Coastal Banking Company, Inc.

Quarterly Financial Results (Unaudited)

As of September 30, 2014

Coastal Banking Company
Consolidated Balance Sheets

	September 31, 2014 (unaudited)	December 31, 2013 (audited)
Assets		
Cash and due from banks	$ 2,343,922	$ 5,920,153
Interest-bearing deposits in banks	2,007,679	786,483
Federal funds sold	92,251	60,356
Securities available for sale, at fair value	26,825,109	38,754,470
Restricted equity securities, at cost	6,206,900	3,504,050
Loans held for sale, at fair value	29,272,968	32,283,708
Loans, net of unearned income	267,392,515	244,543,025
Less allowance for loan losses	4,634,523	4,273,099
Loans, net	262,757,992	240,269,926
Premises and equipment, net	7,299,428	7,538,177
Cash surrender value of life insurance	2,381,561	2,286,590
SBA loan servicing rights	1,621,630	1,432,976
Other real estate owned	7,880,069	11,544,720
Loan sales receivable	87,543,300	24,621,985
Other assets	9,066,177	6,636,515
Total assets	$ 445,298,986	$ 375,640,109
Liabilities and Shareholders’ Equity		
Deposits:		
Noninterest-bearing	$ 41,325,825	$ 33,961,565
Interest-bearing	251,698,386	258,029,192
Total deposits	293,024,211	291,990,757
Securities sold under agreements to repurchase	—	—
Other borrowings	101,150,000	36,350,000
Junior subordinated debentures	7,217,000	7,217,000
Mortgage banking indemnification reserve	1,937,801	2,455,350
Other liabilities	4,901,475	2,718,114
Total liabilities	408,230,487	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; 2,637,138 shares issued and outstanding at September 30, 2014; 2,618,275 shares issued and outstanding at December 31, 2013	26,371	26,183
Additional paid-in capital	41,371,316	41,207,631
Accumulated deficit	(14,651,576)	(16,156,346)
Accumulated other comprehensive income	372,388	(118,580)
Total shareholders’ equity	37,068,499	34,908,888
Total liabilities and shareholders’ equity	$ 445,298,986	$ 375,640,109

See accompanying notes to unaudited consolidated financial statements.

Coastal Banking Company
Consolidated Statements of Income
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Interest income:				
Interest and fees on loans	$ 4,517,488	$ 3,660,449	$ 12,279,582	$ 11,686,354
Interest on taxable securities	214,735	181,434	635,514	462,470
Interest on nontaxable securities	52,715	34,324	187,890	65,066
Interest on deposits in other banks	1,597	20,715	5,135	45,554
Interest on federal funds sold	41	30	115	108
Total interest income	4,786,576	3,896,952	13,108,236	12,259,552
Interest expense:				
Interest on deposits	439,687	560,815	1,357,484	1,896,607
Interest on junior subordinated debentures	42,847	48,585	127,589	153,801
Interest on other borrowings	162,587	136,569	432,619	501,760
Total interest expense	645,121	745,969	1,917,692	2,552,168
Net interest income	4,141,455	3,150,983	11,190,544	9,707,384
Provision for loan losses	222,657	170,999	951,447	258,827
Net interest income after provision for loan losses	3,918,798	2,979,984	10,239,097	9,448,557
Non-interest income:				
Service charges on deposit accounts	63,839	72,721	190,499	219,774
Other service charges, commissions and fees	106,993	94,384	318,899	267,394
SBA loan income	464,861	911,101	2,434,316	3,419,757
Mortgage banking income	8,955,346	3,779,045	21,237,524	19,478,547
Gain on sale of securities available for sale	83,873	118,561	124,663	119,376
Income from investment in life insurance contracts	21,181	20,298	60,293	59,201
Other income	451,047	14,805	486,467	57,247
Total other income	10,147,140	5,010,915	24,852,661	23,621,296
Non-interest expenses:				
Salaries and employee benefits	9,435,872	4,707,774	22,790,738	18,943,484
Occupancy and equipment expense	892,915	663,789	2,178,334	1,947,289
Mortgage loan expense	810,805	421,562	1,908,570	1,512,412
Data processing fees	306,871	458,426	1,130,629	1,382,344
Other real estate expenses	485,615	241,084	983,893	1,974,816
Legal and other professional fees	149,066	189,032	624,955	665,358
Advertising fees	74,522	393,733	272,370	1,556,334
Audit fees	114,814	119,435	291,354	337,345
FDIC insurance expense	95,720	134,110	264,693	432,108
Director fees	57,750	69,350	186,750	143,225
OCC examination fees	28,844	28,845	84,471	127,013
Amortization of intangible assets	—	1,699	—	5,095
Other operating	479,747	411,961	1,286,734	1,682,269
Total other expenses	12,932,541	7,840,800	32,003,491	30,709,092
Income before income tax (benefits)	1,133,397	150,099	3,088,267	2,360,761
Income tax expense (benefits)	337,489	102,550	968,511	(761,603)
Net income	$ 795,908	$ 47,549	$ 2,119,756	$ 3,122,364
Preferred stock dividends	223,875	124,374	614,986	420,520
Net earnings (loss) available to common shareholders	$ 572,033	$ (76,825)	$ 1,504,770	$ 2,701,844
Basic earnings (loss) per common share	$ 0.22	$ (0.03)	$ 0.57	$ 1.04
Diluted earnings (loss) per common share	$ 0.21	$ (0.03)	$ 0.57	$ 1.03

See accompanying notes to unaudited consolidated financial statements.

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

	2014	2013
Net income	$ 2,119,756	$ 3,122,364
Other comprehensive income, net of tax:		
Net unrealized holding gains (losses) arising during period, net of tax (benefit) of $295,309 and ($128,726)	573,246	(249,880)
Reclassification adjustment for gains included in net income, net of tax of $42,385 and $40,588	(82,278)	(78,788)
Total other comprehensive income (loss)	490,968	(328,668)
Comprehensive income	$ 2,610,724	$ 2,793,696

See accompanying notes to unaudited consolidated financial statements.

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

	2014	2013
Cash flows from operating activities:		
Net income	$ 2,119,756	$ 3,122,364
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	600,089	509,383
Amortization of intangible assets	—	5,095
Stock-based compensation expense	59,117	78,435
Provision for loan losses	951,447	258,827
Gain on sale of securities available for sale	(124,663)	(119,376)
Gain on sale of premises and equipment	(9,522)	—
Net (increase) decrease in loan sales receivable	(62,921,354)	62,359,267
Write downs and losses on sale of other real estate owned	737,548	1,560,818
Proceeds from sales of other real estate owned	4,350,422	4,414,689
Increase in cash value of life insurance	(94,971)	(59,201)
Originations of mortgage loans held for sale	(1,096,105,846)	(1,112,582,604)
Proceeds from sales of mortgage loans held for sale	1,120,354,110	1,177,806,604
Net increase (decrease) in interest receivable	(44,747)	59,412
Net increase (decrease) in interest payable	4,540	(258,205)
SBA loan income	(2,434,316)	(3,419,757)
Mortgage banking income	(21,237,524)	(19,478,547)
Net other operating activities	654,148	1,212,760
Net cash provided by (used in) operating activities	(53,141,766)	115,469,964
Cash flows from investing activities:		
Net(increase) in interest-bearing deposits in banks	(1,221,196)	(3,346,845)
Net (increase) in federal funds sold	(31,895)	(1,520,997)
Proceeds from maturities of securities available for sale	3,253,819	4,081,284
Proceeds from sale of securities available for sale	9,261,009	1,516,826
Proceeds from sale of fixed assets	29,379	—
Purchases of securities available for sale	—	(23,169,143)
Purchase (redemption) of restricted equity securities	(2,702,850)	2,991,750
Net (increase) decrease in loans	(24,862,832)	2,577,860
Purchase of premises and equipment	(98,109)	(702,840)
Net cash used in investing activities	(16,372,675)	(17,572,105)
Cash flows from financing activities:		
Net increase (decrease) in deposits	1,033,454	(31,170,953)
Net decrease in securities sold under agreements to repurchase	—	(6,055,000)
Proceeds from exercise of stock options	23,460	12,376
Proceeds from issuance of new shares of stock	81,296	45,345
Warrant repurchase	—	(324,648)
Net increase (decrease) in other borrowings	64,800,000	(64,427,609)
Net cash provided by (used in) financing activities	65,938,210	(101,920,489)
Net (decrease) in cash and due from banks	(3,576,231)	(4,022,630)
Cash and due from banks at beginning of period	5,920,153	7,936,393
Cash and due from banks at end of period	$ 2,343,922	$ 3,913,763
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 1,913,152	$ 2,810,373
Cash paid during the year for Federal income taxes	$ —	$ 1,099,000
Noncash Transactions:		
Principal balances of loans transferred to other real estate owned	$ 1,423,319	$ 6,304,123

See accompanying notes to unaudited consolidated financial statements.

Notes to Consolidated Financial Statements – September 30, 2014 and 2013 (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 September 30, 2014 and September 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 nine months ended September 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 September 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 September 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%	21.32%	21.46%
Tier 1 capital (to risk-weighted assets)	6.00%	20.05%	20.20%
Tier 1 capital (to total average assets)	5.00%	9.82%	9.90%

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.

At issue, the preferred stock had an annual 5% cumulative preferred dividend rate for a $12.50 dividend per share, 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 quarterly dividends to $22.50 per share. Dividends compound if they are unpaid when due. On August 15, 2014 the quarterly dividend was paid to shareholders of record on August 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 $2,120,000 for the nine months ended September 30, 2014 compared to net income of $3,122,000 for the nine months ended September 30, 2013, a 32% year over year decline in net income for the comparative nine month period. The third 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 $3.1 million in the nine months ended September 30, 2014 was up 31% from the pre-tax income of $2.4 million during the nine months ended September 30, 2013. This year over year improvement in nine month earnings was driven primarily by a $1.5 million or 15% increase in net interest income, partially offset by an increase to provision for loan loss expense of $693,000. Included in the Q3 results was a nonrecurring income event of $437,000 from the impact of reducing the mortgage banking indemnification reserve recorded as other income (see Note 4 Supplemental Segment Information for additional information).

For the quarter ended September 30, 2014 the Company recorded net income of $796,000 compared to net income of $48,000 during the third quarter of 2013, nearly a seventeen fold year over year increase in third quarter net income. The increase in year over year third quarter earnings reflects higher levels of core earnings with net interest income of $4.1 million up by $990,000 or 31% and non-interest income of $10.1 million up by $5.1 million, double that from a year ago on improving mortgage banking income, offset by a $5.1 million increase in expenses related to higher mortgage loan volume.

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, federal funds purchased lines of credit, and the Federal Reserve Bank discount window.

As of September 30, 2014, the Company had $226.6 million in total borrowing capacity, of which we had utilized $110.6 million or 48.8%, leaving remaining available liquidity of $116.0 million. The following tables present available sources of liquidity at September 30, 2014 and December 31, 2013:

	September 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	29,317,281	9,476,618	19,840,663
Repurchase agreements secured by investment securities	10,535,474	—	10,535,474
Federal Reserve Borrowing Capacity at Discount Window	24,120,459	—	24,120,459
Federal Home Loan Bank Advance Availability	132,610,000	101,150,000	31,460,000
Total sources of liquidity	$ 226,583,214	$ 110,626,618	$ 115,956,596

	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 include 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 slightly over $88 million during the first nine 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 75% at September 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 nine months ended September 30.

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Net income	$ 795,908	$ 47,549	$ 2,119,756	$ 3,122,364
Preferred stock dividends	(223,875)	(124,374)	(614,986)	(420,520)
Net income (loss) available to common shareholders	$ 572,033	$ (76,825)	$ 1,504,770	$ 2,701,844
Weighted average common shares	2,637,101	2,608,879	2,630,514	2,602,977
Effect of dilutive securities	31,394	37,612	27,488	31,471
Diluted average common shares	2,668,495	2,646,491	2,658,002	2,634,448
Earnings (losses) per common share	$ 0.22	$ (0.03)	$ 0.57	$ 1.04
Diluted earnings (losses) per common share	$ 0.21	$ (0.03)	$ 0.57	$ 1.03

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 Lending 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 Lending 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 September 30,	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Interest income	$ 2,357	$ 2,478	$ 632	$ 615	$ 1,797	$ 804
Interest expense	60	483	134	30	451	233
Net interest income	2297	1,995	498	585	1,346	571
Provision for loan losses	80	47	25	33	117	91
Net interest income after provision	2,217	1,948	473	552	1,229	480
Non interest income	302	368	465	912	9,380	3,731
Non interest expense	2,678	3,101	549	651	9,706	4,089
Net income (loss) before tax expense (benefit)	(159)	(785)	389	813	903	122
Income tax expense (benefit)	(34)	(196)	113	260	258	39
Net income (loss)	$ (125)	$ (589)	$ 276	$ 553	$ 645	$ 83

(In thousands)	**Community Banking**		**SBA Lending Operations**		**Mortgage Banking Operations**	
Nine months ended September 30,	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Interest income	$ 7,169	$ 7,830	$ 1,829	$ 1,602	$ 4,110	$ 2,828
Interest expense	458	1,463	423	86	1,037	1,003
Net interest income	6,711	6,367	1,406	1,516	3,073	1,825
Provision for loan losses	508	47	187	33	256	179
Net interest income after provision	6,203	6,320	1,219	1,483	2,817	1,646
Non interest income	797	873	2,436	3,421	21,620	19,327
Non interest expense	7,596	10,286	2,019	1,745	22,389	18,678
Net income (loss) before tax expense (benefit)	(596)	(3,093)	1,636	3,159	2,048	2,295
Income tax expense (benefit)	(177)	(2,510)	512	1,011	633	738
Net income (loss) after taxes	$ (419)	$ (583)	$ 1,124	$ 2,148	$ 1,415	$ 1,557

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 September 30, 2014 this segment had 67 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. Myers, Tampa 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 September 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 263 full time equivalent employees at September 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 nine months of 2014, approximately 23% 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 September 30, 2014, we have sold over 32,500 residential mortgage loans into the secondary market with a principal balance of nearly $7.0 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 929 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 September 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, over 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. During September 2014 we updated our analysis of the indemnification reserve considering current business volume, known claims outstanding, trends in presentment of new claims, and recent changes announced by Fannie Mae related to the vintage of future loan repurchase demands. As a result of this analysis the indemnification reserve was reduced by $437,000 to $1,938,000 at September 30, 2014, and reflected as other income. Management believes the reserve level 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 the suspension of additions to the reserve or alternatively decide that further additions to the reserve may be appropriate. However, we can provide no assurance that our methodology will not change and that the balance of this indemnification reserve will prove sufficient to cover actual costs in the future.

The primary source of direct income generated by the mortgage banking division is the gain on sale of mortgage loans which was $8,955,000 for the quarter ended September 30, 2014 compared to $3,779,000 for the quarter ended September 30, 2013. For the first nine months of 2014, the gain was $21,238,000 compared to $19,479,000 for the same period in 2013. The increase in gain on sale is a result of higher volume caused by a stable to downward trend in long term interest rates which has fueled increasing loan demand for purchase money loans. 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 51% of units funded for the nine months ended September 30, 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 be well positioned to maintain funding levels when long term rates begin to rise.

The direct noninterest expenses incurred by the division were $9,706,000 for the third quarter of 2014, an increase of $5,617,000 over the third quarter 2013 expenses of $4,089,000. The largest contributor to this increase was in salaries and benefits, which were $7,623,000 for third quarter 2014, compared to $2,506,000 for the third quarter 2013, a year over year increase of 204%. This Q3 year over year rise in mortgage banking compensation expense occurred as a result of an increase lending volume of $237.3 million or 88%, from $271.0 million in Q3-2013 to $508.3 million in Q3-2014. Typically lending volume and compensation expense are closely correlated. 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 third quarter loan funding activity, wholesale loans funded in 2014 were down from 2013 by $194.6 million or 35% while retail loans funded increased by $192.8 million or 33%. This shifted the delivery channel mix from 48%/52% wholesale/retail in 2013 to 31%/69% wholesale/retail in 2014. The increase in retail lending mix resulted in higher commission expense in addition to the effect of higher funding levels.

For the nine months ended September 30, 2014, noninterest expenses incurred by the mortgage banking division were $22,389,000, an increase of $3,711,000 compared to $18,678,000 of noninterest expense for the first nine months of 2013. The largest contributor to this increase was a $4,363,000 increase in salaries and benefits, which totaled $17,152,000 for the nine months of 2014, compared to $12,789,000 for the same period in 2013 partially offset by a reduction of $1,237,000 in leads-based advertising expense to $183,000 in the nine months ended September 30, 2014 compared to $1,420,000 during the same period in 2013.

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 $116,644,000 for the three months ended September 30, 2014 versus $62,657,000 for the three months ended September 30, 2013. The interest income earned on these loans available for sale was $1,253,000 and $651,000 during the three months ended September 30, 2014 and 2013, respectively. For the nine months ended September 30, the average outstanding daily balance of residential loans available for sale was $88,051,000 in 2014 and $93,409,000 in 2013. The interest income earned on these loans available for sale was $2,845,000 and $2,573,000 during the first three quarters 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 September 30, 2014, net interest income totaled $4,141,000 as compared to $3,151,000 for the quarter ended September 30, 2013 for an increase of $990,000. On a consecutive quarter basis, net interest income was up by $442,000, or 12%, from the $3,699,000 earned during the quarter ended June 30, 2014.

Total interest income increased by $890,000 to $4,787,000 for the three months ended September 30, 2014 compared to $3,897,000 for the three months ended September 30, 2013. On a consecutive quarter basis, total interest income increased by $432,000, or 10%, from the $4,355,000 earned during the quarter ended June 30, 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 September 30, 2014 and September 30, 2013 the Bank held $116,027,000 and $109,781,000 respectively, in loans carrying rates based on the Prime interest rate index.

Average earning assets increased to an average balance of $414,657,000 during the quarter ended September 30, 2014, up by $62,818,000 or 18%, from the average balance during the quarter ended September 30, 2013. The most significant increase in interest income was in interest earned on mortgage loans held for sale, which increased $602,000 to $1,253,000 during the third quarter of 2014, compared to $651,000 during the third quarter of 2013. Interest and fees earned on portfolio loans increased by $255,000, or 8%, to $3,264,000 in the three months ended September 30, 2014 from $3,009,000 in the three months ended September 30, 2013. Interest income from investment securities increased $51,000, or 24%, to $267,000 in the three months ended September 30, 2014 compared to $216,000 earned in the three months ended September 30, 2013. On a consecutive quarter basis, interest income from investments increased by $32,000 from $235,000 earned during the quarter ended June 30, 2014. Interest and fees earned on loans increased by $399,000, or 10%, from $4,118,000 during the quarter ended June 30, 2014.

Interest income not recognized on non-accruing loans during the quarter ended September 30, 2014 was $3,000, a decrease of $6,000 from the $9,000 of interest income not recognized during the same quarter in 2013. On a consecutive quarter basis, interest income not recognized on non-accruing loans decreased $56,000 from the $59,000 interest lost during the quarter ended June 30, 2014. There have been no non-accruing loans returned to accrual status during the nine month period ended September 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 $101,000, or 14%, to $645,000 for the three months ended September 30, 2014 compared to $746,000 for the same period in 2013. Although average interest bearing liabilities increased $56.2 million to $364.4 million for the three months ended September 30, 2014 compared to the same period in 2013, the rate on those average liabilities declined 26 basis points as a result of an increase in the level of lower cost, short term borrowings. On a consecutive quarter basis, total interest expense decreased by $11,000, or 2%, from $656,000 expensed during the quarter ended 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 42 basis points to 4.01% for the three months ended September 30, 2014 when compared to the 3.59% net interest margin earned during the same three months in 2013. On a consecutive quarter basis, the net interest margin increased by 17 basis points from 3.84% during the quarter ended June 30, 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 45 basis points to 3.92% for the three months ended September 30, 2014 compared to the 3.47% net interest rate spread earned during the same three month period in 2013. On a consecutive quarter basis, the net interest rate spread increased by 18 basis points from 3.74% during the quarter ended June 30, 2014.

For the nine months ended September 30, 2014, net interest income totaled $11,191,000 as compared to $9,707,000 for the same period in 2013, for an increase of $1,484,000, or 15%. Total interest income increased $848,000 or 7% to $13,108,000 at September 30, 2014 as compared to $12,260,000 for the same period last year. Interest and fees on loans increased by $594,000, or 5%, to $12,280,000 in the nine months ended September 30, 2014 from $11,686,000 in the nine months ended September 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 nine months of last year, the increase in loan interest income for the nine months ended September 30, 2014 totals $909,000 compared to the same period last year. Interest income on investment securities increased by $295,000, or 56%, to $823,000 in the nine months ended September 30, 2014 compared to $528,000 in the nine months ended September 30, 2013. Total interest expense decreased by $634,000, or 25%, to $1,918,000 for the nine months ended September 30, 2014 compared to $2,552,000 for the same period in 2013. The net interest margin and the interest rate spread were 3.93% and 3.83%, respectively, for the nine months ended September 30, 2014. The net interest margin realized on earning assets and the interest rate spread were 3.48% and 3.38%, respectively, for the nine months ended September 30, 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)	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012
Portfolio loans, gross	$ 267,393	$ 258,022	$ 253,803	$ 244,543	$ 232,872	$ 235,566	$ 232,592	$ 242,437
Loans past due > 30 days and still accruing interest	$ 455	$ 1,720	$ 152	$ 785	$ 261	$ 584	$ 388	$ 1,442
Loans on nonaccrual	$ 2,881	$ 2,787	$ 2,045	$ 2,116	$ 3,152	$ 3,673	$ 4,881	$ 9,439
(as a % of loans, gross)	1.08%	1.08%	0.81%	0.87%	1.35%	1.56%	2.10%	3.90%
Net loan charge offs (recoveries)	$ 256	$ 85	$ 249	$ 64	$ 92	$ 412	$ 180	$ 1,807
(as a % of loans, gross)	0.10%	0.03%	0.10%	0.03%	0.04%	0.18%	0.08%	0.75%

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 increasing trends 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 $455,000 at September 30, 2014, a decrease of $330,000 or 42% 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, then spiked up to $1.7 million at the end of Q2-2014 before dropping back to $455,000. As a result, the previous quarter increase appears to be an aberration rather than indicative of a negative trend. 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 September 30, 2014 nonaccrual balance of $2,881,000 is an increase of $94,000 over the balance of nonaccrual loans at June 30, 2014. During the three months ended September 30, 2014 one loan migrated to nonaccrual status and one loan had a principal reduction of $440,000 and the remaining balance of $239,000 was charged off. 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 September 30, 2014, we recorded charge offs net of recoveries of $256,000. This amount represented an increase of $171,000, or 201%, from the $85,000 in net charge offs recorded during the prior quarter ended June30, 2014, and an increase of $164,000, or 178% from the $92,000 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 $223,000 for the three months ended September 30, 2014, as compared to $171,000 for the three months ended September 30, 2013. On a consecutive quarter basis, this provision level was $250,000, or 53%, lower than the $473,000 provision charged to expense during the quarter ended June 30, 2014. The decreased level of provision expense for the three months ended September 30, 2014, as related to the prior comparative periods, does not necessarily indicate a general overall improvement of loan portfolio credit quality, but rather was driven by a combination of reduced levels directional risk factors of past due loans, nonaccrual loans, and loans classified as substandard.

(In thousands)	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012
Provision during quarter ended	$ 223	$ 473	$ 256	$ 83	$ 171	$ 57	$ 31	$ 957
Provision added in excess of net charge-offs	$ (33)	$ 388	$ 7	$ 19	$ 79	$ (355)	$ (149)	$ (850)
Allowance for loan losses	$ 4,635	$ 4,668	$ 4,280	$ 4,273	$ 4,254	$ 4,175	$ 4,530	$ 4,679
(as a % of loans, gross)	1.73	1.81%	1.69%	1.75%	1.83%	1.77%	1.95%	1.93%

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 September 30, 2014 the current provision for loan losses of $223,000 was less than net charge offs against the allowance of $256,000 by $33,000. The result was a decrease to the allowance for loan losses by $33,000 to a level of $4,635,000, or 1.73% of gross loans outstanding at September 30, 2014, as compared to $4,668,000, or 1.81% of gross loans outstanding at June 30, 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 September 30, 2014 totaled $10,147,000 as compared to $5,011,000 for the three months ended September 30, 2013. SBA loan income declined $446,000 or 49% to $465,000 for the three month period ended September 30, 2014 compared to $911,000 for the third quarter of 2013. Mortgage banking income was $8,955,000 for the quarter ended September 30, 2014 compared to $3,779,000 for the same period during 2013 for an increase of $5,176,000 or 137%. Other income for the three month period ended September 30, 2014 increased $436,000 to $451,000 as compared to $15,000 for the same period last year as a result of reducing the mortgage banking indemnification reserve by $437,000. This reserve was established by reducing the gain recognized on each loan sold to the secondary market. Recording a reduction to the reserve balance, as discussed above, could have been appropriately recorded as an increase to gain on sale of loans for the current period. The intent in recording the reserve adjustment as other income was to highlight the unusual and non-recurring nature of this reduction to the reserve.

Noninterest income for the nine months ended September 30, 2014 totaled $24,853,000, an increase of $1,232,000 or 5%, as compared to $23,621,000 for the nine months ended September 30, 2013. The largest increase was in mortgage banking income, which increased $1,759,000 to $21,238,000 for the nine months of 2014, compared to $19,479,000 for the same period of 2013. During the three quarters of 2014, we recorded net gains of $125,000 on sales of securities available for sale, compared to net gains of $119,000 recorded during the same period of 2013.

Note 8 - Noninterest Expense

Total noninterest expense for the three months ended September 30, 2014 was $12,933,000, an increase of $5,092,000 or 65%, compared to $7,841,000 for the same period in 2013. Salaries and benefits expense doubled to $9,436,000 for the three month period ended September 30, 2013 from $4,708,000 for the same period last year and is the primary cause of the increase in total noninterest expense. Noninterest expenses at the mortgage banking segment increased $5,617,000 or 137% to $9,706,000 for the three months ended September 30, 2014 as compared to $4,089,000 for the same period of 2013 partially offset by a $423,000 or 14% decrease for the community banking segment to $2,678,000 for the third quarter of 2014, compared to $3,101,000 in the third quarter of 2013, reflective of the successful cost cutting efforts during the final quarter of 2013.

Mortgage loan expenses increased $389,000 or 92% from $422,000 to $811,000 for the three months ended September 30, 2014 compared to the same period a year ago. The increase in mortgage loan related expenditures is the result of the higher volume of mortgage loan closings similar to the increase in salary and benefits expense at the mortgage division.

Other real estate expense increased $245,000 to $486,000 for the third quarter of 2014 compared to $241,000 during the same period of 2013. The increase in other real estate expense is primarily the result a $398,000 loss on sale of one residential development property consisting of 83 parcels during the three months ended September 30, 2014.

Advertising expenses totaled $75,000 for the third quarter of 2014, a decrease of $319,000, or 81% from the $394,000 expensed in the third 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 nine months ended September 30, 2014 was $32,003,000, as compared to $30,709,000 for the same period in 2013. The largest contributor to this increase was in salary and benefit expenses, which increased $3,847,000 or 20% to $22,791,000 during the three quarters of 2014 compared to $18,943,000 during the same three quarters of 2013. The increase in salaries and benefits expense was partially offset by a decline of $1,284,000 or 83% in advertising expense to $272,000 for the nine months ended September 30, 2014 compared to $1,556,000 for the same period in 2013. Other real estate expense totaled $984,000 for the nine months ended September 30, 2014, a decline of $991,000 or 50% from $1,975,000 for the same period in 2013. The improvement in expenses related to other real estate is the result of a decline of $588,000 in valuation write-downs, a decline of $235,000 in losses on sale of properties, and a reduction of $168,000 in expenses related to holding those properties.

Note 9 – Investment Securities

Investment securities are as follows:

	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
State and municipal securities	$ 4,224,722	$ 347,728	$ (350)	$ 4,572,100
Mortgage-backed securities	22,036,162	272,960	(56,113)	22,253,009
	$ 26,260,884	$ 620,688	$ (56,463)	$ 26,825,109

	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:

	September 30, 2014	December 31, 2013
Commercial and financial	$ 11,611,952	$ 12,463,122
Agricultural	3,748	852
Real estate – construction, commercial	23,975,614	22,958,615
Real estate – construction, residential	11,042,263	9,356,006
Real estate – mortgage, commercial	95,756,500	98,710,146
Real estate – mortgage, residential	123,473,121	99,669,408
Real estate – mortgage, farmland	268,263	—
Consumer installment loans	1,261,054	1,384,876
Gross loans	267,392,515	244,543,025
Less: Allowance for loan losses	4,634,523	4,273,099
Net loans	$ 262,757,992	$ 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:

(In thousands)	September 30, 2014 30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due & Accruing	Nonaccrual	Total Past Due & Nonaccrual	Current Loans	Total Loans
Commercial and financial	$ 10	$ 15	$ —	$ 91	$ 116	$ 11,496	$ 11,612
Agricultural	—	—	—	—	—	4	4
Real estate – construction, commercial	—	—	—	39	39	23,937	23,976
Real estate – construction, residential	—	—	—	—	—	11,042	11,042
Real estate – mortgage, commercial	428	—	—	1,355	1,783	93,974	95,757
Real estate – mortgage, residential	—	—	—	1,396	1,396	122,077	123,473
Real estate – mortgage, farmland	—	—	—	—	—	268	268
Consumer installment loans	—	2	—	—	2	1,259	1,261
	$ 438	$ 17	$ —	$ 2,881	$ 3,336	$ 264,057	$ 267,393

(In thousands)	December 31, 2013 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

<u>Other Risk Elements in the Loan Portfolio</u>

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

	Loans with Interest Only Payments			
(In thousands)	September 30, 2014		December 31, 2013	
Commercial and financial	$ 3,347	8%	$ 3,310	10%
Agricultural	4	—%	—	—%
Real estate – construction, commercial	9,242	23%	8,974	26%
Real estate – construction, residential	4,702	11%	2,635	8%
Real estate – mortgage, commercial	5,510	13%	5,673	16%
Real estate – mortgage, residential	18,331	45%	13,593	40%
Consumer installment loans	33	—%	49	—%
	$ 41,169		$ 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			
	September 30, 2014			
(In thousands)	**Florida**	**Georgia**	**South Carolina**	**Other**
Commercial and financial	$ 4,999	$ 1,978	$ 3,712	$ 923
Agricultural	—	—	4	—
Real estate – construction, commercial	8,702	2,174	11,422	1,678
Real estate – construction, residential	4,190	3,125	3,645	82
Real estate – mortgage, commercial	45,551	15,506	31,073	3,627
Real estate – mortgage, residential	45,257	41,614	28,686	7,916
Real estate – mortgage, farmland	—	268	—	—
Consumer installment loans	324	259	601	77
	$ 109,023	$ 64,924	$ 79,143	$ 14,303

	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	512	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 September 30, 2014 the Company held $17,135,000 of loans secured by junior liens, which represented approximately 6.4% of the total net loan portfolio. Net loan charge-offs totaled 391,000 in the nine months ended September 30, 2014 for all loans secured by junior liens for an annualized loss rate of 3.04%. 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 September 30, 2014 the loan portfolio included 61 loans with an aggregate balance of $20,384,000, or 7.6% 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.

	September 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	5,519,416	6,180,501	12	6,211,822	6,557,725
Total troubled debt restructurings	10	$ 5,519,416	$ 6,180,501	13	$ 6,909,842	$ 7,255,745

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

	September 30, 2014		September 30, 2013	
	Number of loans	**Recorded Investment**	**Number of loans**	**Recorded Investment**
Restructured loans less than 30 days past due				
Real estate – mortgage	—	$ —	1	$ 397,287
Total restructured loans less than 30 days past due	—	$ —	1	$ 397,287
Restructured loans 30 days or more past due				
Total restructured loans 30 days or more past due	—	$ —	—	$ —
Restructured loans on nonaccrual				
Total restructured loans on nonaccrual	—	$ —	—	$ —

Loans 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)	September 30, 2014			
	Pass	**Special Mention**	**Substandard**	**Total**
Commercial and financial	$ 10,430	$ 1,066	$ 116	$ 11,612
Agricultural	4	—	—	4
Real estate – construction, commercial	23,937	—	39	23,976
Real estate – construction, residential	11,042	—	—	11,042
Real estate – mortgage, commercial	93,975	350	1,432	95,757
Real estate – mortgage, residential	120,891	1,186	1,396	123,473
Real estate – mortgage, farmland	268	—	—	268
Consumer installment loans	1,259	—	2	1,261
	$ 261,806	$ 2,602	$ 2,985	$ 267,393

(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 nine Months Ended September 30,	
	2014	2013
Balance, beginning of year	$ 4,273,099	$ 4,679,154
Provision for loan losses	951,447	258,827
Loans charged off	(924,420)	(1,249,193)
Recoveries of loans previously charged off	334,397	565,315
Balance, end of period	$ 4,634,523	$ 4,254,103

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 September 30, 2014, the carrying value of the SBA LSRs was $1,622,000 and the fair value of the SBA LSRs was $1,996,000. 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 $78,643,000 at September 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:

	Nine Months Ended September 30,	
	2014	2013
Balance, beginning of year	$ 11,544,720	$ 13,520,752
Additions	1,423,319	6,304,123
Disposals	(4,350,422)	(4,414,689)
Valuation write downs and losses on sales	(737,548)	(1,560,818)
Balance, end of period	$ 7,880,069	$ 13,849,368

Expenses related to other real estate owned include the following:

	Nine Months Ended September 30,	
	2014	2013
Net loss on sales of real estate	$ 439,427	$ 674,855
Valuation write downs	298,121	885,962
Operating expenses	246,345	413,999
	$ 983,893	$ 1,974,816

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 September 30, 2014			
(In thousands)	Florida	Georgia	South Carolina	Total
Residential	$ 338	$ —	$ 48	$ 386
Commercial	2,453	—	1,637	4,090
Finished lots	263	—	551	814
Raw land	2,193	142	255	2,590
	$ 5,247	$ 142	$ 2,491	$ 7,880

	Number of Parcels at September 30, 2014			
	Florida	Georgia	South Carolina	Total
Residential	2	—	2	4
Commercial	2	—	9	11
Finished lots	6	—	38	44
Raw land	7	1	1	9
	17	1	50	68

	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 nine months ended September 30, 2014 we sold a total of 97 other real estate owned properties with a total book value of $4,790,000. The net proceeds from these sales were $4,350,000, which resulted in a net recovery of approximately 52.2% of the original loan amounts and 90.8% of the book value of the other real estate sold. During the nine months ended September 30, 2013 we sold a total of 57 other real estate owned properties with a total book value of $5,090,000. The net proceeds from these sales were $4,415,000, which resulted in a net recovery of approximately 52.7% of the original loan amounts and 86.7% 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 nine months of 2014 increasing by $1,033,000 or less than one percent, to a total of $293,024,000 at September 30, 2014 from $291,991,000 at December 31, 2013. Noninterest-bearing demand deposits increased $7,364,000 or 22% while interest-bearing demand deposits increased $3,709,000 or 3%. While daily balances for demand deposit accounts can vary significantly on specific days, the nine month average balance for noninterest-bearing demand deposit accounts at September 30, 2014 increased $4.3 million or 14% over the twelve month average balance at December 31, 2013. The Company has continued to use a modest level of brokered deposits, which historically 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 within the major deposit categories are as follows:

	September 30, 2014			
(In thousands)	**Core Retail Deposits**	**Core Reciprocal Deposits**	**Brokered Deposits**	**Total Deposits**
Noninterest-bearing demand deposits	$ 41,326	$ —	$ —	$ 41,326
Interest-bearing demand deposits	119,564	—	—	119,564
Savings deposits	4,638	—	—	4,638
Certificates of deposit $100,000 and over	43,190	35,826	—	79,016
Other time deposits	38,124	880	9,476	48,480
	$ 246,842	$ 36,706	$ 9,476	$ 293,024

	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 $101,150,000 at September 30, 2014 are composed of advances from the Federal Home Loan Bank of Atlanta (FHLB) and represent a $64,800,000 increase from $36,350,000 at December 31, 2013.

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

		FHLB Advances Outstanding September 30, 2014		
Type advance	**Balance**	**Interest rate**	**Maturity date**	**Convertible date**
Fixed rate	25,000,000	0.19%	October 6, 2014	
Fixed rate	10,000,000	0.19%	October 14, 2014	
Fixed rate	10,000,000	0.16%	October 20, 2014	
Fixed rate	15,000,000	0.16%	October 27, 2014	
Fixed rate	12,000,000	0.15%	October 29, 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	December 7, 2014
Fixed rate	3,000,000	2.94%	August 9, 2018	
Variable rate overnight	12,150,000	0.36%		
Total	$ 101,150,000	0.58%		

		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 September 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 3,404 shares for the three month period ending September 30, 2014, 11,963 shares for the nine month period ended September 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 $1,362 for the three month period ended September 30, 2014, $4,282 for the nine month period ended September 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 September 30, 2013, have been reclassified to conform with the presentation of September 30, 2014. These reclassifications had no effect on previously reported net loss or shareholders' equity.