Bank from lending or otherwise supplying funds to the Company to meet its obligations, including paying dividends. In addition, the terms of the Consent Order described below further limits the Bank's ability to pay dividends to the Company to satisfy its funding needs. Unless the Company is able to raise capital, it will have no means of satisfying its funding needs.

Management believes the Bank's liquidity sources are adequate to meet its needs for at least the next 12 months, but if the Bank is unable to meet its liquidity needs, then the Bank may be placed into a federal conservatorship or receivership by the FDIC, with the FDIC appointed conservator or receiver.

The Company will also need to raise substantial additional capital to increase the Bank's capital levels to meet the standards set forth by the FDIC. Receivership by the FDIC is based on the Bank's capital ratios rather than those of the Company. As of December 31, 2014, the Bank is categorized as significantly undercapitalized.

There can be no assurances that the Company or the Bank will be able to raise additional capital. An equity financing transaction by the Company would result in substantial dilution to the Company's current shareholders and could adversely affect the market price of the Company's common stock. Likewise, an equity financing transaction by the Bank would result in substantial dilution to the Company's ownership interest in the Bank. It is difficult to predict if these efforts will be successful, either on a short-term or long-term basis. Should these efforts be unsuccessful, the Company would be unable to realize its assets and discharge its liabilities in the normal course of business.

The Company has been deferring interest payments on its trust preferred securities since March 2011 and has deferred interest payments for 16 consecutive quarters. The Company is allowed to defer payments for up to 20 consecutive quarterly periods, although interest will also accrue and compound quarterly from the date such deferred interest would have been payable were it not for the extension period. All of the deferred interest, including interest accrued on such deferred interest, is due and payable at the end of the applicable deferral period, which is in March 2016. At December 31, 2014, total accrued interest equaled \$714 thousand. The Company will not be able to pay this interest when it becomes due if we are not able to raise a sufficient amount of additional capital for the Bank to be in compliance with the Consent Order and for the Company to make the payments due under the subordinated notes, which are senior to the trust preferred securities. Even if the Company succeeds in raising this capital, it will have to be released from the Written Agreement or obtain approval from the Federal Reserve Bank of Richmond to pay this interest on the trust preferred securities. If this interest is not paid by March 2016, the Company will be in default under the terms of the indenture related to the trust preferred securities. If the Company fails to pay the deferred and compounded interest at the end of the deferral period, the trustee or the holders of 25% of the aggregate trust preferred securities outstanding, by providing written notice to the Company, may declare the entire principal and unpaid interest amounts of the trust preferred securities immediately due and payable. The aggregate principal amount of these trust preferred securities is \$6.0 million. The trust preferred securities are junior to the subordinated notes, so even if a default is declared, the trust preferred securities cannot be repaid prior to repayment of the subordinated notes. However, if the trustee or the holders of the trust preferred securities declare a default under the trust preferred securities, the Company could be forced into involuntary bankruptcy.

As a result of management's assessment of the Company's ability to continue as a going concern, the accompanying consolidated financial statements for the Company have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future, and does not include any adjustments to reflect the possible future effects on the recoverability or classification of assets. There is substantial doubt about the Company's ability to continue as a going concern.

NOTE 3 - CASH AND DUE FROM BANKS

The Bank is required by regulation to maintain an average cash reserve balance based on a percentage of deposits. At December 31, 2014, 2013 and 2012, the requirements were satisfied by amounts on deposit with the Federal Reserve Bank and cash on hand.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - INVESTMENT SECURITIES

Securities available-for-sale consisted of the following:

	<u>Amortized Cost</u>	<u>Gross Unrealized</u>		<u>Estimated Fair Value</u>
		<u>Gains</u>	<u>Losses</u>	
<i>(Dollars in thousands)</i>				
December 31, 2014				
Government-sponsored enterprises	\$ 40,952	\$ 7	\$ (877)	\$ 40,082
Mortgage-backed securities	65,328	447	(427)	65,348
Obligations of state and local governments	1,239	10	(5)	1,244
Total	<u>\$ 107,519</u>	<u>\$ 464</u>	<u>\$ (1,309)</u>	<u>\$ 106,674</u>
December 31, 2013				
Government-sponsored enterprises	\$ 60,628	\$ —	\$ (5,553)	\$ 55,075
Mortgage-backed securities	37,731	167	(864)	37,034
Obligations of state and local governments	2,516	113	(136)	2,493
Total	<u>\$ 100,875</u>	<u>\$ 280</u>	<u>\$ (6,553)</u>	<u>\$ 94,602</u>
December 31, 2012				
Government-sponsored enterprises	\$ 27,024	\$ 111	\$ (27)	\$ 27,108
Mortgage-backed securities	44,557	391	(486)	44,462
Obligations of state and local governments	5,569	193	(12)	5,750
Total	<u>\$ 77,150</u>	<u>\$ 695</u>	<u>\$ (525)</u>	<u>\$ 77,320</u>

The following is a summary of maturities of securities available-for-sale as of December 31, 2014. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	<u>Securities Available-For-Sale</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
<i>(Dollars in thousands)</i>		
Due after one year but within five years	\$ 1,492	\$ 1,500
Due after five years but within ten years	16,364	16,308
Due after ten years	89,663	88,866
Total	<u>\$ 107,519</u>	<u>\$ 106,674</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - INVESTMENT SECURITIES - continued

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at:

December 31, 2014	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>						
Government-sponsored enterprises	\$ —	\$ —	\$ 38,076	\$ (877)	\$ 38,076	\$ (877)
Mortgage-backed securities	22,024	(244)	7,458	(183)	29,482	(427)
Obligations of state and local governments	—	—	623	(5)	623	(5)
Total	<u>\$ 22,024</u>	<u>\$ (244)</u>	<u>\$ 46,157</u>	<u>\$ (1,065)</u>	<u>\$ 68,181</u>	<u>\$ (1,309)</u>
December 31, 2013	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>						
Government-sponsored enterprises	\$ 47,311	\$ (4,433)	\$ 7,764	\$ (1,120)	\$ 55,075	\$ (5,553)
Mortgage-backed securities	17,826	(471)	7,373	(393)	25,199	(864)
Obligations of state and local governments	552	(67)	568	(69)	1,120	(136)
Total	<u>\$ 65,689</u>	<u>\$ (4,971)</u>	<u>\$ 15,705</u>	<u>\$ (1,582)</u>	<u>\$ 81,394</u>	<u>\$ (6,553)</u>
December 31, 2012	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>						
Government-sponsored enterprises	\$ 6,003	(27)	\$ —	\$ —	\$ 6,003	\$ (27)
Mortgage-backed securities	9,881	(380)	5,299	(106)	15,180	(486)
Obligations of state and local governments	635	(12)	—	—	635	(12)
Total	<u>\$ 16,519</u>	<u>(419)</u>	<u>\$ 5,299</u>	<u>(106)</u>	<u>\$ 21,818</u>	<u>(525)</u>

Management evaluates its investment portfolio periodically to identify any impairment that is other than temporary. At December 31, 2014, the Company had 17 government-sponsored enterprise securities, six mortgage-backed securities, and one state and local government obligation security that have been in an unrealized loss position for more than twelve months. Management believes these losses are temporary and are a result of the current interest rate environment. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost.

At December 31, 2014, 2013 and 2012, investment securities with a book value of \$42.8 million, \$40.1 million, and \$30.4 million, respectively, and a market value of \$42.2 million, \$36.8 million and \$30.6 million, respectively, were pledged to secure deposits.

Proceeds from sales of available-for-sale securities were \$32.8 million, \$25.9 million and \$46.7 million for the years ended December 31, 2014, 2013, and 2012 respectively. Gross realized gains and losses on sales of available for sale securities for the years ended were as follows:

<i>(Dollars in thousands)</i>	Years ended December 31,		
	2014	2013	2012
Gross realized gains	\$ 269	\$ 298	1,643
Gross realized losses	(68)	—	—
Net gain	<u>\$ 201</u>	<u>\$ 298</u>	<u>\$ 1,643</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – LOAN PORTFOLIO

Loans consisted of the following:

<i>(Dollars in thousands)</i>	December 31,		
	2014	2013	2012
Residential	\$ 84,568	\$ 84,335	\$ 91,606
Commercial Real Estate	113,852	130,450	161,335
Commercial	30,894	33,711	41,200
Consumer	6,229	7,928	8,093
Total gross loans	<u>\$235,543</u>	<u>\$256,424</u>	<u>\$302,234</u>

Certain parties (principally certain directors and officers of the Company, their immediate families, and business interests) were loan customers and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the lender and do not involve more than normal risk of collectibility. Related party loans consisted of the following:

<i>(Dollars in thousands)</i>	For the Year ended December 31,		
	2014	2013	2012
Beginning balance	\$ 3,088	\$ 2,867	\$ 4,325
New loans and advances	1,785	1,195	1,645
Repayments	(1,016)	(974)	(3,103)
Ending balance	<u>\$ 3,857</u>	<u>\$ 3,088</u>	<u>\$ 2,867</u>

Provision and Allowance for Loan Losses

An allowance for loan losses is maintained at a level deemed appropriate by management to adequately provide for known and inherent losses in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

In evaluating the adequacy of the Company's loan loss reserves, management identifies loans believed to be impaired. Impaired loans are those not likely to be repaid as to principal and interest in accordance with the terms of the loan agreement. Impaired loans are reviewed individually by management and the net present value of the collateral is estimated. Reserves are maintained for each loan in which the principal balance of the loan exceeds the net present value of the collateral. In addition to the specific allowance for individually reviewed loans, a general allowance for potential loan losses is established based on management's review of the composition of the loan portfolio with the purpose of identifying any concentrations of risk, and an analysis of historical loan charge-offs and recoveries. The final component of the allowance for loan losses incorporates management's evaluation of current economic conditions and other risk factors which may impact the inherent losses in the loan portfolio. These evaluations are highly subjective and require that a great degree of judgmental assumptions be made by management. This component of the allowance for loan losses includes additional estimated reserves for internal factors such as changes in lending staff, loan policy and underwriting guidelines, and loan seasoning and quality, and external factors such as national and local economic trends and conditions.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

The following tables detail the activity within our allowance for loan losses as of and for the years ended December 31, 2014, 2013 and 2012, by portfolio segment:

December 31, 2014

(Dollars in thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Allowance for loan losses:					
Beginning balance	\$ 1,020	\$ 5,312	\$ 144	\$ 2,967	\$ 9,443
Charge-offs	(1,068)	(4,646)	(343)	(974)	(7,031)
Recoveries	549	1,117	38	610	2,314
Provision	96	1,808	346	(1,189)	1,061
Ending balance	<u>\$ 597</u>	<u>\$ 3,591</u>	<u>\$ 185</u>	<u>\$ 1,414</u>	<u>\$ 5,787</u>
Ending balances:					
Individually evaluated for impairment	<u>\$ 151</u>	<u>\$ 1,008</u>	<u>\$ 11</u>	<u>\$ 737</u>	<u>\$ 1,907</u>
Collectively evaluated for impairment	<u>\$ 446</u>	<u>\$ 2,583</u>	<u>\$ 174</u>	<u>\$ 677</u>	<u>\$ 3,880</u>
Loans receivable:					
Ending balance, total	<u>\$ 30,894</u>	<u>\$ 113,852</u>	<u>\$ 6,229</u>	<u>\$ 84,568</u>	<u>\$ 235,543</u>
Ending balances:					
Individually evaluated for impairment	<u>\$ 3,644</u>	<u>\$ 25,146</u>	<u>\$ 175</u>	<u>\$ 12,418</u>	<u>\$ 41,383</u>
Collectively evaluated for impairment	<u>\$ 27,250</u>	<u>\$ 88,706</u>	<u>\$ 6,054</u>	<u>\$ 72,150</u>	<u>\$ 194,160</u>

December 31, 2013

(Dollars in thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Allowance for loan losses:					
Beginning balance	\$ 1,982	\$ 7,587	\$ 124	\$ 4,457	\$ 14,150
Charge-offs	(1,691)	(3,927)	(217)	(1,641)	(7,476)
Recoveries	724	2,230	48	1,264	4,266
Provision	5	(578)	189	(1,113)	(1,497)
Ending balance	<u>\$ 1,020</u>	<u>\$ 5,312</u>	<u>\$ 144</u>	<u>\$ 2,967</u>	<u>\$ 9,443</u>
Ending balances:					
Individually evaluated for impairment	<u>\$ 218</u>	<u>\$ 2,455</u>	<u>\$ 18</u>	<u>\$ 1,105</u>	<u>\$ 3,796</u>
Collectively evaluated for impairment	<u>\$ 802</u>	<u>\$ 2,857</u>	<u>\$ 126</u>	<u>\$ 1,862</u>	<u>\$ 5,647</u>
Loans receivable:					
Ending balance, total	<u>\$ 33,711</u>	<u>\$ 130,450</u>	<u>\$ 7,928</u>	<u>\$ 84,335</u>	<u>\$ 256,424</u>
Ending balances:					

Individually evaluated for impairment	<u>\$ 3,946</u>	<u>\$ 29,540</u>	<u>\$ 223</u>	<u>\$ 11,970</u>	<u>\$ 45,679</u>
Collectively evaluated for impairment	<u>\$ 29,765</u>	<u>\$ 100,910</u>	<u>\$ 7,705</u>	<u>\$ 72,365</u>	<u>\$ 210,745</u>

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

December 31, 2012

(Dollars in thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Allowance for loan losses:					
Beginning balance	\$ 3,239	\$ 10,240	\$ 103	\$ 7,596	\$ 21,178
Charge-offs	(3,242)	(10,045)	(106)	(5,148)	(18,541)
Recoveries	284	331	12	356	983
Provision	1,701	7,061	115	1,653	10,530
Ending balance	<u>\$ 1,982</u>	<u>\$ 7,587</u>	<u>\$ 124</u>	<u>\$ 4,457</u>	<u>\$ 14,150</u>
Ending balances:					
Individually evaluated for impairment	<u>\$ 833</u>	<u>\$ 3,499</u>	<u>\$ 15</u>	<u>\$ 1,236</u>	<u>\$ 5,583</u>
Collectively evaluated for impairment	<u>\$ 1,149</u>	<u>\$ 4,088</u>	<u>\$ 109</u>	<u>\$ 3,221</u>	<u>\$ 8,567</u>
Loans receivable:					
Ending balance, total	<u>\$ 41,200</u>	<u>\$ 161,335</u>	<u>\$ 8,093</u>	<u>\$ 91,606</u>	<u>\$ 302,234</u>
Ending balances:					
Individually evaluated for impairment	<u>\$ 4,957</u>	<u>\$ 45,208</u>	<u>\$ 239</u>	<u>\$ 11,179</u>	<u>\$ 61,583</u>
Collectively evaluated for impairment	<u>\$ 36,243</u>	<u>\$ 116,127</u>	<u>\$ 7,854</u>	<u>\$ 80,427</u>	<u>\$ 240,651</u>

Loan Performance and Asset Quality

Generally, a loan will be placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the loan is doubtful. When a loan is placed in nonaccrual status, interest accruals are discontinued and income earned but not collected is reversed. Cash receipts on nonaccrual loans are not recorded as interest income, but are used to reduce principal.

The following chart summarizes delinquencies and nonaccruals, by portfolio class, as of December 31, 2014, 2013 and 2012.

December 31, 2014

(Dollars in thousands)

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90+ Days Past Due</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans Receivable</u>	<u>Non- accrual</u>
Commercial	\$ 282	\$ 27	\$ —	\$ 309	\$ 30,585	\$ 30,894	\$ 633
Commercial real estate:							
Construction	199	—	364	563	30,907	31,470	4,464
Other	493	283	2,023	2,799	79,583	82,382	2,643
Real Estate:							
Residential	2,576	372	2,810	5,758	78,810	84,568	3,917
Consumer:							
Other	101	2	—	103	5,449	5,552	—
Revolving credit	<u>4</u>	<u>4</u>	<u>1</u>	<u>9</u>	<u>668</u>	<u>677</u>	<u>4</u>

Total	<u>\$ 3,655</u>	<u>\$ 688</u>	<u>\$ 5,198</u>	<u>\$ 9,541</u>	<u>\$ 226,002</u>	<u>\$ 235,543</u>	<u>\$ 11,661</u>
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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued**December 31, 2013**

(Dollars in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans Receivable	Non- accrual
Commercial	\$ 771	\$ 146	\$ 407	\$ 1,324	\$ 32,387	\$ 33,711	\$ 430
Commercial real estate:							
Construction	215	33	2,243	2,491	36,408	38,899	4,208
Other	1,156	—	3,414	4,570	86,981	91,551	4,017
Real Estate:							
Residential	2,188	830	1,381	4,399	79,936	84,335	1,936
Consumer:							
Other	191	219	35	445	6,710	7,155	40
Revolving credit	18	3	—	21	752	773	—
Total	<u>\$ 4,539</u>	<u>\$ 1,231</u>	<u>\$ 7,480</u>	<u>\$ 13,250</u>	<u>\$ 243,174</u>	<u>\$ 256,424</u>	<u>\$ 10,631</u>

December 31, 2012

(Dollars in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans Receivable	Non- accrual
Commercial	\$ 767	\$ 730	\$ 956	\$ 2,453	\$ 38,747	\$ 41,200	\$ 1,197
Commercial real estate:							
Construction	2,350	882	15,189	18,421	39,853	58,274	15,189
Other	3,626	1,903	4,170	9,699	93,362	103,061	4,129
Real Estate:							
Residential	3,100	691	1,846	5,637	85,969	91,606	1,919
Consumer:							
Other	120	132	118	370	6,896	7,266	129
Revolving credit	7	10	4	21	806	827	4
Total	<u>\$ 9,970</u>	<u>\$ 4,348</u>	<u>\$ 22,283</u>	<u>\$ 36,601</u>	<u>\$ 265,633</u>	<u>\$ 302,234</u>	<u>\$ 22,567</u>

At December 31, 2014, one residential real estate loan in the amount of \$170 thousand was past due more than 90 days and still accruing interest. There were no loans outstanding 90 days or more and still accruing interest at December 31, 2013. One commercial real estate loan in the amount of \$115 thousand and one residential real estate loan in the amount of \$42 thousand were past due more than 90 days and still accruing interest at December 31, 2012.

The following tables summarize management's internal credit risk grades, by portfolio class, as of December 31:

December 31, 2014

(Dollars in thousands)

	Commercial	Commercial Real Estate	Consumer	Residential	Total
Grade 1 - Minimal	\$ 1,093	\$ —	\$ 531	\$ —	\$ 1,624
Grade 2 – Modest	1,164	679	93	1,216	3,152
Grade 3 – Average	3,868	5,618	156	4,688	14,330
Grade 4 – Satisfactory	16,367	59,536	4,928	56,758	137,589

Grade 5 – Watch	2,905	16,091	178	4,695	23,869
Grade 6 – Special Mention	1,191	4,249	132	3,747	9,319
Grade 7 – Substandard	4,306	27,679	211	13,464	45,660
Grade 8 – Doubtful	—	—	—	—	—
Grade 9 – Loss	—	—	—	—	—
Total loans receivable	<u>\$ 30,894</u>	<u>\$ 113,852</u>	<u>\$ 6,229</u>	<u>\$ 84,568</u>	<u>\$ 235,543</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - *continued*

December 31, 2013

(Dollars in thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Grade 1 - Minimal	\$ 1,364	\$ —	\$ 775	\$ —	\$ 2,139
Grade 2 – Modest	314	1,066	98	1,835	3,313
Grade 3 – Average	4,782	6,412	914	3,437	15,545
Grade 4 – Satisfactory	17,092	67,453	5,045	53,868	143,458
Grade 5 – Watch	3,204	17,288	221	6,933	27,646
Grade 6 – Special Mention	1,788	10,028	133	5,127	17,076
Grade 7 – Substandard	5,167	28,203	742	13,135	47,247
Grade 8 – Doubtful	—	—	—	—	—
Grade 9 – Loss	—	—	—	—	—
Total loans receivable	<u>\$ 33,711</u>	<u>\$ 130,450</u>	<u>\$ 7,928</u>	<u>\$ 84,335</u>	<u>\$ 256,424</u>

December 31, 2012

(Dollars in thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Residential</u>	<u>Total</u>
Grade 1 - Minimal	\$ 1,345	\$ —	\$ 822	\$ —	\$ 2,167
Grade 2 – Modest	546	2,412	67	2,517	5,542
Grade 3 – Average	4,508	5,871	228	4,094	14,701
Grade 4 – Satisfactory	18,554	63,658	6,038	53,955	142,205
Grade 5 – Watch	6,997	32,640	366	10,923	50,926
Grade 6 – Special Mention	2,603	10,893	258	8,443	22,197
Grade 7 – Substandard	6,544	44,521	314	11,674	63,053
Grade 8 – Doubtful	103	1,340	—	—	1,443
Grade 9 – Loss	—	—	—	—	—
Total loans receivable	<u>\$ 41,200</u>	<u>\$ 161,335</u>	<u>\$ 8,093</u>	<u>\$ 91,606</u>	<u>\$ 302,234</u>

Loans graded one through four are considered “pass” credits. As of December 31, 2014, \$156.7 million, or 66.5% of the loan portfolio had a credit grade of “minimal,” “modest,” “average” or “satisfactory.” For loans to qualify for this grade, they must be performing relatively close to expectations, with no significant departures from the intended source and timing of repayment.

Loans with a credit grade of “watch” and “special mention” are not considered classified; however, they are categorized as a watch list credit and are considered potential problem loans. This classification is utilized by us when there is an initial concern about the financial health of a borrower. These loans are designated as such in order to be monitored more closely than other credits in the portfolio. Loans on the watch list are not considered problem loans until they are determined by management to be classified as substandard. As of December 31, 2014, loans with a credit grade of “watch” and “special mention” totaled \$33.2 million. Watch list loans are considered potential problem loans and are monitored as they may develop into problem loans in the future.

Loans graded “substandard” or greater are considered classified credits. At December 31, 2014, classified loans totaled \$45.7 million, with \$41.1 million being collateralized by real estate. Classified credits are evaluated for impairment on a quarterly basis. This amount included \$33.2 million in TDRs, of which \$28.2 million were considered to be performing at December 31, 2014. Classified loans included \$31.5 million in TDRs, of which \$25.0 million were considered to be performing at December 31, 2013.

The Bank identifies impaired loans through its normal internal loan review process. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan-by-loan basis by calculating either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Any resultant shortfall is charged to provision for loan losses and is classified as a specific reserve. When an impaired loan is ultimately charged-off, the charge-off is taken against the specific reserve.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Impaired consumer and residential loans are identified for impairment disclosures, however, it is policy to individually evaluate for impairment all loans with a credit grade of “substandard” or greater that have an outstanding balance of \$50 thousand or greater, and all loans with a credit grade of “special mention” that have outstanding principal balance of \$100 thousand or greater.

Impaired loans are valued on a nonrecurring basis at the lower of cost or market value of the underlying collateral. Market values were obtained using independent appraisals, updated in accordance with our reappraisal policy, or other market data such as recent offers to the borrower. At December 31, 2014, the recorded investment in impaired loans was \$41.4 million, compared to \$45.7 million and \$61.6 million at December 31, 2013 and 2012, respectively.

The following chart details our impaired loans, which includes troubled debt restructurings (“TDRs”) totaling \$33.2 million, \$31.5 million and \$44.9 million, by category as of December 31, 2014, 2013 and 2012, respectively:

December 31, 2014

(Dollars in thousands)

	<u>Recorded- Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:					
Commercial	\$ 1,852	\$ 2,678	\$ —	\$ 2,649	\$ 79
Commercial real estate	19,156	24,441	—	22,377	1,083
Residential	5,950	6,528	—	6,249	268
Consumer	<u>32</u>	<u>32</u>	<u>—</u>	<u>34</u>	<u>3</u>
Total:	<u>\$ 26,990</u>	<u>\$ 33,679</u>	<u>\$ —</u>	<u>\$ 31,309</u>	<u>\$ 1,433</u>
With an allowance recorded:					
Commercial	1,792	1,792	151	1,892	81
Commercial real estate	5,990	6,194	1,008	6,143	282
Residential	6,468	6,468	737	6,506	271
Consumer	<u>143</u>	<u>143</u>	<u>11</u>	<u>150</u>	<u>8</u>
Total:	<u>\$ 14,393</u>	<u>\$ 14,597</u>	<u>\$ 1,907</u>	<u>\$ 14,691</u>	<u>\$ 642</u>
Total:					
Commercial	3,644	4,470	151	4,541	160
Commercial real estate	25,146	30,635	1,008	28,520	1,365
Residential	12,418	12,996	737	12,755	539
Consumer	<u>175</u>	<u>175</u>	<u>11</u>	<u>184</u>	<u>11</u>
Total:	<u>\$ 41,383</u>	<u>\$ 48,276</u>	<u>\$ 1,907</u>	<u>\$ 46,000</u>	<u>\$ 2,075</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued**December 31, 2013***(Dollars in thousands)*

	Recorded- Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 1,464	\$ 1,657	\$ —	\$ 1,621	\$ 50
Commercial real estate	14,120	17,052	—	14,275	606
Residential	3,729	4,366	—	3,901	206
Consumer	<u>55</u>	<u>79</u>	<u>—</u>	<u>60</u>	<u>7</u>
Total:	<u>\$ 19,368</u>	<u>\$ 23,154</u>	<u>\$ —</u>	<u>\$ 19,857</u>	<u>\$ 869</u>

With an allowance recorded:

Commercial	2,482	2,482	218	2,556	106
Commercial real estate	15,420	15,747	2,455	15,674	469
Residential	8,241	8,454	1,105	8,381	384
Consumer	<u>168</u>	<u>168</u>	<u>18</u>	<u>163</u>	<u>8</u>
Total:	<u>\$ 26,311</u>	<u>\$ 26,851</u>	<u>\$ 3,796</u>	<u>\$ 26,774</u>	<u>\$ 967</u>

Total:

Commercial	3,946	4,139	218	4,177	156
Commercial real estate	29,540	32,799	2,455	29,949	1,075
Residential	11,970	12,820	1,105	12,282	590
Consumer	<u>223</u>	<u>247</u>	<u>18</u>	<u>223</u>	<u>15</u>
Total:	<u>\$ 45,679</u>	<u>\$ 50,005</u>	<u>\$ 3,796</u>	<u>\$ 46,631</u>	<u>\$ 1,836</u>

December 31, 2012*(Dollars in thousands)*

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 1,347	\$ 1,367	\$ —	\$ 1,660	\$ 45
Commercial real estate	18,926	24,381	—	26,255	708
Residential	3,504	4,288	—	3,523	118
Consumer	<u>99</u>	<u>100</u>	<u>—</u>	<u>100</u>	<u>4</u>
Total:	<u>\$ 23,876</u>	<u>\$ 30,136</u>	<u>\$ —</u>	<u>\$ 31,538</u>	<u>\$ 875</u>

With an allowance recorded:

Commercial	3,610	3,719	833	3,521	143
Commercial real estate	26,282	27,904	3,499	21,704	542
Residential	7,675	8,033	1,236	7,917	369
Consumer	<u>140</u>	<u>140</u>	<u>15</u>	<u>141</u>	<u>3</u>
Total:	<u>\$ 37,707</u>	<u>\$ 39,796</u>	<u>\$ 5,583</u>	<u>\$ 33,283</u>	<u>\$ 1,057</u>

Total:					
Commercial	4,957	5,086	833	5,181	188
Commercial real estate	45,208	52,285	3,499	47,959	1,250
Residential	11,179	12,321	1,236	11,440	487
Consumer	239	240	15	241	7
Total:	<u>\$ 61,583</u>	<u>\$ 69,932</u>	<u>\$ 5,583</u>	<u>\$ 64,821</u>	<u>\$ 1,932</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

TDRs are loans which have been restructured from their original contractual terms and include concessions that would not otherwise have been granted outside of the financial difficulty of the borrower. The Bank only restructures loans for borrowers in financial difficulty that have designed a viable business plan to fully pay off all obligations, including outstanding debt, interest and fees, either by generating additional income from the business or through liquidation of assets. Generally, these loans are restructured to provide the borrower additional time to execute upon their plans.

With respect to restructured loans, we grant concessions by (1) reduction of the stated interest rate for the remaining original life of the debt, or (2) extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk. We do not generally grant concessions through forgiveness of principal or accrued interest. Restructured loans where a concession has been granted through extension of the maturity date generally include extension of payments in an interest only period, extension of payments with capitalized interest and extension of payments through a forbearance agreement. These extended payment terms are also combined with a reduction of the stated interest rate in certain cases.

Success in restructuring loans has been mixed but it has proven to be a useful tool in certain situations to protect collateral values and allow certain borrowers additional time to execute upon defined business plans. In situations where a TDR is unsuccessful and the borrower is unable to follow through with terms of the restricted agreement, the loan is placed on nonaccrual status and continues to be written down to the underlying collateral value.

Our policy with respect to accrual of interest on loans restructured in a TDR follows relevant supervisory guidance. That is, if a borrower has demonstrated performance under the previous loan terms and shows capacity to perform under the restructured loan terms, continued accrual of interest at the restructured interest rate is likely. If a borrower was materially delinquent on payments prior to the restructuring but shows capacity to meet the restructured loan terms, the loan will likely continue as nonaccrual going forward. Lastly, if the borrower does not perform under the restructured terms, the loan is placed on nonaccrual status.

We will continue to closely monitor these loans and will cease accruing interest on them if management believes that the borrowers may not continue performing based on the restructured note terms. If, after previously being classified as a TDR, a loan is restructured a second time, then that loan is automatically placed on nonaccrual status. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms before that loan can be placed back on accrual status. Further, the borrower must show capacity to continue performing into the future prior to restoration of accrual status. To date, we have not restored any nonaccrual loan classified as a TDR to accrual status. We believe that all of our modified loans meet the definition of a TDR.

The following is a summary of information pertaining to our TDRs:

	December 31,		
	2014	2013	2012
<i>(Dollars in thousands)</i>			
Nonperforming TDRs	\$ 5,013	\$ 6,443	\$ 14,891
Performing TDRs:			
Commercial	2,942	3,496	3,611
Commercial real estate	17,499	14,673	20,343
Residential	7,537	6,690	5,967
Consumer	175	151	73
Total performing TDRs	28,153	25,010	29,994
Total TDRs	\$ 33,166	\$ 31,453	\$ 44,885

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

The following table summarizes how loans that were considered TDRs were modified during the years indicated:

For the Year Ended December 31, 2014

(Dollars in thousands)

	TDRs that are in compliance with the terms of the agreement			TDRs that subsequently defaulted ⁽¹⁾		
	Number of contracts	Pre- modification outstanding recorded investment	Post modification outstanding recorded investment	Number of contracts	Pre- modification outstanding recorded investment	Post- modification outstanding recorded investment
Commercial real estate	25	\$ 6,016	\$ 5,837	1	\$ 36	\$ 36
Residential	19	3,171	2,992	3	518	518
Commercial	5	455	455	—	—	—
Consumer	2	31	31	—	—	—
Total	51	\$ 9,673	\$ 9,315	4	\$ 554	\$ 554

For the Year Ended December 31, 2013

(Dollars in thousands)

	TDRs that are in compliance with the terms of the agreement			TDRs that subsequently defaulted ⁽¹⁾		
	Number of contracts	Pre- modification outstanding recorded investment	Post modification outstanding recorded investment	Number of contracts	Pre- modification outstanding recorded investment	Post- modification outstanding recorded investment
Commercial real estate	4	\$ 1,309	\$ 1,309	—	\$ —	\$ —
Residential	6	1,401	1,401	—	—	—
Commercial	12	636	636	—	—	—
Consumer	5	84	84	—	—	—
Total	27	\$ 3,430	\$ 3,430	—	\$ —	\$ —

For the Year Ended December 31, 2012

(Dollars in thousands)

	TDRs that are in compliance with the terms of the agreement			TDRs that subsequently defaulted ⁽¹⁾		
	Number of contracts	Pre- modification outstanding recorded investment	Post modification outstanding recorded investment	Number of contracts	Pre- modification outstanding recorded investment	Post- modification outstanding recorded investment
Commercial real estate	7	\$ 9,326	\$ 9,326	4	\$ 2,730	\$ 2,730
Residential	4	2,182	2,182	—	—	—
Commercial	15	756	756	1	91	91

Consumer	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total	<u>26</u>	<u>\$ 12,264</u>	<u>\$ 12,264</u>	<u>5</u>	<u>\$ 2,821</u>	<u>\$ 2,821</u>

⁽¹⁾ Loans past due 90 days or more are considered to be in default.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - LOAN PORTFOLIO - continued

Portions of the allowance for loan losses may be allocated for specific loans or portfolio segments. However, the entire allowance for loan losses is available for any loan that, in management's judgment, should be charged-off. While management utilizes the best judgment and information available to it, the ultimate adequacy of the allowance for loan losses depends on a variety of factors beyond our control, including the performance of our loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period.

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

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional 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.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The fair value of standby letters of credit is insignificant.

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

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties. The following table summarizes the Company's off-balance sheet financial instruments whose contract amounts represent credit risk:

	December 31,		
<i>(Dollars in thousands)</i>	2014	2013	2012
Commitments to extend credit	\$ 27,017	\$ 29,836	\$ 29,473
Standby letters of credit	247	361	490

NOTE 6 - PREMISES, FURNITURE AND EQUIPMENT

Premises, furniture and equipment consisted of the following:

	December 31,		
<i>(Dollars in thousands)</i>	2014	2013	2012
Land	\$ 7,099	\$ 7,099	\$ 7,099
Buildings and land improvements	16,082	16,134	16,213
Furniture and equipment	7,874	7,608	7,599
Leasehold improvements	65	65	65
	<u>31,120</u>	<u>30,906</u>	<u>30,976</u>
Less accumulated depreciation	<u>(10,828)</u>	<u>(10,104)</u>	<u>(9,282)</u>

Premises, furniture and equipment, net	<u>\$ 20,292</u>	<u>\$ 20,802</u>	<u>\$ 21,694</u>
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Depreciation expense for the years ended December 31, 2014, 2013 and 2012 was \$789 thousand, \$824 thousand, and \$923 thousand, respectively. In January 2012, we closed our Meeting Street and Homewood's branches to reduce our expenses, and wrote those properties down to appraised value, less costs to sell, in 2012.

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 – OTHER REAL ESTATE OWNED

Transactions in other real estate owned for the years ended December 31:

<i>(Dollars in thousands)</i>	2014	2013	2012
Balance, beginning of year	\$ 24,972	\$ 19,464	\$ 15,665
Additions	2,183	17,659	14,398
Sales	(7,337)	(11,383)	(7,839)
Write-downs	(317)	(768)	(2,760)
Balance, end of period	<u><u>\$ 19,501</u></u>	<u><u>\$ 24,972</u></u>	<u><u>\$ 19,464</u></u>

NOTE 8 - OTHER ASSETS

Other assets consisted of the following at December 31:

<i>(Dollars in thousands)</i>	2014	2013	2012
Prepaid expenses and insurance	\$ 736	\$ 471	\$ 603
Unamortized software	52	29	42
Receivable from sale of other real estate owned	—	3,348	—
Proceeds due from life insurance	1,208	—	—
Other	508	358	181
Total	<u><u>\$ 2,504</u></u>	<u><u>\$ 4,206</u></u>	<u><u>\$ 826</u></u>

NOTE 9 - DEPOSITS

At December 31, 2014, the scheduled maturities of time deposits were as follows *(in thousands)*:

Maturing in:	Amount
Less than one year	\$115,492
One to three years	77,616
Three to five years	25,801
Beyond five years	1,890
	<u><u>\$220,799</u></u>

Time deposits in excess of the FDIC insurance limit of \$250 thousand were \$40.1 million, \$47.7 million, \$69.9 million as of December 31, 2014, 2013, and 2012, respectively.

Overdrawn transaction accounts in the amount of \$17 thousand, \$41 thousand and \$43 thousand were classified as loans as of December 31, 2014, 2013 and 2012, respectively.

Brokered deposits were \$14.1 million, \$18.6 million and \$43.1 million as of December 31, 2014, 2013 and 2012, respectively.

Related party deposits by directors including their affiliates and executive officers totaled approximately \$1.4 million, \$589 thousand and \$618 thousand at December 31, 2014, 2013 and 2012, respectively.

NOTE 10 - ADVANCES FROM THE FEDERAL HOME LOAN BANK

Advances from the Federal Home Loan Bank consisted of the following at December 31, 2014:

<i>(Dollars in thousands)</i>	Advance Type	Advance Amount	Advance Rate	Maturing On
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Convertible Advance	\$ 2,000	3.60%	9/4/18
Convertible Advance	5,000	3.45%	9/10/18
Convertible Advance	5,000	2.95%	9/18/18
Fixed Rate	5,000	3.86%	8/20/19
	<u>\$ 17,000</u>		

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - ADVANCES FROM THE FEDERAL HOME LOAN BANK - *continued*

As of December 31, 2014 we had advances totaling \$17.0 million with various interest rates and maturity dates. Interest on fixed rate advances is generally payable monthly and interest on fixed rate advances is payable quarterly. Convertible advances are callable by the Federal Home Loan Bank on their respective call dates. The Company has the option to either repay any advance that has been called or to refinance the advance as a convertible advance.

At December 31, 2014, the Company had pledged as collateral for FHLB advances approximately \$791 thousand of one-to-four family first mortgage loans, \$3.7 million of commercial real estate loans, \$4.7 million in home equity lines of credit, \$45 thousand in multifamily loans and \$21.2 million of agency and private issue mortgage-backed securities. The Company has an investment in Federal Home Loan Bank stock of \$1.2 million. The Company has \$11.6 million in excess borrowing capacity with the Federal Home Loan Bank that is available if liquidity needs should arise. As a result of negative financial performance indicators, there is also a risk that the Bank's ability to borrow from the FHLB could be curtailed or eliminated, although to date the Bank has not been denied advances from the FHLB or had to pledge additional collateral for its borrowings.

As of December 31, 2014, scheduled principal reductions include \$12.0 million in 2018, and \$5.0 million in 2019.

NOTE 11 – JUNIOR SUBORDINATED DEBENTURES

On December 21, 2004, HCSB Financial Trust I, (a non-consolidated subsidiary) issued \$6.0 million floating rate trust preferred securities with a maturity of December 31, 2034. In accordance with current accounting standards, the trust has not been consolidated in these financial statements. The Company received from the Trust the \$6.0 million proceeds from the issuance of the securities and the \$186 thousand initial proceeds from the capital investment in the Trust and, accordingly, has shown the funds due to the trust as a \$6.2 million junior subordinated debenture. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital. The debenture issuance costs, net of accumulated amortization, totaled \$73 thousand at December 31, 2014 and are included in other assets on the consolidated balance sheet. Amortization of debt issuance costs totaled approximately \$4 thousand for each of the years ended December 31, 2014, 2013 and 2012. The Federal Reserve Bank of Richmond has prohibited the Company from paying interest due on the trust preferred securities since February 2011 and as a result, the Company has deferred interest payments in the amount of approximately \$714 thousand as of December 31, 2014. All of the deferred interest, including interest accrued on such deferred interest, is due and payable at the end of the applicable deferral period, which is in March 2016. The Company will not be able to pay this interest when it becomes due if it is not able to raise a sufficient amount of additional capital for the Bank to be in compliance with the Consent Order and for the Company to make the payments due under the subordinated notes, which are senior to the trust preferred securities. Even if the Company succeeds in raising this capital, it will have to be released from the Written Agreement or obtain approval from the Federal Reserve Bank of Richmond to pay this interest on the trust preferred securities. If this interest is not paid by March 2016, the Company will be in default under the terms of the indenture related to the trust preferred securities. If the Company fails to pay the deferred and compounded interest at the end of the deferral period, the trustee or the holders of 25% of the aggregate trust preferred securities outstanding, by providing written notice to the Company, may declare the entire principal and unpaid interest amounts of the trust preferred securities immediately due and payable. The aggregate principal amount of these trust preferred securities is \$6.0 million. If the trustee or the holders of the trust preferred securities demand immediate payment in full of the entire principal and unpaid interest amounts of the trust preferred securities, the Company could be forced into involuntary bankruptcy.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - SUBORDINATED DEBENTURES

On July 31, 2010, the Company completed a private placement of subordinated promissory notes that totaled \$12.1 million. The notes initially bear interest at a rate of 9% per annum payable semiannually on April 5th and October 5th and are callable by the Company four years after the date of issuance and mature 10 years from the date of issuance. After October 5, 2014 and until maturity, the notes bear interest at a rate equal to the current Prime Rate in effect, as published by the Wall Street Journal, plus 3%; provided, that the rate of interest shall not be less than 8% per annum or more than 12% per annum. The subordinated notes have been structured to fully count as Tier 2 regulatory capital on a consolidated basis.

During 2013, \$1.0 million of the subordinated notes were cancelled by the holder as part of a settlement of litigation between the holder, the Bank, and the Company. The Company is obligated to downstream funds in this amount to the Bank when it is able to do so, but the forgiveness of this debt has been included in noninterest income in the consolidated statements of operations.

The Federal Reserve Bank of Richmond has prohibited the Company from paying interest due on the subordinated notes since October 2011 and, as a result, the Company has deferred interest payments in the amount of approximately \$3.7 million as of December 31, 2014.

NOTE 13 - LEASE COMMITMENTS

On January 1, 2013, the Company renewed a lease agreement for land on which to operate its Tabor City branch. The lease has a five-year term that expires December 31, 2017. The Company has an option for eight additional five-year renewal periods thereafter. The lease has a rental amount of \$1,047 per month. The lease gives the Company the first right of refusal to purchase the property at an unimproved value if the owners decide to sell. The Company also pays applicable property taxes on the property.

Future minimum lease payments are expected to be approximately \$12,564 per year for the next three years.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2014, the Company is being investigated related to the sale of senior subordinated debentures in 2010 by the Company and has received subpoenas from the United States Attorney for the District of South Carolina, the South Carolina Attorney General and the Securities and Exchange Commission. The Company has fully responded to all of the subpoenas and provided testimony. The Company is also involved in litigation by certain subordinated debt holders alleging misuse of the funds and wrongful conduct amount other allegations in the issuance of the subordinated debentures. In 2012, certain investors, seeking class action treatment, filed suit against the Company alleging sale of its stock without disclosure of material financial information. The Bank is also involved in another legal matter related to unauthorized charges on a customer account. The Company and the Bank believe that all claims or legal proceedings are without merit and will not have a material adverse effect on the financial condition or operation of the Company. Management was not aware of any other pending or threatened litigation or unassisted claims that could result in losses, if any, that would be material to the financial statements.

The Federal Reserve Bank of Richmond has informed the Company that it is required to contribute \$1 million to the Bank as soon as the Company has the funds available to do so for repayment of a loan deemed made from the Bank to the Company in such amount. The Bank considers this to be a contingency and is a general unsecured creditor of the Company.

The details of the above cases are included in "Legal Proceedings" under Part I, Item 3 of the Annual Report on Form 10-K.

NOTE 15 - SHAREHOLDERS' EQUITY

Preferred Stock – In March 2009, in connection with the CPP, established as part of the Emergency Economic Stabilization Act of 2008, the Company issued to the U.S. Treasury 12,895 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series T (the "Series T Preferred Stock"), having a liquidation preference of \$1,000 per share. The Series T Preferred Stock has a dividend rate of 5% for the first five years and 9% thereafter, and has a call feature after three years.

In connection with the sale of the Series T Preferred Stock, the Company also issued to the U.S. Treasury a ten-year warrant to purchase up to 91,714 shares of the Company's common stock at an initial exercise price of \$21.09 per share.

As required under the CPP, dividend payments on and repurchases of the Company's common stock are subject to certain restrictions. For as long as the Series T Preferred Stock is outstanding, no dividends may be declared or paid on the Company's common stock until all accrued and unpaid dividends on the Series T Preferred Stock are fully paid. In addition, the U.S. Treasury's consent is required for any increase in dividends on common stock before the third anniversary of issuance of the Series T Preferred Stock and for any repurchase of any common stock except for repurchases of common shares in connection with benefit plans.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 - SHAREHOLDERS' EQUITY- *continued*

The Series T Preferred Stock and the CPP warrant were sold to the U.S. Treasury for an aggregate purchase price of \$12.9 million in cash. The purchase price was allocated between the Series T Preferred Stock and the CPP warrant based upon the relative fair values of each to arrive at the amounts recorded by the Company. This resulted in the Series T Preferred Stock being issued at a discount which is being amortized on a level yield basis as a charge to retained earnings over an assumed life of five years.

As of February 2011, the Federal Reserve Bank of Richmond, the Company's primary federal regulator, has required the Company to defer dividend payments on the 12,895 shares of the Series T Preferred Stock issued to the U.S. Treasury in March 2009 pursuant to the CPP and interest payments on the \$6.0 million of trust preferred securities issued in December 2004. Therefore, for each quarterly period beginning in February 2011, the Company notified the U.S. Treasury of its deferral of quarterly dividend payments on the 12,895 shares of Series T Preferred Stock and also informed the Trustee of the \$6.0 million of trust preferred securities of its deferral of the quarterly interest payments. The amount of each of the Company's quarterly interest payments was approximately \$161 thousand through March 2014 and then increased to \$290 thousand and, as of December 31, 2014, the Company had \$3.0 million of deferred dividend payments due on the Series T Preferred Stock issued to the U.S. Treasury. Because the Company has deferred these sixteen payments, the Company is prohibited from paying any dividends on its common stock until all deferred payments have been made in full. In addition, whenever dividends payable on the shares of the Series T Preferred Stock have been deferred for an aggregate of six or more quarterly dividend periods, the holders of the preferred stock have the right to elect two directors to fill newly created directorships at the Company's next annual meeting of the shareholders. As a result of the Company's deferral of dividend payments on the Series T Preferred Stock, the U.S. Treasury, the current holder of all 12,895 shares of the Series T Preferred Stock, requested the Company's non-objection to appoint a representative to observe monthly meetings of the Company's Board of Directors. The Company granted the Treasury's request and a representative of Treasury has attended the Company's monthly board meetings since June 2012. As of the date of this report, Treasury has not notified the Company whether it intends to elect two directors to fill newly created directorships at the Company's 2015 annual meeting of the shareholders. The Company has never paid a cash dividend, but as a result of the Company's financial condition and these restrictions on the Company, including the restrictions on the Bank's ability to pay dividends to the Company, the Company has not been permitted to pay a dividend on its common stock since 2009.

Restrictions on Dividends - South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to the Company are payable only from the undivided profits of the Bank. At December 31, 2014, the Bank had negative retained earnings. In addition, pursuant to the terms of the Consent Order, the Bank is prohibited from declaring a dividend on its shares of common stock unless it receives approval from the FDIC and the State Board. Under Federal Reserve Board regulations, the amounts of loans or advances from the Bank to the parent company are also restricted. Under the terms of the Written Agreement, the Company is also prohibited from declaring or paying any dividends without the prior written approval of the Federal Reserve Bank of Richmond. In addition, the Company is prohibited from paying any dividends on its common stock until all deferred payments on the 12,985 shares of preferred stock issued to Treasury pursuant to the Capital Purchase Program have been made in full.

NOTE 16 - CAPITAL REQUIREMENTS

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum ratios of Tier 1 and total capital as a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. Tier 1 capital consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan

losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital. The Company and the Bank are also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 – CAPITAL REQUIREMENTS - continued

To be considered “well-capitalized,” the Bank must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. To be considered “adequately capitalized” under these capital guidelines, the Bank must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital. In addition, Bank must maintain a minimum Tier 1 leverage ratio of at least 4%. Further, pursuant to the terms of the Consent Order with the FDIC and the State Board, the Bank must achieve and maintain Tier 1 capital at least equal to 8% and total risk-based capital at least equal to 10%.

At December 31, 2014, the Company was categorized as “critically undercapitalized” and the Bank was categorized as “significantly undercapitalized.” Our losses for the past few years have adversely impacted our capital. As a result, we have been pursuing a plan to increase our capital ratios in order to strengthen our balance sheet and satisfy the commitments required under the Consent Order. However, if we continue to fail to meet the capital requirements in the Consent Order in a timely manner, then this would result in additional regulatory actions, which could ultimately lead to the Bank being taken into receivership by the FDIC. Our auditors have noted that the uncertainty of our ability to obtain sufficient capital raises concerns about our ability to continue as a going concern.

The following table summarizes the capital ratios and the regulatory minimum requirements for the Company and the Bank.

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in thousands)</i>						
December 31, 2014						
The Company						
Total Capital (to Risk-Weighted Assets)	\$(10,402)	(3.61)%	\$23,031	8.00%	N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	\$(10,402)	(3.61)%	\$11,516	4.00%	N/A	N/A
Tier I Capital (to Average Assets)	\$(10,402)	(2.36)%	\$17,614	4.00%	N/A	N/A
The Bank						
Total Capital (to Risk-Weighted Assets)	\$ 14,533	5.05%	\$23,008	8.00%	\$28,760	10.00%
Tier I Capital (to Risk-Weighted Assets)	\$ 10,911	3.79%	\$11,504	4.00%	(1)	(1)
Tier I Capital (to Average Assets)	\$ 10,911	2.53%	\$17,255	4.00%	\$34,510	8.00%
December 31, 2013						
The Company						
Total Capital (to Risk-Weighted Assets)	\$(10,169)	(3.19)%	\$25,512	8.00%	N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	\$(10,169)	(3.19)%	\$12,756	4.00%	N/A	N/A
Tier I Capital (to Average Assets)	\$(10,169)	(2.23)%	\$18,242	4.00%	N/A	N/A
The Bank						
Total Capital (to Risk-Weighted Assets)	\$ 13,842	4.34%	\$25,505	8.00%	\$31,881	10.00%
Tier I Capital (to Risk-Weighted Assets)	\$ 9,789	3.07%	\$12,753	4.00%	(1)	(1)
Tier I Capital (to Average Assets)	\$ 9,789	2.17%	\$18,067	4.00%	\$36,135	8.00%
December 31, 2012						
The Company						
Total Capital (to Risk-Weighted Assets)	\$(11,932)	(3.44)%	\$27,754	8.00%	N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	\$(11,932)	(3.44)%	\$13,877	4.00%	N/A	N/A

Tier I Capital (to Average Assets)	\$(11,932)	(2.34)%	\$20,367	4.00%	N/A	N/A
The Bank						
Total Capital (to Risk-Weighted Assets)	\$ 12,175	3.51%	\$27,733	8.00%	\$34,667	10.00%
Tier I Capital (to Risk-Weighted Assets)	\$ 7,720	2.23%	\$13,867	4.00%	(1)	(1)
Tier I Capital (to Average Assets)	\$ 7,720	1.56%	\$19,816	4.00%	\$39,632	8.00%

⁽¹⁾ Minimum capital amounts and ratios presented are amounts to be well-capitalized under the various regulatory capital requirements administered by the FDIC. On February 10, 2011, the Bank became subject to a regulatory Consent Order with the FDIC. Minimum capital amounts and ratios presented for the Bank are the minimum levels set forth in the Consent Order. No minimum Tier 1 capital to risk-weighted assets ratio was specified in the Consent Order. Regardless of the Bank's capital ratios, it is unable to be classified as "well-capitalized" while it is operating under the Consent Order with the FDIC.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 – CAPITAL REQUIREMENTS - *continued*

As noted above, in July 2013, the federal bank regulatory agencies issued a final rule that will revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. The rule applies to all national and state banks, such as the Bank, and savings associations and most bank holding companies and savings and loan holding companies, which we collectively refer to herein as “covered” banking organizations. Bank holding companies with less than \$500 million in total consolidated assets, such as the Company, are not subject to the final rule, nor are savings and loan holding companies substantially engaged in commercial activities or insurance underwriting. The requirements in the rule began to phase in on January 1, 2015 for covered banking organizations such as the Bank. The requirements in the rule will be fully phased in by January 1, 2019.

Effective January 1, 2015, the final rules require the Company to comply with the following new minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets (increased from the current requirement of 4.0%); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from current requirement); and (iv) a leverage ratio of 4.0% of total assets. These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

With respect to the Bank, the rules also revised the “prompt corrective action” regulations pursuant to Section 38 of the FDIA by (i) introducing a common equity Tier 1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0% (as compared to the current 6.0%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized.

The new capital 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 (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and nonresidential mortgage loans that are 90 days past due or otherwise on nonaccrual status, a 20% (up from 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 (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital, and increased risk-weights (from 0% to up to 600%) for equity exposures.

If the new minimum capital ratios described above had been effective as of December 31, 2014, based on management’s interpretation and understanding of the new rules, the Company would have remained critically undercapitalized and the Bank would have remained significantly undercapitalized as of such date.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 - RETIREMENT AND BENEFITS

Trustee Retirement Savings Plan - The Bank has a trustee retirement savings plan which provides retirement benefits to substantially all officers and employees who meet certain age and service requirements. The plan includes a “salary reduction” feature pursuant to Section 401(k) of the Internal Revenue Code. Under the plan and present policies, participants are permitted to contribute up to 15% of their annual compensation. At its discretion, the Bank can make matching contributions up to 4% of the participants’ compensation. In an effort to reduce expenses, the Bank made no contributions to employee 401(k) plans in 2014, 2013 or 2012.

Directors Deferred Compensation Plan - The Company has a deferred compensation plan whereby directors may elect to defer the payment of their fees. Under the terms of the plan, the Company accrues an expense equal to the amount deferred plus an interest component based on the prime rate of interest at the beginning of each year. The Company has also purchased life insurance contracts on each of the participating directors. All active directors have relinquished the right to their deferred directors’ fees. At December 31, 2014, 2013 and 2012, \$37 thousand, \$49 thousand and \$62 thousand, respectively, of deferred directors’ fees relating to retired directors were included in other liabilities.

NOTE 18 – INCOME (LOSS) PER SHARE

(Dollars in thousands, except per share amounts)

	Years ended December 31,		
	2014	2013	2012
Basic income (loss) per common share:			
Net income (loss) available to common shareholders	\$ (1,403)	\$ 911	\$ (10,396)
Weighted average common shares outstanding - basic	3,770,355	3,738,337	3,738,337
Basic income (loss) per common share	\$ (0.37)	\$ 0.24	\$ (2.78)
Diluted income (loss) per common share:			
Net income (loss) available to common shareholders	\$ (1,403)	\$ 911	\$ (10,396)
Weighted average common shares outstanding - basic	3,770,355	3,738,337	3,738,337
Incremental shares	—	—	—
Average common shares outstanding - diluted	3,770,355	3,738,337	3,738,337
Diluted income (loss) per common share	\$ (0.37)	\$ 0.24	\$ (2.78)

For the years ended December 31, 2014, 2013 and 2012, there were 91,714 common stock equivalents outstanding associated with the CPP Warrant. These common stock equivalents were not included in the diluted income per share computation for 2013 because their exercise price exceeded the market value of the Company’s stock. For the years ended December 31, 2014 and 2012, the common stock equivalents were not included in the diluted loss per share computation because their effect would have been anti-dilutive.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 - STOCK COMPENSATION PLAN

In 2004, upon shareholder approval, the Company adopted an Omnibus Stock Ownership and Long Term Incentive Plan (the "Stock Plan"). The Stock Plan authorizes the grant of options and awards of restricted stock to certain of our employees for up to 400,000 shares of the Company's common stock from time to time during the term of the Stock Plan, subject to adjustments upon change in capitalization. The Stock Plan is administered by the Compensation Committee of the Board of Directors of the Company.

There were no stock options outstanding as of December 31, 2014, 2013 or 2012.

Restricted stock awards included in the Stock Plan vest after the first three consecutive periods during which the Bank's return on average assets ("ROAA") averages 1.15%. There were no awards outstanding as of December 31, 2014, 2013 or 2012.

NOTE 20 - OTHER EXPENSES

Other expenses are summarized as follows:

	Years Ended December 31,		
	2014	2013	2012
<i>(Dollars in thousands)</i>			
Stationery, printing, and postage	\$ 275	\$ 318	\$ 337
Dues and subscriptions	59	72	104
Telephone	202	204	208
Director and officer insurance	212	486	120
ATM services	27	115	170
Appraisal fee expense	123	140	97
Accountant fees	277	84	180
Legal fees	697	1,875	991
Consulting fees	112	186	511
Courier services	51	58	74
Other	880	774	1,107
Total	<u>\$ 2,915</u>	<u>\$ 4,312</u>	<u>\$ 3,899</u>

NOTE 21 - INCOME TAXES

Income tax expense is summarized as follows:

	Years Ended December 31,		
	2014	2013	2012
<i>(Dollars in thousands)</i>			
Currently payable:			
Federal	\$ —	\$ —	\$ —
State	78	—	—
Total current	<u>78</u>	<u>—</u>	<u>—</u>
Deferred income taxes	—	—	—
Income tax expense	<u>\$ 78</u>	<u>\$ —</u>	<u>\$ —</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21 - INCOME TAXES - *continued*

The components of the net deferred tax asset are as follows:

(Dollars in thousands)	December 31,		
	2014	2013	2012
Deferred tax assets:			
Allowance for loan losses	\$ 1,968	\$ 3,211	\$ 4,811
Net unrealized losses on securities available-for-sale	313	2,321	—
Net capitalized loan costs	23	25	33
Net operating loss	19,572	16,751	14,412
Deferred compensation	13	17	21
Nonaccruing interest	232	241	908
Tax credits	259	276	307
Other real estate owned	655	638	1,238
Loss on equity securities	1	43	43
Other	8	5	3
Total deferred tax assets	<u>23,044</u>	<u>23,528</u>	<u>21,776</u>
Valuation Allowance	(21,971)	(22,361)	(20,451)
Total net deferred tax assets	<u>1,073</u>	<u>1,167</u>	<u>1,325</u>
Deferred tax liabilities:			
Accumulated depreciation	(965)	(1,046)	(1,120)
Gain on sale of real estate	—	(73)	(73)
Prepaid expenses	(108)	(48)	(69)
Net unrealized gains on securities available-for-sale	—	—	(63)
Total deferred tax liabilities	<u>(1,073)</u>	<u>(1,167)</u>	<u>(1,325)</u>
Net deferred tax asset	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Deferred tax assets represent the future tax benefit of deductible items. The Company, under the current Internal Revenue Code, is allowed up to a two year carryback and a twenty year carryforward of these timing items. A valuation allowance is established if it is more likely than not that the tax asset will not be realized. The valuation allowance reduces the recorded deferred tax assets to the net realizable value. As of December 31, 2014, 2013 and 2012, management had established a full valuation allowance of \$22.0 million, \$22.4 million and \$20.5 million, respectively, to reflect the portion of the deferred income tax asset that was not able to be offset against net operating loss carrybacks and reversals of net future taxable temporary differences. When the Company generates future taxable income, it will be able to reevaluate the amount of the valuation allowance.

The Company has federal net operating loss carryforwards of \$56.8 million, \$48.6 million and \$41.8 million for income tax purposes as of December 31, 2014, 2013 and 2012, respectively. These net operating losses will begin to expire in the year 2030. The Company has South Carolina net operating loss carryforwards of \$7.9 million, \$6.5 million and \$6.2 million for income tax purposes as of December 31, 2014, 2013 and 2012, respectively. These net operating losses will begin to expire in the year 2019.

The Company has analyzed the tax position taken or expected to be taken on its tax returns and concluded it has no liability related to uncertain tax positions. Tax returns for 2011 and subsequent years are subject to examination by taxing authorities.

A reconciliation between the income tax expense (benefit) and the amount computed by applying the Federal statutory rates of 34% to income before income taxes follows:

(Dollars in thousands)	Years ended December 31,		
	2014	2013	2012

Tax benefit at statutory rate	\$ (73)	\$ 599	\$ (3,239)
State income tax, net of federal income tax benefit	52	—	(54)
Tax-exempt interest income	(5)	(16)	(40)
Bank owned life insurance	(113)	—	—
Life insurance proceeds	(315)	—	—
Valuation allowance	542	(473)	3,454
Other	<u>(10)</u>	<u>(110)</u>	<u>(121)</u>
Income tax expense (benefit)	<u>\$ 78</u>	<u>\$ —</u>	<u>\$ —</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 - UNUSED LINES OF CREDIT

As of December 31, 2014, the Company had no available lines of credit, however the Company may utilize its unpledged securities, if liquidity needs should arise. At December 31, 2014, investment securities with a book value of \$64.8 million and a market value of \$64.4 million were not pledged.

NOTE 23 - FAIR VALUE

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Fair value estimates are made at a specific point in time based on relevant market and other information about the financial instruments. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on current economic conditions, risk characteristics of various financial instruments, and such other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Accounting principles establish a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasuries and money market funds.
- Level 2** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities, and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

Financial Instruments

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Cash Equivalents - The carrying amount is a reasonable estimate of fair value.

Securities Available-for-Sale - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Nonmarketable Equity Securities - The carrying amount is a reasonable estimate of fair value since no ready market exists for these securities.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - continued

Loans Receivable - For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk, fair values are based on the carrying amounts. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to the borrowers with similar credit ratings and for the same remaining maturities.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Repurchase Agreements - The carrying value of these instruments is a reasonable estimate of fair value.

Advances from the Federal Home Loan Bank - For the portion of borrowings immediately callable, fair value is based on the carrying amount. The fair value of the portion maturing at a later date is estimated using a discounted cash flow calculation that applies the interest rate of the immediately callable portion to the portion maturing at the future date.

Subordinated Debentures - The Company is unable to determine the fair value of these debentures.

Junior Subordinated Debentures - The Company is unable to determine the fair value of these debentures.

Off-Balance Sheet Financial Instruments - The contractual amount is a reasonable estimate of fair value for the instruments because commitments to extend credit and standby letters of credit are issued on a short-term or floating rate basis and include no unusual credit risks.

The carrying values and estimated fair values of the Company's financial instruments were as follows:

December 31, 2014

December 31, 2014	Fair Value Measurements				
	Carrying Amount	Estimated Fair Value	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars in thousands)					
Financial Assets:					
Cash and cash equivalents	\$ 28,527	\$ 28,527	\$ 28,527	\$ —	\$ —
Securities available-for-sale	106,674	106,674	—	106,674	—
Nonmarketable equity securities	1,342	1,342	—	—	1,342
Loans, net	229,756	230,038	—	—	230,038
Financial Liabilities:					
Demand deposit, interest-bearing transaction, and savings accounts	170,538	170,538	170,538	—	—
Certificates of deposit	220,799	222,789	—	222,789	—
Repurchase agreements	1,612	1,612	—	1,612	—
Advances from the Federal Home Loan Bank	17,000	17,136	—	17,136	—
Subordinated debentures	11,062	*	—	—	—
Junior subordinated debentures	6,186	*	—	—	—
	Notional Amount	Estimated Fair Value			
Off-Balance Sheet Financial Instruments:					

Commitments to extend credit	\$ 27,017	n/a
Standby letters of credit	247	n/a

* The Company is unable to determine this value.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - *continued*

December 31, 2013

			Fair Value Measurements		
	Carrying Amount	Estimated Fair Value	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars in thousands)					
Financial Assets:					
Cash and cash equivalents	\$ 28,081	\$ 28,081	\$ 28,081	\$ —	\$ —
Securities available-for-sale	94,602	94,602	—	94,602	—
Nonmarketable equity securities	1,743	1,743	—	—	1,743
Loans, net	246,981	248,633	—	—	248,633
Financial Liabilities:					
Demand deposit, interest-bearing transaction, and savings accounts	163,505	163,505	163,505	—	—
Certificates of deposit	242,539	244,463	—	244,463	—
Repurchase agreements	1,337	1,337	—	1,337	—
Advances from the Federal Home Loan Bank	22,000	25,055	—	25,055	—
Subordinated debentures	11,062	*	—	—	—
Junior subordinated debentures	6,186	*	—	—	—
	Notional Amount	Estimated Fair Value			
Off-Balance Sheet Financial Instruments:					
Commitments to extend credit	\$ 29,836	n/a			
Standby letters of credit	361	n/a			

* The Company is unable to determine this value.

December 31, 2012

			Fair Value Measurements		
	Carrying Amount	Estimated Fair Value	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<i>(Dollars in thousands)</i>					
Financial Assets:					
Cash and cash equivalents	\$ 46,600	\$ 46,600	\$ 46,600	\$ —	\$ —
Securities available-for-sale	77,320	77,320	—	77,320	—
Nonmarketable equity securities	1,983	1,983	—	—	1,983
Loans, net	288,084	290,230	—	—	290,230
Financial Liabilities:					
Demand deposit, interest-bearing transaction, and savings accounts	168,832	168,832	168,832	—	—
Certificates of deposit	267,029	269,776	—	269,776	—

Repurchase agreements	1,303	1,303	—	1,303	—
Advances from the Federal Home Loan Bank	22,000	25,802	—	25,802	—
Subordinated debentures	12,062	*	—	—	—
Junior subordinated debentures	6,186	*	—	—	—

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - *continued*

	<u>Notional Amount</u>	<u>Estimated Fair Value</u>
Off-Balance Sheet Financial Instruments:		
Commitments to extend credit	\$ 29,473	n/a
Standby letters of credit	490	n/a

* The Company is unable to determine this value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

Securities Available-for-Sale - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans - The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. Substantially all of the impaired loans were evaluated based upon the fair value of the collateral for the years presented. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. The fair value of Impaired Loans is generally based on judgment and therefore classified as nonrecurring Level 3.

Other Real Estate Owned - Foreclosed real estate is adjusted to fair value upon transfer of the loans to foreclosed real estate. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. The fair value of foreclosed assets is generally based on judgment and therefore is classified as nonrecurring Level 3.

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - *continued*

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis by level within the fair value hierarchy.

(Dollars in thousands)

	<u>Total</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>December 31, 2014</u>				
Assets:				
Government sponsored enterprises	\$ 40,082	\$ —	\$ 40,082	\$ —
Mortgage-backed securities	65,348	—	65,348	—
Obligations of state and local governments	1,244	—	1,244	—
Total	<u>\$ 106,674</u>	<u>\$ —</u>	<u>\$ 106,674</u>	<u>\$ —</u>
<u>December 31, 2013</u>				
Assets:				
Government sponsored enterprises	\$ 55,075	\$ —	\$ 55,075	\$ —
Mortgage-backed securities	37,034	—	37,034	—
Obligations of state and local governments	2,493	—	2,493	—
Total	<u>\$ 94,602</u>	<u>\$ —</u>	<u>\$ 94,602</u>	<u>\$ —</u>
<u>December 31, 2012</u>				
Assets:				
Government sponsored enterprises	\$ 27,108	\$ —	\$ 27,108	\$ —
Mortgage-backed securities	44,462	—	44,462	—
Obligations of state and local governments	5,750	—	5,750	—
Total	<u>\$ 77,320</u>	<u>\$ —</u>	<u>\$ 77,320</u>	<u>\$ —</u>

The Company has no liabilities measured at fair value on a recurring basis.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following tables present the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy described above for which a nonrecurring change in fair value has been recorded.

(Dollars in thousands)

	<u>Total</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>December 31, 2014</u>				
Assets:				
Impaired loans, net of valuation allowance	\$ 39,476	\$ —	\$ —	\$ 39,476
Other real estate owned	19,501	—	—	19,501
Total	<u>\$ 58,977</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 58,977</u>

December 31, 2013**Assets:**

Impaired loans, net of valuation allowance	\$ 41,883	\$ —	\$ —	\$ 41,883
Other real estate owned	24,972	—	—	24,972
Total	<u>\$ 66,855</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 66,855</u>

December 31, 2012**Assets:**

Impaired loans, net of valuation allowance	\$ 56,000	\$ —	\$ —	\$ 56,000
Other real estate owned	19,464	—	—	19,464
Total	<u>\$ 75,464</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 75,464</u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - *continued*

The Company has no liabilities measured at fair value on a nonrecurring basis.

Level 3 Valuation Methodologies

The fair value of impaired loans is estimated using one of several methods, including collateral value and discounted cash flows and, in rare cases, the market value of the note. Those impaired loans not requiring an allowance represent loans for which the net present value of the expected cash flows or fair value of the collateral less costs to sell exceed the recorded investments in such loans. A majority of the total impaired loans were evaluated based on the fair value of the collateral for the years presented. When the fair value of the collateral is based on an executed sales contract with an independent third party, the Company records the impaired loans as nonrecurring Level 1. If the collateral is based on another observable market price or a current appraised value, the Company records the impaired loans as nonrecurring Level 2. When an appraised value is not available or the Company determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. Impaired loans can be evaluated for impairment using the present value of expected future cash flows discounted at the loan's effective interest rate. The measurement of impaired loans using future cash flows discounted at the loan's effective interest rate rather than the market rate of interest is not a fair value measurement and is therefore excluded from fair value disclosure requirements. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. Foreclosed real estate is carried at fair value less estimated selling costs. Fair value is generally based upon current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for selling costs. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the asset as nonrecurring Level 2. However, the Company also considers other factors or recent developments which could result in adjustments to the collateral value estimates indicated in the appraisals such as changes in absorption rates or market conditions from the time of valuation. In situations where management adjustments are significant to the fair value measurements in its entirety, such measurements are classified as Level 3 within the valuation hierarchy.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014.

(Dollars in thousands)

	<u>December 31, 2014</u>	<u>Valuation Techniques</u>	<u>Unobservable Inputs</u>	<u>Range (Weighted Avg)</u>
Impaired loans:				
Commercial	\$ 3,493	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-75.06% (14.41%)
Commercial real estate	24,138	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-84.15% (14.77%)
Residential	11,681	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/	0.00%-92.12% (49.91%)

			Independent quotes	
Consumer	164	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-35.41% (6.20%)
Other real estate owned	19,501	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-50.00% (6.27%)

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HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 - FAIR VALUE - *continued*

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013.

(Dollars in thousands)

	December 31, 2013	Valuation Techniques	Unobservable Inputs	Range (Weighted Avg)
Impaired loans:				
Commercial	\$ 3,728	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-76.50% (3.36%)
Commercial real estate	27,085	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-88.29% (16.51%)
Residential	10,865	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-90.23% (23.60%)
Consumer	205	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-38.68% (14.67%)
Other real estate owned	24,972	Appraised Value/ Discounted Cash Flows	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-50.00% (6.27%)

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012.

(Dollars in thousands)

	December 31, 2012	Valuation Techniques	Unobservable Inputs	Range (Weighted Avg)
Impaired loans:				
Commercial	\$ 4,124			

		Appraised Value/ Discounted Cash	Appraisals and/or sales of comparable properties/ Independent quotes	0.00% -100.00%
		Flows		(13.12%)
Commercial real estate	41,709	Appraised Value/ Discounted Cash	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-73.91%
		Flows		(19.22%)
Residential	9,943	Appraised Value/ Discounted Cash	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-89.26%
		Flows		(20.80%)
Consumer	224	Appraised Value/ Discounted Cash	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-25.11%
		Flows		(7.38%)
Other real estate owned	19,464	Appraised Value/ Discounted Cash	Appraisals and/or sales of comparable properties/ Independent quotes	0.00%-50.00%
		Flows		(6.27%)

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 24 - HCSB FINANCIAL CORPORATION (PARENT COMPANY ONLY)

Presented below are the condensed financial statements for HCSB Financial Corporation (Parent Company Only).

Condensed Balance Sheets

<i>(Dollars in thousands)</i>	December 31,		
	2014	2013	2012
Assets			
Cash	\$ 26	\$ 59	\$ 86
Investment in banking subsidiary	10,066	3,516	7,890
Investment in trust	186	186	186
Other assets	123	136	149
Total assets	<u><u>\$ 10,401</u></u>	<u><u>\$ 3,897</u></u>	<u><u>\$ 8,311</u></u>
Liabilities and shareholders' equity			
Accrued interest payable-subordinated debentures	\$ 3,685	\$ 2,553	\$ 1,472
Accrued interest payable-junior subordinated debentures	714	536	351
Subordinated debentures	11,062	11,062	12,062
Junior subordinated debentures	6,186	6,186	6,186
Other liabilities	1	2	2
Total liabilities	<u>21,648</u>	<u>20,339</u>	<u>20,073</u>
Shareholders' deficit	<u>(11,247)</u>	<u>(16,442)</u>	<u>(11,762)</u>
Total liabilities and shareholder's deficit	<u><u>\$ 10,401</u></u>	<u><u>\$ 3,897</u></u>	<u><u>\$ 8,311</u></u>

Condensed Statements of Operations

<i>(Dollars in thousands)</i>	Years ended December 31,		
	2014	2013	2012
Income			
Forgiveness of debt	<u>\$ —</u>	<u>\$ 1,000</u>	<u>\$ —</u>
Expenses			
Interest expense on subordinated debentures	1,132	1,081	1,213
Interest expense on junior subordinated debentures	178	186	177
Other expenses	104	39	237
	<u>1,414</u>	<u>1,306</u>	<u>1,627</u>
Loss before income taxes, and equity in undistributed gains (losses) of banking subsidiary	<u>(1,414)</u>	<u>(306)</u>	<u>(1,627)</u>
Income tax expense	—	—	—
Equity in undistributed gains (losses) of banking subsidiary	<u>1,123</u>	<u>2,069</u>	<u>(7,900)</u>
Net income (loss)	<u><u>\$ (291)</u></u>	<u><u>\$ 1,763</u></u>	<u><u>\$ (9,527)</u></u>

HCSB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 24 - HCSB FINANCIAL CORPORATION (PARENT COMPANY ONLY)- continued**Condensed Statements of Cash Flows**

<i>(Dollars in thousands)</i>	Years ended December 31,		
	2014	2013	2012
Cash flows from operating activities:			
Net income (loss)	\$ (291)	\$ 1,763	\$ (9,527)
Adjustments to reconcile net income (loss) to net cash used by operating activities:			
Forgiveness of debt	—	(1,000)	—
Equity in undistributed (gains) losses of banking subsidiary	(1,123)	(2,069)	7,900
Decrease in other assets	13	13	236
Increase in accrued interest payable	1,310	1,266	1,386
Net cash used by operating activities	<u>(91)</u>	<u>(27)</u>	<u>(5)</u>
Cash flows from financing activities:			
Sale of common stock	58	—	—
Net cash provided by financing activities	<u>58</u>	<u>—</u>	<u>—</u>
Net decrease in cash	(33)	(27)	(5)
Cash and cash equivalents, beginning of year	59	86	91
Cash and cash equivalents, end of year	<u>\$ 26</u>	<u>\$ 59</u>	<u>\$ 86</u>

NOTE 25 – SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued, and the following subsequent event occurred requiring accruals or disclosures that are not otherwise disclosed herein.

On March 24, 2015, the Bank entered into a definitive agreement with Sandhills Bank, North Myrtle Beach, South Carolina, to sell its Socastee, Windy Hill, and Carolina Forest branches with total deposits of approximately \$45.5 million and approximately \$8 million in loans. The deposit premium will be approximately 2.5% of deposits acquired. The transaction, which is subject to regulatory approval and other customary conditions, is expected to close in third quarter of 2015.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.**Evaluation of Disclosure Controls and Procedures**

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2014 based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of this assessment, management concluded that, as of December 31, 2014, our internal control was effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Remediation of Prior Year Material Weakness

The material weakness that was previously disclosed as of December 31, 2013 was remediated as of December 31, 2014. See "Item 9A. Controls and Procedures – Management's Report on Internal Control over Financial Reporting" and "Item 9A. Controls and Procedures – Management's Remediation Initiatives" contained in the Company's report on Form 10-K for the fiscal year ended December 31, 2013 for disclosure of information about the material weakness that was reported as a result of the Company's annual assessment as of December 31, 2013 and remediation plans for that material weakness. The Company has implemented and executed the remediation plans, and as of December 31, 2014, such remediation plans were successful and the internal weakness was deemed remediated.

Changes in Internal Controls

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2014 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Item 9B. Other Information.

On March 24, 2015, the Bank entered into a definitive agreement with Sandhills Bank, North Myrtle Beach, South Carolina, to sell its Socastee, Windy Hill, and Carolina Forest branches with total deposits of approximately \$45.5 million and approximately \$8 million in loans. The deposit premium will be approximately 2.5% of deposits acquired. The transaction, which is subject to regulatory approval and other customary conditions, is expected to close in third quarter of 2015. A copy of the Purchase and Assumption Agreement is attached hereto as Exhibit 10.10.

PART III**Item 10. Directors, Executive Officers and Corporate Governance*****Directors***

The following provides information regarding each of our directors, including their business experience for at least the past five years, the names of other publicly-held companies where they currently serve as a director or served as a director during the past five years, and additional information about the specific experience, qualifications, attributes, or skills that led to the Board's conclusion that such person should serve as a director for the Company. Each of the following directors is also a director of our Bank:

James R. Clarkson, 63, has served as President, Chief Executive Officer and director of the Company since its formation in 1999 and of the Bank since 1987. He received his B.A. degree in Economics from Clemson University in 1973. He is a 1985 graduate of the Graduate School of Banking at Louisiana State University, where he presently serves on the faculty. Mr. Clarkson is also an instructor and a course coordinator for the South Carolina Bankers School and past chairman of the school. He presently serves as a director of Horry Telephone Cooperative, Inc., and Trustee of the South Carolina Bankers Employee Benefit Trust. Mr. Clarkson's intimate understanding of the Company's business and organization, substantial leadership ability, banking industry expertise, knowledge of financial reporting requirements of public companies, and business and personal ties to the Bank's market areas enhance his ability to contribute as a director.

Michael S. Addy, 63, has been President of Addy's Harbor Dodge, Inc. and MSA, Inc. in Myrtle Beach, S.C., since 1990, and is Managing Member of Addy's Limited Liability Company. Mr. Addy received his B.S. degree in Business Administration from the University of South Carolina in 1973. He is a member of the Myrtle Beach Sertoma Club. Mr. Addy has served as a director of the Company and of the Bank since 2006. His leadership experience and business and personal ties to the Bank's Myrtle Beach market area enhance his ability to contribute as a director. Mr. Addy currently serves as Chairman of the board of directors of both the Company and the Bank.

Johnny C. Allen, 68, has served as a director of the Company and of the Bank since 2002. Mr. Allen served as the Horry County Treasurer from 1983 until his retirement in 2005. He attended the University of South Carolina. Mr. Allen's political experience and knowledge of the local real estate market provides him with political insights and a useful appreciation of markets that we serve.

D. Singleton Bailey, 64, has served as a director of the Company since its formation in 1999 and of the Bank since 1987. Mr. Bailey has been the President of Loris Drug Store, Inc., located in Loris, S.C. since 1988. He received a B.A. degree in sociology from Wofford College in 1972. Mr. Bailey now serves as the Vice Chairman and Secretary of the board of directors of the Company and the Bank. Mr. Bailey's business and personal experience in certain of the communities that the Bank serves provides him with a useful appreciation of markets that we serve.

Clay D. Brittain, III, 60, has served as a director of the Company and of the Bank since 2002. Mr. Brittain received his B.A. degree in Economics from Wofford College in 1977 and received his Juris Doctorate from the University of South Carolina Law School in 1980. He is an attorney in the firm of Thomas & Brittain, PA in Myrtle Beach, S.C. Mr. Brittain served as a director of United Carolina Bank of South Carolina until April 1997. Through his legal and business experience, Mr. Brittain has an extensive background in the South Carolina real estate market, including local real estate markets that we serve. Mr. Brittain's institutional knowledge of the Company's business, as well as his own business and personal experience in certain of the communities that the Bank serves, provides him with a useful appreciation of markets that we serve. Mr. Brittain's legal training and experience enhance his ability to understand the Company's regulatory framework.

Tommie W. Grainger, 76, has served as a director of the Company since its formation in 1999 and of the Bank since 1998. He graduated from the Forest Ranger School of the University of Florida in 1959 with an associates degree in Forestry. Mr. Grainger retired from Coastal Timber Co., Inc. in Conway, S.C. in 2014 where he had served as president since 1966. Mr. Grainger's business experience and personal ties to certain of the Bank's market area enhance his ability to contribute as a director.

Gwyn G. McCutchen, D.D.S., 71, has served as a director of the Company since its formation in 1999 and of the Bank since 1987. Dr. McCutchen received his B.S. degree in Biology in 1966 from Presbyterian College and his D.D.S. from the Medical College of Virginia Dentistry in 1970. Dr. McCutchen has been a dentist in Loris, S.C. since 1970. Dr. McCutchen's business and personal experience in certain of the communities that the Bank serves provides him with a useful appreciation of the markets that we serve.

T. Freddie Moore, 74, has served as a director of the Company since its formation in 1999 and of the Bank since 1987. Mr. Moore retired from Gateway Drug Store, Inc., in Loris, S.C. in 2007. He received his B.S. degree in Pre-Medicine from The Citadel in 1963 and a B.S. degree in Pharmacy in 1966 from the Medical University of South Carolina. Mr. Moore's business experience and personal ties to certain of the Bank's market areas enhance his ability to contribute as a director. On February 26, 2015, Mr. Moore notified the Company of his decision not to stand for reelection at the 2015 Annual Shareholders Meeting and to resign from his position as a director to each of the Company and the Bank effective as of the Annual Shareholders Meeting. Mr. Moore's decision to resign from the Board of Directors was for personal reasons and did not arise or result from any disagreement with the Company on any matters relating to the Company's operations, policies or practices. The Company is grateful for his years of dedicated service.

Executive Officers

Other than Mr. Clarkson, whose information appears above in the list of directors, the following provides information regarding our executive officers:

Glenn R. Bullard, 66, is the Senior Executive Vice President of the Company and of the Bank. He served as Vice President and Manager of our Little River office from February 1997 through December 1999. Mr. Bullard received his B.S. degree in Business Administration from the University of South Carolina in 1977. Mr. Bullard has served as an executive officer of the Company and of the Bank since 2000. Mr. Bullard has an intimate understanding of the Company's business and organization, as well as substantial leadership ability, banking industry expertise, and management experience.

Edward L. Loehr, Jr., 61, is the Senior Vice President and Chief Financial Officer of the Company and of the Bank and has served as an executive officer of the Company and of the Bank since 2008. He has over 30 years of experience in the banking industry. He was employed with Coastal Federal Bank in Myrtle Beach, South Carolina from 1983 to 2007 where he most recently served as Vice President and Treasury Manager. Mr. Loehr received his B.S. degree in Business Administration in 1983 from the University of South Carolina at Coastal Carolina. He presently serves as a board member of the North Myrtle Beach Area Historical Museum and the North Myrtle Beach Lions Club. Mr. Loehr also currently serves on the Asset/Liability Management Committee of the South Carolina Bankers Association.

Ron L. Paige, 59, is the Executive Vice President – Myrtle Beach Region of the Bank and has served as an executive officer of the Bank since 2008. He has over 38 years of experience in the banking industry. He began his banking career in 1976 with Southern National Bank in Southern Pines, North Carolina and eventually served as Senior Vice President and City Executive Officer in Myrtle Beach, South Carolina. Mr. Paige most recently served as Regional Executive Officer of RBC Centura in Myrtle Beach, South Carolina. He has been in banking in Myrtle Beach, South Carolina since 1991. Mr. Paige is a 1976 graduate of Central Piedmont Community College and a 1981 graduate of the North Carolina Bankers School.

Family Relationships

There are no family relationships among the members of our board of directors or our executive officers.

Audit Committee

The Board of Directors of the Company has appointed an Audit Committee. The Audit Committee has the responsibility of reviewing the Company's financial statements, evaluating internal accounting controls, reviewing reports of regulatory agencies and the Bank's internal auditor and determining that all audits and examinations required by law are performed. The Audit Committee reports its finding to the Board of Directors. The Audit Committee also recommends to the Board of Directors the appointment of the independent accounting firm. The current members of the Audit Committee are D. Singleton Bailey, Tommie W. Grainger, Gwyn G. McCutchen, D.D.S. and T. Freddie Moore.

None of the current members of the Audit Committee nor any other member of our Board qualifies as an “Audit Committee Financial Expert” as defined under the rules of the SEC. As a relatively small public company, it is difficult to identify potential qualified candidates that are willing to serve on our Board and otherwise meet our requirements for service. At present, we do not know if or when we will appoint a new Board member who qualifies as an Audit Committee Financial Expert.

Although none of the members of our Audit Committee qualify as “financial experts” as defined in the SEC rules, each of our Audit Committee members has made valuable contributions to the Company and its shareholders as members of the Audit Committee. The Board has determined that each member is independent under SEC rules and fully qualified to monitor the performance of management, the public disclosures by the Company of its financial condition and performance, our internal accounting operations, and our independent auditors.

Code of Ethics

We expect all of our employees to conduct themselves honestly and ethically, particularly in handling actual and apparent conflicts of interest and providing full, accurate, and timely disclosure to the public.

We have adopted a Code of Business Conduct and Ethics that is specifically applicable to our senior management and financial officers, including our principal executive officer, our principal financial officer, and our principal accounting officer and controllers. Our Code of Business Conduct Ethics is available for review on the Bank’s website at www.hcsbaccess.com under the “Investor Relations” tab.

Section 16(a) Beneficial Ownership Reporting Compliance

As required by Section 16(a) of the Exchange Act, the Company’s directors, its executive officers, and certain individuals are required to report periodically their ownership of the Company’s common stock and any changes in ownership to the SEC. Based on review of Forms 3, 4, and 5 and any representations made to the Company, the Company believes that all such reports for these persons were filed in a timely fashion during 2014.

Item 11. Executive Compensation.

Summary of Cash and Certain Other Compensation

The following table shows the compensation we paid for the years ended December 31, 2014 and 2013 to our Chief Executive Officer and the two other most highly compensated executive officers that earned over \$100,000 for the years ended 2014 and 2013 (collectively, the “named executive officers”).

Summary Compensation Table

Names and Principal Positions	Year	Salary	Bonus	Stock/ Option Awards⁽¹⁾	Non-Equity Incentive Plan Compensation	All Other Compensation ⁽²⁾	Total
James R. Clarkson President and Chief Executive Officer of the Company and the Bank	2014	\$ 211,375	\$ —	\$ —	\$ —	\$7,140	\$ 218,515
	2013	\$ 211,375	\$ —	\$ —	\$ —	\$6,859	\$ 218,234
Glenn R. Bullard Senior Executive Vice President of the Company and the Bank	2014	\$ 158,072	\$ —	\$ —	\$ —	\$1,326	\$ 159,398
	2013	\$ 158,072	\$ —	\$ —	\$ —	\$1,326	\$ 159,398
Ron L. Paige, Sr. Executive Vice President Myrtle Beach Region	2014	\$ 154,128	\$ —	\$ —	\$ —	\$6,831	\$ 160,959
	2013	\$ 154,128	\$ —	\$ —	\$ —	\$6,549	\$ 160,677

- (1) In 2004, with shareholder approval, we adopted the Stock Plan. Stock options and restricted stock awards have been granted under the Stock Plan to our named executive officers from time to time to reward performance and promote our long-term success. However, there were no stock options or restricted stock awards granted in 2014 or 2013, and each named executive

officer voluntarily forfeited all of his stock options and restricted stock awards in February 2011 as a means to help us reduce expenses.

- (2) All other compensation includes premiums paid by the Bank for life, long-term disability, health and dental insurance.

Compensation Arrangements

Employment Agreements

Neither the Company nor the Bank has entered into any employment agreements with any of our officers or employees.

Outstanding Equity Awards at Fiscal Year-End

In February 2011, each named executive officer and all other executive officers of the Bank voluntarily forfeited all of their stock options and restricted stock awards as a means to help us reduce expenses. Thus, there were no outstanding equity awards as of fiscal year-end 2011 and no stock options or restricted stock awards have been granted since that time.

Salary Continuation Agreements

In April 2008, the Bank entered into salary continuation agreements with Glenn R. Bullard, James R. Clarkson and Ronald L. Paige pursuant to which these executives were entitled to receive certain post-termination, retirement, disability, and death benefits. However, effective as of December 31, 2010, each of the executives voluntarily terminated his salary continuation agreement and thereby forfeited and cancelled any and all benefits under the executive's accrual balance, including any and all future benefits under the executive's accrual balance, as a means to help the Bank reduce expenses. The executives were not paid or promised anything of value in exchange for their decision to terminate the salary continuation agreements. In addition, each additional Bank employee who had also entered into a similar salary continuation agreement in April 2008 voluntarily terminated his or her salary continuation agreement effective as of December 31, 2010.

TARP Executive Compensation Restrictions

In March 2009, as part of the Treasury's CPP, the Company entered into a Letter Agreement (the "CPP Purchase Agreement") with the Treasury pursuant to which the Company issued and sold to Treasury (i) 12,895 shares of the Company's Series T Preferred Stock, and (ii) the CPP Warrant, for an aggregate purchase price of \$12,895,000 in cash.

Under the terms of the CPP Purchase Agreement, we adopted certain standards for executive compensation and corporate governance for the period during which the Treasury holds the equity we issued or may issue to the Treasury, including the common stock we may issue under the CPP Warrant. These standards apply to our named executive officers. The standards include (i) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (ii) required clawback of any bonus or incentive compensation paid to a senior executive and the next 20 most highly compensated employees based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) prohibition on making golden parachute payments to senior executives and the next five most highly compensated employees; (iv) prohibition on providing any tax gross-up provisions; and (v) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

In connection with entry into the CPP Purchase Agreement, Messrs. Clarkson and Bullard entered into letter agreements with the Company (the "Letter Amendments") amending any benefit plans as necessary to comply with Section 111 of the Emergency Economic Stabilization Act of 2008, as amended by the Recovery Act, during the period that the Treasury owns any debt or equity securities of the Company.

As our most highly compensated employee, Mr. Clarkson will be ineligible for any bonuses or incentive awards other than restricted stock as long as the equity issued under the CPP is held by the Treasury and he remains our most highly compensated employee. Any restricted stock awards made to Mr. Clarkson while the Treasury holds our equity would be subject to the following limitations: (i) the restricted stock cannot become fully vested until the Treasury no longer holds the preferred stock, and (ii) the value of the restricted stock award cannot exceed one third of Mr. Clarkson's total annual compensation.

Director Compensation

Effective October 1, 2011, the Board of Directors suspended further payments of all director fees and fees for committee meetings in order to help the Bank reduce expenses. As a result, no fees were paid to the directors in 2014.

Deferred Compensation Plan

In February 1997, the Bank established a Deferred Compensation Plan for its directors including Mr. Clarkson to defer payment of all or a portion of his director and committee fees until the director's termination of service from the Board of Directors. As of December 31, 2012, all active director participants had relinquished the right to their deferred director fees, which resulted in an aggregate reduction of accrued expenses of approximately \$857 thousand.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table sets forth information known to the Company with respect to beneficial ownership of the Company's common stock as of March 27, 2015 for (i) each director and nominee, (ii) each holder of 5% or greater of the Company's common stock, (iii) the Company's named executive officers, and (iv) all executive officers and directors as a group. Unless otherwise indicated, the mailing address for each beneficial owner is: care of HCSB Financial Corporation, P.O. Box 218, Loris, South Carolina, 29569. Beneficial ownership is determined under the rules of the SEC and generally includes voting or investment power with respect to securities.

Name	Number of Shares Owned⁽¹⁾	Right to Acquire	Percentage of Beneficial Ownership⁽²⁾
Michael S. Addy	13,727	—	*
Johnny C. Allen	12,463	—	*
D. Singleton Bailey	54,504	—	1.43%
Clay D. Brittain, III	14,326	—	*
Glenn R. Bullard	7,707	—	*
James R. Clarkson	34,753	—	*
Tommie W. Grainger	9,067	—	*
Gwyn G. McCutchen, D.D.S.	41,626	—	1.09%
T. Freddie Moore	27,608	—	*
Executive officers and directors as a group (9 persons)	215,781	—	5.66%

* Less than 1%

(1) Includes shares for which the named person has sole voting and investment power, has shared voting and investment power with a spouse or holder in an IRA or other retirement plan program.

(2) The calculations are based on 3,816,340 shares of common stock outstanding on March 1, 2015.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The Company's Code of Business Conduct and Ethics provides that personal interests of directors, officers and employees of the Company must not interfere with, or appear to interfere with, the interests of the Company. Directors, officers and employees of the Company may not compete with the Company or disadvantage the Company by taking for personal gain corporate opportunities or engage in any action that creates actual or apparent conflicts of interest with the Company. Any director or officer involved in a transaction with the Company or that has an interest or a relationship that reasonably could be expected to give rise to a conflict of interest must report the matter promptly to the Board of Directors, which is responsible for determining if the particular situation is acceptable.

The Company has had, and expects to have in the future, transactions in the ordinary course of the Company's business with its directors, executive officers, principal shareholders and their related interests (collectively referred to as "related parties"). All such transactions between the Company and related parties are made in the ordinary course of the Company's business, on substantially the same terms, including (in the case of loans) interest rates, collateral, and repayment terms, as those prevailing at the same time for other comparable transactions with persons not related to the lender, and have not involved more than normal risks of collectibility or presented other unfavorable features.

The Company does not have a written policy regarding the review, approval or ratification of transactions with related parties, but reviews, approves, ratifies and discloses transactions with related parties consistent with SEC rules and regulations. As transactions are reported, the Board of Directors considers any related party transactions on a case-by-case basis to determine whether the transaction or arrangement was undertaken in the ordinary course of business and whether the terms of the transaction are no less favorable to the Company than terms that could have been reached with an unrelated party. If any member of the Board of Directors is interested in the transaction, that member will recuse himself from the discussion and decision on the transaction.

In addition, the Bank is subject to the provisions of Section 23A of the Federal Reserve Act, which places limits on the amount of loans or extensions of credit to, or investments in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The Bank is also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The aggregate dollar amount of loans outstanding to directors and executive officers of the Bank was approximately \$3.9 million at March 1, 2015.

Independence

Our Board of Directors has determined that Michael S. Addy, Johnny C. Allen, D. Singleton Bailey, Clay D. Brittain, III, Tommie W. Grainger, Gwyn G. McCutchen, D.D.S. and T. Freddie Moore are “independent” directors, based upon the independence criteria set forth in the corporate governance listing standards of The NASDAQ Stock Market, the exchange that we selected in order to determine whether our directors and committee members meet the independence criteria of a national securities exchange, as required by Item 407(a) of Regulation S-K.

Item 14. Principal Accountant Fees and Services.

The following table shows the fees that we paid for services performed in fiscal years ended December 31, 2014 and 2013:

	Year Ended December 31, 2014	Year Ended December 31, 2013
Audit Fees	\$ 107,000	\$ 98,000
Audit-Related Fees	38,200	23,000
Tax Fees	11,550	7,750
Total	<u>\$ 156,750</u>	<u>\$ 128,750</u>

Audit Fees. This category includes the aggregate fees billed for each of the last two fiscal years for professional services rendered by Elliott Davis Decosimo, LLC for the audit of our annual financial statements and for reviews of the condensed financial statements included in our quarterly reports on Form 10-Q.

Audit-Related Fees. This category includes the aggregate fees billed for non-audit services, exclusive of the fees disclosed relating to audit fees, rendered by Elliott Davis Decosimo, LLC during the fiscal years ended December 31, 2014 and 2013. These services principally included the audit of the Company’s Trusteed Retirement Savings Plan (401k) and the Health and Welfare Plan, discussions related to possible capital and merger opportunities, a review of the settlement of litigation and the Company’s corresponding obligation to downstream funds to the Bank, and a review of management’s analysis of the deferred tax asset.

Tax Fees. This category includes the aggregate fees billed for tax services rendered by Elliott Davis Decosimo, LLC during the fiscal years ended December 31, 2014 and 2013. These services include preparation of state and federal tax returns for the Company and its subsidiary and review of deferred taxes for GAAP and call reporting.

Oversight of Accountants; Approval of Accountant Fees. Under the provisions of its charter, the Audit Committee is responsible for the retention, compensation, and oversight of the work of the independent auditors. The charter provides that the Audit Committee must pre-approve the fees paid for the audit. The Audit Committee has delegated approval of non-audit services and fees to the chairman of the Audit Committee for presentation to the full Audit Committee at the next scheduled meeting. The policy specifically prohibits certain non-audit services that are prohibited by securities laws from being provided by an independent auditor. All of the accounting services and fees reflected in the table above were reviewed and approved by the Audit Committee, and none of the services were performed by individuals who were not employees of the independent auditor.

PART IV**Item 15. Exhibits**

(a) 1. Financial Statements

The following consolidated financial statements are included in Item 8 of this report:

Audited Financial Statements as of and for the years ended December 31, 2014, 2013 and 2012:

- Report of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets as of December 31, 2014, 2013 and 2012
- Consolidated Statements of Operations for the years ended December 31, 2014, 2013 and 2012
- Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2014, 2013 and 2012
- Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012
- Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012
- Notes to Consolidated Financial Statements

2. Financial Statement Schedules

These schedules have been omitted because they are not required, are not applicable or have been included in our consolidated financial statements.

3. The exhibits required to be filed as part of this Annual Report on Form 10-K are listed in the Exhibit Index attached hereto and are incorporated herein by reference.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HCSB FINANCIAL CORPORATION

Date: March 30, 2015

By: /s/ James R. Clarkson
James R. Clarkson, President
and Chief Executive Officer

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James R. Clarkson his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

By: /s/ Michael S. Addy
Michael S. Addy, Director

Date: March 30, 2015

By: /s/ Johnny C. Allen
Johnny C. Allen, Director

Date: March 30, 2015

By: /s/ Clay D. Brittain, III
Clay D. Brittain, III, Director

Date: March 30, 2015

By: /s/ D. Singleton Bailey
D. Singleton Bailey, Director

Date: March 30, 2015

By: /s/ James R. Clarkson
James R. Clarkson, Director,
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 30, 2015

By: /s/ Tommie W. Grainger
Tommie W. Grainger, Director

Date: March 30, 2015

By: /s/ Edward L. Loehr, Jr.
Edward L. Loehr, Jr.,
Chief Financial Officer
(Principal Financial and Accounting
Officer)

Date: March 30, 2015

By: /s/ Gwyn G. McCutchen
Gwyn G. McCutchen, Director

Date: March 30, 2015

By: /s/ T. Freddie Moore
T. Freddie Moore, Director

Date: March 30, 2015

EXHIBIT INDEX

- 3.1 Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-KSB for the fiscal year ended December 31, 1999).
 - 3.2 Amended and Restated Bylaws of HCSB Financial Corporation dated December 30, 2010 (incorporated by reference to Exhibit 3.2 to the Company's Form 10-K filed March 23, 2012).
 - 3.3 Articles of Amendment to Authorize Preferred Shares, filed March 2, 2009 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed March 6, 2009).
 - 3.4 Articles of Amendment to the Company's Restated Articles of Incorporation establishing the terms of the Series T Preferred Stock (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed March 10, 2009).
 - 4.1 Warrant to Purchase up to 91,714 shares of Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed March 10, 2009).
 - 4.2 Form of Series T Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Company's Form 8-K filed March 10, 2009).
 - 10.1 Form of Director Deferred Compensation Agreement adopted in 1997 by and between the Board of Directors and Horry County State Bank (incorporated by reference to Exhibit 10.4 to the Company's Form 10-KSB for the fiscal year ended December 31, 2006).*
 - 10.2 Letter Agreement, dated March 6, 2009, including Securities Purchase Agreement – Standard Terms incorporated by reference therein, between the Company and the United States Department of the Treasury (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed March 10, 2009).*
 - 10.3 ARRA Side Letter Agreement, dated March 6, 2009, between the Company and the United States Department of the Treasury (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed March 10, 2009).*
 - 10.4 Form of Waiver, executed by each of Messrs. James R. Clarkson, Edward L. Loehr, Jr., and Glenn R. Bullard (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed March 10, 2009).*
 - 10.5 Form of Letter Amendment, executed by each of Messrs. James R. Clarkson, Edward L. Loehr, Jr., and Glenn R. Bullard with the Company (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K filed March 10, 2009).*
 - 10.6 Subordinated Note Purchase Agreement, dated March 29, 2010 (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed April 23, 2010).
 - 10.7 Form of HCSB Financial Corporation Subordinated Note Due 2020 (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K filed April 23, 2010).
 - 10.8 Consent Order, effective February 10, 2011, between the FDIC, the South Carolina State Board of Financial Institutions, and Horry County State Bank (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed February 16, 2011).
 - 10.9 Written Agreement, effective May 9, 2011, with the Federal Reserve Bank of Richmond (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q filed May 12, 2011).
 - 10.10 Purchase and Assumption Agreement dated as of March 24, 2015 between Horry County State Bank and Sandhills Bank
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- 21 Subsidiaries of Registrant.
- 24 Power of Attorney (contained on signature pages).
- 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer.
- 32 Section 1350 Certifications.
- 99.1 Certification of the Chief Executive Officer Pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008.
- 99.2 Certification of the Chief Financial Officer Pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008.
- 101 The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2014, formatted in XBRL; (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Changes in Shareholders' Equity (iv) Consolidated Statements of Comprehensive Income (Loss), (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.

*Management contract of compensatory plan or arrangement required to be filed as an Exhibit to this Annual Report on Form 10-K.
