FIRST COMMUNITY CORP /SC/
Form 10-Q
August 13, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the quarterly period ended June 30, 2013

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act**

for the transition period from to

Commission File No. 000-28344

FIRST COMMUNITY CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina	**57-1010751**

(State of Incorporation)	(I.R.S. Employer Identification No.)

5455 Sunset Boulevard, Lexington, South Carolina 29072

(Address of Principal Executive Offices, Including Zip Code)

(803) 951-2265

(Registrant s Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: On August 13, 2013, 5,293,116 shares of the issuer s common stock, par value $1.00 per share, were issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST COMMUNITY CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par value)	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and due from banks	$ 9,727	$ 11,517
Interest-bearing bank balances	14,155	6,779
Federal funds sold and securities purchased under agreements to resell	405	412
Investment securities - available for sale	223,646	203,445
Other investments, at cost	2,269	2,527
Loans held for sale	5,789	9,658
Loans	341,089	332,111
Less, allowance for loan losses	4,439	4,621
Net loans	336,650	327,490
Property, furniture and equipment - net	17,255	17,258
Bank owned life insurance	11,024	10,868
Other real estate owned	2,824	3,987
Intangible assets	65	160
Goodwill	571	571
Other assets	8,805	8,253
Total assets	$ 633,185	$ 602,925
LIABILITIES		
Deposits:		
Non-interest bearing demand	$ 105,478	$ 97,526
NOW and money market accounts	186,778	150,874
Savings	47,238	41,100
Time deposits less than $100,000	102,311	111,182
Time deposits $100,000 and over	67,814	74,295
Total deposits	509,619	474,977
Securities sold under agreements to repurchase	15,650	15,900
Federal Home Loan Bank advances	34,335	36,344
Junior subordinated debt	15,464	15,464
Other liabilities	5,289	6,057
Total liabilities	580,357	548,742
SHAREHOLDERS EQUITY		
Preferred stock, par value $1.00 per share, 10,000,000 shares authorized; none issued and outstanding		
Common stock, par value $1.00 per share; 10,000,000 shares authorized; issued and outstanding 5,293,116 at June 30, 2013 5,227,300 at December 31, 2012	5,293	5,227
Common stock warrants issued	50	50
Additional paid in capital	62,151	61,615
Restricted stock	(593)	(152)
Accumulated Deficit	(13,193)	(14,915)
Accumulated other comprehensive income (loss)	(880)	2,358

Total shareholders equity		52,828		54,183
Total liabilities and shareholders equity	$	633,185	$	602,925

See Notes to Consolidated Financial Statements

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FIRST COMMUNITY CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share amounts)	Six Months Ended June 30, 2013 (Unaudited)	Six Months Ended June 30, 2012 (Unaudited)
Interest income:		
Loans, including fees	$ 8,823	$ 9,256
Taxable securities	1,312	2,341
Non taxable securities	486	249
Federal funds sold and securities purchased under resale agreements	15	17
Other	17	21
Total interest income	10,653	11,884
Interest expense:		
Deposits	970	1,735
Federal funds sold and securities sold under agreement to repurchase	18	18
Other borrowed money	963	1,171
Total interest expense	1,951	2,924
Net interest income	8,702	8,960
Provision for loan losses	250	301
Net interest income after provision for loan losses	8,452	8,659
Non-interest income:		
Deposit service charges	728	764
Mortgage origination fees	2,198	1,600
Investment advisory fees and non-deposit commissions	416	309
Gain (loss) on sale of securities	148	(27)
Gain on sale of other assets	30	14
Fair value loss adjustments	(2)	(37)
Other-than-temporary-impairment write-down on securities		(200)
Loss on early extinguishment of debt	(141)	(121)
Other	1,001	1,016
Total non-interest income	4,378	3,318
Non-interest expense:		
Salaries and employee benefits	5,986	5,305
Occupancy	680	680
Equipment	597	570
Marketing and public relations	205	294
FDIC assessments	201	380
Other real estate expense	206	386
Amortization of intangibles	96	102
Other	1,791	1,803
Total non-interest expense	9,762	9,520
Net income before tax	3,068	2,457
Income taxes	827	730
Net income	$ 2,241	$ 1,727
Preferred stock dividends		337
Net income available to common shareholders	$ 2,241	$ 1,390
Basic earnings per common share	$ 0.42	$ 0.42
Diluted earnings per common share	$ 0.42	$ 0.42

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FIRST COMMUNITY CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share amounts)		Three Months Ended June 30, 2013 (Unaudited)		Three Months Ended June 30, 2012 (Unaudited)
Interest income:				
Loans, including fees	$	4,462	$	4,629
Taxable securities		632		1,026
Non taxable securities		259		163
Federal funds sold and securities purchased under resale agreements		9		11
Other		8		11
Total interest income		5,370		5,840
Interest expense:				
Deposits		457		808
Federal funds sold and securities sold under agreement to repurchase		9		9
Other borrowed money		481		572
Total interest expense		947		1,389
Net interest income		4,423		4,451
Provision for loan losses		100		71
Net interest income after provision for loan losses		4,323		4,380
Non-interest income:				
Deposit service charges		367		375
Mortgage origination fees		1,183		877
Investment advisory fees and non-deposit commissions		218		162
Gain (loss) on sale of securities		133		(38)
Gain (loss) on sale of other assets		32		(36)
Fair value gain (loss) adjustments		(2)		(4)
Loss on early extinguishment of debt		(141)		
Other		505		519
Total non-interest income		2,295		1,855
Non-interest expense:				
Salaries and employee benefits		2,994		2,747
Occupancy		334		335
Equipment		314		283
Marketing and public relations		112		108
FDIC assessment		102		196
Other real estate expense		115		267
Amortization of intangibles		45		51
Other		939		921
Total non-interest expense		4,955		4,908
Net income before tax		1,663		1,327
Income taxes		460		399
Net income	$	1,203	$	928
Preferred stock dividends				168
Net income available to shareholders		1,203	$	760
Basic earnings per common share	$	0.23	$	0.23
Diluted earnings per common share	$	0.23	$	0.23

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FIRST COMMUNITY CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(Dollars in thousands)	**Six months ended June 30, 2013**	**2012**
Net income	$ 2,241	$ 1,727
Other comprehensive income (loss):		
Unrealized loss during the period on available-for-sale securities, net of tax benefit of $1,617 and $2, respectively	(3,140)	(4)
Less: Reclassification adjustment for (gain)loss included in net income, net of tax (expense)benefit of $50 and ($9), respectively	(98)	18
Reclassification adjustment for other-than-temporary-impairment on securities net of tax benefit of $0 and $68, respectively		132
Other comprehensive income (loss)	(3,238)	146
Comprehensive income (loss)	$ (997)	$ 1,873

(Dollars in thousands)	**Three months ended June 30, 2013**	**2012**
Net income	$ 1,203	$ 928
Other comprehensive income (loss):		
Unrealized loss during the period on available-for-sale securities, net of tax benefit of $1,492 and $394, respectively.	(2,896)	(742)
Less: Reclassification adjustment for (gain) loss included in net income, net of tax (expense)benefit of $45 and ($13) respectively.	(88)	25
Other comprehensive loss	(2,984)	(717)
Comprehensive income (loss)	$ (1,781)	$ 211

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FIRST COMMUNITY CORPORATION

Consolidated Statements of Changes in Shareholders Equity

Six Months ended June 30, 2013 and June 30, 2012

(Unaudited)

(Dollars and shares in thousands)	**Preferred Stock**	**Shares Issued**	**Common Stock**	**Common Stock Warrants**	**Additional Paid-in Capital**	**Nonvested Restricted Stock**	**Accumulated Deficit**	**Accumulated Other Comprehensive Income (Loss)**	**Total**
Balance, December 31, 2011	$ 11,137	3,308	$ 3,308	$ 560	$ 49,165	$	$ (17,603)	$ 1,329	$ 47,896
Net income							1,727		1,727
Other comprehensive income net of tax expense of $75								146	146
Issuance of restricted stock		33	33		239	(272)			
Amortization compensation restricted stock						30			30
Dividends: Common ($0.08 per share)							(264)		(264)
Preferred							(337)		(337)
Accretion	54								54
Dividend reinvestment plan		5	5		39				44
Balance, June 30, 2012	$ 11,191	3,346	$ 3,346	$ 560	$ 49,443	$ (242)	$ (16,477)	$ 1,475	$ 49,296
Balance, December 31, 2012	$	5,227	$ 5,227	$ 50	$ 61,615	$ (152)	$ (14,915)	$ 2,358	$ 54,183
Net income							2,241		2,241
Other comprehensive loss net of tax benefit of $1,667								(3,238)	(3,238)
Issuance of restricted stock		60	60		493	(553)			
Amortization compensation restricted stock						112			112
Dividends: Common ($0.10 per share)							(519)		(519)
Dividend reinvestment plan		6	6		43				49
Balance, June 30, 2013	$	5,293	$ 5,293	$ 50	$ 62,151	$ (593)	$ (13,193)	$ (880)	$ 52,828

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FIRST COMMUNITY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)	**Six months ended June 30, 2013**		**2012**	
Cash flows from operating activities:				
Net income	$	2,241	$	1,727
Adjustments to reconcile net income to net cash provided in operating activities:				
Depreciation		445		417
Premium amortization (discount accretion)		2,208		1,298
Provision for loan losses		250		301
Writedowns of other real estate owned		21		206
Gain on sale of other real estate owned		(30)		(14)
Sale of loans held-for-sale		76,725		51,242
Originations of loans held-for-sale		(72,856)		(51,874)
Amortization of intangibles		96		102
(Gain) loss on sale of securities		(148)		27
Other-than-temporary-impairment on securities				200
Net decrease in fair value option instruments and derivatives		2		37
Loss on early extinguishment of debt		141		121
Decrease in other assets		1,047		1,217
Decrease in other liabilities		(763)		(543)
Net cash provided from operating activities		9,379		4,464
Cash flows from investing activities:				
Purchase of investment securities available-for-sale and other investments		(58,755)		(63,384)
Maturity of investment securities available-for-sale		28,187		17,443
Proceeds from sale of securities available-for-sale		3,515		49,075
Proceeds from sale of other investments		257		937
Increase in loans		(9,548)		(1,813)
Proceeds from sale of other real estate owned		1,214		3,130
Purchase of property and equipment		(442)		(385)
Net cash provided (used) in investing activities		(35,572)		5,003
Cash flows from financing activities:				
Increase in deposit accounts		34,642		9,434
Decrease in securities sold under agreements to repurchase		(250)		(799)
Advances from the Federal Home Loan Bank		16,500		1,500
Repayment of advances from FHLB		(18,650)		(6,987)
Dividends paid: Common Stock		(519)		(264)
Preferred Stock				(337)
Dividend reinvestment plan		49		44
Net cash provided from financing activities		31,772		2,591
Net increase in cash and cash equivalents		5,579		12,058
Cash and cash equivalents at beginning of period		18,708		16,492
Cash and cash equivalents at end of period	$	24,287	$	28,550
Supplemental disclosure:				
Cash paid during the period for:				
Interest	$	2,314	$	3,351
Income taxes	$		$	
Non-cash investing and financing activities:				
Unrealized gain (loss) on securities	$	(3,238)	$	146
Transfer of loans to foreclosed property	$	46	$	904

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Notes to Consolidated Financial Statements (unaudited)

Note 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

The following table summarizes the changes in accumulated other comprehensive income (loss) by component, net of tax impact, at the dates and for the periods indicated (in thousands). All amounts are net of income taxes.

	Three months ended June 30,	
	2013	**2012**
Beginning Balance	$ 2,104	$ 2,192
Other comprehensive loss before reclassifications(a)	(2,896)	(742)
Amounts reclassified from accumulated other comprehensive income (loss)(a)	(88)	25
Net current-period other comprehensive income loss	(2,984)	(717)
Ending Balance	$ (880)	$ 1,475

	Six months ended June 30,	
	2013	**2012**
Beginning Balance	$ 2,358	$ 1,329
Other comprehensive loss before reclassifications(a)	(3,140)	(4)
Amounts reclassified from accumulated other comprehensive income (loss)(a)	(98)	150
Net current-period other comprehensive income (loss)	(3,238)	146
Ending Balance	$ (880)	$ 1,475

(a) All other comprehensive income (loss) and reclassifications are related to available-for-sale securities.

In the opinion of management, all adjustments necessary to fairly present the consolidated financial position and consolidated results of operations have been made. All such adjustments are of a normal, recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements and notes thereto are presented in accordance with the instructions for Form 10-Q. The information included in the Company s 2012 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (the SEC) on March 28, 2013, should be referred to in connection with these unaudited interim financial statements.

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Note 2 Earnings Per Common Share

The following reconciles the numerator and denominator of the basic and diluted earnings per common share computation:

(In thousands, except price per share)	Six months Ended June 30, 2013	Six months Ended June 30, 2012	Three months Ended June 30, 2013	Three months Ended June 30, 2012
Numerator (Net income available to common shareholders)	$ 2,241	$ 1,390	$ 1,203	$ 760
Denominator				
Weighted average common shares outstanding for:				
Basic earnings per share	5,274	3,319	5,292	3,329
Dilutive securities:				
Warrants Treasury stock method	38	24	37	28
Diluted earnings per share	5,312	3,343	5,329	3,357
The average market price used in calculating assumed number of shares	$ 9.15	$ 7.63	$ 9.05	$ 7.99

At June 30, 2013, there were 73,022 outstanding options at an average exercise price of $20.23. None of these options has an exercise price below the average market price of $9.05 for the three-month period ended June 30, 2013 or $9.15 for the six-month period ended June 30, 2013, and, therefore they are not deemed to be dilutive. In the fourth quarter of 2011, we issued $2.5 million in 8.75% subordinated notes maturing on December 16, 2019. On November 15, 2012, the subordinated notes were redeemed in full at par. Warrants for 107,500 shares of common stock at $5.90 per share were issued in connection with the issuance of the subordinated debt. These warrants expire December 16, 2019 and are included in dilutive securities in the table above.

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Note 3 Investment Securities

The amortized cost and estimated fair values of investment securities are summarized below:

AVAILABLE-FOR-SALE:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2013:				
Government sponsored enterprises	$ 1,518	$ 1	$ 57	$ 1,462
Mortgage-backed securities	122,527	1,492	1,370	122,649
Small Business Administration pools	56,886	711	293	57,304
State and local government	41,753	108	1,939	39,922
Corporate and other securities	2,349	2	42	2,309
	$ 225,033	$ 2,314	$ 3,701	$ 223,646
December 31, 2012:				
Government sponsored enterprises	$ 1,522	$ 12	$	$ 1,534
Mortgage-backed securities	110,425	2,343	624	112,144
Small Business Administration pools	54,148	1,008	163	54,993
State and local government	31,483	936	46	32,373
Corporate and other securities	2,349	53	1	2,401
	$ 199,927	$ 4,352	$ 834	$ 203,445

During the six months ended June 30, 2013 and June 30, 2012, the Company received proceeds of $3.5 million and $49.1 million, respectively, from the sale of investment securities available-for-sale. Gross realized gains amounted to $148.4 thousand for the six months ended June 30, 2013 and there were no gross realized losses for the same period. For the six months ended June 30, 2012, gross realized gains amounted to $2.0 million and gross realized losses amounted to $2.1 million. During the three months ended June 30, 2013 and June 30, 2012, the Company received proceeds of $ 1.7 million and $44.8 million, respectively, from the sale of investment securities available-for-sale. Gross realized gains amounted to $133 thousand for the three months ended June 30, 2013 and there were no gross realized losses for the same period. For the three months ended June 30, 2012, gross realized gains amounted to $1.9 million and gross realized losses amounted to $1.9 million.

At June 30, 2013, corporate and other securities available-for-sale included the following at fair value: corporate bonds at $1.0 million, mutual funds at $829.9 thousand, foreign debt of $59.5 thousand, and Corporate preferred stock in the amount of $416.8 thousand. At December 31, 2012, corporate and other securities available-for-sale included the following at fair value: corporate bonds at $1.0 million, mutual funds at $884.5 thousand, foreign debt of $59.7 thousand, Federal Home Loan Mortgage Corporation preferred stock of $30.0 thousand and Corporate preferred stock in the amount of $416.8 thousand.

Other investments, at cost, include Federal Home Loan Bank (FHLB) stock in the amount of $2.3 million and $2.5 million at June 30, 2013 and December 31, 2012 respectively.

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Note 3 Investment Securities continued

During the three month period ended June 30, 2012 and during the three and six month periods ended June 30, 2013, the Company did not record any other-than-temporary impairment (OTTI) losses. During the six month period ended June 30, 2012, the Company recorded OTTI losses on available-for-sale securities as follows:

(Dollars in thousands)		**Six months ended June 30, 2012 Available-for-sale securities**
Total OTTI charge realized and unrealized	$	415
OTTI recognized in other comprehensive income (non-credit component)		215
Net impairment losses recognized in earnings (credit component)	$	200

During 2013 and 2012, OTTIs occurred for which only a portion was attributed to credit loss and recognized in earnings. The remainder was reported in other comprehensive income. The following is an analysis of amounts relating to credit losses on debt securities recognized in earnings during the six months ended June 30, 2013 and 2012.

(Dollars in thousands)		**2013 Available for Sale**		**2012 Available for Sale**
Balance at beginning of period	$	271	$	930
Other-than-temporary-impairment not previously recognized				173
Additional increase for which an other-than-temporary impairment was previously recognized related to credit losses				27
Other-than-temporary-impairment previously recognized on securities sold				(679)
Realized losses during the period		(46)		(136)
Balance related to credit losses on debt securities at end of period	$	225	$	315

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Note 3 Investment Securities continued

In evaluating the non-agency mortgage-backed securities, relevant assumptions, such as prepayment rate, default rate and loss severity on a loan level basis, are used in determining the expected recovery of the contractual cash flows. The balance of the underlying portfolio cash flows are evaluated using ongoing assumptions for loss severities, prepayment rates and default rates. The ongoing assumptions for average prepayment rate, default rate and severity used in the valuations were approximately 16.7%, 7.6%, and 50.9%, respectively. The underlying collateral on substantially all of these securities is fixed rate residential first mortgages located throughout the United States. The underlying collateral includes various percentages of owner-occupied as well as investment related single-family, 2-4 family and condominium residential properties. The securities were purchased at various discounts to par value. Based on the assumptions used in valuing the securities, the Company believes the existing discount and remaining subordinated collateral provide coverage against future credit losses on the downgraded securities for which no OTTI has been recognized.

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Note 3 Investment Securities continued

The following table shows gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous loss position at June 30, 2013 and December 31, 2012.

June 30, 2013	**Less than 12 months**		**12 months or more**		**Total**	
(Dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Available-for-sale securities:						
Government Sponsored Enterprises	$ 1,444	$ 57	$	$	$ 1,444	$ 57
Small Business Administration Pools	21,213	289	882	4	22,095	293
Government Sponsored Enterprise mortgage-backed securities	53,766	1,330	3,118	35	56,884	1,365
Non-agency mortgage-backed securities	64	1	983	4	1,047	5
Corporate bonds and other	871	41	50	1	921	42
State and local government	29,518	1,939			29,518	1,939
Total	$ 106,876	$ 3,657	$ 5,033	$ 44	$ 111,909	$ 3,701

December 31, 2012	**Less than 12 months**		**12 months or more**		**Total**	
(Dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Available-for-sale securities:						
Government Sponsored Enterprise mortgage-backed securities	$ 22,662	$ 233	$ 4,583	$ 13	$ 27,245	$ 246
Small Business Administration pools	11,013	158	2,447	5	13,460	163
Non-agency mortgage-backed securities			2,363	378	2,363	378
State and local government	2,599	46			2,599	46
Corporate bonds and other			50	1	50	1
Total	$ 36,274	$ 437	$ 9,443	$ 397	$ 45,717	$ 834

Government Sponsored Enterprise, Mortgage-Backed Securities: At June 30, 2013, the Company owned mortgage-backed securities (MBSs), including collateralized mortgage obligations (CMOs), with an amortized cost of $119.9 million and approximate fair value of $120.0 million issued by government sponsored enterprises (GSEs). As of June 30, 2013 and December 31, 2012, all of the MBSs issued by GSEs were classified as Available for Sale. Unrealized losses on certain of these investments are not considered to be other than temporary, and we have the intent and ability to hold these until they mature or recover the current book value. The contractual cash flows of the investments are guaranteed by the GSE. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company s investment. Because the Company does not intend to sell these securities and it is more likely than not the Company will not be required sell these securities before a recovery of its amortized cost, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at June 30, 2013.

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Note 3 Investment Securities continued

Non-agency mortgage backed securities: The Company also held private label mortgage-backed securities (PLMBSs), including CMOs, at June 30, 2013 with an amortized cost of $2.7 million and approximate fair value of $2.7 million. Management monitors each of these securities on a quarterly basis to identify any deterioration in the credit quality, collateral values and credit support underlying the investments.

During the three and six months ended June 30, 2013, no OTTI charges were recorded in earnings for the PLMBS portfolio. During the six months ended June 30, 2012, the Company identified two PLMBS with a fair value of $2.5 million that it considered other-than-temporarily-impaired. As prescribed by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, the Company recognized an impairment charge in earnings of $199.8 thousand (credit component) during the six months ended June 30, 2012. The $199.8 thousand represents the estimated credit losses on these securities for the six months ended June 30, 2012. One of the securities identified as other-than-temporarily-impaired during the six months ended June 30, 2012 was subsequently sold after the impairment was recognized. The credit losses were estimated by projecting the expected cash flows estimating prepayment speeds, increasing defaults and collateral loss severities. The credit loss portion of the impairment charge represents the difference between the present value of the expected cash flows and the amortized cost basis of the securities. During the three months ended June 30, 2012, no OTTI charges were recorded in earnings for the PLMBS portfolio.

The following table summarizes as of June 30, 2013 the number of CUSIPs, par value, carrying value and fair value of the non-agency MBSs/CMOs by credit rating. The credit rating reflects the lowest credit rating by any major rating agency.

(Dollars in thousands)

Credit Rating	**Number of CUSIPs**	**Par Value**	**Amortized Cost**	**Fair Value**
AA	2	$ 198	$ 198	$ 201
A1	1	324	324	343
A3	1	281	281	283
BBB	3	240	240	237
Baa1	1	65	65	64
Baa2	1	33	33	33
Below Investment Grade	4	1,847	1,528	1,542
Total	13	$ 2,988	$ 2,669	$ 2,703

Corporate Bonds: Corporate bonds held by the Company are reviewed on a quarterly basis to identify downgrades by rating agencies as well as deterioration of the underlying collateral or the issuer s ability to service the debt obligation. As of June 30, 2013, the Company owns one corporate bond which is rated above investment grade. The Company does not consider this investment to be OTTI.

Small Business Administration Pools: These pools are guaranteed pass-thru with the full faith and credit of the United States government. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider the investments to be OTTI at June 30, 2013.

State and Local Governments and Other: Management monitors these securities on a quarterly basis to identify any deterioration in the credit quality. Included in the monitoring is a review of the credit rating, a financial analysis and certain demographic data on the underlying issuer. The Company does not consider these securities to be OTTI at June 30, 2013.

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Note 3 Investment Securities continued

The amortized cost and fair value of investment securities at June 30, 2013 by contractual maturity are as follows. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay the obligations with or without prepayment penalties. MBSs are based on average life at estimated prepayment speeds.

	Available-for-sale	
(Dollars in thousands)	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 20,260	$ 20,442
Due after one year through five years	86,248	86,729
Due after five years through ten years	88,107	86,334
Due after ten years	30,418	30,141
	$ 225,033	$ 223,646

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Note 4 Loans

Loans summarized by category as of June 30, 2013 and December 31, 2012 are as follows:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Commercial, financial and agricultural	$ 20,908	$ 20,924
Real estate:		
Construction	15,232	13,052
Mortgage-residential	38,363	38,892
Mortgage-commercial	233,769	226,575
Consumer:		
Home equity	25,437	27,173
Other	7,380	5,495
Total	$ 341,089	$ 332,111

At June 30, 2013 and December 31, 2012, there were $5.8 million and $9.7 million, respectively, of residential mortgage loans held for sale at fair value. These loans are originated with firm purchase commitments from various investors at the time the loans are closed. Generally, funds are received and the loans transferred to the investors within three to seven business days.

Activity in the allowance for loan losses for the six months and three months ended June 30, 2013 and 2012 was as follows:

	Six months ended	
(Dollars in thousands)	June 30, 2013	June 30, 2012
Balance at the beginning of period	$ 4,621	$ 4,699
Provision for loan losses	250	301
Charged off loans	(523)	(307)
Recoveries	91	49
Balance at end of period	$ 4,439	$ 4,742

	Three months ended	
(Dollars in thousands)	June 30, 2013	June 30, 2012
Balance at the beginning of period	$ 4,534	$ 4,745
Provision for loan losses	100	71
Charged off loans	(209)	(95)
Recoveries	14	21
Balance at end of period	$ 4,439	$ 4,742

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Note 4 Loans-continued

The detailed activity in the allowance for loan losses and the recorded investment in loans receivable as of and for the six months ended June 30, 2013 and the year ended December 31, 2012 is as follows:

(Dollars in thousands)	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2013								
Allowance for loan losses:								
Beginning balance December 31, 2012	$ 338	$	$ 235	$ 1,322	$ 400	$ 17	$ 2,309	$ 4,621
Charge-offs	7		36	397	44	39		523
Recoveries	20		62		1	8		91
Provisions	(87)	25	58	157	(131)	110	118	250
Ending balance June 30, 2013	$ 264	$ 25	$ 319	$ 1,082	$ 226	$ 96	$ 2,427	$ 4,439
Ending balances:								
Individually evaluated for impairment	$	$	$ 5	$	$	$	$	$ 5
Collectively evaluated for impairment	264	25	314	1,082	226	96	2,427	4,434
Loans receivable:								
Ending balance-total	$ 20,908	$ 15,232	$ 38,363	$ 233,769	$ 25,437	$ 7,380	$	$ 341,089
Ending balances:								
Individually evaluated for impairment	84		721	5,759		7		6,571
Collectively evaluated for impairment	$ 20,824	$ 15,232	$ 37,642	$ 228,010	$ 25,437	$ 7,373	$	$ 334,518

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Note 4 Loans-continued

(Dollars in thousands)	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2012								
Allowance for loan losses:								
Beginning balance December 31, 2011	$ 331	$	$ 514	$ 1,475	$ 521	$ 57	$ 1,801	$ 4,699
Charge-offs	62		30	178		37		307
Recoveries	25		9		2	13		49
Provisions	(45)		106	16	(78)	12	290	301
Ending balance June 30, 2012	$ 249	$	$ 599	$ 1,313	$ 445	$ 45	$ 2,091	$ 4,742
Ending balances:								
Individually evaluated for impairment	$	$	$	$	$	$	$	$
Collectively evaluated for impairment	249		599	1,313	445	45	2,091	4,742
Loans receivable:								
Ending balance-total	$ 19,741	$ 12,302	$ 38,779	$ 221,880	$ 26,945	$ 5,266	$	$ 324,913
Ending balances:								
Individually evaluated for impairment	24		581	8,650		28		9,283
Collectively evaluated for impairment	$ 19,717	$ 12,302	$ 38,198	$ 213,230	$ 26,945	$ 5,238	$	$ 315,630

Loans outstanding to bank directors, executive officers and their related business interests amounted to $9.7 million and $11.3 million at June 30, 2013 and June 30, 2012, respectively. Repayments on these loans during the six months ended June 30, 2013 were $2.1 million and loans made amounted to $500 thousand. Repayments on these loans during the six months ended June 30, 2012 were $208 thousand and loans made amounted to $77 thousand. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and generally do not involve more than the normal risk of collectability.

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Note 4 Loans-continued

The detailed activity in the allowance for loan losses as of and for the three months ended June 30, 2013 and the three months ended June 30, 2012 is as follows:

(Dollars in thousands)	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2013								
Allowance for loan losses:								
Beginning balance March 31, 2013	$ 409	$ 21	$ 199	$ 1,075	$ 236	$ 78	$ 2,516	$ 4,534
Charge-offs			32	162	2	13		209
Recoveries	9		1		1	3		14
Provisions	(154)	4	151	169	(9)	28	(89)	100
Ending balance June 30, 2013	$ 264	$ 25	$ 319	$ 1,082	$ 226	$ 96	$ 2,427	$ 4,439

(Dollars in thousands)	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2012								
Allowance for loan losses:								
Beginning balance March 31, 2012	$ 307	$	$ 500	$ 1,430	$ 566	$ 53	$ 1,889	$ 4,745
Charge-offs	62		17			16		95
Recoveries	13		2			6		21
Provisions	(9)		114	(117)	(121)	2	202	71
Ending balance June 30, 2012	$ 249	$	$ 599	$ 1,313	$ 445	$ 45	$ 2,091	$ 4,742

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Note 4 Loans-continued

The following table presents at June 30, 2013 and December 31, 2012 loans individually evaluated and considered impaired under FAS ASC 310 Accounting by Creditors for Impairment of a Loan. Impairment includes performing troubled debt restructurings.

(Dollars in thousands)	**June 30, 2013**	**December 31, 2012**
Total loans considered impaired	$ 6,571	$ 6,176
Loans considered impaired for which there is a related allowance for loan loss:		
Outstanding loan balance	57	
Related allowance	5	
Loans considered impaired and previously written down to fair value	6,514	6,176
Average impaired loans	7,719	6,704

The following tables are by loan category and present at June 30, 2013, June, 2012 and December 31, 2012 loans individually evaluated and considered impaired under FAS ASC 310 Accounting by Creditors for Impairment of a Loan. Impairment includes performing troubled debt restructurings.

				Six months ended		**Three months ended**	
(Dollars in thousands) June 30, 2013	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
With no allowance recorded:							
Commercial	$ 84	$ 84	$	$ 149	$ 8	$ 264	$
Real estate:							
Construction							
Mortgage-residential	664	679		749	15	744	12
Mortgage-commercial	5,759	6,429		6,747	97	6,764	16
Consumer:							
Home Equity							
Other	7	7		18		17	
With an allowance recorded:							
Commercial							
Real estate:							
Construction							
Mortgage-residential	57	57	5	56	7	58	2
Mortgage-commercial							
Consumer:							
Home Equity							
Other							
Total:							
Commercial	$ 84	$ 84	$	$ 149	$ 8	$ 264	
Real estate:							
Construction							
Mortgage-residential	721	736	5	805	22	802	14
Mortgage-commercial	5,759	6,429		6,747	97	6,764	16

Consumer:							
Home Equity							
Other	7	7		18		17	
	$ 6,571	$ 7,256	$ 5	$ 7,719	$ 127	$ 7,847	$ 30

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Note 4 Loans-continued

(Dollars in thousands) June 30, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Six months ended Average Recorded Investment	Six months ended Interest Income Recognized	Three months ended Average Recorded Investment	Three months ended Interest Income Recognized
With no allowance recorded:							
Commercial	$ 24	$ 54	$	$ 95	$ 1	$ 93	$ 1
Real estate:							
Construction							
Mortgage-residential	581	609		645	1	637	1
Mortgage-commercial	8,650	9,059		9,535	142	11,679	68
Consumer:							
Home Equity							
Other	28	28		41		37	
With an allowance recorded:							
Commercial							
Real estate:							
Construction							
Mortgage-residential							
Mortgage-commercial							
Consumer:							
Home Equity							
Other							
Total:							
Commercial	$ 24	$ 54	$	$ 95	$ 1	$ 93	$ 1
Real estate:							
Construction							
Mortgage-residential	581	609		645	1	637	1
Mortgage-commercial	8,650	9,059		9,535	142	11,679	68
Consumer:							
Home Equity							
Other	28	28		41		37	
	$ 9,283	$ 9,750	$	$ 10,316	$ 144	$ 12,446	$ 70

(Dollars in thousands) December 31, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance recorded:					
Commercial	$ 37	$ 50	$	$ 53	$
Real estate:					
Construction					
Mortgage-residential	357	381		442	1
Mortgage-commercial	5,772	6,162		6,188	178
Consumer:					
Home Equity					
Other	10	10		21	
With an allowance recorded:					
Commercial					
Real estate:					

Construction					
Mortgage-residential					
Mortgage-commercial					
Consumer:					
Home Equity					
Other					
Total:					
Commercial	37	50		53	
Real estate:					
Construction					
Mortgage-residential	357	381		442	1
Mortgage-commercial	5,772	6,162		6,188	178
Consumer:					
Home Equity					
Other	10	10		21	
	$ 6,176	$ 6,603	$	$ 6,704	$ 179

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Note 4 Loans-continued

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution s credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified 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.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with 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.

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Note 4 Loans-continued

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of June 30, 2013 and December 31, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans is shown in the table below. As of June 30, 2013 and December 31, 2012, no loans were classified as doubtful.

(Dollars in thousands) **June 30, 2013**	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial, financial & agricultural	$ 20,741	$ 52	$ 115	$	$ 20,908
Real estate:					
Construction	12,182	1,222	1,828		15,232
Mortgage residential	35,900	1,186	1,277		38,363
Mortgage commercial	217,627	5,899	10,243		233,769
Consumer:					
Home Equity	25,156	139	142		25,437
Other	7,357	14	9		7,380
Total	$ 318,963	$ 8,512	$ 13,614	$	$ 341,089

(Dollars in thousands) **December 31, 2012**	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial, financial & agricultural	$ 20,826	$ 27	$ 71	$	$ 20,924
Real estate:					
Construction	8,595	2,047	2,410		13,052
Mortgage residential	36,493	1,677	722		38,892
Mortgage commercial	208,825	3,803	13,947		226,575
Consumer:					
Home Equity	26,604	124	445		27,173
Other	5,475	3	17		5,495
Total	$ 306,818	$ 7,681	$ 17,612	$	$ 332,111

At June 30, 2013 and December 31, 2012, non-accrual loans totaled $6.0 million and $4.7 million, respectively.

Troubled debt restructurings that are still accruing and included in impaired loans at June 30, 2013 and December 31, 2012 amounted to $593 thousand and $1.5 million, respectively. Troubled debt restructurings in nonaccrual status at June 30, 2013 and December 31, 2012 amounted to $2.2 million and $1.8 million, respectively.

Loans greater than ninety days delinquent and still accruing interest at December 31, 2012 amounted to $55 thousand. There were no loans greater than ninety days delinquent and still accruing interest at June 30, 2013.

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Note 4 Loans-continued

The following tables are by loan category and present loans past due and on non-accrual status as of June 30, 2013 and December 31, 2012:

(Dollars in thousands) June 30, 2013	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Commercial	$ 16	$	$	$ 84	$ 100	$ 20,808	$ 20,908
Real estate:							
Construction						15,232	15,232
Mortgage-residential	514	70		663	1,247	37,116	38,363
Mortgage-commercial	1,448	464		5,224	7,136	226,633	233,769
Consumer:							
Home equity	170	21			191	25,246	25,437
Other	53	3		7	63	7,317	7,380
Total	$ 2,201	$ 558	$	$ 5,978	$ 8,737	$ 332,352	$ 341,089

(Dollars in thousands) December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Commercial	$ 17	$ 107	$	$ 85	$ 209	$ 20,715	$ 20,924
Real estate:							
Construction						13,052	13,052
Mortgage-residential	311	378		357	1,046	37,846	38,892
Mortgage-commercial	627	898	55	4,263	5,843	220,732	226,575
Consumer:							
Home equity	211				211	26,962	27,173
Other	32	7		10	49	5,446	5,495
Total	$ 1,198	$ 1,390	$ 55	$ 4,715	$ 7,358	$ 324,753	$ 332,111

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Note 4 Loans-continued

As a result of adopting the amendments in Accounting Standards Update (ASU) 2011-02 (Receivables-Topic 310), the Company reassessed all restructurings that occurred on or after the beginning of the fiscal year of adoption (January 1, 2011) to determine whether they are considered TDRs under the amended guidance. The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company identified them as impaired under the guidance in ASC 310-10-35. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those loans newly identified as impaired.

The following tables, by loan category, present loans determined to be TDRs during the six month period ended June 30, 2013 and June 30, 2012 and for the three month period ended June 30, 2012. There were no loans determined to be TDRs during the three month period ended June 30, 2013.

	For the six months ended June 30, 2013		
Troubled Debt Restructurings (Dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Nonaccrual			
Mortgage-Commercial	1	$ 257	$ 257
Total TDRs	1	$ 257	$ 257

As shown in the table above, one loan was determined to be a TDR during the six months ended June 30, 2013. The loan was modified to extend the terms outside the Company s guidelines.

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Note 4 Loans-continued

	For the three months ended June 30, 2012		
Troubled Debt Restructurings (Dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Nonaccrual			
Mortgage-Commercial	1	$ 53	$ 40
Total nonaccrual	1	$ 53	$ 40
Accrual			
Mortgage-Commercial	2	$ 596	$ 596
Total Accrual	2	$ 596	$ 596
Total TDRs	3	$ 649	$ 636

	For the six months ended June 30, 2012		
Troubled Debt Restructurings (Dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Nonaccrual			
Mortgage-Commercial	1	$ 53	$ 40
Total nonaccrual	1	$ 53	$ 40
Accrual			
Mortgage-Commercial	2	$ 596	$ 596
Total Accrual	2	$ 596	$ 596
Total TDRs	3	$ 649	$ 636

During the three and six months ended June 30, 2012, the Company modified three loans that were considered to be TDRs. The payment and interest rate were lowered for two of these loans and the payment was modified to interest only for one loan.

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Note 4 Loans-continued

The following tables, by loan category, present loans determined to be TDRs in the last twelve months that subsequently defaulted during the three or six month periods ended June 30, 2012. There were no loans determined to be TDRs in the last twelve months that subsequently defaulted during the three or six month periods ended June 30, 2013. Defaulted loans are those loans that are greater than 89 days past due.

Troubled Debt Restructurings that subsequently defaulted this period (Dollars in thousands)	**For the three months ended June 30, 2012** Number of Contracts		**Recorded Investment**
Mortgage-Commercial	1	$	638
Total TDRs	1	$	638

Troubled Debt Restructurings that subsequently defaulted this period (Dollars in thousands)	**For the six months ended June 30, 2012** Number of Contracts		**Recorded Investment**
Mortgage-Commercial	1	$	638
Total TDRs	1	$	638

During the three and six months ended June 30, 2012, one loan that had previously been restructured defaulted.

In the determination of the allowance for loan losses, all TDRs are reviewed to ensure that one of the three proper valuation methods (fair market value of the collateral, present value of cash flows, or observable market price) is adhered to. Each non-accrual loan is written down to its corresponding collateral value. All TDR accruing loans that have a loan balance which exceeds the present value of cash flow will have a specific allocation. All nonaccrual loans are considered impaired. Under ASC 310-10, a loan is impaired when it is probable that the Company will be unable to collect all amounts due, including both principal and interest, according to the contractual terms of the loan agreement.

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Note 5 - Recently Issued Accounting Pronouncements

In July 2012, the Intangibles topic was amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that indefinite-lived intangible assets are impaired. If it is determined to be more likely than not that indefinite-lived intangible assets are impaired, then the entity is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The amendments did not have a material effect on the Company s financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company on January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments are effective for the Company on a prospective basis for reporting periods beginning after December 15, 2012. These amendments did not have a material effect on the Company s financial statements.

On February 28, 2013, the FASB amended the Liabilities topic to address obligations resulting from joint and several liability arrangements. The guidance addresses recognition of financial commitments arising from joint and several liability arrangements. Specifically, the amendments require recognition of financial commitments arising from loans, contracts, and legal rulings if the Company can be held liable for the entire claim. The amendments will be effective for the Company for reporting periods beginning after December 15, 2013. The Company does not expect these amendments to have a material effect on its financial statements.

On April 22, 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments will be effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company does not expect these amendments to have any 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.

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Note 6 Fair Value of Financial Instruments

The Company adopted FASB ASC Fair Value Measurement Topic 820, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level l Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

FASB ASC 825-10-50 Disclosure about Fair Value of Financial Instruments , requires the Company to disclose estimated fair values for its financial instruments. Fair value estimates, methods, and assumptions are set forth below.

Cash and short term investments The carrying amount of these financial instruments (cash and due from banks, interest-bearing bank balances, federal funds sold and securities purchased under agreements to resell) approximates fair value. All mature within 90 days and do not present unanticipated credit concerns and are classified as Level 1.

Investment Securities Measurement is on a recurring basis based upon quoted market prices, if available. If quoted market 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 prepayment assumptions, projected credit losses, and liquidity. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or by dealers or brokers in active over-the-counter markets. Level 2 securities include mortgage-backed securities issued both by government sponsored enterprises and private label mortgage-backed securities. Generally these fair values are priced from established pricing models. Level 3 securities include corporate debt obligations and asset backed securities that are less liquid or for which there is an inactive market.

Loans Held for Sale The Company originates fixed rate residential loans on a servicing released basis in the secondary market. Loans closed but not yet settled with an investor, are carried in the Company s loans held for sale portfolio. These loans are fixed rate residential loans that have been originated in the Company s name and have closed. Virtually all of these loans have commitments to be purchased by investors at a locked in price with the investors on the same day that the loan was locked in with the company s customers. Therefore, these loans present very little market risk for the Company and are classified as Level 2. The carrying amount of these loans approximates fair value.

Loans The fair value of loans are 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 and are classified as Level 2. As discount rates are based on current loan rates as well as management estimates, the fair values presented may not be indicative of the value negotiated in an actual sale.

Other Real Estate Owned (OREO) OREO is carried at the lower of carrying value or fair value on a non-recurring basis. Fair value is based upon independent appraisals or management s estimation of the collateral and is considered a Level 3 measurement. When the OREO value is based upon a current appraisal or when a current appraisal is not available or there is estimated further impairment, the measurement is considered a Level 3

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measurement.

Note 6 Fair Value of Financial Instruments - continued

Accrued Interest Receivable The fair value approximates the carrying value and is classified as Level 1.

Interest rate swap The fair value approximates the carrying value and is classified as Level 3.

Deposits The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities. Deposits are classified as Level 2.

Federal Home Loan Bank Advances Fair value is estimated based on discounted cash flows using current market rates for borrowings with similar terms and are classified as Level 2.

Short Term Borrowings The carrying value of short term borrowings (securities sold under agreements to repurchase and demand notes to the Treasury) approximates fair value. These are classified as Level 2.

Junior Subordinated Debentures The fair values of junior subordinated debentures is estimated by using discounted cash flow analyses based on incremental borrowing rates for similar types of instruments. These are classified as Level 2.

Accrued Interest Payable The fair value approximates the carrying value and is classified as Level 1.

Commitments to Extend Credit The fair value of these commitments is immaterial because their underlying interest rates approximate market.

The carrying amount and estimated fair value by classification Level of the Company s financial instruments as of June 30, 2013 are as follows:

	June 30, 2013			
		Fair Value		
(Dollars in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**

	Carrying Amount				
Financial Assets:					
Cash and short term investments	$ 24,287	$ 24,287	$ 24,287	$	$
Available-for-sale securities	223,646	223,646	830	222,399	417
Other investments, at cost	2,269				2,269
Loans held for sale	5,789	5,789		5,789	
Net Loans receivable	336,650	340,151		333,580	6,571
Accrued interest	2,177	2,177	2,177		
Interest rate swap	(172)	(172)			(172)
Financial liabilities:					
Non-interest bearing demand	$ 105,478	$ 105,478	$	$ 105,478	$
NOW and money market accounts	186,778	186,778		186,778	
Savings	47,238	47,238		47,238	
Time deposits	170,125	171,732		171,732	
Total deposits	509,619	511,226		511,226	
Federal Home Loan Bank Advances	34,335	38,458		38,458	
Short term borrowings	15,650	15,650		15,650	
Junior subordinated debentures	15,464	15,464		15,464	
Accrued interest payable	666	666	666		

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Note 6 Fair Value of Financial Instruments - continued

The carrying amount and estimated fair value of the Company s financial instruments as of December 31, 2012 are as follows:

	December 31, 2012				
		Fair Value			
(Dollars in thousands)	**Carrying Amount**	**Total**	**Level 1**	**Level 2**	**Level 3**
Financial Assets:					
Cash and short term investments	$ 18,708	$ 18,708	$ 18,708	$	$
Available-for-sale securities	203,445	203,445	914	202,114	417
Other investments, at cost	2,527				2,527
Loans held for sale	9,658	9,658		9,658	
Net loans receivable	327,490	328,893		322,717	6,176
Accrued interest	2,098	2,098	2,098		
Interest rate swap	(338)	(338)			(338)
Financial liabilities:					
Non-interest bearing demand	$ 97,526	$ 97,526	$	$ 97,526	$
NOW and money market accounts	150,874	150,874		150,874	
Savings	41,100	41,100		41,100	
Time deposits	185,477	187,313		187,313	
Total deposits	474,977	476,813		476,813	
Federal Home Loan Bank Advances	36,344	41,977		41,977	
Short term borrowings	15,900	15,900		15,900	
Junior subordinated debentures	15,464	15,464		15,464	
Accrued interest payable	1,029	1,029	1,029		

The following tables reflect the changes in fair values for the six and three-month periods ended June 30, 2013 and 2012 and where these changes are included in the income statement:

(Dollars in thousands)

	Six months ended June 30,		Three months ended June 30,	
Description	**2013 Non-interest income: Fair value adjustment loss**	**2012 Non-interest income: Fair value adjustment loss**	**2013 Non-interest income: Fair value adjustment loss**	**2012 Non-interest income: Fair value adjustment loss**
Interest rate swap	$ (2)	$ (37)	$ (2)	$ (4)
Total	$ (2)	$ (37)	$ (2)	$ (4)

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Note 6 Fair Value of Financial Instruments continued

The following table summarizes quantitative disclosures about the fair value for each category of assets carried at fair value as of June 30, 2013 and December 31, 2012 that are measured on a recurring basis. There were no liabilities carried at fair value as of June 30, 2013 or December 31, 2012 that are measured on a recurring basis.

(Dollars in thousands)

Description	**June 30, 2013**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities				
Government sponsored enterprises	$ 1,462	$	$ 1,462	$
Mortgage-backed securities	122,649		122,649	
Small Business Administration securities	57,304		57,304	
State and local government	39,922		39,922	
Corporate and other securities	2,309	830	1,062	417
	223,646	830	222,399	417
Interest rate swap	(172)			(172)
Total	$ 223,474	$ 830	$ 222,399	$ 245

(Dollars in thousands)

Description	**December 31, 2012**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities				
Government sponsored enterprises	$ 1,534	$	$ 1,534	$
Mortgage-backed securities	112,144		112,144	
Small Business Administration securities	54,993		54,993	
State and local government	32,373		32,373	
Corporate and other securities	2,401	914	1,070	417
	203,445	914	202,114	417
Interest rate swap	(338)			(338)
Total	$ 203,107	$ 914	$ 202,114	$ 79

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Note 6 Fair Value of Financial Instruments - continued

The following tables reconcile the changes in Level 3 financial instruments for the six and three months ended June 30, 2013, that are measured on a recurring basis.

(Dollars in thousands)	Interest rate Swap	Corporate Preferred Stock
Beginning Balance December 31, 2012	$ (338)	417
Total gains or losses (realized/unrealized)		
Included in earnings	(2)	
Included in other comprehensive income		
Purchases, issuances, and settlements	168	
Transfers in and/or out of Level 3		
Ending Balance June 30, 2013	$ (172)	$ 417

(Dollars in thousands)	Interest rate Swap	Corporate Preferred Stock
Beginning Balance March 31, 2013	$ (254)	417
Total gains or losses (realized/unrealized)		
Included in earnings	(2)	
Included in other comprehensive income		
Purchases, issuances, and settlements	84	
Transfers in and/or out of Level 3		
Ending Balance June 30, 2013	$ (172)	$ 417

The following tables reconcile the changes in Level 3 financial instruments for the six and three months ended June 30, 2012, that are measured on a recurring basis.

(Dollars in thousands)	Interest rate Cap/Floor/Swap
Beginning Balance December 31, 2011	$ (602)
Total gains or losses (realized/unrealized)	
Included in earnings	(37)
Included in other comprehensive income	
Purchases, issuances, and settlements	160

Transfers in and/or out of Level 3		
Ending Balance June 30, 2012	$	(479)

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Note 6 Fair Value of Financial Instruments - continued

(Dollars in thousands)	Interest rate Cap/Floor/Swap
Beginning Balance March 31, 2012	$ (553)
Total gains or losses (realized/unrealized)	
Included in earnings	(4)
Included in other comprehensive income	
Purchases, issuances, and settlements	78
Transfers in and/or out of Level 3	
Ending Balance June 30, 2012	$ (479)

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Note 6 Fair Value of Financial Instruments - continued

The following tables summarize quantitative disclosures about the fair value for each category of assets carried at fair value as of June 30, 2013 and December 31, 2012 that are measured on a non-recurring basis.

(Dollars in thousands)

Description	June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial & Industrial	$ 84	$	$	$ 84
Real estate:				
Mortgage-residential	716			716
Mortgage-commercial	5,759			5,759
Consumer:				
Home equity				
Other	7			7
Total impaired	6,566			6,566
Other real estate owned:				
Construction	301			301
Mortgage-residential	302			302
Mortgage-commercial	2,221			2,221
Total other real estate owned	2,824			2,824
Total	$ 9,390	$	$	$ 9,390

(Dollars in thousands)

Description	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial & Industrial	$ 37	$	$	$ 37
Real estate:				
Mortgage-residential	357			357
Mortgage-commercial	5,772			5,772
Consumer:				
Home equity				
Other	10			10
Total impaired	6,176			6,176
Other real estate owned:				

Construction		301						301
Mortgage-residential		488						488
Mortgage-commercial		3,198						3,198
Total other real estate owned		3,987						3,987
Total	$	10,163	$		$		$	10,163

The Company has a large percentage of loans with real estate serving as collateral. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs. Third party appraisals are generally obtained when a loan is identified as being impaired or at the time it is transferred to OREO. This internal process consists of evaluating the underlying collateral to independently obtained comparable properties. With respect to less complex or smaller credits, an internal evaluation may be performed. Generally the independent

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and internal evaluations are updated annually. Factors considered in determining the fair value include geographic sales trends, the value of comparable surrounding properties as well as the condition of the property. The aggregate

Note 6   Fair Value of Financial Instruments - continued

amount of impaired loans was $6.6 million and $6.2 million for the six months ended June 30, 2013 and year ended December 31, 2012, respectively.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2013 and December 31, 2012, the significant unobservable inputs used in the fair value measurements were as follows:

(Dollars in thousands)		**Fair Value as of June 30, 2013**	**Valuation Technique**	**Significant Observable Inputs**	**Significant Unobservable Inputs**
Interest Rate Swap	$	(172)	Discounted cash flows	Weighted Average Credit Factor	3.20%
Preferred stock	$	417	Estimation based on comparable non-listed securities	Comparable transactions	n/a
OREO	$	2,824	Appraisal Value/Comparison Sales/Other estimates	Appraisals and or sales of comparable properties	Appraisals discounted 6% to 16% for sales commissions and other holding cost
Impaired loans	$	6,566	Appraisal Value	Appraisals and or sales of comparable properties	Appraisals discounted 6% to 16% for sales commissions and other holding cost

(Dollars in thousands)		**Fair Value as of December 31, 2012**	**Valuation Technique**	**Significant Observable Inputs**	**Significant Unobservable Inputs**
Interest Rate Swap	$	(338)	Discounted cash flows	Weighted Average Credit Factor	3.20%
Preferred stock	$	417	Estimation based on comparable non-listed securities	Comparable transactions	n/a
OREO	$	3,987	Appraisal Value/Comparison Sales/Other estimates	Appraisals and or sales of comparable properties	Appraisals discounted 6% to 16% for sales commissions and other holding cost

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Impaired loans	$	6,176	Appraisal Value	Appraisals and or sales of comparable properties	Appraisals discounted 6% to 16% for sales commissions and other holding cost

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Note 7 Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were available to be issued and no subsequent events other than disclosed above occurred requiring accrual or disclosure.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may relate to, among other matters, the financial condition, results of operations, plans, objectives, future performance, and business of our Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words may, would, could, should, will, expect, anticipate, predict, project, potential, continue, assume, be forecast, goal, and estimate, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitation, those described under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2012 as filed with the SEC and the following:

- credit losses as a result of, among other potential factors, declining real estate values, increasing interest rates, increasing unemployment, changes in payment behavior or other factors;

- the amount of our loan portfolio collateralized by real estate and weaknesses in the real estate market;

- restrictions or conditions imposed by our regulators on our operations;

- the adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;

- examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;

- reduced earnings due to higher other-than-temporary impairment charges resulting from additional decline in the value of our securities portfolio, specifically as a result of increasing default rates, and loss severities on the underlying real estate collateral;

- increases in competitive pressure in the banking and financial services industries;

- changes in the interest rate environment which could reduce anticipated or actual margins;

- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;

- general economic conditions resulting in, among other things, a deterioration in credit quality;

- changes occurring in business conditions and inflation;

- changes in access to funding or increased regulatory requirements with regard to funding;

- increased cybersecurity risk, including potential business disruptions or financial losses;

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- changes in deposit flows;
- changes in technology;
- changes in monetary and tax policies;
- changes in accounting policies and practices;
- the rate of delinquencies and amounts of loans charged-off;
- the rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;
- our ability to maintain appropriate levels of capital;
- our ability to attract and retain key personnel;
- our ability to retain our existing clients, including our deposit relationships;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- loss of consumer confidence and economic disruptions resulting from terrorist activities; and
- other risks and uncertainties detailed from time to time in our filings with the SEC.

These risks are exacerbated by the developments since 2008 in national and international financial markets, and we are unable to predict what effect continued uncertainty in market conditions will have on the Company. Beginning in 2008 and continuing into 2013, the capital and credit markets have experienced severe levels of volatility. During the first six months of 2013, economic conditions, while slow by historical standards and still fluctuating on a day-to-day basis, have shown general signs of stabilization. However, as a result of U.S. government fiscal challenges, continued volatility in European sovereign and bank debt, slow improvement in domestic employment conditions, the economic and monetary policy statements by the Board of Governors of the Federal Reserve System (the Federal Reserve), and other variables, it is difficult to predict if this stabilization is indicative of a lasting trend. There can be no assurance that these challenging developments of the past few years will not further materially and adversely affect our business, financial condition and results of operations.

If any of these risks or uncertainties materialize, or if any of the assumptions underlying our forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. Forward-looking statements in this Form 10-Q speak as of the date of this document, and we do not intend, and assume no obligation, to update such forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements.

Overview

The following discussion describes our results of operations for the six months and three months ended June 30, 2013 as compared to the six month and three month period ended June 30, 2012 and also analyzes our financial condition as of June 30, 2013 as compared to December 31, 2012. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

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

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

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

Critical Accounting Policies

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our unaudited consolidated financial statements as of June 30, 2013 and our notes included in the consolidated financial statements in our 2012 Annual Report on Form 10-K as filed with the SEC.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the credit worthiness of borrowers, the estimated value of the underlying collateral, the assumptions about cash flow, determination of loss factors for estimating credit losses, the impact of current events, and conditions, and other factors impacting the level of probable inherent losses. Under different conditions or using different assumptions, the actual amount of credit losses incurred by us may be different from management s estimates provided in our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

The evaluation and recognition of OTTI on certain investments, including our private label MBSs and other corporate debt security holdings, requires significant judgment and estimates. Some of the more critical judgments supporting the evaluation of OTTI include projected cash flows including prepayment assumptions, default rates and severities of losses on the underlying collateral within the security. Under different conditions or utilizing different assumptions, the actual OTTI recognized by us may be different from the actual amounts recognized in our consolidated financial statements. See Note 3 to the financial statements for the disclosure of certain of the assumptions used as well as OTTI recognized in the financial statements during the six and three months ended June 30, 2013 and 2012.

Comparison of Results of Operations for Six Months Ended June 30, 2013 to the Six Months Ended June 30, 2012

Net Income

Our net income for the six months ended June 30, 2013 was $2.2 million, or $0.42 diluted earnings per common share, as compared to $1.4 million, or $0.42 diluted earnings per common share, for the six months ended June 30, 2012. The increase in net income between the two periods is primarily due to an increase of $1.1 million in non-interest income. This was partially offset by a decrease in net interest income of $258 thousand and a $242 thousand increase in non- interest expense during the six months ended June 30, 2013 as compared to the same period in 2012. Average earning assets increased by $26.6 million in the first six months of 2013 as compared to the same period in 2012. Average earning assets were $573.6 million during the six months ended June 30, 2013 as compared to $547.0 million during the six months ended June 30, 2012. The increase in average earning assets was primarily a result of continued growth in our pure deposit balances (demand deposits, interest-bearing transaction accounts, money market and savings accounts). Despite the increase in our earning assets net interest income decreased as a result of a lower net interest margin.

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Net Interest Income

Please refer to the table at the end of this Item 2 for the yield and rate data for interest-bearing balance sheet components during the six-month periods ended June 30, 2013 and 2012, along with average balances and the related interest income and interest expense amounts.

Net interest income was $8.7 million for the six months ended June 30, 2013 as compared to $9.0 million for the six months ended June 30, 2012. Net interest margin on a taxable equivalent basis decreased by 20 basis points, from 3.33% at June 30, 2012 to 3.13% at June 30, 2013. The yield on earning assets decreased by 62 basis points in the first half of 2013 as compared to the same period in 2012. The yield on earning assets for the six months ended June 30, 2013 and 2012 was 3.75% and 4.37%, respectively. The cost of interest-bearing liabilities during the first six months of 2013 was 0.86% as compared to 1.30% in the same period of 2012, reflecting a 44 basis points decrease. During the six months ended June 30, 2013, we experienced an increase in loans outstanding which reflects an increase in loans outstanding for three consecutive quarters and a reversal of declining loan balances for a number of previous quarters. Despite the growth in outstanding loans, as a percentage of average earning assets, loans comprised 59.4% of average earning assets in the first six months of 2013 as compared to 60.4% in the same period of 2012. This is a result of the significant growth in pure deposits and the excess funds being in our securities portfolio. The average balance of our securities portfolio was $219.1 million for the six month period ended June 30, 2013 as compared to $201.9 million in the same period of 2012. Our cost of funds has declined by 44 basis points on average in the first six months of 2013 as compared to the same period of 2012. Interest-bearing transaction accounts, money market accounts and savings deposits, which are typically our lower costing funds, represent 46.0% of our average interest bearing liabilities during the first six months of 2013 as compared to 38.8% in the same period of 2012. Time deposits and borrowed funds, typically the higher costing funds, represent 53.9% of our average interest-bearing funds in the first six months of 2013 as compared to 61.2% during the same period in 2012. Throughout 2012 and the first half of 2013, we continued to focus on shifting our funding from higher cost certificates of deposit to pure deposits. The improvement in the overall mix of our funding sources has contributed to the reduction in our cost of funds and along with overall growth in earning assets, offset some of the impact of declining earning asset yields.

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Provision and Allowance for Loan Losses

At June 30, 2013 and December 31, 2012, the allowance for loan losses was $4.4 and $4.6 million, respectively. This represented 1.30% of total loans and 1.39% of loans at June 30, 2013 and December 31, 2012, respectively. Our provision for loan losses was $250 thousand for the six months ended June 30, 2013 as compared to $301 thousand for the six months ended June 30, 2012. This provision is made based on our assessment of general loan loss risk and asset quality. The allowance for loan losses represents an amount which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, the experience ability and depth of lending personnel, economic conditions (local and national) that may affect the borrower s ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, and concentrations of credit. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses.

The modest decrease in the provision for loan losses for the first six months of 2013 as compared to the same period in 2012 is a result of a continuation of moderating levels of classified and non-performing loans as well as continued moderate improvement in economic conditions in our markets, including stabilizing unemployment levels. Our loan portfolio consists of a large percentage of real estate secured loans. Real estate values continue to be adversely impacted as a result of the economic downturn over the last several years. Impaired values of the underlying real estate collateral as well as lower historical residential and commercial real estate sales impacts our ability to sell collateral upon foreclosure. There is a risk that this trend will continue. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If real estate values continue to decline, it is also more likely that we would be required to increase our allowance for loan losses. If during a period of reduced real estate values we are required to liquidate the property collateralizing a loan to satisfy the debt or to increase the allowance for loan losses, it could materially reduce our profitability and adversely affect our financial condition.

Non-performing assets were $8.8 million (1.39% of total assets) at June 30, 2013 as compared to $9.0 million (1.45% of total assets) and $8.8 million (1.45% of total assets) at March 31, 2013 and December 31, 2012, respectively. While we believe these ratios are favorable in comparison to current industry results, we continue to be concerned about the impact of this economic environment on our customer base of local businesses and professionals. There were 31 loans, totaling $6.0 million, included in non-performing status (non-accrual loans and loans past due 90 days and still accruing) at June 30, 2013. The largest non-performing loan, with a carrying value of $1.3 million, is secured by a first lien on an owner occupied commercial business property located in the midlands of South Carolina. The average balance of the remaining 30 loans is approximately $154.5 thousand and the majority of these loans are secured by first mortgage liens. At the time the loans are placed in non-accrual status, we typically obtain an updated appraisal and, if the loan balance exceeds fair value, write the balance down to the fair value. At June 30, 2013, we had no loans delinquent more than 90 days and still accruing interest, and we had loans totaling $2.8 million that were delinquent 30 days to 89 days which represented 0.81% of total loans.

Our management continuously monitors non-performing, classified and past due loans, to identify deterioration regarding the condition of these loans. We have identified one loan relationships in the amount of $964.1 thousand that is current as to principal and interest and not included in non-performing assets that could represent potential problem loans. This balance is included as substandard loans in Note 4 of the financial statements.

We perform an analysis quarterly to assess the risk within the loan portfolio. The portfolio is segregated into similar risk components for which historical loss ratios are calculated and adjusted for identified changes in current portfolio characteristics. Historical loss ratios are calculated by product type and by regulatory credit risk classification. The allowance consists of an allocated and unallocated allowance. The allocated portion is determined by types and ratings of loans within the portfolio. The unallocated portion of the allowance is established for losses that exist in the remainder of the portfolio and compensates for uncertainty in estimating the loan losses. The annualized weighted average loss ratios over the 24 month period ended June 30, 2013 for loans classified substandard, special mention and pass have been approximately 3.02%, 1.46% and 0.11%, respectively. The unallocated portion of the allowance as a percentage of the total allowance has grown over the last several years. The allocated portion of the allowance is

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based on historical loss experience as well as certain qualitative factors as explained above. The qualitative factors have been established based on certain assumptions made as a result of the current economic conditions and as conditions change are adjusted to be directionally consistent with these changes. Due the ongoing slow economic conditions and particularly slow recovery of real estate valuations, we do not believe it would be prudent to reduce substantially the overall level of our allowance at this time.

There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period. The allowance is also subject to examination and testing for adequacy by regulatory agencies, which may consider such factors as the methodology used to determine adequacy and the size of the allowance relative to that of peer institutions. Such regulatory agencies could require us to adjust our allowance based on information available to them at the time of their examination.

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

Allowance for Loan Losses

(Dollars in thousands)	Six Months Ended June 30, 2013		2012	
Average loans (including loans held for sale) outstanding	$	340,983	$	330,342
Loans outstanding at period end	$	341,089	$	324,913
Non-performing assets:				
Nonaccrual loans	$	5,978	$	4,640
Loans 90 days past due still accruing				
Repossessed-other				2
Foreclosed real estate and other assets		2,824		4,909
Total non-performing assets	$	8,802	$	9,551
Beginning balance of allowance	$	4,621	$	4,699
Loans charged-off:				
Construction and development				
1-4 family residential mortgage		36		30
Non-residential real estate		397		178
Home equity		44		
Commercial		7		62
Installment & credit card		39		37
Total loans charged-off		523		307
Recoveries:				
1-4 family residential mortgage		62		9
Non-residential real estate				
Home equity		1		2
Commercial		20		25
Installment & credit card		8		13
Total recoveries		91		49
Net loan charge offs		432		258
Provision for loan losses		250		301
Balance at period end	$	4,439	$	4,742
Net charge -offs to average loans		0.13%		0.08%
Allowance as percent of total loans		1.30%		1.46%
Non-performing assets as % of total assets		1.39%		1.60%
Allowance as % of non-performing loans		74.26%		102.20%

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The following allocation of the allowance to specific components is not necessarily indicative of future losses or future allocations. The entire allowance is available to absorb losses in the portfolio.

Composition of the Allowance for Loan Losses

	June 30, 2013		December 31, 2012	
(Dollars in thousands)	Amount	% of loans in Category	Amount	% of loans in Category
Commercial, Financial and Agricultural	$ 264	6.1%	$ 338	6.3%
Real Estate Construction	25	4.5%		3.9%
Real Estate Mortgage:				
Commercial	1,082	68.5%	1,322	68.2%
Residential	319	11.2%	235	11.7%
Consumer:				
Home Equity	226	7.5%	400	8.2%
Other	96	2.2%	17	1.7%
Unallocated	2,427	N/A	2,309	N/A
Total	$ 4,439	100.0%	$ 4,621	100.0%

Accrual of interest is discontinued on loans when management believes, after considering economic and business conditions and collection efforts that a borrower s financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. At the time a loan is placed in nonaccrual status, all interest, which has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

Non-interest Income and Non-interest Expense

Non-interest income during the first six months of 2013 was $4.4 million as compared to $3.3 million during the same period in 2012. Deposit service charges decreased $36 thousand during the first six months of 2013 as compared to the same period in 2012. The decrease in deposit service charges is primarily a result of lower overdraft protection fees due to a continued decrease in the number of items being presented on insufficient funds accounts. Mortgage origination fees increased $598 thousand. The low interest rates during the period continued to result in a strong incentive for borrowers seeking to refinance as well as those seeking purchase money, although in the last few weeks of the six month period longer term rates began to rise. We believe, on an industry wide basis, the refinance activity is decreasing in volume while the purchase activity is increasing. The outcome of this change may result in less overall volume with a higher component of purchase transactions. The pre-tax net income margin in our mortgage line of business is in a range of 35%-45%, depending upon volume and product mix. In the six months ended June 30, 2013, we had gains on sale of securities in the amount of $148 thousand, as compared to a loss of $27 thousand in the first six months of 2012. The gain for the six months ended June 30, 2013 was offset by paying down FHLB advances in the amount of $2.0 million which resulted in a loss in the amount of $141 thousand. During the first six months of 2012, we sold eight below investment grade non-agency MBSs with a total book value of approximately $11.2 million. The loss on the sales amounted to $2.1 million and was offset by gains of the approximate same amount from the sale of certain agency MBSs and municipal securities. In addition, we paid down FHLB advances in the amount of $4.0 million and incurred a loss in the amount of $121 thousand. During the first six months of 2012, we incurred OTTI charges of $200 thousand (credit component) on certain non-agency MBSs that were sold as part of the transactions noted above (see Note 3 Investment Securities to our Consolidated Financial Statements for further information).

Total non-interest expense increased by $242 thousand, or 2.54%, during the first six months of 2013, as compared to the same period in 2012. Salary and benefit expense increased $681 thousand from $5.3 million, during the first six months of 2012, to $6.0 million during the first six months of 2013. At June 30, 2012, we had 158 full time equivalent employees as compared to 164 at June 30, 2013. This increase in number of full time equivalent employees, normal salary adjustments as well as increased incentives and commissions account for the increase in salary and benefit expense between the two periods. Marketing and public relations expense decreased from $294

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thousand in the first six months of 2012 to $205 thousand in the comparable period of 2013. The timing of a media campaign in 2012 resulted in increased marketing costs as compared to the same period of 2013. FDIC insurance assessments decreased $179 thousand in the first six months of 2013 as compared to the same period in 2012. The decrease results from our assessment rate changing from approximately 14 basis points on average total assets during the first six months of 2012 to approximately 7.5 basis points of average total assets during the comparable period in 2013. In November 2009, all insured institutions, with limited exceptions, were required to prepay insurance assessments for a three-year period. Our prepayment made to the FDIC in December 2009 totaled approximately $2.9 million. As of June 30, 2013, the remaining prepaid insurance assessment in the amount of $252 thousand was refunded by the FDIC to the Bank. Future FDIC insurance payments will be assessed and paid quarterly. Other real estate expenses decreased $180 thousand in the first six months of 2013 as compared to the same period in 2012. The decrease relates to moderating levels of accumulated delinquent taxes, insurance, legal fees and repair expenses incurred as the level of other real estate owned continues to decline. Other changes in non-interest expense categories reflect normal fluctuations between the two periods.

The following is a summary of the components of other non-interest expense:

	Six months ended June 30,	
(In thousands)	**2013**	**2012**
Data processing	$ 205	$ 252
Supplies	53	80
Telephone	167	146
Correspondent services	90	85
Insurance	122	107
Loss on limited partnership interest	101	88
Postage	88	87
Professional fees	288	427
Director fees	141	151
Other Miscellaneous	536	380
	$ 1,791	$ 1,803

Income Tax Expense

Our effective tax rate was 27.0% and 29.7% in the first six months of 2013 and 2012, respectively. As a result of our current level of tax exempt securities in our investment portfolio, our effective tax rate is expected to remain at 26.5% to 28.0% throughout the remainder of 2013.

Comparison of Results of Operations for Three Months Ended June 30, 2013 to the Three Months Ended June 30, 2012:

Net Income

Please refer to the table Yields on Average Earning Assets and Rates on Average Interest-Bearing Liabilities appearing at the end of this Item for the yield and rate data for interest-bearing balance sheet components during the three-month periods ended June 30, 2013 and 2012, along with average balances and the related interest income and interest expense amounts.

Our net income for the second quarter of 2013 was $1.2 million, or $0.23 diluted earnings per common share, as compared to $928 thousand, or $0.23 diluted earnings per common share, in the same period of 2012. Net interest income decreased by $28 thousand for the three months ended June 30, 2013 compared to the same period in 2012. Our taxable equivalent net interest margin in the second quarter of 2013 declined to 3.11% compared to 3.30% in the same period of 2012. The decline in the margin was substantially offset by an increase in average earning assets between the two periods. The yield on average earning assets decreased to 3.68% in the second quarter of 2013 from 4.26% in the second quarter of 2012. The cost of interest bearing liabilities also decreased to 0.81% in the second quarter of 2013 as compared to 1.23% in the second quarter of 2012. Average earning assets were $585.2 million during the second quarter of 2013 as compared to $550.9 million during the second quarter of 2012.

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Provision for Loan Losses

The provision for loan losses for the three months ended June 30, 2013 was $100 thousand as compared to $71 thousand for the three months ended June 30, 2012. The provision for loan losses for the second quarter of 2013 and 2012 reflect moderating levels of classified and non-performing loans as well as continued moderate improvement in economic conditions in our markets, including stabilizing unemployment levels.

Non-interest Income and Non-interest Expense

For the three months ended June 30, 2013, we had non-interest income of $2.3 million as compared to non-interest income of $1.9 million in the same period of 2012. Mortgage origination fees increased $306 thousand during the second quarter of 2013 as compared to the same period in 2012. As noted previously, the low interest rates during the period continued to result in a strong incentive for borrowers seeking to refinance as well as those seeking purchase money. Fees from investment advisory and sale of non-deposit products increased $56 thousand in the first quarter of 2013 as compared to the same period of 2012. The increase is a result of increased level of assets under management. As previously discussed, during the second quarter of 2013 we sold securities that resulted in a gain of $133 thousand. The proceeds from the sale were used to pay down $2.0 million in FHLB advances which resulted in a $141 thousand prepayment penalty.

Total non-interest expense increased only $47 thousand in the second quarter of 2013, compared to the same period of 2012. Salaries and benefits increased by $247 thousand in the second quarter of 2013 as compared to the same period in 2012. This increase is a result of the addition of approximately six full time equivalent employees, normal annual salary adjustments between the two periods and additional commission compensation resulting from higher mortgage origination fees between the two periods. FDIC insurance assessments decreased $94 thousand in the second quarter of 2013 as compared to the same period in 2012. As discussed previously, our FDIC assessment rate changed from 14 basis points on average total assets during the second half of 2012 to 7.5 basis points on average total assets during the first half of 2013. A decrease in other real estate expenses of $152 thousand in the second quarter of 2013 as previously discussed in the six month results is primarily due to moderating levels of non-performing assets. All other variances in non-interest expenses during the three months ended June 30, 2013 as compared to the same period of 2012 reflect normal fluctuations in each of the categories.

Financial Position

Assets totaled $633.2 million at June 30, 2013, as compared to $602.9 million at December 31, 2012, an increase of $30.3 million. Loans (excluding loans held for sale) at June 30, 2013 were $341.1 million as compared to $332.1 million at December 31, 2012. This increase of $9.0 million in loans resulted from funding in excess of $30.6 million in new loan production in the first half of 2013, less scheduled and unscheduled pay downs during the period. At June 30, 2013 and December 31, 2012, loans (excluding loans held for sale) accounted for 58.1% and 59.8% of earning assets, respectively. The loan-to-deposit ratio at June 30, 2013 was 66.9% as compared to 69.9% at December 31, 2012. Investment securities increased to $225.9 million at June 30, 2013 from $206.0 million at December 31, 2012. Deposits increased by $34.6 million to $509.6 million at June 30, 2013 as compared to $475.0 million at December 31, 2012. The growth in deposits is a result of a continued focus on pure deposit (deposits less certificates of deposits) growth while closely controlling the pricing on time deposits. One of our goals as a community bank has been, and continues to be, to grow our assets through quality loan growth by providing credit to small and mid-size businesses, as well as individuals within the markets we serve. Although we have experienced moderate loan growth over the last three quarters, loan production and portfolio growth rates continue to be impacted by the current economic cycle, as borrowers are less inclined to leverage their corporate and personal balance sheets. However, we remain committed to meeting the credit needs of our local markets. A continuation of the slow recovery from national and local economic conditions as well as deterioration of asset quality within our Company could significantly impact our ability to grow our loan portfolio.

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The following table shows the composition of the loan portfolio by category:

(In thousands)	June 30, 2013 Amount	Percent	December 31, 2012 Amount	Percent
Commercial, financial & agricultural	$ 20,908	6.1%	$ 20,924	6.3%
Real estate:				
Construction	15,232	4.5%	13,052	3.9%
Mortgage residential	38,363	11.2%	38,892	11.7%
Mortgage commercial	233,769	68.5%	226,575	68.2%
Consumer:				
Home Equity	25,437	7.5%	27,173	8.2%
Other	7,380	2.2%	5,495	1.7%
Total gross loans	341,089	100.0%	332,111	100.0%
Allowance for loan losses	(4,439)		(4,621)	
Total net loans	$ 336,650		$ 327,490	

In the context of this discussion, a real estate mortgage loan is defined as any loan, other than loans for construction purposes and advances on home equity lines of credit, secured by real estate, regardless of the purpose of the loan. Advances on home equity lines of credit are included in consumer loans. We follow the common practice of financial institutions in our market areas of obtaining a security interest in real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase the magnitude of the real estate loan components. Generally we limit the loan-to-value ratio to 80%.

Market Risk Management

The effective management of market risk is essential to achieving our strategic financial objectives. Our most significant market risk is interest rate risk. We have established an Asset/Liability Management Committee (ALCO) to monitor and manage interest rate risk. The ALCO monitors and manages the pricing and maturity of assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on net interest income. The ALCO has established policy guidelines and strategies with respect to interest rate risk exposure and liquidity.

A monitoring technique employed by the ALCO is the measurement of interest sensitivity gap, which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Also, asset/liability simulation modeling is performed to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity or by adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in the same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates.

We are currently slightly liability sensitive within one year. However, neither the gap analysis nor the asset/liability modeling is a precise indicator of our interest sensitivity position due to the many factors that affect net interest income, including changes in the volume and mix of earning assets and interest-bearing liabilities. Net interest income is also impacted by other significant factors, including changes in the volume and mix of earning assets and interest-bearing liabilities. Through simulation modeling, we monitor the effect that an immediate and sustained change in interest rates of 100 basis points and 200 basis points up and down will have on net interest income over the next twelve months.

We entered into a five year interest rate swap agreement on October 8, 2008 which expires on October 8, 2013. The swap agreement has a $10.0 million notional amount. We receive a variable rate of interest on the notional amount based on a three month LIBOR rate and pay a fixed rate interest of 3.66%. The contract was entered into to protect us from the negative impact of rising interest rates. Our exposure to credit risk is limited to the ability of the counterparty to make potential future payments required pursuant to the agreement. Our exposure to market risk of loss is limited to the changes in the market value of the swap between reporting periods. At June 30, 2013 and December 31, 2012, the

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fair value of the contract was a negative $172 thousand and $338 thousand, respectively. A fair value adjustment for the swap of ($2 thousand) and ($37 thousand) was recognized in other income for the six month periods ended June 30, 2013 and 2012, respectively. The fair value of the contract is the present value, over the remaining term of the contract, of the difference between the swap rate to maturity at the reporting date multiplied by the notional amount and the fixed interest rate of 3.66% multiplied by the notional amount of the contract.

Based on the many factors and assumptions used in simulating the effect of changes in interest rates, the following table estimates the percentage change in net interest income at June 30, 2013, March 31, 2013 and December 31, 2012 over twelve months.

Net Interest Income Sensitivity

Change in short-term interest rates	**June 30, 2013**	**March 31, 2013**	**December 31, 2012**
+200bp	+ 5.23%	+ 6.52%	+ 6.52%
+100bp	+ 2.64%	+ 3.47%	+ 3.83%
Flat			
-100bp	- 6.44%	- 7.92%	- 9.05%
-200bp	- 11.19%	- 11.73%	- 13.58%

The significant decrease in net interest income in a down 200 basis point environment primarily results from the current level of interest rates being paid on our interest bearing transaction accounts as well as money market accounts. The interest rates on these accounts are at a level where they cannot be repriced in proportion to the change in interest rates. The increase and decrease of 100 and 200 basis points assume a simultaneous and parallel change in interest rates along the entire yield curve. At the current historically low interest rate levels, we believe that a downward shift of 200 basis points across the entire yield curve is unlikely.

We also perform a valuation analysis projecting future cash flows from assets and liabilities to determine the Present Value of Equity (PVE) over a range of changes in market interest rates. The sensitivity of PVE to changes in interest rates is a measure of the sensitivity of earnings over a longer time horizon. At June 30, 2013, March 31, 2013 and December 31, 2012 the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be 0.1%, 5.5% and 7.5%, respectively.

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Liquidity and Capital Resources

We believe our liquidity remains adequate to meet operating and loan funding requirements. Interest-bearing bank balances, federal funds sold, and investment securities available-for-sale represent 37.6% of total assets at June 30, 2013. We believe that our existing stable base of core deposits along with continued growth in this deposit base will enable us to meet our long-term and short-term liquidity needs successfully. These needs include the ability to respond to short-term demand for funds caused by the withdrawal of deposits, maturity of repurchase agreements, extensions of credit and the payment of operating expenses. Sources of liquidity, in addition to deposit gathering activities, include maturing loans and investments, purchase of federal funds from other financial institutions and selling securities under agreements to repurchase. We monitor closely the level of large certificates of deposits in amounts of $100 thousand or more as they tend to be more sensitive to interest rate levels and, thus, less reliable sources of funding for liquidity purposes. At June 30, 2013, the amount of certificates of deposits of $100 thousand or more represented 13.3% of total deposits. These deposits are issued to local customers many of whom have other product relationships with the Bank and none are brokered deposits.

Through the operations of our Bank, we have made contractual commitments to extend credit in the ordinary course of our business activities. These commitments are legally binding agreements to lend money to our customers at predetermined interest rates for a specified period of time. At June 30, 2013, we had issued commitments to extend credit of $47.3 million, including $25.4 million in unused home equity lines of credit, through various types of lending arrangements. We evaluate each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. We manage the credit risk on these commitments by subjecting them to normal underwriting and risk management processes.

Other than as described elsewhere in this report, we are not aware of any trends, events or uncertainties that we expect to result in a significant adverse effect on our liquidity position. However, no assurances can be given in this regard, as rapid growth, deterioration in loan quality, and poor earnings, or a combination of these factors, could change the liquidity position in a relatively short period of time.

The Company has generally maintained a high level of liquidity and adequate capital, which along with continued retained earnings, we believe will be sufficient to fund the operations of the Bank for at least the next 12 months. Shareholders equity was 8.3% and 9.0% of total assets at June 30, 2013 and December 31, 2012, respectively. The Bank maintains federal funds purchased lines, in the total amount of $20.0 million, with two financial institutions, although these were not utilized in 2012 or the first half of 2013. In addition, the Bank has a repo line in the amount of $10.0 million with another financial institution. Specific investment securities would be pledged if and when we were to utilize the line. The FHLB of Atlanta has approved a line of credit of up to 25% of the Bank s assets, which would be collateralized by a pledge against specific investment securities and/or eligible loans. We regularly review the liquidity position of the Company and have implemented internal policies establishing guidelines for sources of asset based liquidity and evaluate and monitor the total amount of purchased funds used to support the balance sheet and funding from noncore sources. We believe that our existing stable base of core deposits along with continued growth in this deposit base will enable us to meet our long term liquidity needs successfully.

The Federal Reserve Board and bank regulatory agencies require bank holding companies and financial institutions to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. Under the capital adequacy guidelines, regulatory capital is classified into two tiers. These guidelines require an institution to maintain a certain level of Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common shareholders equity, excluding the unrealized gain or loss on securities available for sale, minus certain intangible assets. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% based on the risks believed to be inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the general reserve for loan losses, subject to certain limitations. We are also required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio. At both the holding company and bank level, we are subject to various regulatory capital requirements administered by the federal banking agencies. To be considered well capitalized, we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. Generally, to be considered adequately capitalized, the Federal Deposit Insurance Corporation and the Federal Reserve regulatory capital guidelines for Tier 1 capital, total capital and leverage capital ratios are 4.0%, 8.0% and 4.0%, respectively.

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The Bank s risk-based capital ratios of leverage ratio, Tier 1, and total capital were 10.21%, 16.61%, and 17.77%, respectively, at June 30, 2013 as compared to 10.34%, 16.94%, and 18.19%, respectively, at December 31, 2012. The Company s risk-based capital ratios of leverage ratio, Tier 1, and total capital were 10.61%, 17.25%, and 18.41%, respectively at June 30, 2013 as compared to 10.63%, 17.33% and 18.58%, respectively at December 31, 2012. Our management anticipates that the Bank and the Company will remain a well capitalized institution for at least the next 12 months.

Since the Company is a bank holding company, its ability to declare and pay dividends is dependent on certain federal and state regulatory considerations, including the guidelines of the Federal Reserve Board. The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve Board s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization s capital needs, asset quality and overall financial condition. The Federal Reserve Board s policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

In addition, since the Company is a legal entity separate and distinct from the Bank and does not conduct stand-alone operations, its ability to pay dividends depends on the ability of the Bank to pay dividends to it, which is also subject to regulatory restrictions. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the South Carolina Board of Financial Institutions, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Board of Financial Institutions. The FDIC also has the authority under federal law to enjoin a bank from engaging in what in its opinion constitutes an unsafe or unsound practice in conducting its business, including the payment of a dividend under certain circumstances.

In July 2013, the Federal Reserve Board announced its approval of a final rule to implement the Basel III regulatory capital reforms, among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The framework requires banking organizations to hold more and higher quality capital, which acts as a financial cushion to absorb losses, taking into account the impact of risk. The approved rule includes a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% as well as a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking institutions. For the largest, most internationally active banking organizations, the rule includes a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures. In terms of quality of capital, the final rule emphasizes common equity Tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. It also improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. The phase-in for smaller banking organizations will not begin until January 2015, while the phase-in period for larger banks starts in January 2014. The ultimate impact of the U.S. implementation of the new capital and liquidity standards on the Company and the Bank is currently being reviewed.

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FIRST COMMUNITY CORPORATION

Yields on Average Earning Assets and Rates

on Average Interest-Bearing Liabilities

	Six months ended June 30, 2013			Six months ended June 30, 2012		
	Average Balance	Interest Earned/Paid	Yield/ Rate	Average Balance	Interest Earned/Paid	Yield/ Rate
Assets						
Earning assets						
Loans	$ 340,983	$ 8,823	5.22%	$ 330,342	$ 9,256	5.63%
Securities:	219,084	1,798	1.65%	201,908	2,590	2.58%
Federal funds sold and securities purchased under agreements to resell	13,548	32	0.48%	14,772	38	0.52%
Total earning assets	573,615	10,653	3.75%	547,022	11,884	4.37%
Cash and due from banks	8,570			8,520		
Premises and equipment	17,226			17,430		
Other assets	22,458			27,815		
Allowance for loan losses	(4,596)			(4,739)		
Total assets	$ 617,273			$ 596,048		
Liabilities						
Interest-bearing liabilities						
Interest-bearing transaction accounts	$ 91,056	58	0.13%	$ 87,318	83	0.19%
Money market accounts	75,869	79	0.21%	51,226	84	0.33%
Savings deposits	44,485	24	0.11%	37,598	24	0.13%
Time deposits	177,972	809	0.92%	204,822	1,544	1.52%
Other borrowings	69,466	981	2.85%	72,838	1,189	3.28%
Total interest-bearing liabilities	458,848	1,951	0.86%	453,802	2,924	1.30%
Demand deposits	98,386			88,306		
Other liabilities	5,195			5,290		
Shareholders equity	54,844			48,650		
Total liabilities and shareholders equity	$ 617,273			$ 596,048		
Cost of funds, including demand deposits			0.71%			1.08%
Net interest spread			2.89%			3.07%
Net interest income/margin		$ 8,702	3.06%		$ 8,960	3.29%
Net interest income/margin FTE basis	$ 202	$ 8,904	3.13%	$ 96	$ 9,056	3.33%

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FIRST COMMUNITY CORPORATION

Yields on Average Earning Assets and Rates

on Average Interest-Bearing Liabilities

	Three months ended June 30, 2013			Three months ended June 30, 2012		
	Average Balance	Interest Earned/Paid	Yield/ Rate	Average Balance	Interest Earned/Paid	Yield/ Rate
Assets						
Earning assets						
Loans	$ 344,009	$ 4,462	5.20%	$ 332,081	$ 4,629	5.61%
Securities:	229,845	891	1.55%	200,308	1,189	2.39%
Federal funds sold and securities purchased	11,320	17	0.60%	18,510	22	0.48%
Total earning assets	585,174	5,370	3.68%	550,899	5,840	4.26%
Cash and due from banks	8,403			8,408		
Premises and equipment	17,230			17,416		
Other assets	22,050			26,148		
Allowance for loan losses	(4,527)			(4,747)		
Total assets	$ 628,330			$ 598,124		
Liabilities						
Interest-bearing liabilities						
Interest-bearing transaction accounts	$ 101,247	$ 29	0.11%	$ 89,647	$ 41	0.18%
Money market accounts	76,272	44	0.23%	52,309	42	0.32%
Savings deposits	46,355	13	0.11%	38,752	12	0.12%
Time deposits	173,879	371	0.86%	201,079	713	1.43%
Other borrowings	69,455	490	2.83%	71,746	581	3.26%
Total interest-bearing liabilities	467,208	947	0.81%	453,533	1,389	1.23%
Demand deposits	100,967			90,168		
Other liabilities	4,993			5,216		
Shareholders equity	55,162			49,207		
Total liabilities and shareholders equity	$ 628,330			$ 598,124		
Cost of funds, including demand deposits			0.67%			1.03%
Net interest spread			2.87%			3.03%
Net interest income/margin		$ 4,423	3.03%		$ 4,451	3.25%
Net interest income/margin FTE basis	$ 109	$ 4,532	3.11%	$ 65	$ 4,516	3.30%

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our quantitative and qualitative disclosures about market risk as of June 30, 2013 from that presented in our Annual Report on Form 10-K for the year ended December 31, 2012. See the Market Risk Management subsection in Item 2, Management Discussion and Analysis of Financial Condition and Results of Operations for quantitative and qualitative disclosures about market risk, which information is incorporated herein by reference.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There has been no change in the Company s internal control over financial reporting during the three months ended June 30, 2013, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

We are a party to claims and lawsuits arising in the course of normal business activities. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, the Company believes would have a material adverse impact on the Company s financial position, results of operations or cash flows.

Item 1A. Risk Factors.

Not Applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable.

Item 3. Defaults Upon Senior Securities.

Not Applicable.

Item 4. Mine Safety Disclosures.

Not Applicable.

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Item 5. Other Information.

None.

Item 6. Exhibits

Exhibit	Description
31.1	Rule 13a-14(a) Certification of the Principal Executive Officer.
31.2	Rule 13a-14(a) Certification of the Principal Financial Officer.
32	Section 1350 Certifications.
101	The following materials from the Quarterly Report on Form 10-Q of First Community Corporation for the quarter ended June 30, 2013, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Changes in Shareholders Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements. (1)

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(1) As provided in Rule 406T of Regulation S-T, this information shall not be deemed filed or part of a registration statement or prospectus for purposes of Section 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST COMMUNITY CORPORATION
(REGISTRANT)

Date:	August 13, 2013	By:	/s/ Michael C. Crapps
		Michael C. Crapps President and Chief Executive Officer (Principal Executive Officer)	
Date:	August 13, 2013	By:	/s/ Joseph G. Sawyer
		Joseph G. Sawyer Senior Vice President (Principal Financial and Accounting Officer)	

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