Coastal Banking Company, Inc.

Quarterly Financial Results (Unaudited)

As of June 30, 2014

Coastal Banking Company
Consolidated Balance Sheets

		June 30, 2014		December 31, 2013
		(unaudited)		(audited)
Assets				
Cash and due from banks	$	3,349,443	$	5,920,153
Interest-bearing deposits in banks		3,643,154		786,483
Federal funds sold		87,048		60,356
Securities available for sale, at fair value		31,457,967		38,754,470
Restricted equity securities, at cost		6,013,186		3,504,050
Loans held for sale, at fair value		47,605,807		32,283,708
Loans, net of unearned income		258,022,380		244,543,025
Less allowance for loan losses		4,667,898		4,273,099
Loans, net		253,354,482		240,269,926
Premises and equipment, net		7,383,206		7,538,177
Cash surrender value of life insurance		2,360,460		2,286,590
SBA loan servicing rights		1,610,322		1,432,976
Other real estate owned		11,649,780		11,544,720
Loan sales receivable		66,633,868		24,621,985
Other assets		7,443,322		6,636,515
Total assets	$	442,592,045	$	375,640,109
Liabilities and Shareholders' Equity				
Deposits:				
Noninterest-bearing	$	35,158,978	$	33,961,565
Interest-bearing		257,101,135		258,029,192
Total deposits		292,260,113		291,990,757
Securities sold under agreements to repurchase		—		—
Other borrowings		99,200,000		36,350,000
Junior subordinated debentures		7,217,000		7,217,000
Mortgage banking indemnification reserve		2,375,114		2,455,350
Other liabilities		5,088,293		2,718,114
Total liabilities		406,140,520		340,731,221
Commitments and contingencies				
Shareholders' Equity:				
Preferred stock, par value $.01; 10,000,000 shares authorized; 9,950 shares issued and outstanding at June 30, 2014 and December 31, 2013		9,950,000		9,950,000
Common stock, par value $.01; 10,000,000 shares authorized; 2,633,734 shares issued and outstanding at June 30, 2014; 2,618,275 shares issued and outstanding at December 31, 2013		26,337		26,183
Additional paid-in capital		41,328,435		41,207,631
Accumulated deficit		(15,223,609)		(16,156,346)
Accumulated other comprehensive income		370,362		(118,580)
Total shareholders' equity		36,451,525		34,908,888
Total liabilities and shareholders' equity	$	442,592,045	$	375,640,109

See accompanying notes to unaudited consolidated financial statements.

Coastal Banking Company
Consolidated Statements of Income
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest income:				
Interest and fees on loans	$ 4,118,308	$ 3,637,694	$ 7,762,094	$ 8,025,905
Interest on taxable securities	167,101	128,117	420,779	281,036
Interest on nontaxable securities	67,575	15,676	135,175	30,742
Interest on deposits in other banks	1,694	23,330	3,538	24,839
Interest on federal funds sold	44	31	74	78
Total interest income	4,354,722	3,804,848	8,321,660	8,362,600
Interest expense:				
Interest on deposits	463,720	655,859	917,798	1,335,792
Interest on junior subordinated debentures	42,603	49,454	84,742	105,216
Interest on other borrowings	149,806	174,484	270,031	365,191
Total interest expense	656,129	879,797	1,272,571	1,806,199
Net interest income	3,698,593	2,925,051	7,049,089	6,556,401
Provision for loan losses	473,202	56,719	728,790	87,828
Net interest income after provision for loan losses	3,225,391	2,868,332	6,320,299	6,468,573
Non-interest income:				
Service charges on deposit accounts	65,478	72,949	126,660	147,053
Other service charges, commissions and fees	112,231	93,182	211,906	173,010
SBA loan income	1,057,397	1,058,967	1,969,455	2,508,656
Mortgage banking income	7,801,948	7,194,241	12,282,178	15,699,502
Gain on sale of securities available for sale	40,790	—	40,790	815
Income from investment in life insurance contracts	18,750	18,632	39,112	38,903
Other income	15,810	14,354	35,420	42,442
Total other income	9,112,404	8,452,325	14,705,521	18,610,381
Non-interest expenses:				
Salaries and employee benefits	7,828,405	6,732,477	13,354,866	14,235,710
Occupancy and equipment expense	619,808	635,655	1,285,419	1,283,500
Mortgage loan expense	603,881	525,708	1,097,765	1,090,850
Data processing fees	384,868	471,516	823,758	912,450
Other real estate expenses	152,065	840,453	498,278	1,733,732
Legal and other professional fees	304,380	207,782	475,889	476,326
Advertising fees	110,928	532,396	197,848	1,162,601
Audit fees	77,364	99,575	176,540	217,910
FDIC insurance expense	90,321	145,385	168,973	297,998
Director fees	60,100	48,775	129,000	73,875
OCC examination fees	28,844	49,084	55,627	98,168
Amortization of intangible assets	—	1,698	—	3,396
Other operating	415,228	535,864	806,987	1,281,776
Total other expenses	10,676,192	10,826,368	19,070,950	22,868,292
Income before income tax (benefits)	1,661,603	494,289	1,954,870	2,210,662
Income tax expense (benefits)	538,465	(1,475,203)	631,022	(864,153)
Net income	$ 1,123,138	$ 1,969,492	$ 1,323,848	$ 3,074,815
Preferred stock dividends	223,875	152,547	391,111	296,146
Net earnings available to common shareholders	$ 899,263	$ 1,816,945	$ 932,737	$ 2,778,669
Basic earnings per common share	$ 0.34	$ 0.70	$ 0.36	$ 1.07
Diluted earnings per common share	$ 0.34	$ 0.69	$ 0.35	$ 1.06

See accompanying notes to unaudited consolidated financial statements.

Coastal Banking Company
Consolidated Statements of Comprehensive Income
For the Six Months Ended June 30, 2014 and 2013
(Unaudited)

	2014	2013
Net income	$ 1,323,848	$ 3,074,815
Other comprehensive income (loss), net of tax:		
Net unrealized holding gains (losses) arising during period, net of tax (benefit) of $265,749 and ($131,778)	515,863	(255,805)
Reclassification adjustment for gains included in net income, net of tax of $13,869 and $277	(26,921)	(538)
Total other comprehensive income (loss)	488,942	(256,343)
Comprehensive income	$ 1,812,790	$ 2,818,472

See accompanying notes to unaudited consolidated financial statements.

Coastal Banking Company
Consolidated Statements of Cash Flows
For the Six Months Ended June 30, 2014 and 2013
(Unaudited)

	2014	2013
Cash flows from operating activities:		
Net income	$ 1,323,848	$ 3,074,815
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	393,917	332,803
Amortization of intangible assets	—	3,396
Stock-based compensation expense	42,072	52,290
Provision for loan losses	728,790	87,828
Gain on sale of securities available for sale	(40,790)	(815)
Gain on sale of premises and equipment	(9,522)	—
Net (increase) decrease in loan sales receivable	(42,011,922)	69,409,415
Write downs and losses on sale of other real estate owned	337,217	1,425,626
Proceeds from sales of other real estate owned	981,042	3,863,327
Increase in cash value of life insurance	(73,870)	(38,903)
Originations of mortgage loans held for sale	(601,534,299)	(850,854,469)
Proceeds from sales of mortgage loans held for sale	596,903,468	888,071,668
Net increase in interest receivable	(14,842)	(44,461)
Net decrease in interest payable	(4,864)	(216,107)
SBA loan income	(1,969,455)	(2,508,656)
Mortgage banking income	(12.282.178)	(15,699,502)
Net other operating activities	2,651,999	1,946,200
Net cash (used in) provided by operating activities	(54,579,389)	98,904,455
Cash flows from investing activities:		
Net increase in interest-bearing deposits in banks	(2,856,671)	(26,065,284)
Net increase in federal funds sold	(26,692)	(23,585)
Proceeds from maturities of securities available for sale	2,190,249	2,728,656
Proceeds from sale of securities available for sale	5,705,645	—
Proceeds from sale of fixed assets	29,379	—
Purchases of securities available for sale	—	(3,780,258)
Purchase (redemption) of restricted equity securities	(2,509,136)	2,991,750
Net (increase) decrease in loans	(13,645,755)	790,588
Purchase of premises and equipment	(76,582)	(440,300)
Net cash used in investing activities	(11,189,563)	(23,798,433)
Cash flows from financing activities:		
Net increase (decrease) in deposits	269,356	(6,275,512)
Net decrease in securities sold under agreements to repurchase	—	(6,055,000)
Proceeds from exercise of stock options	23,460	2,176
Proceeds from employee stock purchase plan	55,426	—
Warrant repurchase	—	(324,648)
Net increase (decrease) in other borrowings	62,850,000	(64,427,609)
Net cash provided by (used in) financing activities	63,198,242	(77,080,593)
Net decrease in cash and due from banks	(2,570,710)	(1,974,571)
Cash and due from banks at beginning of period	5,920,153	7,936,393
Cash and due from banks at end of period	$ 3,349,443	$ 5,961,822
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 1,277,435	$ 2,022,306
Cash paid during the year for Federal income taxes	$ —	$ 722,000
Noncash Transactions:		
Principal balances of loans transferred to other real estate owned	$ 1,423,319	$ 5,488,774

See accompanying notes to unaudited consolidated financial statements.

Notes to Consolidated Financial Statements – June 30, 2013 and 2012 (Unaudited) and December 31, 2012

Note 1 - Basis of Presentation

The corporate history of Coastal Banking Company, Inc. (the "Company") is available at www.coastalbanking.com/history.html

On May 2, 2012 the Company filed a Form 15-12G with the Securities and Exchange Commission to terminate the registration of its common stock under Section 12(G) of the Securities Exchange Act of 1934 and thereby suspend its duty to file reports with the SEC under Sections 13 and 15(D) of the Act. As a result, the Form 10Q filed for the period ended March 31, 2012 was the final financial report filed with the SEC by the Company. Management intends to continue to prepare and publish quarterly and annual financial reports with similar information as required in filings with the SEC to ensure that investors have access to timely, meaningful information related to the Company's results. These financial reports will be published on the Company's web site at intervals consistent with the comparable SEC filing deadlines.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, CBC National Bank (the "Bank"). All intercompany accounts and transactions have been eliminated in consolidation.

The financial statements for the interim periods ended June 30, 2014 and June 30, 2013 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The financial information as of December 31, 2013 has been derived from the audited financial statements as of that date

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates that affect the amounts of assets and liabilities and changes therein. Actual results could differ from those estimates.

Note 2 – Regulatory Oversight, Capital Adequacy, Operating Results and Liquidity

Regulatory Oversight

The Company operates under the supervision and monitoring of the Federal Reserve Bank of Richmond while the Bank's primary regulator is the Office of the Comptroller of the Currency. In 2008 the Company issued preferred stock and warrants to purchase common stock to the US Treasury under the Capital Purchase Program within the Troubled Asset Relief Program (TARP). In February 2013, Coastal Banking Company preferred stock was included in a Treasury Department TARP auction, and that transaction settled on March 11, 2013. As a result, the Company's preferred stock is no longer held by US Treasury. Rather, preferred stock shares are now owned by a small group of private investors.

On December 5, 2008 the Company issued to the US Treasury a warrant to purchase 205,579 shares of common stock at a price of $7.26 per share as part of the original TARP Preferred Stock issuance. On April 10, 2013 the Company repurchased and cancelled 60,000 of these common stock warrants at a price of $1.65 per share. On June 12, 2013 the Company repurchased and cancelled the remaining 145,579 common stock warrants at a price of $1.55 per share. More detailed information on the status and requirements of the regulatory oversight under which we operate is available at www.coastalbanking.com/regulatoryoversight.html

Capital Adequacy

As of June 30, 2014, the Bank exceeded all of the regulatory capital ratio levels to be categorized as "well capitalized." The following table summarizes the Company's and Bank's capital ratios at June 30, 2014:

	Regulatory Levels To Be Well Capitalized (Applies to Bank)	CBC National Bank	Coastal Banking Company
Total capital (to risk-weighted assets)	10.00%	20.63%	20.77%
Tier 1 capital (to risk-weighted assets)	6.00%	19.35%	19.50%
Tier 1 capital (to total average assets)	5.00%	10.33%	10.42%

On December 5, 2008, Coastal issued and sold 9,950 preferred shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "TARP preferred stock"), along with a Warrant to purchase 205,579 shares of common stock at $7.26 per share to the United States Department of the Treasury (the "Treasury") as part of the Capital Purchase Program ("CPP"). As discussed above, the preferred stock was sold by Treasury through an auction to private investor on March 11, 2013 and as a result the Company is no longer subject to TARP restrictions.

When issued, the preferred stock had an annual 5% cumulative preferred dividend rate, payable quarterly on February 15, May 15, August 15 and November 15. On February 16, 2014 the annual cumulative dividend increased to 9% payable quarterly on the same dates, resulting in an increase of future quarterly dividends to $22.50 per share. Dividends compound if they are unpaid when due. On May 15, 2014 the quarterly dividend was paid to shareholders of record on May 5, 2014 in the amount of $223,875 or $22.50 per share of the Fixed Rate Cumulative Preferred Series A Stock. Management is engaged in ongoing efforts to redeem all outstanding shares of this Series A Preferred Stock as soon as practical.

Operating Results

The Company recorded net income of 1,324,000 for the six months ended June 30, 2014 compared to net income of $3,075,000 for the six months ended June 30, 2013, a 57% year over year decline in first half net income. The second quarter results in 2013 included nonrecurring revenue of $1.73 million from the reversal of a deferred tax asset valuation reserve. Excluding the impact of this prior-year nonrecurring event, pre-tax income of $1.95 million in the first half of 2014 was down less than 12% from the pre-tax income of $2.21 million in the first half of 2013. This year over year decline in first half earnings was driven primary by a decline in noninterest income, specifically lower levels of SBA and Mortgage Banking income that was partially offset by the impact of lower noninterest expenses in compensation, advertising and other real estate expenses.

For the quarter ended June 30, 2014 the Company recorded net income of $1,123,000 compared to net income of $1,969,000 during the second quarter of 2013, a 43% year over year decline in second quarter net income. Excluding the impact of the nonrecurring revenue item described above, pre-tax income of $1.66 million in the second quarter of 2014 was up by 236% from the pre-tax income of $494,000 in the second quarter of 2013. The increase in year over year second quarter earnings reflects higher levels of core earnings with net interest income of $3.7 million up by $774,000 or 26% and non-interest income of $9.1 million up by $660,000 or 8% on improving mortgage banking income, partially offset by increases to the provision for loan losses to reflect recent loan portfolio growth and recently identified at-risk credit relationships

Liquidity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control. Our primary liquidity needs involve the funding of mortgage loans available for sale, new portfolio loans, and maturing deposits.

We meet our liquidity needs through scheduled maturities of loans and investments on the asset side and through pricing policies on the liability side for interest-bearing deposit accounts and with advances from approved borrowing facilities with correspondent banks, the Federal Home Loan Bank of Atlanta, and the Federal Reserve Bank discount window.

As of June 30, 2014, the Company had $225.9 million in total borrowing capacity, of which we had utilized $110.5 million or 49%, leaving remaining available liquidity of $115.4 million. The following tables present available sources of liquidity at June 30, 2014 and December 31, 2013:

	June 30, 2014		
	Total Line of Credit	Funds Borrowed	Funds Available
Available sources of liquidity			
Federal funds purchased lines of credit	$ 30,000,000	$ —	$ 30,000,000
Available brokered certificates of deposit	29,238,134	11,273,000	17,965,134
Repurchase agreements secured by investment securities	14,089,000	—	14,089,000
Federal Reserve Borrowing Capacity at Discount Window	29,586,986	—	29,586,986
Federal Home Loan Bank Advance Availability*	122,940,000	99,200,000	23,740,000
Total sources of liquidity	$ 225,854,120	$ 110,473,000	$ 115,381,120

	December 31, 2013		
	Total Line of Credit	Funds Borrowed	Funds Available
Available sources of liquidity			
Federal funds purchased lines of credit	$ 25,000,000	$ —	$ 25,000,000
Available brokered certificates of deposit	29,226,187	7,610,000	21,616,187
Repurchase agreements secured by investment securities	19,088,712	—	19,088,712
Federal Reserve Borrowing Capacity at Discount Window	29,908,765	—	29,908,765
Federal Home Loan Bank Advance Availability*	76,991,704	37,350,000	39,641,704
Total sources of liquidity	$ 180,215,368	$ 44,960,000	$ 135,255,368

*Funds borrowed includes a $1 million letter of credit issued on the Bank's behalf by Federal Home Loan Bank.

Additionally, loans available for sale are considered by management as a key source of liquidity as a result of the speed with which these loans are sold and settled for cash. Management expects that, on average, loans originated for sale will be sold and converted to cash within 18 to 20 business days after the loan is originated. The balance of loans available for sale averaged just over $73 million during the first six months of 2014. Accordingly, in the event of a liquidity crisis, we anticipate having the ability to slow or stop loan origination activity to allow the loans available for sale to convert into cash. Another key metric of our liquidity position is the loan-to-total deposit ratio, calculated using loans, net of unearned income, which was 78% at June 30, 2014 and 84% at December 31, 2013. Based on current and expected liquidity needs and sources, management expects the Company to be able to meet all obligations as they become due.

Note 3 –Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30.

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Net income	$ 1,123,138	$ 1,969,492	$ 1,323,848	$ 3,074,815
Preferred stock dividends	(223,875)	(152,547)	(391,111)	(296,146)
Net income available to common shareholders	$ 899,263	$ 1,816,945	$ 932,737	$ 2,778,669
Weighted average common shares	2,630,294	2,601,087	2,627,166	2,599,978
Effect of dilutive securities	27,929	32,854	26,255	30,738
Diluted average common shares	2,658,223	2,633,941	2,653,421	2,630,716
Earnings per common share	$ 0.34	$ 0.70	$ 0.36	$ 1.07
Diluted earnings per common share	$ 0.34	$ 0.69	$ 0.35	$ 1.06

Note 4 - Supplemental Segment Information

The Bank has three reportable business segments: community banking, SBA lending, and mortgage banking operations. The Company evaluates performance based on profit and loss from operations before income taxes, not including nonrecurring gains and losses.

All direct costs and revenues generated by each business segment are allocated to the segment; however, there is no allocation of indirect corporate overhead costs to the SBA lending or mortgage banking segments. Additionally, interest expense is allocated to the SBA and Mortgage Banking segments based on the Bank's cost of funds plus a small margin through an intersegment charge. As a result, the interest expense reflected in the SBA and Mortgage Banking segments is significantly lower than would be paid by these two operations in an arm's length, market rate borrowing relationship, and conversely the interest income credited to the Community Bank from this intersegment allocation is much lower than would otherwise be earned by the Bank in arm's length investments or loans. Except as described above, the Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were to third parties at current market prices.

The Company's reportable business segments are strategic business units that offer different products and services to a different customer base. They are managed separately because each segment has different types and levels of credit and interest rate risk.

(In thousands)	**Community Banking**		**SBA Lending Operations**		**Mortgage Banking Operations**	
Three months ended June 30,	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Interest income	$ 2,345	$ 2,463	$ 593	$ 527	$ 1,417	$ 816
Interest expense	154	551	148	27	355	302
Net interest income	2,191	1,912	445	500	1,062	514
Provision for loan losses	289	—	110	—	74	57
Net interest income after provision	1,902	1,912	335	500	988	457
Non interest income	300	247	1,059	1,059	7,754	7,146
Non interest expense	2,379	3,517	766	558	7,531	6,751
Net income (loss) before tax expense (benefit)	(177)	(1,358)	628	1,001	1,211	852
Income tax expense (benefit)	(57)	(2,072)	201	321	395	276
Net income (loss)	$ (120)	$ 714	$ 427	$ 680	$ 816	$ 576

(In thousands)	**Community Banking**		**SBA Lending Operations**		**Mortgage Banking Operations**	
Six months ended June 30,	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Interest income	$ 4,812	$ 5,352	$ 1,197	$ 987	$ 2,313	$ 2,024
Interest expense	398	980	289	56	586	770
Net interest income	4,414	4,372	908	931	1,727	1,254
Provision for loan losses	428	—	162	—	139	88
Net interest income after provision	3,986	4,372	746	931	1,588	1,166
Non interest income	495	505	1,971	2,509	12,240	15,596
Non interest expense	4,918	7,185	1,470	1,094	12,683	14,589
Net income (loss) before tax expense (benefit)	(437)	(2,308)	1,247	2,346	1,145	2,173
Income tax expense (benefit)	(143)	(2,314)	399	751	375	699
Net income (loss) after taxes	$ (294)	$ 6	$ 848	$ 1,595	$ 770	$ 1,474

The community banking segment provides traditional banking services offered through the Bank's three full service branch locations in Lady's Island and Port Royal, South Carolina; Fernandina Beach, Florida. At June 30, 2014 this segment had 64 full time equivalent employees including staff that provides operational and administrative support to the other two reportable segments.

The Small Business Administration lending division segment originates SBA loans throughout the southeastern United States by the Bank's SBA business development officers. These officers serve markets in Jacksonville, Ft. Meyers and Vero Beach, Florida; Greensboro, North Carolina; and Beaufort, South Carolina. The majority of loans originated by the division are processed through the SBA 7(a) loan program. Participations in these loans are typically sold to secondary market investors within 30 days of the loan being funded. At June 30, 2014 the division had seventeen full time equivalent employees and conducted all loan funding, sales and servicing activity from the Bank's operations center in Fernandina Beach, Florida.

The mortgage banking operations segment was staffed by 282 full time equivalent employees at June 30, 2014 who originate residential mortgage loans through one of four distinct delivery channels. These channels include (1.) a network of independent mortgage brokers, (2.) a national network of traditional retail mortgage lending branches, (3.) an internet leads based retail loan origination branch, and (4.) retail mortgage lending through the Bank's deposit branch locations. Most of these loans are closed by the Bank and sold to various investors on the secondary market while a limited number of loans are retained in the Bank's loan portfolio. Additionally, during the first six months of 2014, approximately 18% of the loan production was brokered away to other lenders and so were not closed by the Bank. All wholesale and internet retail mortgage banking activity is conducted in the Bank's mortgage banking offices in Atlanta, Georgia, as is the national retail mortgage lending administration function. The national retail lending branches are located in Arizona, Florida, Georgia, Maryland, Michigan, New York, Illinois and Ohio.

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

From the September 2007 inception of the mortgage banking division through June 30, 2014, we have sold over 31,000 residential mortgage loans into the secondary market with a principal balance of nearly $6.7 billion. From this population of sold loans, the Bank has received notification from purchasers of a total of thirty-five EPD claims or on average one EPD claim per 885 loans sold. By year of sale vintage, three of these claims were from loans sold in 2008, seven in 2009, three in 2010, one in 2011, eleven in 2012, eight in 2013 and two in 2014. Beyond the initial payment to the purchasers of $172,000 upon receipt of the EPD claims, the maximum remaining exposure under investor claims of a representation and warranty breach would be the difference between the total loan amount and the liquidated value of the underlying collateral. In the case of our thirty-five EPD claims received since the inception of mortgage banking operations, the aggregate loan balance was $6,800,000 and consisted of thirty five single family residences. Original loan-to-value ratios ranged from 65% to 98%, and loans with a loan-to-value ratio over 80% have a mortgage insurance policy in place. If repurchase was required in the future, management believes that the potential amount of loss would not be material and that sufficient reserves exist to fully absorb any loss. Management does not anticipate any material credit risk related to potential EPD claims on loans that have been previously sold and are no longer on the Bank's balance sheet. Because the risk of an EPD claim only exists during the first four payments after a loan is originated, the Bank reports the total of the most recent four months mortgage banking lending volume as off-balance sheet credit risk from EPD claims. As of June 30, 2014, the total off-balance sheet credit risk from EPD claims was $489,418,000.

As discussed above, the representations and warranties in loan sale agreements require that the Bank repurchase loans or indemnify the investors for losses or costs on loans sold under certain limited conditions. Some of these conditions include underwriting errors or omissions, fraud or material misstatements by the borrower in the loan application, or invalid market value on the collateral property due to deficiencies in the appraisal. From the total population of sold loans, in nearly seven years of operations the Bank has been required to settle sixteen make whole claims or on average one claim per 2,000 loans sold at a total cost of $1,732,000, and has repurchased three loans totaling $1,110,000. Of the three repurchased loans, one has been paid off, and the other two are current and performing in accordance with their loan terms.

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

In recognition of risk from potential EPD claims and breaches of representations and warranties, an indemnification reserve has been established and maintained since mortgage banking loan sales began in late 2007 to cover potential costs. Initially management had limited history of costs incurred, so additions to the reserve were made monthly based on a percentage of loan balances sold that month. This approach recognized that the risk of indemnification costs will rise in relation to the level of loans sold. However we also recognize that over time these loans will pay-off as borrowers refinance their loans or sell the properties, but we have no ability to quantify sold loans that have paid off. During 2013 we evaluated the actual loss experience for six years, current business volume and known claims outstanding relative to the indemnification reserve level. Based on that analysis the decision was made to suspend further additions to the reserve balance beginning in August 2013. At June 30, 2014 the indemnification reserve was $2,375,000 which management believes is adequate for potential exposure in connection with loan sale indemnification or EPD claims. Management will monitor the adequacy of the reserve level based on actual loss experience and future business volume levels, and may continue to suspend additions to the reserve or alternatively decide that further additions to the reserve may be appropriate. However, we can provide no assurance that our methodology will not change and that the balance of this indemnification reserve will prove sufficient to cover actual costs in the future.

The primary source of direct income generated by the mortgage banking division is the gain on sale of mortgage loans which was $7,802,000 for the quarter ended June 30, 2014 compared to $7,194,000 for the quarter ended June 30, 2013. For the first six months of 2014, the gain was $12,282,000 compared to $15,700,000 for the same period in 2013. The decrease in gain on sale is a result of reduced volume caused by an increase in long-term interest rates and the related decline in refinance lending activity. At the peak of refinance activity in 2012, 76.4% of units closed by the mortgage division were for the purpose of refinancing an existing loan and 23.6% were for the purpose of purchasing a home. Management has worked to restructure loan product offerings, geographic sales presence, and pricing incentives to increase the focus on purchase money lending. As a result we have observed a gradual shift from refinance to purchase money lending with refinance lending falling to under 59% of total units funded in 2013 and less than 48% of units funded in the first half of 2014. While mortgage loan volume will always be directly impacted by interest rates, purchase money lending has proven to be more resilient to increasing rate environments than has refinance lending, and so by reducing our reliance on refinance lending we expect to mitigate the impact of increasing interest rates on future loan funding levels.

The direct noninterest expenses incurred by the division were $7,531,000 for the second quarter of 2014, an increase of $780,000 over the second quarter 2013 expenses of $6,751,000. The largest contributor to this increase was in salaries and benefits, which were $5,837,000 for second quarter 2014, compared to $4,741,000 for second quarter 2013, a year over year increase of 23%. This Q2 year over year rise in mortgage banking compensation expense occurred despite a 10% decline in lending volume during the same comparative periods, from $426.6 million in Q2-2013 to $382.8 million in Q2-2014. Typically lending volume and compensation expense are closely correlated, so this inverse change with higher compensation expense on lower volume reflects the impact of a shift in the loan delivery channel mix. Loan officer commissions paid on loans from the broker channel are typically only 10% of the commission levels paid on retail channel loans. In the year over year comparison of the second quarter loan funding activity, wholesale loans funded in 2014 were down from 2013 by $82.5 million or 40% while retail loans funded increased by $38.7 million or 18%. This shifted the delivery channel mix from 48%/52% wholesale/retail in 2013 to 33%/67% wholesale/retail in 2014, and that increase in retail lending resulted in higher commission expense despite the reduction to total funding levels.

For the six months ended June 30, 2014, noninterest expenses incurred by the mortgage banking division were $12,683,000, a decrease of $1,906,000 compared to $14,589,000 of noninterest expense for the first six months of 2013. The largest contributor to this decline was a $1,003,000 reduction in leads expenses, which totaled $112,000 for the first half of 2014, compared to $1,115,000 for the same period in 2013 followed by a $754,000 reduction in salary and benefit expense from $10,283,000 for the six months ended June 30, 2013 to $9,529,000 for the six months ended June 30, 2014.

Beyond the impact of the noninterest income and expense from this division, the Bank earns interest income at the respective note rates on the balance of loans originated by the division from the time the loan is funded until it is sold to a secondary market investor. The average outstanding daily balance of residential mortgage loans available for sale was $94,314,000 for the three months ended June 30, 2014 and $82,861,000 for the three months ended June 30, 2013. The interest income earned on these loans available for sale was $1,016,000 and $747,000 during the three months ended June 30, 2014 and 2013, respectively. For the six months ended June 30, the average outstanding daily balance of residential loans available for sale was $73,517,000 in 2014 and $109,040,000 in 2013. The interest income earned on these loans available for sale was $1,592,000 and $1,922,000 during the first half of 2014 and 2013, respectively.

Note 5 - Net Interest Income

The Bank's net interest income is determined by the level of our earning assets, primarily loans outstanding, and the management of our net interest margin. For the quarter ended June 30, 2014, net interest income totaled $3,699,000 as compared to $2,925,000 for the quarter ended June 30, 2013 for an increase of $774,000. On a consecutive quarter basis, net interest income was up by $349,000, or 10%, from the $3,350,000 earned during the quarter ended March 31, 2014.

Total interest income increased by $550,000 to $4,355,000 for the three months ended June 30, 2014 compared to $3,805,000 for the three months ended June 30, 2013. On a consecutive quarter basis, total interest income increased by $388,000, or 10%, from the $3,967,000 earned during the quarter ended March 31, 2014.

The impact of the interest rate environment is seen in the Prime interest rate, which has been set at a historical low rate of 3.25% since December 16, 2008. This historic low Prime interest rate has had an extremely negative impact on the yield earned by the Bank on that portion of the loan portfolio that carry rates based on the Prime interest rate index. At June 30, 2014 and June 30, 2013 the Bank held $116,994,000 and $106,243,000 respectively, in loans carrying rates based on the Prime interest rate index.

Average earning assets increased to an average balance of $386,760,000 during the quarter ended June 30, 2014, up by $15,595,000 or 4.0%, from the average balance during the quarter ended June 30, 2013. The most significant increase in interest income was in interest earned on mortgage loans held for sale, which increased $269,000 to $1,016,000 during the second quarter of 2014, compared to $747,000 during the second quarter of 2013. Interest and fees earned on portfolio loans increased by $212,000, or 7%, to $3,102,000 in the three months ended June 30, 2014 from $2,890,000 in the three months ended June 30, 2013. Interest income from investment securities increased $91,000, or 63%, to $235,000 in the three months ended June 30, 2014 compared to $144,000 earned in the three months ended June 30, 2013. On a consecutive quarter basis, interest income from investments decreased by $86,000 from $321,000 earned during the quarter ended March 31, 2014. Interest and fees earned on loans increased by $474,000, or 13%, from $3,644,000 during the quarter ended March 31, 2014.

Interest income not recognized on non-accruing loans during the quarter ended June 30, 2014 was $59,000, an increase of $11,000 from the $48,000 of interest income not recognized during the same quarter in 2013. On a consecutive quarter basis, interest income not recognized on non-accruing loans increased $22,000 from the $37,000 interest lost during the quarter ended March 31, 2014. There have been no non-accruing loans returned to accrual status during the six month period ended June 30, 2014; however, during the first quarter of 2013, we lost income on nonaccrual loans totaling $91,000, but we recovered $315,000 of previously non-accrued interest for a net increase to interest income of $224,000 from nonaccrual loans.

Total interest expense decreased by $224,000, or 25%, to $656,000 for the three months ended June 30, 2014 compared to $880,000 for the same period in 2013. On a consecutive quarter basis, total interest expense increased by $40,000, or 6%, from $616,000 expensed during the quarter ended March 31, 2014 primarily as a result of a $43,602,000 increase in average balances for other borrowings from $35,121,000 at March 31, 2014 to $78,723,000 at June 30, 2014.

The net interest margin is a performance metric that reports how successful the Bank's investment decisions have been relative to its funding choices. It is calculated by dividing the annualized net interest income by the balance of the average earning assets for the period. The net interest margin realized on earning assets increased by 68 basis points to 3.84% for the three months ended June 30, 2014 when compared to the 3.16% net interest margin earned during the same three months in 2013. On a consecutive quarter basis, the net interest margin decreased by 7 basis points from 3.91% during the quarter ended March 31, 2014.

The net interest rate spread is the difference between the average yield earned by the Bank on loans, investment securities and other earning assets, and the rate paid by the Bank on interest bearing deposits and other borrowings. The net interest rate spread increased by 69 basis points to 3.74% for the three months ended June 30, 2014 compared to the 3.05% net interest rate spread earned during the same three month period in 2013. On a consecutive quarter basis, the net interest rate spread decreased by 6 basis points from 3.80% during the quarter ended March 31, 2014.

For the six months ended June 30, 2014, net interest income totaled $7,049,000 as compared to $6,556,000 for the same period in 2013, for an increase of $493,000, or 7%. The change in total interest income was nearly flat for the six month period ended June 30, 2014 compared to the same period last year, declining by $40,000 or less than 1%, to $8,322,000 for the six months ended June 30, 2014 compared to $8,363,000 for the six months ended June 30, 2013. Interest and fees on loans decreased by $264,000, or 3%, to $7,762,000 in the six months ended June 30, 2014 from $8,026,000 in the six months ended June 30, 2013. As discussed above, during the first quarter of 2013, we lost income on nonaccrual loans totaling $91,000, but we recovered $315,000 of previously non-accrued interest for a net increase to interest income of $224,000 from nonaccrual loans. If an adjustment is made to remove the $315,000 nonaccrual interest recovery from the first six months of last year, all loan interest income comparisons for the six months ended June 30, 2014 and the same period last year result in year over year increases. Interest income on investment securities increased by $244,000, or 78%, to $556,000 in the six months ended June 30, 2014 compared to $312,000 in the six months ended June 30, 2013. Total interest expense decreased by 534,000, or 30%, to $1,273,000 for the six months ended June 30, 2014 compared to $1,806,000 for the same period in 2013. The net interest margin and the interest rate spread were 3.91% and 3.81%, respectively, for the six months ended June 30, 2013. The net interest margin realized on earning assets and the interest rate spread were 3.45% and 3.35%, respectively, for the six months ended June 30, 2014 and 2013.

Note 6 - Provision and Allowance for Loan Losses

There are risks inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. We establish and maintain an allowance for loan losses based on a number of qualitative factors including, among other things, historical experience, evaluation of economic conditions, regular reviews of delinquencies and loan portfolio quality and a number of assumptions about future events, which we believe to be reasonable, but which may not prove to be accurate. We believe that changes in economic and industry conditions capture the impact of general declines in the value of collateral property, and in this way our qualitative factors reflect general declines in collateral values.

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

The provision for loan losses is the periodic charge to operating earnings that management believes is necessary to maintain the allowance for possible loan losses at an adequate level. The amounts of these periodic charges are based on management's analysis of the potential risk in the loan portfolio. This analysis includes, among other things, evaluation of the trends in key loan portfolio metrics as follows:

(In thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Portfolio loans, gross	$ 258,022	$ 253,803	$ 244,543	$ 232,872	$ 235,566	$ 232,592	$ 242,437	$ 238,824
Loans past due > 30 days and still accruing interest	$ 1,720	$ 152	$ 785	$ 261	$ 584	$ 388	$ 1,442	$ 1,243
Loans on nonaccrual	$ 2,787	$ 2,045	$ 2,116	$ 3,152	$ 3,673	$ 4,881	$ 9,439	$ 14,357
(as a % of loans, gross)	1.08%	0.81%	0.87%	1.35%	1.56%	2.10%	3.90%	6.02%
Net loan charge offs (recoveries)	$ 85	$ 249	$ 64	$ 92	$ 412	$ 180	$ 1,807	$ 923
(as a % of loans, gross)	0.03%	0.10%	0.03%	0.04%	0.18%	0.08%	0.75%	0.39%

Portfolio loans, gross addresses the impact on the provision for loan losses from changes in the size and composition of our loan portfolio. In the past we applied various reserve factors to our portfolio based on the risk-rated categories of loans because we had relatively little charge off activity prior to the quarter ended December 31, 2008. As a result of increasing charge off activity over the past four years, we now rely more on historical levels and trends to establish various reserve percentages based on the relative inherent risk for a particular loan type and grade. The inherent risk is established based on peer group data, information from regulatory agencies, the experience of the Bank's lending officers, and recent trends in portfolio losses. These reserve factors are continuously evaluated and subject to change depending on trends in national and local economic conditions, the depth of experience of the Bank's lenders, delinquency trends and other factors. We have made an effort over the last several years to lower the risk profile of our loan portfolio. In doing so, our loan portfolio size decreased during 2012 and the first three quarters of 2013 primarily from reductions in higher risk rated commercial real estate construction loans and since that time we have increased comparably lower risk rated owner occupied residential real estate loans.

Loans past due greater than 30 days and still accruing interest has proven to be a useful leading indicator of directional trends in future loan losses. As the level of this metric rises, expectations are for a comparable increase in loans moving into a nonaccrual status and ultimately foreclosure resulting in increased losses. This pattern has been observed in the past where increases in loans past due greater than 30 days and still accruing are followed in future quarters with the same directional changes in the level of loans on nonaccrual. The level of loans past due greater than 30 days and still accruing interest totaled $1,720,000 at June 30, 2014, an increase of $935,000 or 119% as compared to $785,000 at December 31, 2013. Loans past due greater than 30 days and still accruing had declined to $152,000 at March 31, 2014, the lowest level in over six years. The increase of $1,568,000 during the current quarter was the result of two borrowers becoming delinquent on five loans totaling $1,344,000 as such, this increase in past due loans does not appear to reflect overall portfolio trends. Management intends to carefully monitor past due loans and work aggressively to manage loan delinquency levels. While the long term trend in credit quality over the last five years has improved significantly, we continue to experience ups and downs throughout the process. While the weakening loan quality that began in late 2008 will continue to be an area of concern in future periods, the trends are clearly pointing to an improving and stable credit environment.

Loans on nonaccrual has been another leading indicator of potential future losses from loans. We typically place loans on nonaccrual status when they become 90 days past due. In addition to the interest lost when a loan is placed on nonaccrual status, there is an increased probability of a loan on nonaccrual moving into foreclosure with a potential loss outcome. Although it is not shown in the table above, the level of loans on nonaccrual peaked at $25,925,000 at June 30, 2009 and then declined by 50% over the following three quarters to $12,992,000 at March 31, 2010. From that March 31, 2010 low point, loans on nonaccrual gradually increased again to peak at $25,399,000 in mid-2011 which was very near the mid-2009 high point. Once again we saw a downward trend over the following nine quarters, however after the mid-2011 spike the improvement in nonaccrual balances has generally been sustained. The June 30, 2014 nonaccrual balance of $2,787,000 is an increase of $742,000 over nonaccrual loans at March 31, 2014. During the three months ended June 30, 2014 three loans migrated to nonaccrual status, one loan was charged off, and another loan migrated to other real estate owned. The primary reason for the increase in nonaccrual loans during the period was the result of a single loan relationship, with a balance of $695,000 being classified as nonaccrual. While management is generally encouraged by the long term improvement in nonaccrual loans, we remain vigilant in our loan monitoring and loss mitigation efforts.

Net loan charge offs or recoveries reflect our practice of charging recognized losses to the allowance and adding subsequent recoveries back to the allowance. During the three months ended June 30, 2014, we recorded charge offs net of recoveries of $85,000. This amount represented a decrease of $164,000, or 66%, from the $249,000 in net charge offs recorded during the prior quarter ended March 31, 2014, and a decrease of $327,000, or 79% from the $412,000 net charge offs during the same quarter in the prior year.

Prior to the fourth fiscal quarter of 2008, we had very little charge off activity and therefore, had limited historical information upon which to base past estimates. Since 2009 charge off activity has been volatile and difficult to predict, but we continue to assess the implications of trends in recent charge off activity on potential future losses. The recent volatility in the level of quarterly net loan charge offs or recoveries makes it difficult to identify a specific trend or establish reliable future expectations. As a result, there can be no assurance that charge offs of loans in future periods will not increase or 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. Thus, there is a risk that substantial additional increases in the allowance for loan losses could be required, which would result in a decrease in our net income and possibly our capital.

In addition to considering the metrics described above, we evaluate the collectability of individual loans, the balance of impaired loans, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans and a review of specific problem loans. Based on this process and as shown below, the provision charged to expense was $473,000 for the three months ended June 30, 2014, as compared to $57,000 for the three months ended June 30, 2013. On a consecutive quarter basis, this provision level was $217,000, or 85%, higher than the $256,000 provision charged to expense during the quarter ended March 31, 2014. The increased level of provision expense for the three months ended June 30, 2014, as related to the prior comparative periods, does not indicate a general weakening of loan portfolio credit quality, but rather was driven by a combination of expanding loan portfolio balances and the recent specific loss experience from the few borrowers discussed above.

(In thousands)	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Provision during quarter ended	$ 473	$ 256	$ 83	$ 171	$ 57	$ 31	$ 957	$ 807
Provision added in excess of net charge-offs	$ 388	$ 7	$ 19	$ 79	$ (355)	$ (149)	$ (850)	$ (116)
Allowance for loan losses	$ 4,668	$ 4,280	$ 4,273	$ 4,254	$ 4,175	$ 4,530	$ 4,679	$ 5,529
(as a % of loans, gross)	1.81%	1.69%	1.75%	1.83%	1.77%	1.95%	1.93%	2.32%

The difference between the amount of the provision for loan losses and net loan charge offs will result in expansion or shrinkage to the level of the allowance for loan losses. As shown above, during the three months ended June 30, 2014 the current provision for loan losses of $473,000 was greater than net charge offs against the allowance of $85,000 by $388,000. The result was an increase to the allowance for loan losses by $388,000 to a level of $4,668,000, or 1.82% of gross loans outstanding at June 30, 2014, as compared to $4,280,000, or 1.69% of gross loans outstanding at March 31, 2014.

From a historical perspective, prior to 2008, while the level of loans on nonaccrual was relatively stable, the allowance for loan losses was maintained in the range of 1.2% to 1.3% of the balance of gross loans. As we moved into 2008 and experienced an increase in loans on nonaccrual, it was determined that an increase to the allowance level was appropriate given the projected increased risk of loss, so the allowance was increased to a range of 1.4% to 1.6% during 2008. The weakening of the loan portfolio performance continued into 2009 with actual loss levels that exceeded projections from earlier in 2008, resulting in the decision to increase the allowance level further, to the range of 1.6% to 1.8% in early 2009. With nonaccrual loans reaching a peak in mid-2009, further analysis and projections of potential loan losses in the Bank's existing portfolio supported a further increase in the allowance level to a range of 2.0% to 2.3% of gross loans outstanding, which was sustained through the end of 2012. As we moved into the final two quarters of 2012 and first three quarters of 2013 we experienced significant improvement in loan portfolio performance with most key asset quality metrics improving to levels last reported during 2008. Based on these improving trends and current projections of future potential loses, we have reduced our target allowance level to a range of 1.60% to 1.85% of gross loans outstanding. Management believes that the changes in the level of the allowance for loan losses are directionally consistent with the trends observed in the various asset quality metrics discussed above.

Management continues to carefully monitor past due and nonaccrual loans. Management acknowledges that future asset quality results may vary from our estimates and expectations, resulting in negative asset quality metrics, which could have a material adverse effect on our results of operations and financial condition.

Note 7 - Noninterest Income

Noninterest income for the three months ended June 30, 2014 totaled $9,112,000 as compared to $8,452,000 for the three months ended June 30, 2013. SBA loan income for the three month period ended June 30, 2014 totaled $1,057,000 virtually unchanged compared to the $1,059,000 for the second quarter of 2013. Mortgage banking income was $7,802,000 for the quarter ended June 30, 2014 compared to $7,194,000 for the same period during 2013 for an increase of $608,000 or 8%.

Noninterest income for the six months ended June 30, 2014 totaled $14,705,000, as compared to $18,610,000 for the six months ended June 30, 2013. The largest decrease was in mortgage banking income, which decreased $3,418,000 to $12,282,000 for the first half of 2013, compared to $15,700,000 for the same period of 2013. The decline in mortgage banking income is primarily the result of a 28% or $239,100,000 decline in mortgages funded for the six month period ending June 30, 2014 compared to the same period in 2013. During the first half of 2014, we recorded net gains of $41,000 on sales of securities available for sale, compared to net gains of $815 recorded during the same period of 2013.

Note 8 - Noninterest Expense

Total noninterest expense for the three months ended June 30, 2014 was $10,676,000 as compared to $10,826,000 for the same period in 2013. While the year-over-year reduction in noninterest operating expense of $150,000 is nearly flat it reflects increases in salary and benefit expenses being offset by reductions in expenses related to other real estate owned and advertising. Noninterest expenses at the community banking segment declined $1,138,000 or 32% to $2,379,000 for the three months ended June 30, 2014 as compared to $3,517,000 for the same period of 2013 nearly offset by a $780,000 or 12% increase for the mortgage banking segment to $7,531,000 for the second quarter of 2014, compared to $6,751,000 in the second quarter of 2013.

Salaries and benefits totaled $7,828,000 for the three months ended June 30, 2014, compared to $6,732,000 for the same period a year ago, for an increase of $1,096,000 or 16%, all of which occurred at the mortgage banking segment. As discussed previously, the origination channel mix for the three months ending June 30, 2014 was at a higher origination cost structure than that of the same three month period in 2013, resulting in the increase in salary expense on lower total lending volume

Other real estate expense decreased $688,000 to $152,000 for the second quarter of 2014 compared to $840,000 during the same period of 2013. This improvement is the result of a decline of $493,000 in valuation write-downs, a decline of $120,000 in losses on sale, and a reduction of $75,000 in expenses related to holding properties.

Advertising expenses totaled $111,000 for the second quarter of 2014, a decrease of $421,000, or 79% from the $532,000 expensed in the second quarter of 2013. Included in this category are expenses related to generating residential real estate loan application leads through various media such as print advertising, mass mailings, internet referrals, and telemarketing efforts. The shift in product mix with reduced emphasis on refinance lending volume as a percent of origination volume as discussed earlier, has reduced the level of such expenditures.

Total noninterest expense for the six months ended June 30, 2014 was $19,071,000, as compared to $22,868,000 for the same period in 2013. The largest contributor to this decrease was in expenses related to other real estate owned, which decreased $1,236,000 or 71% to $498,000 during the first half of 2013 compared to $1,734,000 during the first half of 2013. This improvement is the result of a decline of $544,000 in losses on sale, a decline of $535,000 in valuation write-downs, and a reduction of $156,000 in expenses related to holding those properties. Advertising expense declined $965,000 or 83% to $198,000 for the six months ended June 30, 2014 compared to $1,163,000 for the same period in 2013. Decreased advertising expenses are due to contraction in the mortgage banking division. Also contributing to the decrease was reduction in salaries and benefits, which decreased $881,000 to $13,355,000 for the first half of 2014, compared to $14,236,000 expensed during the first half of 2013.

Note 9 – Investment Securities

Investment securities are as follows:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
State and municipal securities	$ 7,708,173	$ 367,949	$ (37,739)	$ 8,038,383
Mortgage-backed securities	23,188,639	294,846	(63,901)	23,419,584
	$ 30,896,812	$ 662,795	$ (101,640)	$ 31,457,967

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
State and municipal securities	$ 7,739,685	$ 52,290	$ (137,858)	$ 7,654,117
Mortgage-backed securities	31,194,452	216,452	(310,551)	31,100,353
	$ 38,934,137	$ 268,742	$ (448,409)	$ 38,754,470

Note 10 — Loans and allowance for loan losses

The composition of loans is summarized as follows:

	June 30, 2014	December 31, 2013
Commercial and financial	$ 13,398,098	$ 12,463,122
Agricultural	3,984	852
Real estate – construction, commercial	22,031,379	22,958,615
Real estate – construction, residential	10,133,088	9,356,006
Real estate – mortgage, commercial	97,894,424	98,710,146
Real estate – mortgage, residential	112,903,406	99,669,408
Real estate – mortgage, farmland	270,891	—
Consumer installment loans	1,387,110	1,384,876
Gross loans	258,022,380	244,543,025
Less: Allowance for loan losses	4,667,898	4,273,099
Net loans	$ 253,354,482	$ 240,269,926

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

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

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

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

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

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

	June 30, 2014						
(In thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater than 90 Days Past Due & Accruing**	**Nonaccrual**	**Total Past Due & Nonaccrual**	**Current Loans**	**Total Loans**
Commercial and financial	$ 12	$ 16	$ —	$ 91	$ 119	$ 13,279	$ 13,398
Agricultural	—	—	—	—	—	4	4
Real estate – construction, commercial	—	—	—	39	39	21,992	22,031
Real estate – construction, residential	—	—	—	—	—	10,133	10,133
Real estate – mortgage, commercial	603	—	—	2,132	2,735	95,159	97,894
Real estate – mortgage, residential	200	889	—	525	1,614	111,290	112,904
Real estate – mortgage, farmland	—	—	—	—	—	271	271
Consumer installment loans	—	—	—	—	—	1,387	1,387
	$ 815	$ 905	$ —	$ 2,787	$ 4,507	$ 253,515	$ 258,022

	December 31, 2013						
(In thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater than 90 Days Past Due & Accruing**	**Nonaccrual**	**Total Past Due & Nonaccrual**	**Current Loans**	**Total Loans**
Commercial and financial	$ —	$ —	$ —	$ 12	$ 12	$ 12,451	$ 12,463
Agricultural	—	—	—	—	—	1	1
Real estate – construction, commercial	—	—	—	39	39	22,920	22,959
Real estate – construction, residential	—	—	—	19	19	9,337	9,356
Real estate – mortgage, commercial	170	615	—	1,153	1,938	96,772	98,710
Real estate – mortgage, residential	—	—	—	893	893	98,776	99,669
Consumer installment loans	—	—	—	—	—	1,385	1,385
	$ 170	$ 615	$ —	$ 2,116	$ 2,901	$ 241,642	$ 244,543

Other Risk Elements in the Loan Portfolio

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

	Loans with Interest Only Payments			
(In thousands)	**June 30, 2014**		**December 31, 2013**	
Commercial and financial	$ 3,250	8%	$ 3,310	10%
Agricultural	4	—%	—	—%
Real estate – construction, commercial	8,118	20%	8,974	26%
Real estate – construction, residential	6,015	14%	2,635	8%
Real estate – mortgage, commercial	5,867	14%	5,673	16%
Real estate – mortgage, residential	18,099	44%	13,593	40%
Consumer installment loans	55	—%	49	—%
	$ 41,408		$ 34,234	

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

Balances within the major loans receivable categories and geographic concentration of the loan portfolio are presented below:

	Geographic Concentration of Loan Portfolio			
	June 30, 2014			
(In thousands)	Florida	Georgia	South Carolina	Other
Commercial and financial	$ 5,412	$ 1,968	$ 5,345	$ 673
Agricultural	—	—	4	—
Real estate – construction, commercial	8,075	2,185	10,069	1,702
Real estate – construction, residential	3,969	3,164	3,000	—
Real estate – mortgage, commercial	47,948	16,037	30,502	3,407
Real estate – mortgage, residential	41,621	36,945	26,733	7,605
Real estate – mortgage, farmland	—	271	—	—
Consumer installment loans	361	276	620	130
	$ 107,386	$ 60,846	$ 76,273	$ 13,517

	Geographic Concentration of Loan Portfolio			
	December 31, 2013			
(In thousands)	Florida	Georgia	South Carolina	Other
Commercial and financial	$ 4,256	$ 2,040	$ 5,453	$ 714
Agricultural	—	1	—	—
Real estate – construction, commercial	8,587	2,283	10,357	1,732
Real estate – construction, residential	4,600	1,424	3,144	188
Real estate – mortgage, commercial	47,076	15,027	34,143	2,464
Real estate – mortgage, residential	36,483	30,795	26,839	5,552
Consumer installment loans	528	282	504	87
	$ 101,514	$ 51,852	$ 80,440	$ 10,737

We also monitor and evaluate several other loan portfolio characteristics at a total portfolio level rather than by major loan category. These characteristics include:

Junior Liens – Loans secured by liens in subordinate positions tend to have a higher risk profile than loans secured by liens in the first or senior position. At June 30, 2014 the Company held $16,643,000 of loans secured by junior liens, which represented approximately 6.5% of the total net loan portfolio. Net loan charge-offs totaled $293,000 in the six months ended June 30, 2014 for all loans secured by junior liens for an annualized loss rate of 3.5%. At December 31, 2013 the Company held $17,780,000 of loans secured by junior liens which represented approximately 7.3% of the total net loan portfolio. Net loan charge-offs totaled $115,000 for the twelve months ended December 31, 2013 for all loans secured by junior liens representing a loss rate of 0.7%.

High Loan to Value Ratios – Typically the Company will not originate a new loan with a loan to value (LTV) ratio in excess of 100%. However, declines in collateral values can result in the case of an existing loan renewal with an LTV ratio in excess of 100% based on the current appraised value of the collateral. In such cases the borrower may be asked to pledge additional collateral or to renew the loan for a lesser amount. If the borrower lacks the ability to pay down the loan or provide additional collateral, but has the ability to continue to service the debt, the loan will be renewed with an LTV ratio in excess of 100%. At June 30, 2014 the loan portfolio included 63 loans with an aggregate balance of $22,015,000, or 8.5% of the net loan portfolio, with LTV ratios in excess of 100%. At December 31, 2013 the loan portfolio included 65 loans with an aggregate balance of $24,231,000, or 9.9% of the net loan portfolio, with LTV ratios in excess of 100%.

Restructured Loans – Historically, the Company has followed a conservative approach by classifying any loan as restructured whenever the terms of a loan were adjusted to the benefit of any borrower in financial distress, regardless of the status of the loan at the time of restructuring. In some cases we have restructured loans for borrowers who were not delinquent, but for various reasons these borrowers were experiencing financial distress that raised a doubt about their continued ability to make payments under current terms. By adjusting the terms of the loan to better fit the borrower's current financial condition, expectations are that the loan will avoid a future default. In other cases we have restructured loans for borrowers who were in default at the time the loan terms were restructured. The expectation is that by adjusting the terms of such loans, the borrower may begin to make payments again based on the improved loan terms.

The types of changes that are made for troubled borrowers to restructure their obligations include the following:

- Deferral of one or more scheduled loan payments to a future date
- Temporary or permanent reduction of the loan interest rate
- Conversion from principal and interest payment term to an interest only payment term on a temporary basis, or until maturity
- Forgiveness of accrued but uncollected interest
- Extension of loan maturity date
- Reduction in principal due under the loan agreement

The potential financial effects of restructuring troubled debts includes a reduction in the level of interest income collected, a complete loss of interest income, or a loss of some portion of the original loan principal. All troubled debt restructurings are tested for impairment. If a loan is considered to be collateral dependent, the measurement of impairment is based on the fair value of the collateral, net of estimated liquidation costs. If the loan is not considered to be collateral dependent, the present value of expected cash flows is used to determine any amount of impairment. Any impairment is then charged to the allowance for loan and lease losses or designated as a specific reserve, and as such will be considered as a component of the reserve calculation.

The following table provides a summary of all loans that are currently designated as restructured for regulatory purposes.

	June 30, 2014			December 31, 2013		
Troubled debt restructurings	**Number of loans**	**Recorded Investment**	**Unpaid Principal Balance**	**Number of loans**	**Recorded Investment**	**Unpaid Principal Balance**
Real estate – construction	—	$ —	$ —	1	$ 698,020	$ 698,020
Real estate – mortgage	10	5,542,641	6,203,726	12	6,211,822	6,557,725
Total troubled debt restructurings	10	$ 5,542,641	$ 6,203,726	13	$ 6,909,842	$ 7,255,745

The following table provides the payment status as of June 30, 2014 and June 30, 2013 of all loans that were restructured in the twelve month periods ending on those respective dates.

	June 30, 2014		June 30, 2013	
	Number of loans	**Recorded Investment**	**Number of loans**	**Recorded Investment**
Restructured loans less than 30 days past due				
Real estate – mortgage	—	$ —	2	$ 1,070,576
Total restructured loans less than 30 days past due	—	$ —	2	$ 1,070,576
Restructured loans 30 days or more past due				
Real estate – mortgage	—	$ —	1	$ 468,479
Total restructured loans 30 days or more past due	—	$ —	1	$ 468,479
Restructured loans on nonaccrual				
Total restructured loans on nonaccrual	—	$ —	—	$ —

Loans classified as Special Mention or Substandard – Management evaluates all loan relationships periodically in order to assess the financial strength of the borrower and the value of any underlying collateral. Loans that are found to have a potential or actual weakness are classified as special mention or substandard and subject to increased monitoring by management. This typically includes frequent contact with the borrower to actively manage the borrowing relationship as needed to rehabilitate or mitigate the weakness identified. A summary of loan credit quality is presented below:

(In thousands)	June 30, 2014			
	Pass	**Special Mention**	**Substandard**	**Total**
Commercial and financial	$ 12,200	$ 1,078	$ 120	$ 13,398
Agricultural	4	—	—	4
Real estate – construction, commercial	21,992	—	39	22,031
Real estate – construction, residential	10,133	—	—	10,133
Real estate – mortgage, commercial	93,436	2,349	2,109	97,894
Real estate – mortgage, residential	110,134	2,147	623	112,904
Real estate – mortgage, farmland	271	—	—	271
Consumer installment loans	1,382	2	3	1,387
	$ 249,552	$ 5,576	$ 2,894	$ 258,022

(In thousands)	December 31, 2013			
	Pass	**Special Mention**	**Substandard**	**Total**
Commercial and financial	$ 11,412	$ 1,017	$ 34	$ 12,463
Agricultural	1	—	—	1
Real estate – construction, commercial	21,253	—	1,706	22,959
Real estate – construction, residential	9,337	—	19	9,356
Real estate – mortgage, commercial	93,659	514	4,537	98,710
Real estate – mortgage, residential	97,613	991	1,065	99,669
Consumer installment loans	1,378	2	5	1,385
	$ 234,653	$ 2,524	$ 7,366	$ 244,543

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

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

	For the Six Months Ended June 30,	
	2014	**2013**
Balance, beginning of year	$ 4,273,099	$ 4,679,154
Provision for loan losses	728,790	87,828
Loans charged off	(586,848)	(1,094,154)
Recoveries of loans previously charged off	252,857	501,747
Balance, end of period	$ 4,667,898	$ 4,174,575

Note 11 — SBA Loan Servicing Rights

Loan Servicing Rights (LSR) are initially booked at an estimated original fair value during the current quarter. At quarter end the estimated original fair value is determined by an independent evaluation at loan level detail, less accumulated amortization with any resulting adjustment to SBA loan income. Amortization is recorded over the expected life of the loan as a component of SBA loan income. Under the amortization method, loan servicing rights are amortized in proportion to, and over the period of, estimated servicing income. The LSR asset is evaluated for impairment at the end of each quarter, by obtaining a current fair value from an independent third party. For the period ended June 30, 2014, the carrying value of the SBA LSRs was $1,610,000 and the fair value of the SBA LSRs was $1,967,000. As of December 31, 2013, the carrying value of the SBA LSRs was $1,433,000 and the fair value of the SBA LSRs was $1,656,000. As a result of the quarterly independent valuation process, no valuation allowance was required at either period end. The related balance of SBA loans participated and serviced for others was $76,898,000 at June 30, 2014 and $67,185,000 at December 31, 2013.

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

Note 12 — Other Real Estate Owned

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

	Six Months Ended June 30,	
	2014	**2013**
Balance, beginning of year	$ 11,544,720	$ 13,520,752
Additions	1,423,319	5,488,774
Disposals	(981,043)	(3,863,327)
Valuation write downs and losses on sales	(337,216)	(1,425,626)
Balance, end of period	$ 11,649,780	$ 13,720,573

Expenses related to other real estate owned include the following:

	Six Months Ended June 30,	
	2014	2013
Net loss on sales of real estate	$ 60,055	$ 604,330
Valuation write downs	277,161	812,661
Operating expenses	161,061	316,741
	$ 498,277	$ 1,733,732

Other real estate owned represents collateral property taken back from borrowers in partial or full satisfaction of their defaulted debt obligation to the Company. We track our historical experience of loans that ultimately convert to other real estate owned by collateral type and by geographic exposure as shown on the following tables:

	Book Value of Other Real Estate at June 30, 2014			
(In thousands)	Florida	Georgia	South Carolina	Total
Residential	$ 338	$ 392	$ 781	$ 1,511
Commercial	2,453	—	3,248	5,701
Finished lots	292	—	1,388	1,680
Raw land	2,193	142	423	2,758
	$ 5,276	$ 534	$ 5,840	$ 11,650

	Number of Parcels at June 30, 2014			
	Florida	Georgia	South Carolina	Total
Residential	2	1	5	8
Commercial	2	—	17	19
Finished lots	7	—	114	121
Raw land	7	1	3	11
	18	2	139	159

	Book Value of Other Real Estate at December 31, 2013			
(In thousands)	Florida	Georgia	South Carolina	Total
Residential	$ 338	$ 392	$ 733	$ 1,463
Commercial	2,172	397	2,649	5,218
Finished lots	270	—	1,714	1,984
Raw land	2,053	394	433	2,880
	$ 4,833	$ 1,183	$ 5,529	$ 11,545

	Number of Parcels at December 31, 2013			
	Florida	Georgia	South Carolina	Total
Residential	2	1	3	6
Commercial	2	1	15	18
Finished lots	6	—	115	121
Raw land	7	2	3	12
	17	4	136	157

During the six months ended June 30, 2014 we sold a total of six other real estate owned properties with a total book value of $1,041,000. The net proceeds from these sales were $981,000, which resulted in a net recovery of approximately 42.9% of the original loan amounts and 94.2% of the book value of the other real estate sold. During the six months ended June 30, 2013 we sold a total of 52 other real estate owned properties with a total book value of $4,466,000. The net proceeds from these sales were $3,863,000, which resulted in a net recovery of approximately 51.7% of the original loan amounts and 86.5% of the book value of the other real estate sold.

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

Note 13 — Deposits

Total deposits remained nearly flat during the first six months of 2014 increasing by $269,000 or 0.09%, to a total of $292,260,000 at June 30, 2014 from $291,991,000 at December 31, 2013. Noninterest-bearing demand deposits increased $1,197,000 or 4%, while interest-bearing demand deposits increased $3,891,000 or 3%. The Company has continued its use of a modest level of brokered deposits, which carry substantially lower interest rates than comparable term core retail deposits. Brokered deposits are issued in individual's names and in the names of trustees with balances participated out to others. Core retail deposits are deposits which are gathered in the normal course of business, without the use of a broker. Core reciprocal deposits are gathered in the same manner as core retail deposits, but the funds are participated out to other banks through use of the CDARS reciprocal transactions program. The CDARS program allows depositors to obtain FDIC insurance for deposits up to $50 million by exchanging the portions of their deposits in excess of FDIC insurance limitations with other financial institutions participating in the CDARS program. In return, we receive an equal amount of deposits back from other CDARS participating financial institutions, such that there is no net change in the level of total deposits on our balance sheet.

Balances and percentages within the major deposit categories are as follows:

	June 30, 2014			
(In thousands)	Core Retail Deposits	Core Reciprocal Deposits	Brokered Deposits	Total Deposits
Noninterest-bearing demand deposits	$ 35,159	$ —	$ —	$ 35,159
Interest-bearing demand deposits	119,747	—	—	119,747
Savings deposits	4,263	—	—	4,263
Certificates of deposit $100,000 and over	47,074	33,949	—	81,023
Other time deposits	39,797	998	11,273	52,068
	$ 246,040	$ 34,947	$ 11,273	$ 292,260

	December 31, 2013			
(In thousands)	Core Retail Deposits	Core Reciprocal Deposits	Brokered Deposits	Total Deposits
Noninterest-bearing demand deposits	$ 33,961	$ —	$ —	$ 33,961
Interest-bearing demand deposits	115,856	—	—	115,856
Savings deposits	4,301	—	—	4,301
Certificates of deposit $100,000 and over	52,414	33,533	—	85,947
Other time deposits	43,108	1,208	7,610	51,926
	$ 249,640	$ 34,741	$ 7,610	$ 291,991

Note 14 - Other Borrowings

Other Borrowings of $99,200,000 at June 30, 2014 are composed of advances from the Federal Home Loan Bank of Atlanta (FHLB) and represent a $62,850,000 increase from $36,350,000 at December 31, 2013.

FHLB advances outstanding and related terms at June 30, 2014 and December 31, 2013 are shown in the following tables:

		FHLB Advances Outstanding June 30, 2014		
Type advance	**Balance**	**Interest rate**	**Maturity date**	**Convertible date**
Fixed rate	10,000,000	0.21%	July 14, 2014	
Fixed rate	10,000,000	0.21%	July 18, 2014	
Fixed rate	10,000,000	0.19%	July 25, 2014	
Fixed rate	10,000,000	0.20%	July 28, 2014	
Fixed rate	5,000,000	2.09%	August 10, 2015	
Fixed rate	5,000,000	1.95%	August 9, 2016	
Fixed rate	2,000,000	2.84%	August 9, 2017	
Convertible fixed rate	2,000,000	3.69%	September 7, 2017	September 7, 2014
Fixed rate	3,000,000	2.94%	August 9, 2018	
Variable rate overnight	42,200,000	0.36%		
Total	$ 99,200,000	0.66%		

		FHLB Advances Outstanding December 31, 2013		
Type advance	**Balance**	**Interest rate**	**Maturity date**	**Convertible date**
Fixed rate	$ 5,000,000	2.09%	August 10, 2015	
Fixed rate	5,000,000	1.95%	August 9, 2016	
Fixed rate	2,000,000	2.84%	August 9, 2017	
Convertible fixed rate	2,000,000	3.69%	September 7, 2017	March 7, 2014
Fixed Rate	3,000,000	2.94%	August 9, 2018	
Variable rate overnight	19,350,000	0.36%		
Total	$ 36,350,000	1.35%		

Note 15 - Junior Subordinated Debentures

In May 2004, Coastal Banking Company Statutory Trust I issued $3.0 million of trust preferred securities with a maturity of July 23, 2034. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $3,093,000 of the Company's junior subordinated debentures, which pay interest quarterly at a floating rate equal to 3 month LIBOR plus 275 basis points of the stated liquidation value of $1,000 per capital security. The Company used the proceeds from the sale of the junior subordinated debentures to strengthen the capital position of the Bank and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole asset of the Trust.

The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by Trust I, and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust I. The trust preferred securities must be redeemed upon maturity of the debentures on July 23, 2034, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust I in whole or in part, on or after July 23, 2009. As specified in the indentures, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

In June 2006, Coastal Banking Company Statutory Trust II issued $4.0 million of trust preferred securities with a maturity of September 30, 2036. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $4,124,000 of the Company's junior subordinated debentures, which pay interest quarterly at a floating rate equal to 3 month LIBOR plus 160 basis points of the stated liquidation value of $1,000 per capital security. The Company used the proceeds from the sale of the junior subordinated debentures to strengthen the capital position of the Bank and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole asset of the Trust.

The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by Trust II, and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust II. The trust preferred securities must be redeemed upon maturity of the debentures on September 30, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust II in whole or in part, on or after September 30, 2011. As specified in the indentures, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

As of June 30, 2014, the Company has paid all interest payments due on all trust preferred securities.

Note 16 – Employee Stock Purchase Plan

On February 27, 2013 the Board of Directors approved the adoption of the Coastal Banking Company Employee Stock Purchase Plan (the “Plan”) effective April 1, 2013, and set aside 250,000 shares of common stock for issuance under the Plan. The Plan allows eligible full time employees to direct an after-tax deduction from their pay to be accumulated and disbursed once per quarter to purchase newly issued common stock in the Company at a 5% discount to fair market value on the final day of each calendar quarter. Total shares purchased through the plan were 3,711 shares for the three month period ending June 30, 2014, 8,559 shares for the six month period ended June 30, 2014 and 12,686 shares for the year ending December 31, 2013. The 5% discount to fair market value is considered compensation cost to the Company and it totaled $1,299 for the three month period ended June 30, 2014, $2,920 for the six month period ended June 30, 2014 and $4,751 for the year ended December 31, 2013.

Note 17 – Reclassifications

Certain amounts reported as of December 31, 2013, or the periods ended June 30, 2013, have been reclassified to conform with the presentation of June 30, 2014. These reclassifications had no effect on previously reported net loss or shareholders’ equity.