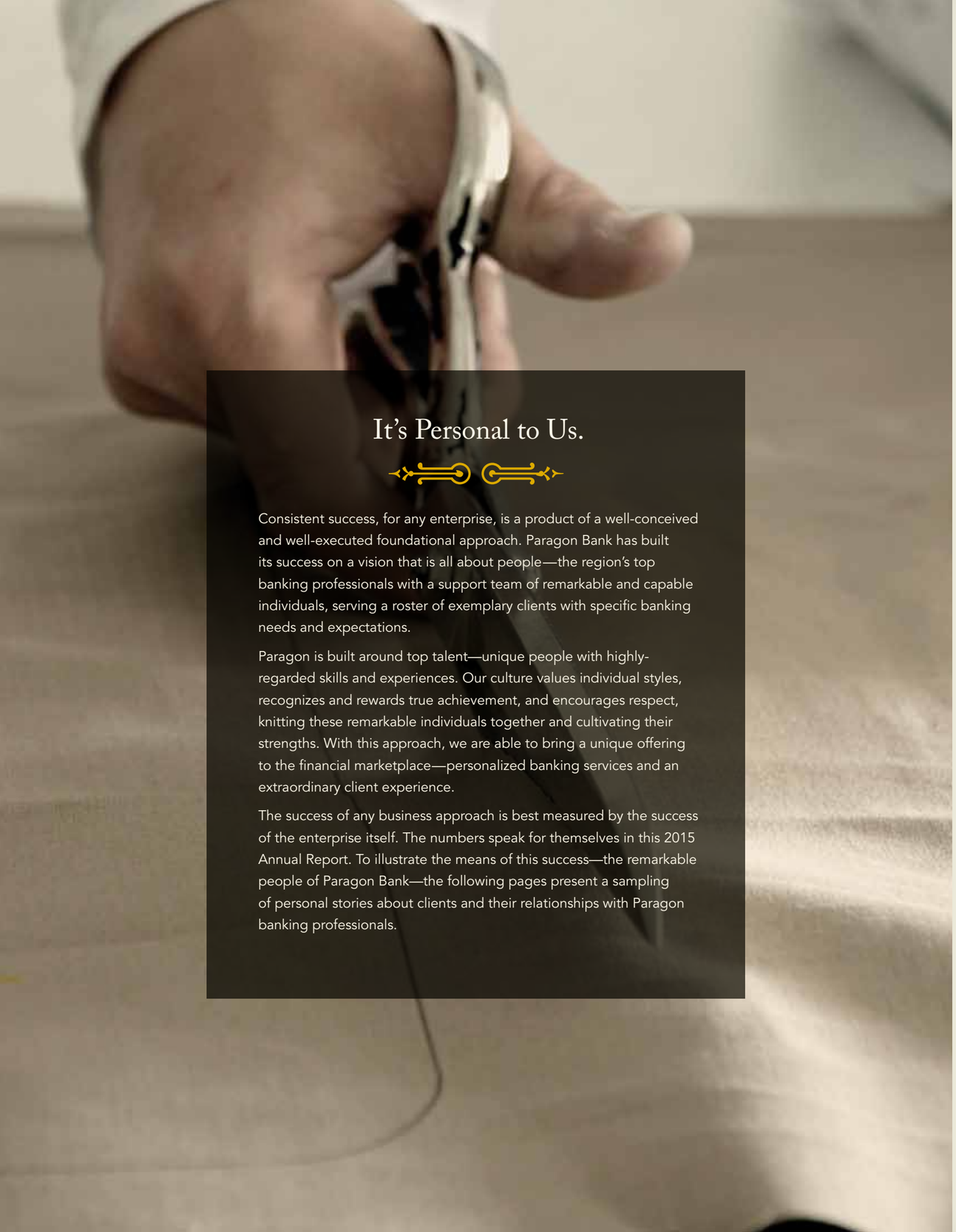
It's Personal to Us.

2015 ANNUAL REPORT

PARAGON
COMMERCIAL CORPORATION



It's Personal to Us.

Consistent success, for any enterprise, is a product of a well-conceived and well-executed foundational approach. Paragon Bank has built its success on a vision that is all about people—the region's top banking professionals with a support team of remarkable and capable individuals, serving a roster of exemplary clients with specific banking needs and expectations.

Paragon is built around top talent—unique people with highly-regarded skills and experiences. Our culture values individual styles, recognizes and rewards true achievement, and encourages respect, knitting these remarkable individuals together and cultivating their strengths. With this approach, we are able to bring a unique offering to the financial marketplace—personalized banking services and an extraordinary client experience.

The success of any business approach is best measured by the success of the enterprise itself. The numbers speak for themselves in this 2015 Annual Report. To illustrate the means of this success—the remarkable people of Paragon Bank—the following pages present a sampling of personal stories about clients and their relationships with Paragon banking professionals.

Selected Financial Data

Years Ended December 31, (Dollars in thousands, except per share data)	2015	2014	% Change
FOR THE YEAR:			
Interest income	$48,435	$42,783	13%
Interest expense	7,384	8,678	-15%
Net interest income	41,051	34,105	20%
Provision for loan losses	750	538	39%
Net interest income after provision for loan losses	40,301	33,567	20%
Non-interest income	1,454	704	107%
Non-interest expense	24,760	21,909	13%
Income before income taxes	16,995	12,362	37%
Income tax (benefit) expense	5,761	4,403	31%
Net income	$11,234	$7,959	41%
PER SHARE DATA:			
Book value per common share (period end)	$21.32	$19.35	10%
Basic earnings per share	2.49	1.79	39%
Diluted earnings per share	2.47	1.77	40%
Period end common shares outstanding	4,581,334	4,530,000	
Average diluted common shares outstanding	4,547,906	4,495,013	
AT YEAR END:			
Total assets	$1,305,911	$1,165,255	12%
Investment securities - at book value	168,896	183,675	-8%
Loans-net	1,008,515	861,536	17%
Deposits	982,847	883,640	11%
Shareholders' equity	97,658	87,662	11%
Full time equivalent employees	139	127	9%
SELECTED AVERAGE BALANCES:			
Total assets	$1,297,064	$1,104,079	17%
Investment securities - at book value	168,650	164,420	3%
Loans	970,153	807,025	20%
Deposits	959,515	834,529	15%
Shareholders' equity	92,073	82,546	12%
PERFORMANCE RATIOS:			
Return on average assets	0.87%	0.72%	
Return on average Equity	12.20%	9.64%	
Average loans to deposits	101.11%	96.70%	
Average tangible common equity ratio	7.10%	7.48%	
Average yield on loans	4.48%	4.71%	
Average cost of deposits	0.63%	0.90%	
Tax equivalent net interest margin	3.51%	3.48%	
Efficiency ratio	59.30%	63.93%	
Overhead to average assets	1.91%	1.98%	
ASSET QUALITY RATIOS:			
Nonperforming assets to total assets - period end	0.46%	1.32%	
Nonperforming loans to total loans - period end	0.05%	0.05%	
Accruing loans past due 30 days or more to total loans	0.00%	0.03%	
Net (recoveries) charge-offs to average loans	0.00%	0.08%	
Allowance for loan losses as a percentage of total loans	0.75%	0.79%	
Allowance for loan losses as a percentage of nonperforming loans	1489.47%	1635.48%	

Letter to our Shareholders

What is Franchise Value? That question (and its answers) drove our management and board to another outstanding year in 2015.

Our overall plan, once again, was to increase Paragon Bank's franchise value. Our primary focus was increasing the value and liquidity of Paragon Commercial Corporation shares. Our franchise value is determined in part by our stock price and reputation in the marketplace, as well as the business our clients bring to the bank and the professionalism and efficiency of our staff.

What did Paragon Bank do in 2015 to build franchise value?

Listing of Paragon Stock:

In the first quarter of 2015, we listed our stock on over the counter (OTC) marketplace, moving into OTCQX market and Bank QX index in the second quarter. Paragon CFO Steve Crouse and I attended investor conferences this year, specifically to talk about our bank. As a result of these strategic moves, more of our stock is trading and our stock price has risen from $10 per share at the beginning of the year to a share price in the $27 range at year end.

Our Financial Success:

The key to any successful company is a healthy growth rate, quality assets, and solid earnings—all achieved with great efficiency. We were able to accomplish these in 2015.

We grew our loan portfolio by $147 million—17 percent growth in spite of selling $29 million in loan participations. This exceeded our goal of 15 percent.

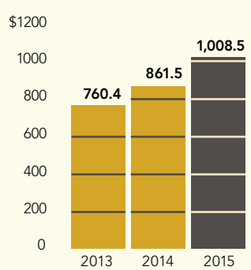
We grew our local core deposits by 27 percent. This is strategically significant, because it shows that our Client Development Officers can grow deposits not only sufficient to fund loan growth, but also to fund planned runoff of brokered and Internet deposits. Our plan is to be able to fund loans locally, without relying on third-party deposits.

In 2015, our earnings continued to grow year over year. We achieved a return on assets (ROA) of .87 percent vs .72 percent in 2014. Consolidated earnings were $11.2 million vs $8.0 million in 2014, a 41 percent increase.

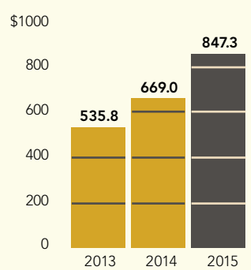
Our diluted earnings-per-share (EPS) goal was $2.29. The corporation exceeded that with an EPS of $2.49 vs $1.79 in 2014.

A good mix of loans and deposits in the bank's portfolio also contributes to franchise value. To that end, we effectively grew demand deposits by 34 percent, greatly reducing our dependence on brokered deposits and Internet deposits. By year end, local core deposits were 83 percent of total deposits (vs 73 percent at December 2014), traditional brokered deposits were 15 percent, and Internet deposits were 2 percent (down from 13 percent). We accomplished this by enhancing our emphasis on attracting deposits through new and existing client relationships.

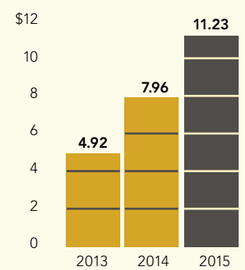
We continued to diversify our loan portfolio in 2015. By the end of the year, our loan portfolio percentage breakdown was 30 percent Commercial and Industrial loans, 44 percent Commercial Real Estate loans, and 26 percent Private Banking loans.



LOANS
IN MILLIONS



LOCAL CORE DEPOSITS
IN MILLIONS



CONSOLIDATED NET INCOME
IN MILLIONS

For a bank, loan portfolio quality is a major determining factor of excellent franchise value. We set a goal of less than 1.0 percent of total assets, for non-performing assets (loans past due by more than 90 days and bank-owned properties due to foreclosure). This is a key indicator of credit quality. Paragon ended the year at .46 percent, a remarkable improvement over 1.32 percent in December 2014. In fact, this places Paragon third in credit quality among the 65 financial institutions headquartered in North Carolina.

Another contributor to our success in 2015 was expense control. Paragon is one of the most efficient banks in North Carolina. By two key measures—overhead to average asset ratio and efficiency ratio—Paragon placed second among North Carolina banks.

Our Dynamic Markets and Sales Culture:

We have never operated this bank as many institutions with the "build it and they will come" philosophy.

Paragon's 2015 financial success was a result of hard work by talented staff members in three of America's most dynamic markets. Raleigh, Cary, and Charlotte have grown considerably in the last three years, constantly receiving accolades from American business publications.

Paragon outperformed the market—and our competition—because we are a very proactive business development firm, with Client Development Officers and Market Presidents who go out into the community and find business through their contacts and stature in their community.

Our Reputation:

Paragon ended 2015 with assets of $1.3 billion, offices in Raleigh, Charlotte, and Cary, and 139 staff members. No other bank in North Carolina does so much with so few offices and staff members.
Our average assets per employee are $9.4 million, which is the highest in North Carolina.

Our staff, board, clients, and communities recognize that the Paragon name is synonymous with high quality.

The execution of our plan to provide an Extraordinary Client Experience is Paragon's great differentiator. This concept is built into our culture, strategic plan, core values, and staff review and recognition process. In fact, we have an ongoing Extraordinary Client Experience (XCX) Leadership Team to ensure that we provide this high-level experience to our clients.

Our happy and dedicated staff is the pride of Paragon, with a turnover rate among the lowest in the industry, which promotes long-term, stable relationships with our clients. In fact, the five-year average turnover rate among Client Development Officers is only 3.7 percent. We are fortunate to be staffing due to our growth, rather than filling vacant positions.

Sixth best bank to work for in America:

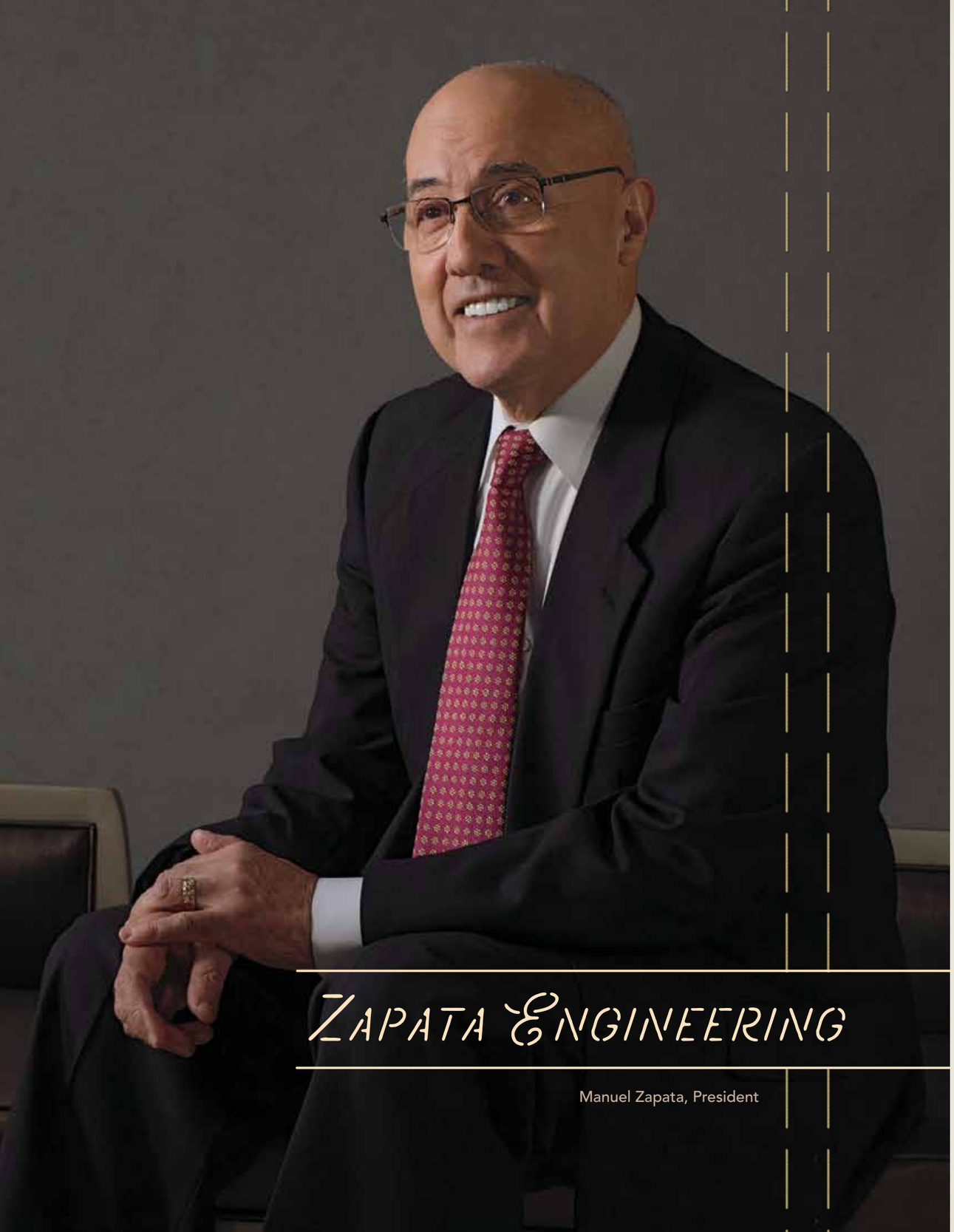
In 2015, the American Bankers Association named Paragon the sixth best bank to work for among banks of all sizes throughout the United States. We see this as affirmation of our efforts in building and retaining an exceptional staff.

Paragon management and Board of Directors are extremely proud of our success in 2015. This success results from a combination of our markets, outstanding staff, attention to clients (XCX), and an efficient business model.

These factors should lead to continued success into 2016 and beyond.

We thank you for being a part of this truly unique experience.

Robert C. Hatley
President
and Chief Executive Officer



Zapata Engineering

Manuel Zapata, President

"There for us..."

Manuel Zapata believes in trust, integrity, quality, and community. With an obsessive adherence to these basic values, as a young engineer from Chile, he built his entrepreneurial, Charlotte-based architectural, engineering, environmental, and construction services company into a global enterprise, that has completed projects in 45 states and 25 countries.

For more than a decade, Zapata Engineering's biggest client has been the United States military. "We've conducted munitions clearance work in places like Iraq and Afghanistan," says Mr. Zapata.

"For the work we do, we need to have a variety of uniquely-skilled individuals," he says of his staff, 45 percent of whom are military veterans.

"We're committed to delivering superior quality regardless of the task or work conditions. And we're unwavering about safety—people's lives depend on it."

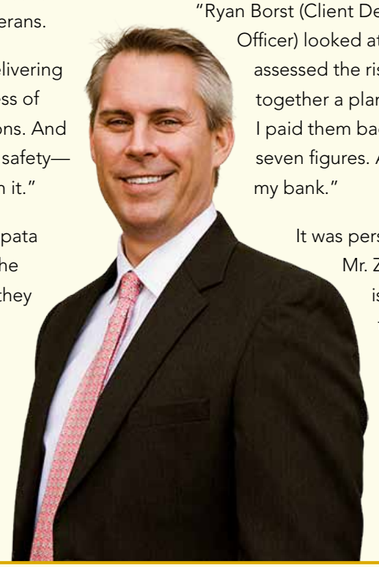
With the kind of work Zapata Engineering does, and the conditions under which they work, qualities such as dependability and loyalty are prized. When the 2013 federal budget sequester occurred, this need for loyalty led Mr. Zapata to Paragon.

"We had millions of dollars in federal contracts. There's nothing more dependable than a signed federal contract. But the sequester put everything on hold. We needed to keep all of the people we had recruited and trained. So I needed a loan to carry us through until the projects started up again.

"I had always worked with large banks. I was even on the boards of a couple. But when I went to ask for help, they declined to help us. So, I called Paragon.

"Ryan Borst (Client Development Officer) looked at my situation, assessed the risk, and put together a plan to help me. I paid them back every penny—seven figures. And now, they're my bank."

It was personal to Mr. Zapata. And it is personal to Paragon.



Ryan Borst, SVP/Client Development Officer

Triangle Capital Corporation

Ashton Poole, CEO

Steven Lilly, CFO

Brent Burgess, CIO

"Understanding our strengths..."

In the words of Triangle Capital's leadership team, "A good partner understands your strengths; a great partner becomes one of them." This operating philosophy has been one of the primary tenets behind this publicly-traded business development company.

"We help small to mid-size companies grow and develop by providing them with capital, financial discipline, and strategic advice, within a personalized relationship," says CFO Steven Lilly.

Focusing on mezzanine funding, Triangle Capital works with private companies looking to grow, family enterprises looking to transition to the next generation, and other good businesses looking to capitalize on an opportunity.

In their business, the ability to recognize credible businesses while understanding and managing risk is of paramount importance. And because of the types of businesses they work with, the ability to balance personal relationships and professional distance is crucial.

"We're a company with a national footprint," says CEO Ashton Poole.

"But we're acutely aware of our role within the local community." This understanding of the importance of the local connection may account for the strong relationship Triangle has sought with Paragon.

"We are in the business of analyzing and quantifying risk," says Mr. Lilly. "We find partners with potential, and then we customize our financial and operating relationship. We appreciate that (Client Development Officer) Bryan Pennington and the entire Paragon team have similar characteristics."

"Paragon understands the essence of what we're trying to do. All bankers are sensitive to risk, but Paragon understands how to quantify risk within the scope of the greater opportunity, and get behind something good. And they're incredibly focused not only on maintaining, but also enhancing the personalized relationship."

Some relationships simply work. When it's important to apply financial rigor and personal attention in equal measure, Paragon has proven to be a great choice. It's clearly personal to Triangle Capital Corporation… just as it is to their partner, Paragon Bank.

Bryan Pennington, SVP/Client Development Officer

David Heyens

The Merrimon-Wynne House

Jodi Heyens Strenkowski

"What's happier than a wedding?"

"I learned what makes a wedding great when I was planning my own," says Jodi Heyens Strenkowski, founder of The Merrimon-Wynne House, a historic mansion in Raleigh. "I decided to start this venue with my father as my first investor."

With the initial success of The Merrimon-Wynne House, it became evident that this could be a much bigger proposition. That's when Jodi joined forces with her brother, Matt Heyens, and her father, David Heyens to create a more ambitious enterprise.

"My father and I always talked about going into business. So, when I saw the opportunity in the wedding niche, I prepared my case and presented it," she said.

"I've started businesses all over the world," says David, retired global president of an international pharmaceutical company. "But creating something with my son and daughter was a unique opportunity.

We decided to create a scalable model, with service and design standards that invite people to have high expectations. We wanted to see what 'good' looks like and give people that option."

The plan is to develop multiple venues across the country, each with its own unique character, with each meeting the overall standard of design and service excellence.

The Merrimon-Wynne House—a success since its opening in 2013—is the first location. The second iteration, The Addison Grove of Austin, TX—under development by Matt—is already receiving bookings and rave "previews."

"We're creating a corporation, not a couple of businesses," says David. "We're elevating the wedding industry like the best resorts have elevated hospitality."

It's a unique vision, just the sort of thing Client Development Officer, John Towles, could understand, get behind, and get excited about. Understanding the big idea is one thing. Being willing to build a plan to support it is a whole other level of confidence.

It's personal.

John Towles, SVP/Client Development Officer

TCG Events

Cassie Brown, Chief Event Architect

"An event is a concept..."

"Clients want a return on their event investment," says Cassie Brown. "It's a lot of fun, but it's also strategic. We start with what clients want to achieve—leads, the attention of specific individuals, good will, media coverage…association with a cause."

TCG starts with a concept—a big idea designed to create a certain guest experience. "It's something they're going to remember, not just a pretty setting. You want to make a long-term impression on behalf of your client."

Cassie got into the event business more than a decade ago. "It's the coolest job ever," she says. "You get to do something different every day!"

With her exuberance and visionary personality, she creates ever more interesting, memorable…smarter events. "Who will ever forget riding a camel or taking a selfie with an elephant," she says. Along with big ideas and events came a reputation for results.

Five years ago, Cassie was given the opportunity to buy TCG. And she began to form the company in the image of her own strategic vision.

To stage events with the scale and panache of TCG, you need to be part strategic planner, part show-business producer, and part ringmaster. Cassie works with an array of specialized vendors—lighting designers to lion tamers. Bringing the whole thing together, in just the right way, at the right moment takes flexibility, confidence, and a rare level of focus.

A banking professional who can work with that sort of energy and spontaneity is rare. "I met (Client Development Officer) Melanie Robinson at an event I was doing," she says.

"Paragon has really come to know me. They get what I'm trying to do. It's never a hassle. I have so many things to think about all the time, I just need for them to handle the banking part. And they do!"

Melanie Robinson, SVP/Client Development Officer

Bank Leadership

EXECUTIVE MANAGEMENT

Bob Hatley
President/CEO

Matt Davis
EVP, Chief Operating Officer

Steve Crouse
EVP, Chief Financial Officer

SENIOR MANAGEMENT

Jim Fielding
SVP, Chief Credit Officer

Carol Isaac
SVP, Human Resource Manager

Phil Jurney
Charlotte Market President

Rebecca McClain
SVP, Director of Operations

Brian Reid
Triangle Market President

Scott Williams
SVP, Director of Marketing

Board of Directors

Howie Jung
Chairman of Paragon Bank Board
Vice President
ACE Hardware Stores, Inc.

Bob Hatley
President/CEO
Paragon Bank

Brent Barringer
Partner
Barringer Sasser, LLP

Curtis Brewer III
Owner
Brewer Properties, LLC

Scott Edwards
Retired

Frank Gray
Paragon Bank Counsel
Partner
Jordan Price Wall Gray Jones & Carlton, PLLC

Roy Harmon, Jr.
Chairman of the Board
Bank of Tennessee

Wes Jones
Managing Partner
Five Oaks Capital Partners, LLC

Tom Oxholm
Vice President
Finance and Administration

Al Ragland
Chief Human Resources Executive
Alliance Healthcare

Billie Redmond
President
TradeMark Properties, Inc.

Alton Russell
Chairman and Counsel
The Title Company of North Carolina, Inc.

Harvey Schmitt*
President Emeritus
Greater Raleigh Chamber of Commerce

*Not in photo. Joined in 2016

Client Development Officers

RALEIGH

Mark Bolash
Senior Vice President

Martin Borden
Senior Vice President

JoAnn Harper
Vice President
Mortgage Loan Officer

Preston Mahan
Vice President

Sally Neuman
Senior Vice President
Business Development Officer

Pat O'Quinn
Senior Vice President

Bryan Pennington
Senior Vice President

Mike Stellar
Senior Vice President

Jonathan Taylor
Senior Vice President

Connie Thames
Senior Vice President

John Towles
Senior Vice President

Lisa Valentino
Vice President

CHARLOTTE

Charlie Bartz
Senior Vice President

Will Bishop*
Senior Vice President

Ryan Borst
Senior Vice President

Stephanie Bryant
Senior Vice President

Lisa Gallimore
Vice President

John Graham*
Senior Vice President

Salley Griffith
Vice President

Jessica Kerr
Vice President

Warren Miller
Senior Vice President

Rusty Page*
Senior Vice President
Business Development Officer

Melanie Robinson
Senior Vice President

Gray Steelman
Senior Vice President

CARY

Patsy Johnson
Senior Vice President
Cary City Executive

Jason Rapuano
Senior Vice President

Kristin Sutton
Senior Vice President

*Joined in 2016

Advisory Board Members

RALEIGH

Jimmy Barnes
President
NAI Carolantic Realty

Jeff Brovet
CPA, Audit Partner
Thomas, Judy & Tucker

Mark Chesson*
Managing Principal
The Chesson Company

Kellie Falk
Managing Director
Drucker & Falk

Linda Folger
Executive Vice President
HUB International Southeast

Bobby Lewis
Principal
Raleigh Development Company

John McKinney
VP of Sales and Marketing
Alfred Williams & Company

Brian Reid
Triangle Market President
Paragon Bank

James Vann
Attorney
Vann Attorneys

Tommy West
Chairman
West Brothers Transportation Services

Erica Winter
Senior Director
Business Development
Merge Healthcare, an IBM Company, eClinical Division

CHARLOTTE

Ralph Breeden
President/CEO
The Woodbury Group

Charles Campbell
Partner
Brackett Flagship Properties, LLC

George Edmiston, Jr.
President
Carolinas Investment Consulting LLC

Hunter Edwards, Jr.
President/CEO
Mechanical Systems & Services, Inc.

Stan Howey
The Howey Co. Inc.

Phil Jurney
Charlotte Market President
Paragon Bank

Wes Jones
Managing Partner
Five Oaks Capital Partners, LLC

Wesley Walls
Development Partner
Collett and Associates

Peirce Ward
Financial Services Professional
Mass Mutual Carolinas

CARY

Jim Baker
CEO
Sumus Development Group, Inc.

Anthony Blackman
President
Atlantic Tire & Sales

Brenda Bost
Co-Founder
Bost Custom Homes

Keith Brokke
Retired

Chris Daltorio
Co-Founder & Partner
New Velocity

Raj Narayana*
Associate Director
Kenan Institute for Engineering, Technology & Science

Sheila Ogle
Managing Partner
Cary Innovation Center

Patsy Johnson
Cary City Executive
Paragon Bank

John Rigsbee
President
Rigsbee Consulting & CPA Services, Inc.

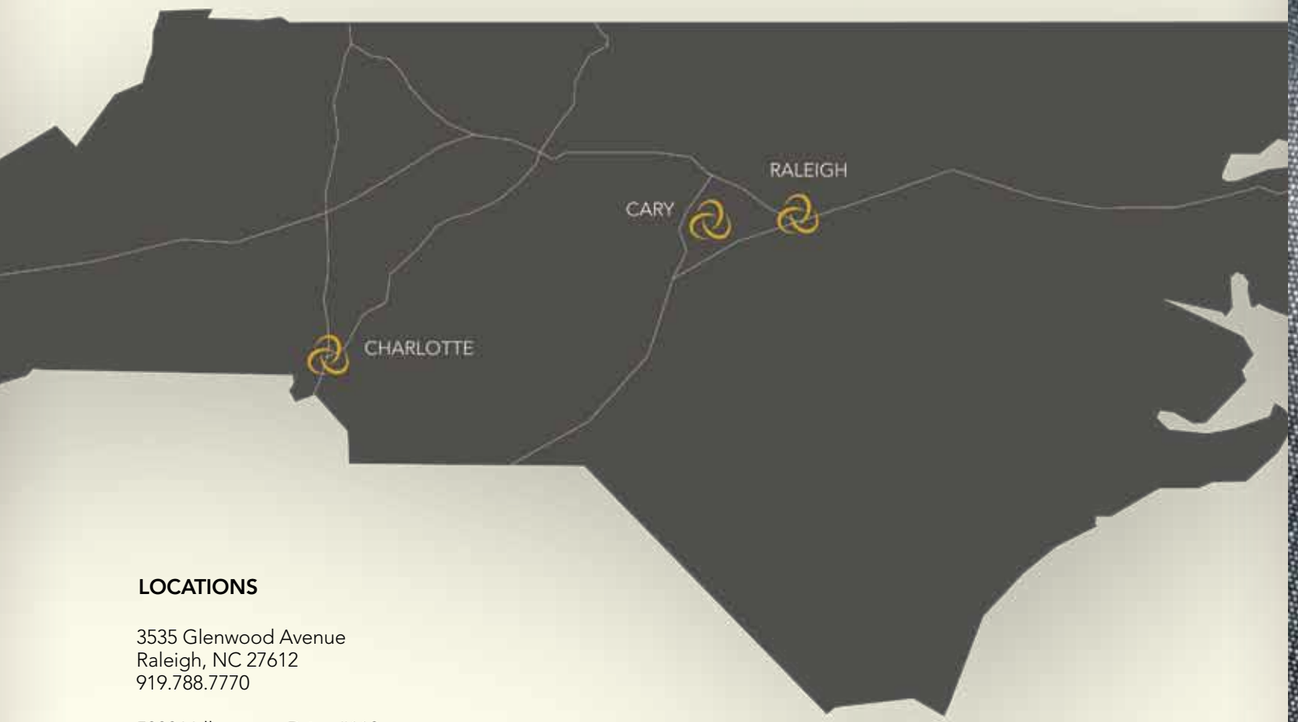
Jennifer Robinson
Director of Local Government Solutions
SAS

Dave Tomick
Experienced Corporate Board Member

Moss Withers
Broker
NAI Carolantic Realty Inc.

*Joined in 2016

Prepared. Present. Proactive.



LOCATIONS

3535 Glenwood Avenue
Raleigh, NC 27612
919.788.7770

5000 Valleystone Drive #110
Cary, NC 27519
919.415.4377

6337 Morrison Boulevard
Charlotte, NC 28211
704.644.4001

PARAGON
BANK

Corporate Profile

Paragon Commercial Corporation is the holding company for Paragon Bank, serving small and middle-market companies, nonprofits, trade associations, property owners associations, law firms, title companies, and private banking clients in the Raleigh and Charlotte metropolitan markets of North Carolina. Paragon's unique business model creates extraordinary client experiences through well-prepared, responsive bankers, select locations in vibrant markets, proprietary courier fleet service and cutting-edge banking technology.

It's Personal to Us.

2015 ANNUAL REPORT

AUDITED FINANCIALS WITH ACCOMPANYING NOTES

PARAGON
COMMERCIAL CORPORATION

TABLE OF CONTENTS

	Page No.
Independent Auditor's Report	1
Consolidated Balance Sheets	2
Consolidated Statements of Income	3
Consolidated Statements of Comprehensive Income	4
Consolidated Statements of Stockholders' Equity	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7
Management's Report on the Financial Statements and the Internal Control Over Financial Reporting	44
Management's Assessment of Compliance with Laws and Regulations	45

This Annual Report serves as the annual financial disclosure statement furnished pursuant to the Federal Deposit Insurance Corporation's rules and regulations. This statement has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

elliott davis decosimo

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Paragon Commercial Corporation
Raleigh, North Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Paragon Commercial Corporation and subsidiary, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Audit of Internal Control Over Financial Reporting

We also have examined in accordance with attestation standards established by the American Institute of Certified Public Accountants, Paragon Commercial Corporation's internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control- Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013 and our report dated March 7, 2016 expressed unmodified opinion.

Elliott Davis Decosimo, PLLC

Raleigh, North Carolina
March 7, 2016

PARAGON COMMERCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2015 and 2014

(In thousands, except share data)	**2015**	**2014**
Assets		
Cash and due from banks:		
Interest-earning	$ 30,993	$ 19,400
Noninterest-earning	24,537	16,995
Investment securities - available-for-sale, at fair value	168,896	183,675
Federal Home Loan Bank stock, at cost	8,061	7,006
Loans - net of unearned income and deferred fees	1,016,156	868,405
Allowance for loan losses	(7,641)	(6,869)
Net loans	1,008,515	861,536
Accrued interest receivable	3,795	3,636
Bank premises and equipment, net	16,433	17,071
Bank owned life insurance	28,274	27,421
Other real estate owned	5,453	14,991
Deferred tax assets	4,118	4,925
Other assets	6,836	8,599
Total assets	$ 1,305,911	$ 1,165,255
Liabilities and stockholders' equity		
Deposits:		
Noninterest-bearing demand	$ 158,974	$ 118,895
Interest-bearing checking and money market	504,092	375,833
Time deposits	319,781	388,912
Total deposits	982,847	883,640
Repurchase agreements and federal funds purchased	30,580	27,482
Federal Home Loan Bank advances	165,000	135,000
Other borrowings	4,800	7,256
Subordinated debentures	18,558	18,558
Accrued interest payable	356	405
Other liabilities	6,112	5,252
Total liabilities	1,208,253	1,077,593
Commitments and contingencies (Notes 8 and 14)		
Stockholders' equity:		
Common stock, $0.008 par value; 20,000,000 shares authorized; 4,581,334 and 4,530,000 issued and outstanding as of December 31, 2015 and 2014, respectively	37	36
Additional paid-in-capital	53,147	52,358
Accumulated other comprehensive income (loss)	(886)	1,142
Retained earnings	45,360	34,126
Total stockholders' equity	97,658	87,662
Total liabilities and stockholders' equity	$ 1,305,911	$ 1,165,255

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

PARAGON COMMERCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2015 and 2014

(In thousands, except per share data)	**2015**	**2014**
Interest income		
Loans and fees on loans	$ 43,500	$ 37,999
Investment securities and FHLB stock	4,786	4,698
Federal funds and other	149	86
Total Interest income	48,435	42,783
Interest expense		
Interest-bearing checking and money market	2,756	2,144
Time deposits	3,313	5,371
Borrowings and repurchase agreements	1,315	1,163
Total interest expense	7,384	8,678
Net interest income	41,051	34,105
Provision for loan losses	750	538
Net interest income after provision for loan losses	40,301	33,567
Non-interest income		
Increase in cash surrender value of bank owned life insurance	853	799
Net gain on sale of securities	542	87
Service charges and fees	219	207
Mortgage origination fees and gains on sale of loans	197	112
Net loss on sale or impairment of foreclosed assets	(759)	(903)
Other fees and income	402	402
Total non-interest income	1,454	704
Non-interest expense		
Salaries and employee benefits	13,331	11,826
Furniture, equipment and software costs	1,878	1,340
Occupancy	1,547	999
Data processing	1,103	1,229
FDIC and other supervisory assessments	939	932
Advertising and public relations	934	876
Director related fees and expenses	921	978
Unreimbursed loan costs and foreclosure related expenses	874	496
Professional fees	737	1,119
Other	2,496	2,114
Total non-interest expense	24,760	21,909
Income before income taxes	16,995	12,362
Income tax expense	5,761	4,403
Net income	$ 11,234	$ 7,959
Net income per common share		
Basic	$ 2.49	$ 1.79
Diluted	$ 2.47	$ 1.77

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

PARAGON COMMERCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2015 and 2014

(In thousands)	**2015**	**2014**
Net income	$ 11,234	$ 7,959
Other comprehensive income (loss) items:		
Securities available for sale:		
Unrealized gains (losses)	(743)	5,965
Reclassification of gains recognized in net income	(542)	(87)
Other comprehensive income (loss)	(1,285)	5,878
Deferred tax (benefit) expense	(488)	2,288
Other comprehensive income (loss), net of tax	(797)	3,590
Cash flow hedges:		
Unrealized losses	(1,965)	(3,099)
Other comprehensive loss	(1,965)	(3,099)
Deferred tax benefit	(734)	(1,213)
Other comprehensive loss, net of tax	(1,231)	(1,886)
Total other comprehensive income (loss), net of tax	(2,028)	1,704
Comprehensive income	$ 9,206	$ 9,663

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

PARAGON COMMERCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2015 and 2014

(In thousands, except share data)	Common Stock						Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Class A		Class B		Common Stock					
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at December 31, 2013	34,608	$ 34	884	$ 1	-	$ -	$ 51,963	$ (562)	$ 26,167	$ 77,603
Net income	-	-	-	-	-	-	-	-	7,959	7,959
Unrealized gain on securities, net of tax expense of $2,288	-	-	-	-	-	-	-	3,590	-	3,590
Unrealized loss on cash flow hedges, net of tax benefit of $1,213	-	-	-	-	-	-	-	(1,886)	-	(1,886)
Stock options and restricted stock awards:										
Compensation expense recognized	-	-	-	-	-	-	23	-	-	23
Exercise of stock options	-	-	-	-	6,000	-	59	-	-	59
Issuance of restricted stock awards	550	1	-	-	18,750	-	313	-	-	314
Reclassification of shares	(35,158)	(35)	(884)	(1)	36,042	36	-	-	-	-
125 for 1 stock split	-	-	-	-	4,469,208	-	-	-	-	-
Balance at December 31, 2014	-	$ -	-	$ -	4,530,000	$ 36	$ 52,358	$ 1,142	$ 34,126	$ 87,662
Net income	-	-	-	-	-	-	-	-	11,234	11,234
Unrealized loss on securities, net of tax benefit of $488	-	-	-	-	-	-	-	(797)	-	(797)
Unrealized loss on cash flow hedges, net of tax benefit of $734	-	-	-	-	-	-	-	(1,231)	-	(1,231)
Stock options and restricted stock awards:										
Exercise of stock options	-	-	-	-	10,000	-	176	-	-	176
Issuance of shares for employee stock purchase plan	-	-	-	-	10,678	1	202	-	-	203
Issuance of restricted stock awards	-	-	-	-	30,656	-	411	-	-	411
Balance at December 31, 2015	-	$ -	-	$ -	4,581,334	$ 37	$ 53,147	$ (886)	$ 45,360	$ 97,658

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

PARAGON COMMERCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2015 and 2014

(In thousands)	**2015**	**2014**
Cash flows from operating activities:		
Net income	$ 11,234	$ 7,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,408	1,087
Provision for loan losses	750	538
Net loss on sale or impairment of foreclosed assets	759	903
Increase in cash surrender value of life insurance	(853)	(799)
Accretion of premiums/discounts on securities, net	(964)	(833)
Net gain on sale of securities	(542)	(87)
Net gain on disposition of premises and equipment	(4)	-
Deferred tax expense	2,030	2,477
Stock based compensation	411	336
Changes in assets and liabilities:		
Accrued interest receivable and other assets	(363)	(7,212)
Accrued interest payable and other liabilities	811	608
Net cash provided by operating activities	14,677	4,977
Cash flows from investing activities:		
Net increase in Federal Home Loan Bank stock	(1,055)	(683)
Purchase of securities available for sale	(60,282)	(75,536)
Proceeds from maturities and paydowns of securities available for sale	20,264	17,389
Proceeds from sales of securities available for sale	55,019	28,466
Net increase in loans	(151,213)	(102,725)
Proceeds from sale of foreclosed real estate	12,336	3,383
Proceeds from sale of property and equipment	24	-
Additions to bank premises and equipment	(790)	(2,890)
Other investing activites, net	(73)	-
Net cash used in investing activities	(125,770)	(132,596)
Cash flows from financing activities:		
Net increase in demand and money market deposit accounts	168,338	133,626
Net decrease in time deposits	(69,131)	(20,138)
Net increase (decrease) in repurchase agreements	3,098	(530)
Net increase in FHLB and other borrowings	27,544	17,640
Net decrease in subordinated debentures	-	(11,780)
Issuance of common stock for employee stock purchase plan	203	-
Exercise of stock options	176	59
Net cash provided by financing activities	130,228	118,877
Net change in cash and cash equivalents	19,135	(8,742)
Cash and cash equivalents at beginning of year	36,395	45,137
Cash and cash equivalents at end of year	$ 55,530	$ 36,395

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

NOTE 1 - ORGANIZATION AND OPERATIONS

On June 30, 2001, Paragon Commercial Corporation (the "Company") was formed as a holding company for Paragon Commercial Bank (the "Bank"). The Company currently has no operations and conducts no business on its own other than owning the Bank and two Trusts, Paragon Commercial Capital Trust I and II.

The Bank was incorporated on May 4, 1999 and began banking operations on May 10, 1999. The Bank is engaged in general commercial banking in Wake and Mecklenburg Counties, NC, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation and the North Carolina Commissioner of Banks. The Bank undergoes periodic examinations by those regulatory authorities.

The Company formed Paragon Commercial Capital Trust I ("Trust I") during 2004 in order to facilitate the issuance of trust preferred securities. Trust I is a statutory business trust formed under the laws of the state of Delaware, of which all common securities are owned by the Company. The Company formed Paragon Commercial Capital Trust II ("Trust II") during 2006 to serve the same purpose. The junior subordinated debentures issued by the Company to the trusts are classified as debt and the Company's equity interest in the trusts are included in other assets.

The trust preferred securities presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as minority interests in unconsolidated subsidiaries. The junior subordinated debentures do not qualify as Tier 1 regulatory capital.

In addition to its headquarters in Raleigh, North Carolina, the Bank has locations in Charlotte and Cary, North Carolina.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts and transactions of Paragon Commercial Corporation and Paragon Commercial Bank. All significant intercompany transactions and balances are eliminated in consolidation. Paragon Commercial Capital Trusts I and II are not consolidated subsidiaries of the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, other than temporary impairment on investment securities, fair value of other real estate owned, realization of deferred tax assets and the fair value of financial instruments.

Cash and Cash Equivalents

Cash and cash equivalents include demand and time deposits (with original maturities of 90 days or less) at other institutions, federal funds sold and other short-term investments. Generally, federal funds are purchased and sold for one-day periods. At times, the Company places deposits with high credit quality financial institutions in amounts which may be in excess of federally insured limits. Depository institutions are required to maintain reserve and clearing balances with the Federal Reserve Bank ("FRB"). Accordingly, the Company has amounts restricted for this purpose of $19.4 million and $14.1 million included in cash and due from banks on the consolidated balance sheets as of December 31, 2015 and 2014, respectively.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as "held-to-maturity" securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling in the near term are classified as "trading" securities and reported at fair value with unrealized gains and losses included in earnings. Available-for-sale securities are reported at fair value and consist of debt or equity securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses on available-for-sale securities are reported as a net amount in other comprehensive income net of income taxes. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

At each reporting date, the Company evaluates each investment security in a loss position for other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as (1) the length of time and the extent to which the fair value has been below cost, (2) changes in the earnings performance, credit rating, asset quality, or business prospects of the issuer, (3) the ability of the issuer to make principal and interest payments, (4) changes in the regulatory, economic, or technological environment of the issuer, and (5) changes in the general market condition of either the geographic area or industry in which the issuer operates.

Regardless of these factors, if the Company has developed a plan to sell the security or it is likely that the Company will be forced to sell the security in the near future, then the impairment is considered other-than-temporary and the carrying value of the security is permanently written down to the current fair value with the difference between the new carrying value and the amortized cost charged to earnings. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current period credit loss, the other-than-temporary impairment is separated into the following: (1) the amount representing the credit loss and (2) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings, and the amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed and any subsequent payments received are applied only to the outstanding principal balance.

Allowance for Loan Losses

The allowance for loan losses ("ALL") is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. The provision for loan losses is based upon management's best estimate of the amount needed to provide for losses that are inherent in the portfolio. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALL.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

The Company conducts an analysis of the loan portfolio on a regular basis. This analysis is used in assessing the sufficiency of the allowance for loan losses and in the determination of the necessary provision for loan losses. The review process generally begins with the identification of problem loans to be reviewed on an individual basis for impairment. When a loan has been identified as impaired, a specific reserve may be established based on the Company's calculation of the loss embedded in the individual loan. In addition to specific reserves on impaired loans, the Company has a nine point grading system for each non-homogeneous loan in the portfolio to reflect the risk characteristic of the loan. The loans identified and measured for impairment are segregated from risk-rated loans within the portfolio. Loans are then grouped by loan type and by risk rating. Each loan type is assigned an allowance factor based on historical loss experience, economic conditions and overall portfolio quality including delinquency rates and concentrations. The ALL is an accounting estimate and as such there is uncertainty associated with the estimate due to the level of subjectivity and judgment inherent in performing the calculation. Management's evaluation of the ALL also includes considerations of existing general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, regulatory examination results and findings of the Company's outsourced loan review consultants. The total of specific reserves required for impaired classified loans and the calculated reserves comprise the allowance for loan losses.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Additionally, management's policy is generally to evaluate only those loans greater than $500,000 for impairment. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Other Real Estate Owned

Other real estate owned acquired through, or in lieu of, loan foreclosure is initially recorded at fair value less selling costs, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of cost or net realizable value. Net realizable value is equivalent to fair market value less costs to sell the assets. Revenue and expenses from holding the properties and adjustments to the cost basis are included in earnings.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets which are 3 - 10 years for furniture and equipment and 40 years for buildings. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred, and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Home Loan Bank Stock

As a requirement for membership, the Company invests in stock of the Federal Home Loan Bank of Atlanta ("FHLB"). This investment is carried at cost. Due to the redemption provisions of the FHLB, the Company estimated that fair value approximates cost.

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key employees. These policies are recorded at their cash surrender value, or the amount that can be realized. Income from these policies and changes in the net cash surrender value are recorded in noninterest income.

Derivative Instruments and Hedging Activities

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of the change in the fair value of the derivative is recognized directly in earnings. The Company engages a third party expert to assess the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions.

The Company's objective in using derivatives is to add stability to net interest income and to manage its exposure to adverse changes in interest rates. To accomplish this objective, the Company uses interest rate caps and swaps as part of its cash flow hedging strategy.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax benefits or consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are also recognized for operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

At December 31, 2015, the Company had $4.1 million in net deferred tax assets. A valuation allowance is provided when it is more-likely-than-not that some portion of the deferred tax asset will not be realized. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. Our forecast process includes qualitative and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryforward periods available under applicable law and prudent tax planning strategies are not sufficient to cover the amount of net deferred tax assets, such assets may be impaired. Based on the Company's analysis of both positive and negative evidence we concluded there were no valuation allowances required with respect to the deferred tax assets at December 31, 2015 and 2014.

Stock Compensation Plans

The Company has two stock-based compensation plans covering certain officers and directors. The Company stock option plan grants stock options under the plan for a fixed number of shares with an exercise price equal to the fair value of the shares on the date of grant. The restricted stock plan grants a fixed number of shares with a grant price equal to the fair value of the shares on the date of grant.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Common Share

Basic and diluted net income per common share have been computed by dividing net income for each period by the weighted average number of shares of common stock outstanding during each period. Diluted net income per common share reflects the potential dilution that could occur if outstanding stock options were exercised.

In May 2014, the Company's shareholders approved and the Company executed a reclassification of its then-outstanding Class A common stock and Class B common stock into a single class of common stock on the basis of one share of common stock for each share of Class A common stock and Class B common stock so reclassified. In June 2014, the Company amended its articles of incorporation to effect a 125-for-1 forward split of each share of common stock then issued and outstanding.

Basic and diluted net income per common share have been computed based upon net income as presented in the accompanying Consolidated Statements of Income divided by the weighted average number of common shares outstanding or assumed to be outstanding as summarized below:

	2015	**2014**
Shares used in the computation of earnings per share:		
Weighted average number of shares outstanding - basic	4,509,884	4,456,002
Dilutive effect of restricted shares	38,022	39,011
Weighted average number of shares outstanding - diluted	4,547,906	4,495,013

In 2015 and 2014, because the exercise price was in excess of the average current trading price, none of the Company's outstanding stock options were used in the calculation of diluted EPS. The dilutive effect of stock options and unvested restricted shares are the only common stock equivalents for purposes of calculating diluted earnings per common share.

Weighted average anti-dilutive stock options and unvested restricted shares excluded from the computation of diluted earnings per share are as follows:

	2015	**2014**
Anti-dilutive stock options	81,500	101,000
Unvested restricted shares	40,936	48,958

Comprehensive Income

The Company reports as comprehensive income all changes in stockholders' equity during the year from sources other than stockholders. Other comprehensive income refers to all components (revenues, expenses, gains, and losses) of comprehensive income that are excluded from net income.

The Company's only two components of other comprehensive income are unrealized gains and losses on investment securities available-for-sale, net of income taxes and unrealized gains and losses on cash flow hedges, net of income taxes. Information concerning the Company's accumulated other comprehensive income for the years ended December 31, 2015 and 2014 is as follows:

	2015	**2014**
(In thousands)		
Unrealized gains on securities available-for-sale	$ 1,378	$ 2,663
Deferred tax expense	(530)	(1,018)
Other comprehensive income, net of tax	848	1,645
Unrealized losses on cash flow hedges	(2,779)	(814)
Deferred tax benefit	1,045	311
Other comprehensive loss, net of tax	(1,734)	(503)
Total other comprehensive income (loss)	$ (886)	$ 1,142

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The accumulated balances related to each component of other comprehensive loss are as follows:

(in thousands)	Unrealized Gains and Losses on Available-for Sale Securities	Unrealized Gains and Losses on Cash Flow Hedges	Total
Balance as of December 31, 2014	$ 1,645	$ (503)	$ 1,142
Other comprehensive loss before reclassification	(255)	(1,231)	(1,486)
Amounts reclassified from accumularted other comprehensive income	(542)	-	(542)
Net current-period other comprehensive loss	(797)	(1,231)	(2,028)
Balance as of December 31, 2015	$ 848	$ (1,734)	$ (886)
Balance as of December 31, 2013	$ (1,945)	$ 1,383	$ (562)
Other comprehensive income (loss) before reclassification	3,677	(1,886)	1,791
Amounts reclassified from accumularted other comprehensive income	(87)	-	(87)
Net current-period other comprehensive income (loss)	3,590	(1,886)	1,704
Balance as of December 31, 2014	$ 1,645	$ (503)	$ 1,142

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board ("FASB") amended the Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned ("OREO"). In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments were effective for the Company for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. These amendments did not have a material effect on the Company's financial statements.

In June 2014, the FASB issued guidance which makes limited amendments to the guidance on accounting for certain repurchase agreements. The new guidance (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The amendments were effective for the Company for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. These amendments did not have a material effect on the Company's financial statements.

In June 2014, the FASB issued guidance which clarifies that performance targets associated with stock compensation should be treated as a performance condition and should not be reflected in the grant date fair value of the stock award. The amendments will be effective for the Company for fiscal years that begin after December 15, 2015. The Company will apply the guidance to all stock awards granted or modified after the amendments are effective. The Company does not expect these amendments to have a material effect on its financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. Although the amendments are expected to result in the deconsolidation of many entities, the Company will need to reevaluate all its previous consolidation conclusions. The amendments will be effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2017, with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance that will require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This update affects disclosures related to debt issuance costs but does not affect existing recognition and measurement guidance for these items. The amendments will be effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016, with early adoption permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Company will apply the guidance using a full retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements

In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral, the guidance in ASU 2014-09 will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019-all other entities. The Company will apply the guidance using a full retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2016, the FASB amended the Financial Instruments topic of the ASC to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

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

Reclassifications

Certain amounts in the 2015 financial statements have been reclassified to conform to the 2014 presentation. The reclassifications had no effect on total assets, net income or stockholders' equity as previously reported.

NOTE 3 - INVESTMENT SECURITIES

The following is a summary of the securities portfolio by major classification at December 31, 2015 and 2014.

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2015				
Available-for-sale:				
U.S. Agency obligations	$ 19,778	$ 196	$ 73	$ 19,901
Collateralized mortgage obligations	60,826	321	206	60,941
Mortgage-backed securities	31,074	326	90	31,310
Municipal bonds	53,163	1,346	75	54,434
Other	2,677	10	377	2,310
	$ 167,518	$ 2,199	$ 821	$ 168,896
2014				
Available-for-sale:				
U.S. Agency obligations	$ 31,710	$ 256	$ 124	$ 31,842
Collateralized mortgage obligations	69,519	672	135	70,056
Mortgage-backed securities	33,921	627	-	34,548
Municipal bonds	44,511	991	322	45,180
Other	1,351	698	-	2,049
	$ 181,012	$ 3,244	$ 581	$ 183,675

The amortized cost and fair values of securities available-for-sale at December 31, 2015 by contractual maturity are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

(In thousands)	Within 1 Year	After One Within Five Years	After Five Within Ten Years	After Ten Years	No Stated Maturity Date	Total
U.S. Agency obligations	$ -	$ -	$ -	$ 19,901	$ -	$ 19,901
Collateralized mortgage obligations	-	-	-	60,941	-	60,941
Mortgage-backed securities	-	-	13,591	17,719	-	31,310
Municipal bonds	-	1,786	4,412	48,236	-	54,434
Other	-	-	500	-	1,810	2,310
	$ -	$ 1,786	$ 18,503	$ 146,797	$ 1,810	$ 168,896

At December 31, 2015, the unrealized losses related to three U.S. Agency obligations, seven collateralized mortgage obligations, twenty-two municipal bonds, six mortgage backed securities, and one other investment. One collateralized mortgage obligation, thirteen of the municipal bonds and two US Agency obligations in a loss position had continuous unrealized losses for more than 12 months. At December 31, 2014, the unrealized losses related to four U.S. Agency obligations, five collateralized mortgage obligations, and twenty-two municipal bonds, one of which was a collateralized mortgage obligation, twenty-two municipal bonds and four U.S. Agency obligations had continuous unrealized losses for more than 12 months. The unrealized losses primarily relate to debt securities that have incurred fair value reductions due to higher market interest rates since the securities were purchased. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses on the debt securities in 2014 or 2015 relate to the marketability of the securities or the issuer's ability to honor redemption obligations and since management has the intent to hold these securities until maturity and believes it is more likely than not that the Company will not have to sell any such securities before a recovery of cost given the current liquidity position, none of those debt securities are deemed to be other than temporarily impaired.

NOTE 3 - INVESTMENT SECURITIES (Continued)

The following tables show gross unrealized losses and fair values of investment securities, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2015 and 2014.

	Less Than 12 Months		12 Months or Greater		Total	
(In thousands) **December 31, 2015**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Securities available-for-sale:						
U.S. Agency obligations	$ 3,007	$ -	$ 3,178	$ 73	$ 6,185	$ 73
Collateralized mortgage obligations	26,086	159	2,983	47	29,069	206
Mortgage-backed securities	18,575	90	-	-	18,575	90
Municipal bonds	3,896	6	7,990	69	11,886	75
Other	1,774	377	-	-	1,774	377
Total temporarily impaired securities	$ 53,338	$ 632	$ 14,151	$ 189	$ 67,489	$ 821

	Less Than 12 Months		12 Months or Greater		Total	
(In thousands) **December 31, 2014**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Securities available-for-sale:						
U.S. Agency obligations	$ -	$ -	$ 10,337	$ 124	$ 10,337	$ 124
Collateralized mortgage obligations	19,051	90	3,630	45	22,681	135
Mortgage-backed securities	-	-	-	-	-	-
Municipal bonds	-	-	12,524	322	12,524	322
Total temporarily impaired securities	$ 19,051	$ 90	$ 26,491	$ 491	$ 45,542	$ 581

During the years ended December 31, 2015 and 2014, the Company recognized gross gains and (losses) on sales of available-for-sale investment securities of $591,000 and ($49,000), respectively, for 2015 and $208,000 and ($121,000), respectively, for 2014. Proceeds received from these sales totaled approximately $55.0 million and $28.5 million in 2015 and 2014, respectively.

Securities with a fair value of $78.4 million and $84.1 million were pledged as of December 31, 2015 and 2014, respectively, to secure repurchase agreements, lines of credit and other borrowings.

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES

Following is a summary of loans at December 31, 2015 and 2014:

(In thousands)	**2015**	**2014**
Construction and land development	$ 64,702	$ 62,817
Commercial real estate:		
Non-farm, non-residential	453,407	408,129
Farmland	1,332	1,078
Multifamily, nonresidential and junior liens	79,170	78,024
Total commercial real estate	533,909	487,231
Consumer real estate:		
Home equity lines	78,943	46,782
Secured by 1-4 family residential, secured by first deeds of trust	167,053	143,793
Secured by 1-4 family residential, secured by second deeds of trust	3,711	4,940
Total consumer real estate	249,707	195,515
Commercial and industrial loans (except those secured by real estate)	153,669	117,126
Consumer and other	13,539	5,722
Total loans	1,015,526	868,411
Deferred loan (fees) costs	630	(6)
Allowance for loan losses	(7,641)	(6,869)
Net loans	$ 1,008,515	$ 861,536

Loans are primarily made in the Research Triangle and Charlotte areas of North Carolina. Real estate loans can be affected by the condition of the local real estate market. Commercial and installment loans can be affected by the local economic conditions.

Changes in the allowance for loan losses for the years ended December 31, 2015 and 2014 were as follows:

(In thousands)	**Construction and Land Development**	**Commercial Real Estate**	**Consumer Real Estate**	**Commercial & Industrial Loans Not Secured By Real Estate**	**Consumer & Other**	**Total Loans**
2015						
Balance at beginning of the year	$ 960	$ 2,510	$ 1,594	$ 1,662	$ 143	$ 6,869
Provision for loan losses	(510)	902	408	(51)	1	750
Loans charged off	(14)	(275)	-	-	-	(289)
Recoveries	73	19	44	175	-	311
Net (chargeoffs) recoveries	59	(256)	44	175	-	22
Balance at end of the year	$ 509	$ 3,156	$ 2,046	$ 1,786	$ 144	$ 7,641
(in thousands)						
2014						
Balance at beginning of the year	$ 2,021	$ 1,184	$ 1,540	$ 2,150	$ 44	$ 6,939
Provision for loan losses	(317)	1,287	104	(635)	99	538
Loans charged off	(898)	(1)	(64)	(99)	-	(1,062)
Recoveries	154	40	14	246	-	454
Net (chargeoffs) recoveries	(744)	39	(50)	147	-	(608)
Balance at end of the year	$ 960	$ 2,510	$ 1,594	$ 1,662	$ 143	$ 6,869

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method for the years ended December 31, 2015 and 2014 were as follows:

(in thousands)	Construction and Land Development	Commercial Real Estate	Consumer Real Estate	Commercial & Industrial Loans Not Secured By Real Estate	Consumer & Other	Total Loans
2015						
Allowance for Loan Losses:						
Individually evaluated for impairment	$ 4	$ 72	$ 115	$ 297	$ 21	$ 509
Collectively evaluated for impairment	505	3,084	1,931	1,489	123	7,132
Total ending allowance	$ 509	$ 3,156	$ 2,046	$ 1,786	$ 144	$ 7,641
Loans:						
Individually evaluated for impairment	$ 238	$ 2,619	$ 411	$ 602	$ 21	$ 3,891
Collectively evaluated for impairment	64,464	531,290	249,296	153,067	13,518	1,011,635
Total ending loans	$ 64,702	$ 533,909	$ 249,707	$ 153,669	$ 13,539	$ 1,015,526
(in thousands)						
2014						
Allowance for Loan Losses:						
Individually evaluated for impairment	$ 5	$ 189	$ 282	$ 178	$ 26	$ 680
Collectively evaluated for impairment	955	2,321	1,312	1,484	117	6,189
Total ending allowance	$ 960	$ 2,510	$ 1,594	$ 1,662	$ 143	$ 6,869
Loans:						
Individually evaluated for impairment	$ 345	$ 4,538	$ 646	$ 720	$ 26	$ 6,275
Collectively evaluated for impairment	62,472	482,693	194,869	116,406	5,696	862,136
Total ending loans	$ 62,817	$ 487,231	$ 195,515	$ 117,126	$ 5,722	$ 868,411

Loans are charged down or off as soon as the Company determines that the full principal balance due under any loan becomes uncollectible. The amount of the charge is determined as follows:

- If unsecured, the loan must be charged off in full.
- If secured, the outstanding principal balance of the loan should be charged down to the net realizable value of the collateral.

Loans are considered uncollectible when:

- No regularly scheduled payment has been made within four months unless fully secured and in the process of collection.
- The collateral value is insufficient to cover the outstanding indebtedness and it is unlikely the borrower will have the ability to pay the debt in a timely manner.

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

- The loan is unsecured, the borrower files for bankruptcy protection and there is no other (guarantor, etc.) support from an entity outside of the bankruptcy proceedings.

Impaired loans totaled $3.9 million and $6.3 million at December 31, 2015 and 2014, respectively. Included in the $3.9 million at December 31, 2015 is $2.8 million of loans classified as troubled debt restructurings ("TDRs"). Included in the $6.3 million at December 31, 2014 is $2.9 million of loans classified as TDRs. A modification of a loan's terms constitutes a TDR if the creditor grants a concession to the borrower for economic or legal reasons related to the borrower's financial difficulties that it would not otherwise consider. All TDRs are considered impaired.

The following table provides information on performing and nonperforming TDRs as of December 31, 2015 and 2014:

(In thousands)	**2015**	**2014**
Performing TDRs:		
Commercial real estate	$ 2,220	$ 2,337
Consumer real estate	346	-
Commercial and industrial loans	47	355
Total performing TDRs	2,613	2,692
Nonperforming TDRs:		
Construction and land development	104	131
Consumer real estate	65	70
Consumer and other	21	-
Total nonperformingTDRs	190	201
Total TDRs	$ 2,803	$ 2,893

During 2015, there were three new loans totaling $1.4 million identified as TDRs. There were no loans considered as TDRs in 2014 that subsequently defaulted in 2015.

Interest is not typically accrued on loans where impairment exists. For loans classified as TDRs, the Company further evaluates the loans as performing or non-performing. If, at the time of restructure, it is determined that no impairment exists, the loan will be classified as performing. At December 31, 2015 and 2014, $2.6 million and $2.7 million of TDRs were accruing interest as they were classified as performing. Interest income recognized on performing TDRs was $161,000 and $151,000 for the years ended December 31, 2015 and 2014, respectively.

In order to quantify the value of impairment, the Company evaluates loans individually. In 2015, the Company had $3.9 million of impaired loans. The detail of loans evaluated for impairment as of December 31, 2015 is presented below:

(in thousands) **2015**	**Recorded Investment**	**Contractual Principal Balance**	**Allocated Allowance**
Loans without a specific valuation allowance:			
Construction and land development	$ 235	$ 397	$ -
Commercial real estate	2,220	2,319	-
Loans with a specific valuation allowance:			
Construction and land development	4	29	4
Commercial real estate	399	480	72
Consumer real estate	410	474	115
Commercial and industrial loans (except those secured by real estate)	602	895	297
Consumer and other	21	26	21
Total	$ 3,891	$ 4,620	$ 509

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

In 2014, the Company had $6.3 million of impaired loans. The detail of loans evaluated for impairment as of December 31, 2014 is presented below:

(in thousands) **2014**	**Recorded Investment**	**Unpaid Contractual Principal Balance**	**Allocated Allowance**
Loans without a specific valuation allowance:			
Construction and land development	$ 339	$ 392	$ -
Commercial real estate	3,059	3,102	-
Consumer real estate			
Commercial and industrial loans (except those secured by real estate)	120	221	-
Consumer and other			
Loans with a specific valuation allowance:			
Construction and land development	6	29	5
Commercial real estate	1,479	1,479	189
Consumer real estate	646	666	282
Commercial and industrial loans (except those secured by real estate)	600	606	178
Consumer and other	26	26	26
Total	$ 6,275	$ 6,521	$ 680

The average recorded investment balance of impaired loans during 2015 and 2014 is as follows:

(In thousands)	2015	2014
Construction and land development	$ 252	$ 1,725
Commercial real estate	5,477	3,704
Consumer real estate	420	939
Commercial and industrial loans (except those secured by real estate)	654	941
Consumer and other	23	180
Total loans	$ 6,826	$ 7,489

When the Company cannot reasonably expect full and timely repayment of its loan, the loan is placed on nonaccrual. The Company will continue to track the contractual interest for purposes of customer reporting and any potential litigation or later collection of the loan but accrual of interest for the Company's financial statement purposes is to be discontinued. Subsequent payments of interest can be recognized as income on a cash basis provided that full collection of principal is expected. Otherwise, all payments received are to be applied to principal only. At the time of non-accrual, past due or accrued interest is reversed from income.

Loans over 90 days past due will automatically be placed on non-accrual. Loans that are less delinquent may also be placed on non-accrual if full collection of principal and interest is unlikely.

The following table presents the recorded investment in nonaccrual loans by portfolio segment as of December 31, 2015 and 2014:

	Nonaccrual	
(in thousands)	**2015**	**2014**
Construction and land development	$ 238	$ 276
Consumer real estate	65	69
Commercial and industrial loans (except those secured by real estate)	189	49
Consumer and other	21	26
Total	$ 513	$ 420

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

There were no loans past due and accruing interest at December 31, 2015 or 2014. If interest had been earned on non-accrual loans, such income would have approximated $28,000 and $54,000 for the years ended December 31, 2015 and 2014, respectively.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2015 and 2014 by portfolio segment:

(in thousands) **2015**	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**Greater than 90 Days Past Due**	**Non-Accrual**	**Total Past Due**	**Current**	**Total Loans**
Construction and land development	$ -	$ -	$ -	$ 238	$ 238	$ 64,464	$ 64,702
Commercial real estate	-	-	-	-	-	533,909	533,909
Consumer real estate	-	-	-	65	65	249,642	249,707
Commercial and industrial loans (except those secured by real estate)	-	-	-	189	189	153,480	153,669
Consumer and other	-	-	-	21	21	13,518	13,539
Total	$ -	$ -	$ -	$ 513	$ 513	$ 1,015,013	$ 1,015,526

(in thousands) **2014**	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**Greater than 90 Days Past Due**	**Non-Accrual**	**Total Past Due**	**Current**	**Total Loans**
Construction and land development	$ -	$ -	$ -	$ 276	$ 276	$ 62,541	$ 62,817
Commercial real estate	-		-	-	-	487,231	487,231
Consumer real estate	185	-	-	69	254	195,261	195,515
Commercial and industrial loans (except those secured by real estate)	71	-	-	49	120	117,006	117,126
Consumer and other	-	-	-	26	26	5,696	5,722
Total	$ 256	$ -	$ -	$ 420	$ 676	$ 867,735	$ 868,411

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Indicators

The Company utilizes its nine point grading system in order to evaluate the level of inherent risk in the loan portfolio as part of its allowance for loan losses methodology. Loans collectively evaluated for impairment are grouped by loan type and, in the case of commercial and construction loans, by risk rating. Each loan type is assigned an allowance factor based on risk grade, historical loss experience, economic conditions, overall portfolio quality including delinquency rates and commercial real estate loan concentrations (as applicable). As risk grades increase, additional reserves are applied stated in basis points in order to account for the added inherent risk.

The Company categorizes all business and commercial purpose loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by setting the risk grade at the inception of a loan through the approval process. A certain percentage of loan dollars is reviewed each year by a third party loan review function. The risk rating process is inherently subjective and based upon management's evaluation of the specific facts and circumstances for individual borrowers. As such, the assigned risk ratings are subject to change based upon changes in borrower status and changes in the external environment affecting the borrower. The Company uses the following definitions for risk ratings:

- *Risk Grade 1 – Minimal* - Credits in this category are virtually risk-free and are well-collateralized by cash-equivalent instruments. The repayment program is well-defined and achievable. Repayment sources are numerous.
- *Risk Grade 2 – Modest* - Loans to borrowers of significantly better than average financial strength or loans secured by readily marketable securities. Earnings performance is consistent and primary and secondary sources of repayment are well established. The borrower exhibits excellent asset quality and liquidity with very strong debt servicing capacity and coverage. Company management has depth, is experienced and well regarded in the industry.
- *Risk Grade 3 – Average* - Loans in this category are to borrowers of satisfactory financial strength. Earnings performance is consistent. Primary and secondary sources of repayment are well defined and adequate to retire the debt in a timely and orderly fashion. These borrowers would generally exhibit satisfactory asset quality and liquidity. They have moderate leverage and experienced management in key positions.
- *Risk Grade 4 – Acceptable* - Loans in this category are to borrowers involving more than average risk which contain certain characteristics that require some supervision and attention by the lender. Asset quality is acceptable, but debt capacity is modest. Little excess liquidity is available. The borrower may be fully leveraged and unable to sustain major setbacks. Covenants are structured to ensure adequate protection. Management may have limited experience and depth. This category includes loans which are highly leveraged transactions due to regulatory constraints and also includes loans involving reasonable exceptions to policy.
- *Risk Grade 5 – Acceptable with Care* - A loan in this category is sound and collectible but contains considerable risk. Although asset quality remains acceptable, the borrower has a smaller and/or less diverse asset base, very little liquidity and limited debt capacity. Earnings performance is inconsistent and the borrower is not strong enough to sustain major setbacks. The borrower may be highly leveraged and below average size or a lower-tier competitor. There might be limited management experience and depth. These loans may be to a well-conceived start-up venture but repayment is still dependent upon a successful operation. This category includes loans with significant documentation or policy exceptions, improper loan structure, or inadequate loan servicing procedures and may also include a loan in which strong reliance for a secondary repayment source is placed on a guarantor who exhibits the ability and willingness to repay or loans which are highly leveraged transactions due to the obligor's financial status.
- *Risk Grade 6 – Special Mention or Critical* - Loans in this category have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. These may also include loans of marginal quality and liquidity that if not corrected may jeopardize the liquidation of the debt and the Company's credit position. These loans require close supervision and must be monitored to ensure there is not a pattern of deterioration in the credit that may lead to further downgrade. These characteristics include but are not limited to:
    - Repayment performance has not been demonstrated to prudent standards and;
    - Repayment performance is inconsistent and highly sensitive to business and operating cycle swings;
    - Fatal documentation errors.
    - Performing as agreed without documented capacity or collateral protection.

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

- *Risk Grade 7 – Substandard* - A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
- *Risk Grade 8 – Doubtful* - Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Among these events are:
    - Injection of capital
    - Alternative financing
    - Liquidation of assets or the pledging of additional collateral.

  The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on non-accrual status and no definite repayment schedule exists. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off. There were no loans rated as Doubtful as of December 31, 2015 or 2014.

- *Risk Grade 9 – Loss* - Loans classified Loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but rather that it is not practical or desirable to defer writing off this worthless loan even though partial recovery may be affected in the future. Probable loss portions of Doubtful assets should be charged against the Allowance for Loan Losses. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty days or calendar quarter-end. There were no loans rated as Loss as of December 31, 2015 or 2014.

As of December 31, and based on the most recent analysis performed, the risk category of unimpaired loans by class of loans is as follows:

	Risk Grade							
(in thousands)	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**Total**
2015								
Construction and land development	$ 26	$ 200	$ 2,545	$ 14,318	$ 47,133	$ 242	$ -	$ 64,464
Commercial real estate	-	619	195,935	243,771	87,492	3,473	-	531,290
Consumer real estate	53	10,933	111,123	92,127	34,346	714	-	249,296
Commercial and industrial loans (except those secured by real estate)	2,168	1,909	24,675	96,900	26,802	612	-	153,066
Consumer and other	980	1,069	960	8,392	1,936	182	-	13,519
Total	$ 3,227	$ 14,730	$ 335,238	$ 455,508	$ 197,709	$ 5,223	$ -	$1,011,635

	Risk Grade							
	1	**2**	**3**	**4**	**5**	**6**	**7**	**Total**
2014								
Construction and land development	$ 47	$ 1,069	$ 3,207	$ 13,112	$ 44,935	$ 102	$ -	$ 62,472
Commercial real estate	-	2,336	167,850	214,413	91,026	7,068	-	482,693
Consumer real estate	-	6,808	91,368	67,677	29,016	-	-	194,869
Commercial and industrial loans (except those secured by real estate)	2,479	1,849	14,123	61,806	35,522	627	-	116,406
Consumer and other	200	68	1,031	2,068	2,141	188	-	5,696
Total	$ 2,726	$ 12,130	$ 277,579	$ 359,076	$ 202,640	$ 7,985	$ -	$ 862,136

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The Company has granted loans to certain directors and executive officers of the Company and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectability. All loans to directors and executive officers or their interests are submitted to the Board of Directors for approval. A summary of loans to directors, executive officers and their related interests follows:

(In thousands)	
Loans to directors and officers	
as a group at December 31, 2014	$ 6,291
Disbursements during 2015	772
Amounts collected during 2015	(1,520)
Loans to directors and officers as a group at December 31, 2015	$ 5,543

NOTE 5 - BANK PREMISES AND EQUIPMENT

Following is a summary of bank premises and equipment at December 31, 2015 and 2014:

(In thousands)	**2015**	**2014**
Building	$ 16,181	$ 16,096
Furniture and equipment	6,532	5,888
Leasehold improvements	350	349
Construction in progress	-	107
Less accumulated depreciation and amortization	(6,630)	(5,369)
	$ 16,433	$ 17,071

Depreciation and amortization expense amounting to $1.4 million and $1.1 million for the years ended December 31, 2015 and 2014 are included in occupancy and equipment expenses.

NOTE 6 - DEPOSITS

At December 31, 2015, the scheduled maturities of time deposits are as follows:

(In thousands)	
2016	$ 257,883
2017	41,620
2018	15,550
2019	1,920
2020 and after	2,808
	$ 319,781

At December 31, 2015 and 2014, time deposits in denominations of $250,000 or more were $34.1 million and $33.6 million, respectively. Interest expense on time deposits of $250,000 or more aggregated to $400,000 in 2015 and $368,000 in 2014.

In the normal course of business, certain directors and executive officers of the Company, including their immediate families and companies in which they have an interest, may be deposit customers.

NOTE 7 - BORROWINGS

Repurchase Agreements and Federal Funds Purchased

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities.

NOTE 7 - BORROWINGS (Continued)

Following is an analysis of short-term borrowed funds at December 31, 2015 and 2014:

(Dollars in thousands) **December 31, 2015**	**End of Period** Balance	**End of Period** Weighted Avg Rate	**Daily Average Balance** Balance	**Daily Average Balance** Interest Rate	**Maximum Outstanding At Any Month End**
Fed funds purchased	$ -	0.00%	$ 99	0.54%	$ -
Repurchase agreements	30,580	0.19%	33,080	0.19%	48,080
	$ 30,580	0.19%	$ 33,179	0.19%	

(Dollars in thousands) **December 31, 2014**	**End of Period** Balance	**End of Period** Weighted Avg Rate	**Daily Average Balance** Balance	**Daily Average Balance** Interest Rate	**Maximum Outstanding At Any Month End**
Fed funds purchased	$ 901	0.55%	$ 421	0.54%	$ 12,137
Repurchase agreements	26,581	0.19%	24,301	0.18%	29,571
	$ 27,482	0.20%	$ 24,722	0.19%	

Interest expense on securities sold under agreements to repurchase totaled $63,600 in 2015 and $43,800 in 2014.

Interest on federal funds purchased totaled $1,500 in 2015 and $2,200 in 2014.

Repurchase agreements are collateralized by mortgage-backed securities with carrying values and fair values of $42.9 million at December 31, 2015.

At December 31, 2015, the Company had available lines of credit of approximately $152.5 million at various financial institutions for borrowing on a short-term basis ("fed funds lines"). The Company had $102.5 million of the fed funds lines with the bank's correspondent banks that were unsecured. However, since the Company had no outstanding balances during the year on the secured portion, it had no collateral pledged at December 31, 2015 for this line.

Federal Home Loan Bank Advances

At December 31, 2015, the Company had an available credit line at the FHLB of up to 30% of assets contingent upon adequate collateralization. These lines are subject to annual renewal and are at varying interest rates. Advances from the FHLB had a weighted average rate of 0.41% and 0.23% and total outstanding balances averaged $166.9 million and $114.6 million for the years ended December 31, 2015 and 2014, respectively. Included in amounts due to the FHLB as of December 2015 were six term borrowings totaling $165.0 million. The term borrowings were all short-term notes maturing by February 2016 with rates varying from 0.26% to 0.62%.

The line of credit and all other advances were collateralized by certain 1 – 4 family mortgages, multifamily first mortgage loans, home equity lines and qualifying commercial loans totaling $520.5 million and by mortgage-backed securities with carrying values of $10.0 million at December 31, 2015. The line offers a borrowing capacity of $366.8 million at December 31, 2015.

Holding Company Loan

The Company has a $10.0 million holding company loan with an unaffiliated institution secured by the stock of the Bank. The loan had an outstanding balance of $4.8 million and $7.3 million at December 31, 2015 and December 31, 2014, respectively. The balance is included in other borrowings on the Consolidated Balance Sheets. The loan accrues interest at prime plus 0.75% and matures in November 2017. The loan called for interest only payments until November 2013 with principal payments starting after that and amortized over the remaining four year term. The loan is subject to following covenants, to be tested quarterly:

- Maintain a Tier I Leverage Ratio at both the Company and the Bank of not less than 6.0%;
- Maintain a Total Risk Based Capital Ratio at both the Company and the Bank of not less than 10.0%;

NOTE 7 - BORROWINGS (Continued)

- LTV<75% as stated in collateral section;
- Maintain a Texas Ratio not to exceed 55%, to be tested quarterly;and
- A "change in control" of Bank entity will trigger the loan being due in full.

Subordinated Debentures

In 2004, the Company issued $10.3 million of junior subordinated debentures to Paragon Commercial Capital Trust I in exchange for the proceeds of trust preferred securities issued by the Trust. The junior subordinated debentures accrue interest quarterly at an annual rate, reset quarterly, equal to LIBOR plus 2.65%. The debentures are redeemable in whole or in part, on any October 23, January 23, April 23, or July 23. Redemption is mandatory at July 23, 2034.

In 2006, the Company issued $8.2 million of junior subordinated debentures to Paragon Commercial Capital Trust II in exchange for the proceeds of trust preferred securities issued by the Trust. The junior subordinated debentures accrue interest quarterly at an annual rate, reset quarterly, equal to LIBOR plus 1.70%. The debentures are redeemable on June 20, 2011 or afterwards, in whole or in part, on any March 30, June 30, September 30, or December 30. Redemption is mandatory at June 30, 2036.

In October 2008, the Company issued $11.8 million of subordinated debentures at the Bank level. $7.3 million of the debentures paid interest quarterly at a fixed rate of 9.14% and the remaining $4.5 million paid at an annual rate, reset quarterly, equal to LIBOR plus 5.00%. The debentures were redeemable on November 1, 2013 or any time afterwards, in whole or in part. Redemption was mandatory at November 1, 2018. The debentures were included in long-term debt in 2013 and qualified as Tier 2 regulatory capital at the Bank level. In January 2014, the Company repaid these debentures, reducing total risk based capital by this amount.

The junior subordinated debentures are included in debt and the Company's equity interest in the trusts are included in other assets. The Company guarantees the trust preferred securities through the combined operation of the junior subordinated debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

The trust preferred securities presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as a minority interest in a consolidated subsidiary. The junior subordinated debentures do not qualify as Tier 1 regulatory capital. On March 1, 2005, the Board of Governors of the Federal Reserve issued a final rule stating that trust preferred securities will continue to be included in Tier 1 capital, subject to stricter quantitative and qualitative standards. For Bank Holding Companies, trust preferred securities will continue to be included in Tier 1 capital up to 25% of core capital elements (including trust preferred securities) net of goodwill less any associated deferred tax liability.

NOTE 8 - LEASES

The Company purchased a building in Raleigh in 2005 and relocated its headquarters in March 2007. The acquired building resides on land subject to a land lease which renews every five years with the next renewal in 2018. The assumed life of the lease for the land is the expected life of the building. In addition the Bank has entered into non-cancelable operating leases for its Charlotte office expiring in February 2019, its Cary office expiring in June 2019 and its operations center expiring in August 2016. Future minimum lease payments under these leases for the years ending December 31 are as follows:

(In thousands)		
2016	$	605
2017		514
2018		524
2019		238
2020		158
Thereafter		4,260
Total	$	6,299

Total rent expense for the years ended December 31, 2015 and 2014 amounted to $534,000 and $272,000 respectively.

NOTE 9 - RELATED PARTY TRANSACTIONS

In addition to those transactions discussed in Note 4 and 6, the Company entered into an agreement for accounting, data processing, and administrative services with a stockholder corporation that owned approximately 18% of the Company's common stock at December 31, 2015 and 2014. The agreement expired in 2015 and was not renewed. Expenses related to this agreement totaled $377,000 and $583,000 during the years ended December 31, 2015 and 2014, respectively.

NOTE 10 - EMPLOYEE BENEFIT PLANS

401(k) Retirement Plan

The Company has adopted a 401(k) retirement plan that covers all eligible employees. The Company's contribution is limited to 6% of each employee's salary. Matching contributions are funded when accrued. The Company matches the first 6% of employee contributions. Matching expenses totaled $589,000 and $471,000 for the years ended December 31, 2015 and 2014, respectively.

Employee Stock Purchase Plan

On September 23, 2003, the Board of Directors adopted, subject to stockholder approval, the 2003 Employee Stock Purchase Plan (the "2003 ESPP"). A split adjusted aggregate of 200,000 shares of common stock of the Company has been reserved for issuance by the Company upon exercise of options to be granted from time to time under the 2003 ESPP.

On November 18, 2014, the Plan was amended to comply with Section 423 of the Internal Revenue Code of 1986. Under this plan, eligible employees have the option to withhold post-tax dollars from their payroll to be placed in an account for purchases of the Company's shares or to buy their allotted shares outright. In order for employees to be eligible to participate, they must have been employed by the Company for 3 consecutive months prior to the annual share allocation date. The Plan allows for employees to purchase shares at 95% of fair market value. The number of shares that could be purchased in any calendar year by any individual was limited to shares with a fair market value of $25,000.

During 2015, 10,678 shares were issued for an aggregate amount for $202,000. During 2014, there were no shares issued under the plan.

Supplemental Retirement Plan

In May 2004, the Company established a non-qualifying supplemental retirement plan for the benefit of certain key executives (the "2004 Plan"). Under the 2004 Plan, the participants will receive a fixed retirement benefit over a 20 year period following that participant's retirement. The 2004 Plan also provides for payment of death or disability benefits in the event a participating officer becomes permanently disabled or dies prior to attainment of retirement age. Benefits vested over a ten year period beginning at 2004 Plan inception and are now fully vested. The discount rate used to compute the liability for the expected benefits was 6%.

In July 2007, the Company established another non-qualifying supplemental retirement plan for the benefit of certain other key employees (the "2007 Plan"). The terms of the plan were the same as those for the 2004 Plan. In addition, at the same time, the Company established a deferred compensation plan for certain key executives (the "Deferred Compensation Plan"). Terms of the Deferred Compensation Plan were the same as those of the 2004 Plan and the 2007 Plan except that in addition to a service requirement, certain financial objectives had to be met.

In 2012, the Company amended the Deferred Compensation Plan to remove the financial objectives for the remaining participants. In 2014, the Deferred Compensation Plan was merged into the 2007 Plan and all benefits became fully vested.

For the year ended December 31, 2015 and 2014, the Company recognized an expense of $397,000 and $415,000, respectively, related to each of these plans. The accrued liability related to these plans was approximately $2.7 million and $2.3 million as of December 31, 2015 and 2014, respectively, and is included in Other liabilities on the Consolidated Balance Sheet.

NOTE 10 - EMPLOYEE BENEFIT PLANS (Continued)

At December 31, 2015, the Company had $28.3 million in cash surrender value invested in bank-owned life insurance policies ("BOLI"). Income earned on these policies may be used, at the Company's sole discretion, to fund the benefits payable under the Plans.

Stock-Based Compensation Plans

Under the 2006 Omnibus Stock Ownership and Long Term Incentive Plan (the "Omnibus Plan"), as amended, an aggregate of 312,500 split adjusted shares of the common stock of the Company, subject to adjustment, were reserved for issuance under the terms of the Omnibus Plan pursuant to the grant of incentive stock options, non-qualified stock options, restricted stock grants, long-term incentive compensation units and stock appreciation rights.

Options granted under the Omnibus Plan become exercisable in accordance with the vesting schedule specified in the stock option agreements. All unexercised options expire ten years after the date of grant.

The following table summarizes the components and classification of stock-based compensation expense for the years ended December 31, 2015 and 2014:

(In thousands)	**2015**	**2014**
Stock options	$ -	$ 23
Restricted stock	411	313
Total stock-based compensation	$ 411	$ 336

As of December 31, 2015, there was no unrecognized compensation expense related to the Omnibus Plan. Unrecognized stock-based compensation expense at December 31, 2015 is as follows:

(In thousands)	
2016	$ 317
2017	263
2018	108
Total	$ 688

Stock Options

A split adjusted summary of the transactions for the Company's stock-based compensation plans as of and for the years ended December 31, 2015 and 2014, including the weighted average exercise price ("WAEP") is as follows:

	2015		**2014**	
	Shares	**WAEP**	**Shares**	**WAEP**
Outstanding at beginning of year	101,000	$ 43.00	111,000	$ 43.27
Granted	-	-	6,000	10.00
Exercised	(10,000)	17.60	(6,000)	10.00
Expired and forfeited	(9,500)	40.00	(10,000)	46.03
Outstanding at end of year	81,500	$ 46.46	101,000	$ 43.00
Options exercisable at year-end	81,500	$ 46.46	101,000	$ 43.00

There were no unvested shares as of December 31, 2015 or 2014.

NOTE 10 - EMPLOYEE BENEFIT PLANS (Continued)

Stock-Based Compensation Plans (Continued)

The following table summarizes information about the Company's stock options at December 31, 2015:

Exercise Price	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Number Exercisable
$40.00 - $45.00	29,250	$ 43.11	2.24	29,250
$45.01 - $50.00	51,250	48.27	1.14	51,250
$50.01 - $52.00	1,000	52.00	0.39	1,000
	81,500	$ 46.46	1.53	81,500

There were no options granted during 2015.

The following table lists the stock option grants from the Plan for the year ended December 31, 2014:

	Number of Options Granted	Exercise Price	Fair Value
August 1, 2014 - Directors	6,000	$ 10.00	$ 3.77

The fair value of each option is estimated as of the date of grant using the Black-Scholes Option Pricing Model. This model requires the input of subjective assumptions that will usually have a significant impact on the fair value estimate. The assumptions for the grants were developed based on ASC 718 and SEC guidance contained in Staff Accounting Bulletin (SAB) No. 107, "Share-Based Payment."

The following table summarizes the weighted average assumptions used to compute the grant-date fair value of options granted during the year ended December 31, 2014:

Dividend yield	0.00%
Expected volatility	31.7% - 31.7%
Weighted average volatility	31.69%
Risk free interest rate	2.160%
Expected life	7 years

- The dividend yield assumption is consistent with management expectations of dividend distributions based upon the Company's business plan. An increase in dividend yield will decrease stock compensation expense.
- The risk-free interest rate was developed using the U.S. Treasury yield curve for periods equal to the expected life of the options on the grant date. An increase in the risk-free interest rate will increase stock compensation expense.
- The expected option life for the current period grants was estimated using the vesting period, the term of the option and estimates of future exercise behavior patterns. An increase in the option life will increase stock compensation expense.
- The volatility was estimated using a peer group assessment for periods approximating the expected option life. Appropriate weight is attributed to financial theory, according to which the volatility of an institution's equity should be related to the volatility of its assets and the entity's financial leverage. An increase in the volatility will increase stock compensation expense.

At December 31, 2015 and 2014, there was no aggregate intrinsic value of options outstanding and exercisable. The aggregate intrinsic value of options exercised during 2015 was $49,000. There was no aggregate intrinsic value of options exercised during 2014.

NOTE 10 - EMPLOYEE BENEFIT PLANS (Continued)

Stock-Based Compensation Plans (Continued)

Restricted Stock

Restricted stock is issued to the grantee but provides no voting or dividend rights and is restricted from transfer until vested, at which time all restrictions are removed. The terms of the restricted stock awards granted to employees during 2015 and 2014 are 100% cliff vesting for a period of 3 years from the date of the grant. The terms of the restricted stock awards granted to directors during 2015 are a vesting period 3 years from the date of the grant with immediate vesting upon retirement of the director. The terms of the restricted stock awards granted to directors during 2014 are a vesting period 2 years from the date of the grant with immediate vesting upon retirement of the director.

The following table lists the various restricted stock awards under the Omnibus Plan for the years ended December 31, 2015 and 2014:

	Number of Shares Granted	Fair Value
2015		
April 1, 2015 - Employees	14,156	$ 20.00
September 15, 2015 - Directors	16,500	23.75
2014		
February 1, 2014 - Directors	68,750	$ 8.00
August 1, 2014 - Employees	6,250	10.00
December 1, 2014 - Employees	12,500	10.00

The fair value of the restricted stock awards granted to employees and directors for the years ended December 31, 2015 and 2014 was estimated to be equal to the closing stock price on the grant date. The value of the restricted stock is being amortized on a straight-line basis over the implied service periods.

The following table summarizes restricted stock award activity for the years ended December 31, 2015 and 2014:

	2015		2014	
	Shares	Weighted Average Grant-Date Fair Value Per Share	Shares	Weighted Average Grant-Date Fair Value Per Share
Outstanding at beginning of year	75,000	$ 8.50	-	$ -
Granted	30,656	22.02	87,500	8.43
Vested	(28,125)	8.00	(12,500)	8.00
Expired or forfeited	-	-	-	-
Outstanding at end of year	77,531	$ 14.03	75,000	$ 8.50

The following table summarizes the shares available for future grants under the Omnibus Plan for the years ended December 31, 2015 and 2014:

NOTE 10 - EMPLOYEE BENEFIT PLANS (Continued)

Stock-Based Compensation Plans (Continued)

	2015			2014		
	Stock Options	**Restricted Stock**	**Available for Future Grants**	**Stock Options**	**Restricted Stock**	**Available for Future Grants**
Outstanding at beginning of year			199,500			283,000
Granted	-	(30,656)	(30,656)	(6,000)	(87,500)	(93,500)
Expired and forfeited	9,500	-	9,500	10,000	-	10,000
Outstanding at end of year			178,344			199,500

NOTE 11 - INCOME TAXES

Allocation of federal and state income tax expense between current and deferred portions for the years ended December 31 is as follows:

(In thousands)	**2015**	**2014**
Current		
Federal	$ 2,845	$ 1,430
State	886	496
Total current	3,731	1,926
Deferred		
Federal	1,925	2,042
State	105	435
Total deferred	2,030	2,477
	$ 5,761	$ 4,403

A reconciliation of income tax benefit computed at the statutory federal income tax rate to income tax expense included in the Consolidated Statements of Income is as follows:

(In thousands)	**2015**	**2014**
Expense computed at statutory rate of 34%	$ 5,768	$ 4,203
Effect of state income taxes, net of federal benefit	654	327
Tax exempt income	(712)	(622)
Other	51	495
	$ 5,761	$ 4,403

NOTE 11 - INCOME TAXES (Continued)

The components of the net deferred tax assets as of December 31 are as follows:

(In thousands)	2015	2014
Deferred tax assets:		
Allowance for loan losses	$ 2,873	$ 2,628
Recorded impairment of assets	982	1,190
Operating loss carryforwards	-	2,527
Deferred compensation	1,015	881
Net unrealized loss on cash flow hedges	1,045	311
Other	1,600	800
Total deferred tax assets	7,515	8,337
Deferred tax liabilities:		
Premises and equipment	(1,050)	(999)
Deferred loan costs	(1,396)	(1,048)
Prepaid expenses	(203)	(208)
Net unrealized gain on available for sale securities	(526)	(1,015)
Other	(222)	(142)
Total deferred tax liabilities	(3,397)	(3,412)
Net recorded deferred tax assets	$ 4,118	$ 4,925

No valuation allowances were required relating to deferred tax assets at December 31, 2015 or 2014 as the Company believes that realization of the net deferred tax asset is more likely than not.

As of December 31, 2015 and 2014, there were no uncertain tax positions. The amount of uncertain tax positions may increase or decrease in the future for various reasons including adding amounts for current tax positions, expiration of open tax returns due to statutes of limitations, changes in management's judgment about the level of uncertainty, status of regulatory examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. The Company's policy is to report interest and penalties, if any, related to uncertain tax positions in income tax expense in the Consolidated Statements of Income. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2012.

NOTE 12 - OTHER NON-INTEREST EXPENSE

The major components of other non-interest expense for the years ended December 31, 2015 and 2014 are as follows:

(In thousands)	2015	2014
Telephone and data lines	431	119
Postage, printing and office supplies	307	276
Franchise and other taxes	286	402
Insurance	214	205
Travel-related expenses	210	175
Correspondent bank fees	168	155
Charitable contributions	130	120
Other	750	662
Total	$ 2,496	$ 2,114

NOTE 13 - REGULATORY MATTERS

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Basel III Capital Rules, a new comprehensive capital framework for U.S. banking organizations, became effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

The Company and the Bank's Common Equity Tier 1 capital includes common stock and related paid-in capital and retained earnings. In connection with the adoption of the Basel III Capital Rules, the Company elected to opt-out of the requirement to include most components of accumulated other comprehensive income in Common Equity Tier 1. Common Equity Tier 1 for both the Company and the Bank is reduced by deferred tax assets that are subject to transition provisions.

Tier 1 capital includes Common Equity Tier 1 capital and additional Tier 1 capital. For the Company, additional Tier 1 capital at December 31, 2015 includes $18.0 million of trust preferred securities issued by our unconsolidated subsidiary trusts. Under the Basel III Capital Rules, trust preferred securities only qualify as Tier 1 capital instruments for banks under $15 billion in total assets.

Total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital for both the Company and the Bank includes the permissible portion of the allowance for loan losses.

Prior to January 1, 2015, under the capital rules then in effect, the Company's and the Bank's Tier 1 capital included total stockholders' equity excluding accumulated other comprehensive income, net of associated deferred tax liabilities. Tier 1 capital for the Company included $18.0 million of trust preferred securities issued by our unconsolidated subsidiary trusts.

The Common Equity Tier 1 (beginning in 2015), Tier 1 and Total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, with certain exclusions, allocated by risk weight category, and certain off-balance-sheet items, among other things. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets, among other things.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% Common Equity Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company or the Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

NOTE 13 - REGULATORY MATTERS (Continued)

The following table presents actual and required capital ratios as of December 31, 2015 for the Company and the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2015 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

			Minimum Requirements To Be:			
	Actual		Adequately Capitalized		Well Capitalized (2)	
(Dollars in thousands)	Amount	Ratio (1)	Amount	Ratio (1)	Amount	Ratio (1)
2015						
The Company						
Total Capital	$ 123,028	11.21%	$ 87,794	8.00%	N/A	N/A
Tier I Capital	115,387	10.51%	65,845	6.00%	N/A	N/A
Common equity Tier I Capital	97,853	8.92%	49,384	4.50%	N/A	N/A
Leverage	115,387	8.66%	53,274	4.00%	N/A	N/A
The Bank						
Total Capital	$ 127,095	11.59%	87,696	8.00%	$ 109,621	10.00%
Tier I Capital	119,454	10.90%	65,772	6.00%	87,696	8.00%
Common equity Tier I Capital	119,454	10.90%	50,425	4.50%	71,253	6.50%
Leverage	119,454	9.15%	52,193	4.00%	65,241	5.00%

1) Total capital ratio is defined as Tier 1 capital plus Tier 2 capital divided by total risk-weighted assets. The Tier 1 Capital ratio is defined as Tier 1 capital divided by total risk-weighted assets. Common equity Tier 1 is defined as Tier 1 capital excluding qualifying trust preferred securities divided by total risk weighted assets. The leverage ratio is defined as Tier 1 capital divided by the most recent quarter's average total assets.

2) Prompt corrective action provisions are not applicable at the bank holding company level.

The following table presents actual and required capital ratios as of December 31, 2014 for the Company and the Bank under the regulatory capital rules then in effect:

	Actual		Adequately Capitalized		Well Capitalized (2)	
(Dollars in thousands)	Amount	Ratio (1)	Amount	Ratio (1)	Amount	Ratio (1)
2014						
The Company						
Total Capital	$ 111,704	12.38%	$ 72,207	8.00%	N/A	N/A
Tier I Capital	104,524	11.58%	36,104	4.00%	N/A	N/A
Leverage	104,524	9.02%	46,340	4.00%	N/A	N/A
The Bank						
Total Capital	118,028	13.09%	72,115	8.00%	$ 90,144	10.00%
Tier I Capital	110,848	12.30%	36,058	4.00%	54,087	6.00%
Leverage	110,848	9.61%	46,160	4.00%	57,700	5.00%

1) Total capital ratio is defined as Tier 1 capital plus Tier 2 capital divided by total risk-weighted assets. The Tier 1 Capital ratio is defined as Tier 1 capital divided by total risk-weighted assets. The leverage ratio is defined as Tier 1 capital divided by the most recent quarter's average total assets.

2) Prompt corrective action provisions are not applicable at the bank holding company level.

Management believes that, as of December 31, 2015, the Company and the Bank were "well capitalized" based on the ratios presented above.

NOTE 13 - REGULATORY MATTERS (Continued)

The Company and the Bank are subject to the regulatory capital requirements administered by the Federal Reserve Board and, for the Bank, the Federal Deposit Insurance Corporation ("FDIC") and the North Carolina Commissioner of Banks. Regulatory authorities can initiate certain mandatory actions if the Company or the Bank fails to meet the minimum capital requirements, which could have a direct material effect on our financial statements.

Management believes, as of December 31, 2015, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

In the ordinary course of business, the Company is dependent upon dividends from the Bank to provide funds for the payment of dividends to trust preferred stockholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining its "well capitalized" status, at December 31, 2015, the Bank could pay aggregate dividends of up to $17.5 million to the Company without prior regulatory approval.

NOTE 14 - OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

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

A summary of the contract amounts of the Company's exposure to off-balance sheet credit risk as of December 31, 2015 and 2014 is as follows:

(In thousands)	**2015**	**2014**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 16,179	$ 16,886
Undisbursed lines of credit	163,572	128,819
Standby letters of credit	3,188	3,207
Total	$ 182,939	$ 148,912

NOTE 15 - DERIVATIVES AND FINANCIAL INSTRUMENTS

To mitigate exposure to variability in expected future cash flows resulting from changes in interest rates, in May 2013 the Company entered into two forward swap arrangements "("the "Swaps") whereby the Company would pay fixed rates on two short term borrowings at some point in the future for a determined period of time. For both agreements, the Company would renew advances with the FHLB for 3-month terms as a primary funding source and pay the prevailing 3-month rate. The first swap, a "2-5 Swap", was a $20 million agreement whereby 2 years from the May 2013 execution date, the Company would begin to swap out the 3-month FHLB advance pricing at that date for a fixed rate of 1.964% for a period of 5 years. The second swap, a "3-5 Swap", was similar in terms except that it was a $30 million agreement whereby 3 years from the May 2013 execution date, the Company would begin to swap out the 3-month FHLB advance pricing at that date for a fixed rate of 2.464% for a period of 5 years.

NOTE 15 - DERIVATIVES AND FINANCIAL INSTRUMENTS (Continued)

The Company designated the forward-starting interest rate swaps (the hedging instruments) as cash flow hedges of the risk of changes attributable to the benchmark 3-Month LIBOR interest rate risk for the forecasted issuances of FHLB advances arising from a rollover strategy. The Company intended to sequentially issue a series of 3-month fixed rate debt as part of a planned roll-over of short term debt for the next seven to eight years.

In September 2014, as a result of continued increasing fixed rate exposure, the Company determined that an additional strategy was needed and, as a result, exited from the Swaps for a deferred gain of $372,000. In their place, the Company purchased three interest rate caps with a strike price of 3-month LIBOR at .50% and a five year term. The instruments hedged were $100 million of Federal Home Loan Bank borrowings maturing quarterly on the same reset dates. The Company executed three separate agreements between $30 million and $35 million maturing between August 2019 and October 2019. The following table reflects the cash flow hedges included in the Consolidated Balance Sheets as of December 31, 2015 and 2014:

	2015		2014	
(In thousands)	**Notational Amount**	**Fair Value**	**Notational Amount**	**Fair Value**
Included in other assets:				
Cap 1 - maturing August 2019	$ 35,000	$ 1,334	$ 35,000	$ 2,064
Cap 2 - maturing September 2019	35,000	1,360	35,000	2,108
Cap 3 - maturing October 2019	30,000	1,216	30,000	1,857
	$ 100,000	$ 3,910	$ 100,000	$ 6,029

Amortization of the premium on the interest rate caps is as follows:

(In thousands)	
2016	$ 913
2017	1,779
2018	2,247
2019	1,751
	$ 6,690

The Company recorded $154,000 and $572 in 2015 and 2014 respectively in amortization associated with the interest rate caps that is reflected in the Consolidated Statements of Income as a component of Borrowings and repurchase agreements interest expense.

Amortization of the gain associated with the exit of the swaps is as follows:

(In thousands)	
2016	$ 57
2017	74
2018	75
Thereafter	147
	$ 353

The Company realized $19,000 in gains on the swaps in 2015 shown as a reduction of Borrowings and repurchase agreements interest expense.

The Company anticipates little to no ineffectiveness in this hedging relationship as long as the terms are matched at each forecasted debt issuance. The Company notes that the actual interest cost incurred at each rollover will be a function of market rates at that time. However the Company is only hedging the benchmark interest rate risk in that rollover.

The Company does not use derivatives for trading or speculative purposes.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is a market-based measurement and is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. In general, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, each reporting entity is required to consider factors specific to the transaction and the asset or liability, the principal or most advantageous market for the asset or liability, and market participants with whom the entity would transact in the market.

Outlined below is the application of the fair value hierarchy applied to the Company's financial assets that are carried at fair value.

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. An active market for the asset or liability is a market in which the transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. As of December 31, 2015, the types of financial assets and liabilities the Company carried at fair value hierarchy Level 1 included marketable equity securities with readily available market values.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. As of December 31, 2015, the types of financial assets and liabilities the Company carried at fair value hierarchy Level 2 included agency bonds, collateralized mortgage obligations, mortgage backed securities, municipal bonds and derivatives.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are supported by little or no market activity or by the entity's own assumptions. As of December 31, 2015, the Company did value certain financial assets including one corporate subordinated debenture, measured on both a recurring and a non-recurring basis, at fair value hierarchy Level 3.

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value on a Recurring Basis

The Company measures certain assets at fair value on a recurring basis, as described below.

Investment Securities Available-for-Sale

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

Derivative Assets and Liabilities

Derivative instruments held or issued by the Company for risk management purposes are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Company measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. The Company classifies derivatives instruments held or issued for risk management purposes as Level 2. As of December 31, 2015 and 2014, the Company's derivative instruments consist solely of interest rate caps.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Below is a table that presents information about assets measured at fair value on a recurring basis at December 31, 2015 and 2014:

(In thousands) Description	Total Fair value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Securities available-for-sale:				
U.S. Agency obligations	$ 19,901	$ -	$ 19,901	$ -
Collateralized mortgage obligations	60,941	-	60,941	-
Mortgage-backed securities	31,310	-	31,310	-
Municipal bonds	54,434	-	54,434	
Other	2,310	1,810	-	500
	168,896	1,810	166,586	500
Interest rate caps	3,910	-	3,910	-
Total assets at fair value	$ 172,806	$ 1,810	$ 170,496	$ 500
December 31, 2014				
Securities available-for-sale:				
U.S. Agency obligations	$ 31,842	$ -	$ 31,842	$ -
Collateralized mortgage obligations	70,056	-	70,056	-
Mortgage-backed securities	34,548	-	34,548	-
Municpal bonds	45,180	-	45,180	-
Other	2,049	2,049	-	-
	183,675	2,049	181,626	-
Interest rate caps	6,029	-	6,029	-
Total assets at fair value	$ 189,704	$ 2,049	$ 187,655	$ -

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2015.

(In thousands)	Level 3 Investment Securities
Balance at December 31, 2014	$ -
Purchases	500
Balance at December 31, 2015	$ 500

Fair Value on a Nonrecurring Basis

The Company measures certain assets at fair value on a nonrecurring basis, as described below.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. Impaired loans totaled $3.9 million and $6.3 million at December 31, 2015 and 2014, respectively.

Other Real Estate Owned

Other real estate owned, which includes foreclosed assets, is adjusted to fair value upon transfer of loans and premises to other real estate. Subsequently, other real estate owned is carried at the lower of carrying value or fair value.

At the date of transfer, losses are charged to the allowance for credit losses. Subsequent write-downs are charged to expense in the period they are incurred.

Below is a table that presents information about assets measured at fair value on a nonrecurring basis at December 31, 2015 and 2014:

		Fair Value Measurements Using		
(In thousands) **December 31, 2015**	**Total Fair value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans	$ 3,382	$ -	$ -	$ 3,382
Other real estate owned	5,453	-	-	5,453
Total	$ 8,835	$ -	$ -	$ 8,835

		Fair Value Measurements Using		
(In thousands) **December 31, 2014**	**Total Fair value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans	$ 5,595	$ -	$ -	$ 5,595
Other real estate owned	14,991	-	-	14,991
Total	$ 20,586	$ -	$ -	$ 20,586

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of December 31, 2015 and 2014, the significant unobservable inputs used in the fair value measurements were as follows:

	December 31, 2015 and 2014		
	Valuation Technique	**Significant Observable Inputs**	**Significant unobservable Inputs**
Impaired loans	Appraisal value	Appraisals and/or sales of comparable properties	Appraisals discounted 5% to 10% for sales commissions and other holding costs
Other real estate owned	Appraisal value/ Comparison sale/ Other estimates	Appraisals and/or sales of comparable properties	Appraisals discounted 5% to 10% for sales commissions and other holding costs

The Bank provides certain disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Accordingly, certain financial instruments and all nonfinancial instruments are excluded from disclosure. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments:

Cash and Due from Banks

The carrying amounts for cash and due from banks approximate fair value because of the short maturities of those instruments.

Federal Home Loan Bank Stock

The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Bank-owned life insurance

The carrying value of bank-owned life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the insurer.

Loans

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits

The fair value of demand deposits is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting expected cash flows using the rates currently offered for instruments of similar remaining maturities.

Accrued Interest

The carrying amount is a reasonable estimate of fair value.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Short-Term Borrowings and Long-Term Debt

The fair values are based on discounting expected cash flows using the current interest rates for debt with the same or similar remaining maturities and collateral requirements.

Financial Instruments with Off-Balance Sheet Risk

With regard to financial instruments with off-balance sheet risk discussed in Note 13, it is not practicable to estimate the fair value of future financing commitments.

The following table presents the estimated fair values and carrying amounts of the Bank's financial instruments, none of which are held for trading purposes, at December 31:

	2015				
	Carrying	Fair Value			
(In thousands)	Amount	Total	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 55,530	$ 55,530	$ 55,530	$ -	$ -
Investment securities available-for-sale	168,896	168,896	1,810	166,586	500
Loans, net	1,016,156	1,013,415	-	1,010,033	3,382
Accrued interest receivable	3,795	3,795	3,795	-	-
Federal Home Loan Bank stock	8,061	8,061	-	-	8,061
Bank-owned life insurance	28,274	28,274	-	28,274	-
Interest rate caps	3,910	3,910	-	3,910	-
Financial liabilities:					
Non-maturing deposits	663,066	663,066	-	663,066	-
Time deposits	319,781	320,246	-	320,246	-
Accrued interest payable	356	356	356	-	-
Repurchase agreements and federal funds purchased	30,580	30,580	-	30,580	-
FHLB Advances and other borrowings	169,800	169,800	-	169,800	-
Subordinated debt	18,558	15,591	-	15,591	-

	2014				
	Carrying	Fair Value			
	Amount	Total	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 36,395	$ 36,395	$ 36,395	$ -	$ -
Investment securities available-for-sale	183,675	183,675	-	183,675	-
Loans, net	861,536	867,569	-	861,974	5,595
Accrued interest receivable	3,636	3,636	3,636	-	-
Federal Home Loan Bank stock	7,006	7,006	-	-	7,006
Bank-owned life insurance	27,421	27,421	-	27,421	-
Interest rate forward swaps	6,029	6,029	-	6,029	-
Financial liabilities:					
Non-maturing deposits	494,728	494,728	-	494,728	-
Time deposits	388,912	389,240	-	389,240	-
Accrued interest payable	405	405	405	-	-
Repurchase agreements and federal funds purchased	27,482	27,482	-	27,482	-
FHLB Advances and other borrowings	142,256	142,256	-	142,256	-
Subordinated debt	18,558	15,449	-	15,449	-

NOTE 17 - PARENT COMPANY FINANCIAL DATA

Following are the condensed financial statements of Paragon Commercial Corporation as of and for the years ended December 31, 2015 and 2014:

Condensed Balance Sheets

(In thousands)	2015	2014
Assets		
Cash and due from banks	$ 224	$ 413
Investment in Paragon Commercial Bank	119,716	111,986
Investment in unconsolidated subsidiaries	558	558
Other assets	584	590
Total Assets	$ 121,082	$ 113,547
Liabilities and Stockholders' Equity		
Subordinated debentures	$ 18,558	$ 18,558
Other borrowings	4,800	7,256
Accrued interest payable and other liabilities	66	71
Total Liabilities	23,424	25,885
Stockholders' Equity:		
Common stock	37	36
Additional paid-in-capital	53,147	52,358
Accumulated other comprehensive income (loss)	(886)	1,142
Retained earnings	45,360	34,126
Total Stockholders' Equity	97,658	87,662
Total Liabilities and Stockholders' Equity	$ 121,082	$ 113,547

Condensed Statements of Income

(In thousands)	2015	2014
Equity in undistributed earnings of subsidiary	$ 11,958	$ 8,706
Interest expense	(715)	(802)
Other operating income	24	22
Other operating expenses	(402)	(352)
Income tax benefit	369	385
Net income	$ 11,234	$ 7,959

NOTE 17 - PARENT COMPANY FINANCIAL DATA (Continued)

Condensed Statements of Cash Flows

(In thousands)	2015	2014
Cash flows from operating activities:		
Net income	$ 11,234	$ 7,959
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Equity in undistributed earnings of subsidiary	(11,958)	(8,706)
Stock based compensation	411	337
Net gain on sale of securities	(1)	-
Deferred tax expense	9	-
Changes in assets and liabilities:		
(Increase) decrease in other assets	(6)	25
Decrease in other liabilities	(6)	(39)
Net cash used in operating activities	(317)	(424)
Cash flows from investing activities:		
Investment in subsidiaries and trusts	-	(23)
Proceeds from sale of securities available for sale	5	-
Dividends received from subsidiary	2,200	2,450
Net cash provided by investing activities	2,205	2,427
Cash flows from financing activities:		
Repayment of long term debt	(2,456)	(2,361)
Proceeds from employee stock purchase plan	203	-
Proceeds from exercise of stock options	176	61
Net cash used in financing activities	(2,077)	(2,300)
Net decrease in cash and cash equivalents	(189)	(297)
Cash and cash equivalents, beginning of year	413	710
Cash and cash equivalents, end of year	$ 224	$ 413

NOTE 18 – SUPPLEMENTAL CASH FLOW DISCLOSURE

(In thousands)	2015	2014
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 7,433	$ 8,897
Income taxes paid	$ 4,320	$ 1,650
Supplemental Schedule of Noncash Investing and Financing Activities:		
Change in fair value of securities available-for-sale, net of taxes	$ (797)	$ 3,590
Change in fair value of cash flow hedges, net of taxes	$ (1,231)	$ (1,886)
Transfer from loans to foreclosed real estate	$ 3,484	$ 1,104

NOTE 19 – SUBSEQUENT EVENTS

The Company has evaluated subsequent events through March 7, 2016, the date the consolidated financial statements were available and has determined that there are no subsequent events that would require recognition or disclosure in the Company's consolidated financial statements.

NOTE 20 – QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table provides selected quarterly financial data for 2015 and 2014:

(in thousands, except per share amounts)	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2015				
Interest income	$ 12,594	$ 12,510	$ 12,011	$ 11,320
Net interest income	10,730	10,656	10,213	9,452
Provision for loan losses	-	-	179	571
Gain (loss) on sale of securities	(26)	145	-	423
Income before income taxes	4,532	5,020	3,958	3,485
Net income	2,963	3,313	2,650	2,308
Net income available to common shareholders	2,963	3,313	2,650	2,308
Net income per share, diluted	$ 0.65	$ 0.73	$ 0.59	$ 0.52
Net income per share, basic	$ 0.65	$ 0.73	$ 0.59	$ 0.51

2014	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income	$ 11,327	$ 10,807	$ 10,401	$ 10,248
Net interest income	9,266	8,628	8,203	8,008
Provision for loan losses	-	-	-	538
Gain (loss) on sale of securities	-	-	(9)	96
Income before income taxes	4,183	2,564	2,977	2,638
Net income	2,702	1,528	2,177	1,552
Net income available to common shareholders	2,702	1,528	2,177	1,552
Net income per share, diluted	$ 0.60	$ 0.34	$ 0.49	$ 0.35
Net income per share, basic	$ 0.60	$ 0.34	$ 0.49	$ 0.35

MANAGEMENT'S REPORT ON THE FINANCIAL STATEMENTS
AND THE INTERNAL CONTROL OVER FINANCIAL REPORTING

March 7, 2016

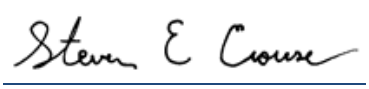
FINANCIAL STATEMENTS

Management of Paragon Commercial Corporation is responsible for the preparation, integrity and fair presentation of the consolidated financial statements as of December 31, 2015, and the year then ended. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts, some of which are based on judgments and estimates of management.

INTERNAL CONTROL STRUCTURE OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) which includes the preparation of the Consolidated Financial Statements of Bank Holding Companies (Form Y-9C) in accordance with the relevant instructions of the Board of Governors of the Federal Reserve System (Federal Reserve instructions) to comply with the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act.

Robert C. Hatley
President and Chief Executive Officer
Paragon Commercial Corporation



Steven E. Crouse
Executive Vice President and Chief Financial Officer
Paragon Commercial Corporation

MANAGEMENT'S ASSESSMENT OF PARAGON COMMERCIAL BANK'S COMPLIANCE WITH LAWS AND REGULATIONS

March 7, 2016

COMPLIANCE WITH LAWS AND REGULATIONS

Management of Paragon Commercial Corporation is responsible for compliance with the federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations (the "Designated Laws").

Management assessed its compliance with the Designated Laws and based on this assessment, management concludes that Paragon Commercial Corporation complied with the designated laws and regulations relating to safety and soundness during the year ended December 31, 2015.

Robert C. Hatley
President and Chief Executive Officer
Paragon Commercial Corporation

Steven E. Crouse
Executive Vice President and Chief Financial Officer
Paragon Commercial Corporation

PARAGON
COMMERCIAL CORPORATION
3535 Glenwood Avenue
Raleigh, NC 27612
919.788.7770
ParagonBank.com
Member FDIC / Equal Housing Lender